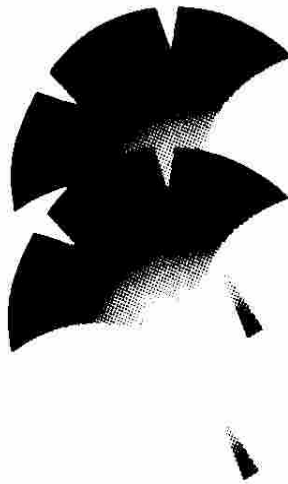


DEUTSCHES INSTITUT FÜR JAPANSTUDIEN



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**International Joint Ventures
in China after WTO Accession:
Will Trust Relations Change?**

Working Paper 05/7

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Erscheinungsort: Tōkyō

2005

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*) Our thanks goes to the managers and expatriates in China who provided the data on which this paper is based. Without their cooperation there would be no research findings to report. For valuable comments on an earlier draft of this paper, which was presented at the EAMSA annual meeting 2002 in Bangkok, we thank two anonymous reviewers. A revised version of this paper will be printed as „Trust or distrust: China's accession to the World Trade Organization and its strategic implications for Chinese-foreign joint ventures“ in „Multinationals and Asia: Organizational and Institutional Relationships“ edited by Axèle Giroud, Alexander T. Mohr and Deli Yang, Routledge International Business in Asia series.

A full report of the survey is available as „Vertrauen im internationalen Geschäft: Fallstudien Chinesisch-Deutscher Joint Ventures“ [International Business and Trust: Case Studies of Chinese-German Joint Ventures], Bonn, Tōkyō: Stiftung D.G.I.A. & DIJ, ISBN 3-938357-18-0.

Abstract:

China's accession to the WTO, finally realized after 13 years of negotiation, will gradually open the "Great Wall" which still protects large areas of what will one day become the largest economy of the world. Our paper addresses the nature and functioning of international joint ventures by investigating Chinese-German joint ventures within this context. In general, for international joint ventures in developing countries, trust seems to be one of the key factors for performance. We explored how China's WTO entry influences the competitive position of partner companies in Chinese-foreign JVs, and their strategic options for coping with that change, depending on their core competences and competitive positions, as well as on their relative bargaining positions.

Key Words:

World Trade Organization (WTO), People's Republic of China, joint-ventures, trust, strategic management.

1. China's World Trade Organization entry

China's accession to the World Trade Organization (WTO) in November 2001 was an important global event that will have a profound impact on both China itself and on world trade. China's WTO entry is the culmination of 15 long years of tough negotiations that started with China's application for entry into the General Agreement on Tariffs and Trade (GATT). This was the predecessor of the WTO, the largest global organization which sets international trade rules and promotes the expansion of economic exchanges among nations ¹.

After lengthy and difficult bilateral negotiations with GATT (and later with the WTO) member nations made sudden progress when Zhu Rongji took over as Chinese premier in the spring of 1998. However, negotiations with some countries, particularly the United States, came to the brink of collapse several times, due mainly to conflicts over the extent to which China would lower tariffs and remove barriers for protecting its domestic industries, as well as the question of giving foreign companies access to the Chinese market in sectors in which they had a competitive edge. The United States and the European Union (EU) demanded that China open its markets as much as developed countries, but China insisted that it be allowed to apply easier market opening standards like other developing countries do. China eventually agreed, as in the case of agriculture, to open its markets almost as much as developed countries. ²

By agreeing to the terms of its accession to the WTO, the government in Beijing is embarking on a course that will fundamentally transform the Chinese economy. It will give a new boost to the economic reform process and to its proponents whose efforts had come under attack from both conservatives in the Chinese Communist Party (CCP), and from managers of previously protected state-owned companies who fear for their existence. Moreover, China had, for thousands of years, contented itself with being a self-sufficient country. But its WTO membership means that it has agreed to accept worldwide common trade rules for the first time in its history, and so, completely abandon its closed society. If the reforms initiated by Deng Xiaoping have opened China's door to the world, WTO membership means that China can never return to its own traditional society (Zhu 2002).

¹ For further information refer to <http://www.wto.org>.

² For further details on the terms of accession refer to http://previw.www.moftec.gov.cn/article/200207/20020700032358_1.xml

Nonetheless, China's integration into the world economy involves a huge gamble by both the Chinese government and the international economy. The economic reforms that WTO membership will encourage will mean further economic pain for China's 1.2 billion people. This will be defined mainly by the bankruptcy of state-owned enterprises, and the unemployment and social problems resulting from those closures. Moreover, there are concerns that the rise in foreign ownership causes resistance in society. One can, however, expect that it will be precisely the foreign capital threat that will offset many of the negative impacts, and so the long-term gains of reform will outweigh its short-term costs.

In this paper, we will describe how WTO membership will change the rules of doing business in China. Over the past few years, international joint ventures have been encouraged by the Chinese government, as they present an ideal form for securing rapid access to capital, technology and export markets within an economy in transition. We will therefore concentrate on the impacts of WTO membership on foreign-invested co-operative ventures which are already active in a wide variety of industry sectors in China. Based on empirical research on the working place relationship in Chinese-foreign joint ventures it will be explored how China's WTO entry influences this relationship, the competitive position of both partner companies, and their strategic options for coping with that change, depending on their core competences and competitive positions, as well as on their relative bargaining positions.

2. Strategic position of Chinese-foreign joint ventures

In emerging economies like China, international co-operative relationships are still the most common basis on which co-operation between host country and foreign partners is established, with foreign direct investment usually being incorporated into the equity of such co-operative ventures. In this paper, co-operative relationships are defined as the combination of resources from more than one company to create a new organizational entity in the form of a joint venture (JV), which is distinct from its parent companies. For the purpose of our research, we have concentrated on international or intercultural joint ventures (IJVs) with at least two parent companies of different nationality.

The operating characteristics and performance of IJVs as co-operative ownership option for investing abroad have been examined frequently in

the literature on ownership strategies in international business (e.g. Yan and Luo 2001; Pausenberger and Nöcker 2000; Matthews 1999; Balling 1998; Herzig, Watin and Ruppert 1997; Chowdhury 1992; Zielke 1992; Geringer and Hebert 1991; Contractor 1990; Contractor and Lorange 1988; Kogut 1988a; Reynolds 1984; Kumar 1975). Compared to wholly owned foreign enterprises IJVs offer substantial economic and political advantages for internationalization strategies. Investments and risks are shared; some investment requirements can be eliminated through the use of the partners' existing infrastructure, for example its local marketing and distribution resources. Sales volumes are also likely to be realized more quickly in IJVs than through wholly owned foreign enterprises. In addition, the local partner's political position can bring great advantages. Overall, IJVs appear to offer greater revenues, lower costs, and less financial risks than other market entry options.

IJVs are one of the most sophisticated ownership options in international business. Presuming that the goals of both partner companies connected with the IJV are not conflicting, the performance of IJVs depends mainly upon qualitative variables such as the individual personalities of the dispatched personnel, organisational cultures, administrative styles, and management philosophies. There are many problems associated with IJV management, such as the issues of staffing, operating procedures, transfer pricing, local and international sourcing, technology selection, product line, pricing cost and investment allocation, market priorities and management control. According to the literature and to the statements of managers in our interviews, all those aspects pose potentially fatal obstacles to IJV survival. The hazards of IJV management thus appear to be numerous. If one shifts the focus to Chinese-foreign JVs, one will find even more problems. The wide-spread assumption that this phenomenon is merely a problem for mid-sized FDI enterprises is not correct for even major multinational companies operating in China also encounter huge obstacles.

The literature reveals that if the two parent companies have fundamentally diverging goals, this produces tremendous difficulties in inter-organizational as well as in interpersonal co-operation in the IJV. Sometimes these goal incongruences might be solely traced back to the companies' different political backgrounds. Chinese (state-owned) enterprises – who were the only possible partner companies at the beginning of economic reforms in China - are used to operating in a socialist plan economy. Their managers often keep close relations with the CCP. In contrast, the foreign partner companies are investing in China from

a market economy background. Their way of doing business is characterized by orientation of sales and competition. While the foreign partner company's focus on China is as a market for its services or products, the local partner is often following a diametric path. It aims to position local products and services on the world market by using of the foreign partner's know-how and advanced technology. Another aspect producing daily problems for JVs is the partners' fundamentally different ways of acting. For example, conflicts between leading the staff in a participative versus a paternalistic way, open-aggressive versus consensus-based problem solving (Herrmann-Pillath 1997), or idiomatic barriers due to communication in a foreign language (Trommsdorff 1991). One underlying principle of staffing implies problems in IJVs in general. The expatriate manager's influence is limited to three to five years according to the individual assignment. As his ongoing career obviously depends on the results of the work during his stay abroad, he will tend to act according to specific objectives set by the foreign partner company. In contrast, as the Chinese managers will stay in the IJV for a longer assignment they need to orientate themselves towards their mother company, and their ethnic group.

A close look at empirical studies dealing with the JV success in China (Hu and Chen 1996; Dong, Buckley and Mirza 1997) reveals the high probability of unsatisfying performance, measurable in hard figures (profitability, quality standards) as well as in soft factors (partner commitment, mutual understanding). Yan (2000) reports that the greater the length of time the IJV has been in operation, the better its profitability tends to be. Especially for IJVs in China, it seems that the accumulated business experience of IJVs increases the confidence of both partner companies in the venture. IJVs with a relatively short experience are not expected to have sufficient skills to deal with operational problems in the Chinese market. Therefore, their chances of obtaining higher returns and meeting the financial objectives are not as good. This finding is in line with previous research on the performance of JVs conducted by Agarwal and Ramaswami (1992) and Contractor and Lorange (1988).

3. WTO, IJV management and trust

One important contribution is that the WTO will underscore the rule of law in China. The European Union is setting up a program in cooperation with

MOFTEC to support and monitor China's adherence to its commitments.³ We can therefore we assume that the predictability of the development of the business environment will increase. Such predictability will come too late for many foreign investors, who have already lost large sums in investment because the Chinese government changed the laws, sometimes even in retrospect, as recently the case in the telecommunications sector. Another implication is that the position of independent courts and the reliability of the legal system will improve over time.

A rules-based system like the WTO would be worthless without a dispute-settling system to enforce these rules making the international trading system more predictable. The dispute settlement for China's accession is based on a clearly defined procedure with a timetable for concluding a case. A panel makes the first ruling, which is then endorsed or rejected by the WTO members. Appeals are possible, but a single country cannot veto the final decision made by the member state. The accession of China to the WTO therefore has a very important impact on China's accountability for its future administrative behaviour. For example, if China imposed technical regulations that could be proven to be motivated by protectionism, the case could be brought before the WTO's dispute settlement body. This authority could then impose fines if China was unwilling to comply with these rules. Similarly, WTO accession includes an agreement on import licensing procedures, which prohibits the government from giving licenses in a non-transparent or arbitrary manner, and offers guidance on how governments should assess applications for licenses.

The institutional environment in China still provides few guarantees to enforce business contracts or to settle disputes between the IJV partner companies. Historically, the Chinese have not been protected by a legal system that was independent of the state and supreme in its own right. In the absence of a codified commercial law, merchants and producers were at the mercy of a system in which imperial officials and their acolytes could exercise arbitrary power through taxes, licensing fees, and restrictions on trade and travel. WTO accession might support changes, but even now government agencies are closely involved in business affairs. Local governmental agencies have powers to interpret regulations, issue licences and impose taxes, which furnish ample scope for negotiations and

³ For further details refer to http://www.europa.eu.int/comm/trade/issues/respectrules/index_en.htm

corruption. As Child (1998: 256) notes, “the way that agreements are interpreted can depend on the influence or autonomy that the Chinese partner enjoys with higher authorities. The signing of a formal contract does not guarantee the end of uncertainty or even the conclusion of negotiation.” As a pure concept of guilt does not exist in China’s Confucian culture, consequences of an individual’s negative behaviour, like opportunism, can only be analyzed in a social context. The feeling of , used as a sanction mechanism in Western cultures, is replaced by moral failure determined by the peer group, for example the work unit, which leads to feelings of shame due to a loss of face (Hermann-Pillath 1997). Being aware of the multilateral dependencies arising from the social “guanxi” web, breaking trust with an insider may result in severe consequences, while breaking trust with an outsider might have no consequence at all.

The fundamental necessity for trust in IJVs has also been recognized in the literature on the subject (e.g. Mohr 2002a; Inkpen and Currall 1997; Inkpen and Beamish 1997; Madhok 1995; Parkhe 1993a, 1993b; Bradach and Eccles 1989; Buckley and Casson 1988; Beamish and Banks 1987), and is mostly associated with an improvement in decision making concerning strategic priorities, goals and management systems (Mead 1998). The greater the trust, the more efficient the IJV will be in transforming an input of co-operation into a collaborative output (Buckley and Casson 1988). As Madhok (1995) pointed out, a foundation of trust, although time-consuming and expensive to create, can contribute to the sustained continuation of cooperative relationships. Thus IJV performance should be viewed as a consequence of IJV trust, with more successful partnerships characterized by higher levels of trust (Inkpen and Currall 1997).

The need for trust in IJVs can be described as ‘the trust dilemma’ in general terms (Dolles 2003). On the one hand, there is an increasing need for trusting co-operative relationships, because the issuing of legal contracts and their enforcement is much more time consuming, expensive and uncertain in cross-border relationships than in co-operative ventures on a national level. Especially in the Chinese context, where foreign investors are still not sure about the cultural system and the legal institutional framework, which supports and monitors international co-operative relationships, you have to build up a trustworthy relationship. Being separated by long distances, it is nearly impossible to control every aspect of potential opportunistic behaviour. On the other hand, it is very difficult to build up a trusting co-operative relationship between business partners from different national origins, because they are not familiar with each

other's rules of social interaction and their basic assumptions, values and norms. The fact that both partners may have different assumptions of what can be taken for granted, places particular difficulties in the way of creating trust-based relationships between them. It is, therefore, quite difficult to know from the very beginning whether actions could be considered as trustworthy in the Chinese context. And there is nothing to rely on as the foreign partner is not considered to be an insider within the social *guanxi* web in China.

As the review of the extant literature on trust reveals, the focus on explaining the nature of trust is mainly on individuals, thus referring to person-oriented trust or interpersonal trust (Lewicki and Bunker 1996; Mayer et al., 1995). Yet, person-oriented trust may not be the sole existent form of trust. For example, Sako (1998) focuses her research on trust between organizations in the production chain and defines this as interorganisational trust which corresponds to another 'level' of trust than interpersonal trust. Bachmann (1998), Currall and Inkpen (2001, 2002) are stressing the importance of a correct discrimination among those different types since confusion hampers comparative research. Even though this demand seems to be obvious, Currall and Inkpen (2001) were able to identify within the existent literature wrongful attributions such as "...trust at the individual level was taken to be isomorphic with inter-firm trust" (p. 329).

In the present research, we look at trust on the individual level by asking executives from both partner companies first. We then tried to differentiate their answers in regards to the following two forms of trust.

The first form is *person-oriented trust*. It refers to a trust relationship in which the trustor and the trustee are individual representatives of co-operating companies. In other words, person-oriented trust is the trust placed by the individual in his individual opposite person from the partner's organisation (Zaheer, McEvily and Perrone 1998). One can assume that there will be only certain individuals, so called 'boundary spanning agents' or 'trust guardians' (Child 1998: 253), who are involved across the boundaries of co-operating companies. Bromiley and Cummings (1995) point out that optimal expenditures on control, monitoring and other kinds of transaction costs are partially a function of the probability of opportunism, which in turn depends on the level of trustworthy behaviour of boundary spanning agents. The trust which exists between both partner companies in an IJV will therefore to a large extent come down to the

quality of normative (mutual) trust which exists between those individuals. However, it should be noted that when there is frequent turnover of personnel allocated by the partners to an IJV, the opportunities for developing trust based cooperation between them will be diminished.

The second form is called *organization-oriented trust*. It characterizes the trust that is displayed when the trustor is an individual and the trustee is the partner company – its organizational structure, organizational culture, etc. - as a whole. Even though the latter form of trust is focusing on the partner company, it belongs to the individual level since the trustor is a single person. This kind of organization-oriented trust is likely to enhance allocative efficiency when it encourages the disclosure of confidential information, and reduces the costs of inter-organizational transaction (Sako 1992).

In the international management literature (e.g. Pausenberger and Nöcker 2000; Child 1998; Smith, Carroll and Ashford 1995; Kumar, Steinmann and Dolles 1993; Buckley and Casson 1988; Kogut 1988b), several writers have argued that international co-operative relationships develop through a number of stages. There are feedback loops in this process whereby the partners evaluate their experience and decide whether to continue their co-operation and, if so, in what form (e.g. Ring and van de Ven 1994). This development leads to the assumption that in the same way as international co-operative relationships develop over time, a corresponding evolution of trust will follow. The theoretical differentiation between calculative, cognitive, and normative trust as suggested by Lewicki and Bunker (1996), Lane (1998) and Child (1998) opens a window to analyse this hypothesis of how the evolution of trust is integral to this dynamic process of evolving co-operation between business partners.

(1) *Calculative trust*: Calculative trust is characterized by the way that trusting involves expectations about the other party, based on calculations which weight the cost and benefits of certain courses of action to either the trustor or the trustee (Lane 1998). In this view, trust is an on-going, market-oriented, economic calculation. Its value is derived from determining the outcomes resulting from creating and sustaining the relationship relative to the costs of maintaining or severing it. Referring to Lane (1998) trust based upon calculation is likely to apply particularly to relationships which are new and hence can only proceed on the basis of institutionalised protection or the reputation of the partner.

(2) *Cognitive trust*: A second basis for trust lies in the sharing of cognitions, including common ways of thinking, between the two partners concerned. Clearly, some cognitive sharing is necessary for a calculative basis of trust (Zucker 1986). However, common cognitions provide the further reassurance that one can now reasonably predict other people's actions on the basis of shared expectations. Normally the individual can only be sure of sharing ways of thinking with others by getting to know them well. This aspect of cognitive trust is what Lewicki and Bunker (1996) have termed knowledge-based trust, namely knowing the other sufficiently well that the other's behaviour can be anticipated.

(3) *Normative trust*: Normative trust depends on people sharing common values, including a common concept of moral obligation. As Lane (1998) points out, common values and norms of obligations can develop in a long-standing relationship where trust was originally created in an incremental manner. Normative trust is likely to find a parallel at the more interpersonal level, what Lewicki and Bunker (1996) call identification-based trust, where both parties effectively understand and appreciate the other's wants. This mutual understanding is developed to the point that each can effectively act for the other, or even think like the other.

4. Survey design and fieldwork methodology

Our study required measures for calculative trust, cognitive trust and normative trust at the interpersonal and inter-organizational level. We therefore reviewed relevant literature to delimit construct domains, developed operational definitions and assembled them for use in semi-structured interviews in Chinese-German JVs in China. We have implemented a qualitative case study approach for the following reasons: First, German enterprises participating in a Chinese-German JV follow a strategy of local integration and usually send only a few expatriates to China. Second, exploring many interpersonal relationships would have also meant analysing many corporate structures leading to distortion due to incomparable surroundings in different companies. Third, to cover the Chinese as well as the German perspective of trust, using quantitative analysis, would have implied squeezing the managers into categories possibly not suitable to cover every aspect of a cross-cultural survey.

Two IJV's, Beijing and Shanghai based, allowed us to interview Chinese managers as well as German managers. Both German partner companies are stock companies from the technical maintenance field on the one hand, and the automotive industry on the other. The local partner companies were both state-owned and operating in the same industry. In total we interviewed ten German managers and ten Chinese managers in both JVs as qualified informants. Those boundary spanning agents were mainly co-operating in a counterpart working relationship in a shared IJV's area management.

We used the method of half-standardized interviews containing 22 questions aiming at stimulating the employees to describe freely their personal attitudes towards trusting behaviour and work place relationships. This method met the condition of having different people from different ethnic and professional backgrounds, and enabled all the interviewees to answer the 22 questions irrespective of the length of the interview. All interviews were tape recorded and transcribed. We have used the method of a "qualitative content analysis" as described by Mayring (1995) to analyse our transcribed interviews. This structural qualitative content analysis consisted of the following steps: (1) Formulating structural categories for interpretation deducted from theory as well as extracted from our data; (2) extracting definitions, examples, and rules for codification of the structural categories; (3) compiling our data by attaching parts of the interviews to the structural categories; and (4) performing both qualitative and quantitative analyses of the assembled data by using the statistical package for social science (SPSS).

5. Key findings

The results gained so far show clearly that all three types of trust exist in Chinese-German IJVs on the interpersonal level. By examining interdependence between the expatriate and his local counterpart on the calculative level, we did not find any evidence for unbalanced relationships. The typical dependence situation found in the group of expatriate managers was the lack of sufficient knowledge of the Chinese language. This situation enables the local counterpart manager to deal nearly exclusively with all business and leadership matters involving the local employees, customers, local authorities or other stakeholders groups. As the access to foreign production technology or product know-how is one

of the most important reasons for Chinese companies to invest in an IJV, the Chinese partner company is dependent on the technical knowledge of the foreign company. It is to the advantage of the expatriate to control all those necessary links. The manifestation of bilateral dependence creates a balance in the relationship. None of the partners will act opportunistically as the threat of reverse sanction is continuously present.

He needs my help. I have a good relationship and this is really important. Guanxi, guanxi, you know? And it is also the language if you come from another country it is not easy.... Language and relationship. This is important and I know it and have it - and he also know. (V6C)⁴

He needs my know-how dealing with production technologies... I mean modern production technologies from Germany. (V14G)

As indicators for the existence of cognitive trust in IJVs, we searched for positive statements about personality characteristics of the local counterpart or the expatriate manager. In addition, we looked for process-based experience of acceptance of working styles, frequent communication modes and open information exchanges between the managers of both sides. One of the interesting points in this respect is that positive statements about working style were only given by local managers, whereas the expatriates complained about the local work place behaviour, for example, it was said to be confusing, not efficient, time consuming. Nearly all managers interviewed quoted a positive view of an open communication mode and open information exchange of relevant facts. In the interviews, it was claimed that this positive attitude towards information sharing and problem solving serves as a basis for JV performance and success. We also found positive statements about expert knowledge and vocational qualifications of the counterpart. Reliability was another question in the context of cognitive trust. Reliability develops over time. Nearly all participants we interviewed feel that after a sufficient amount of time they come to know their counterpart well, so that the other's behaviour can be anticipated and becomes predictable. However this does not mean that the other's actions are always viewed favourably. In this context, the loyalty and dependence structures of the other's to their social network were often mentioned, which does not seem to be acceptable in all circumstances.

⁴ Interviews with German managers are close with „G“ and those with Chinese managers are closing with „C“. Spelling and grammar is partly corrected by the authors from the original interview transcript.

We talk about difficulties very frankly. Besides the professional part we also once discussed his personal problems. Our offices are very close together so it is also the small local distance enabling us to easily exchange. (V18C)

He told me also confidential information. I often thought this is a part one should not talk frankly about as it is confidential. Information which would be rated highly confidential from the German perspective at least. This was really influencing my trust in a positive way in the way to think that a certain trust relationship with him could arise. (A7G)

We are interpreting statements concerning respectful and co-operative behaviour, the positive accomplishment of loyalty expectations and the development of friendship as indicators of the development of normative trust.

There have been situations in daily work life I thought. ... Now the colleague will leave me in the difficult situation, e.g. if I ordered something without talking with him about it in advance which also happens sometimes and I was so surprised that he still supported me in this moment and I would have never thought that he would do so. (A2G)

And when he returned to Shanghai he brought a lot of presents to our office. He gave me a pen signed with my name. This made me really happy and I was so surprised. This was really rising my trust in him ... because he accepts my work. Because he shows understanding for my work and he realizes my efforts. (V19C)

The positive findings are contrasted with statements revealing negative impacts on trust. The partner's behaviour is sometimes interpreted as non co-operative. The managers interviewed perceived three types of action as negatively influencing the co-operative relationship, namely the breaking of contracts, non-inclusion in decision-making, and wrong cultural behaviour.

And then he said he would deal with the subject and I asked him not to deal with it. And then I went to a meeting which was cancelled and when I returned after ten minutes he was dealing with the subject and I got extremely mad at him. (A3G)

I know the Germans. They are always on time, stingy and hate people from other countries. It is bad if they act rude without thinking. If they are arrogant and do not appreciate our effort. (V19C)

Apart from negative impacts on the trusting relationship, we could clearly identify fields of mistrust of cognitive and normative character between Chinese and German managers. On the cognitive level of trust, Chinese managers suppose that the expatriates are unable to think integrally and to behave according to Chinese society's requirements. Their German counterparts on the other hand, tend to criticize the perceived insufficient analytical skills of the Chinese. Watching the local partner with mistrust from the very beginning seems to be more of a German attitude. The 'guanxi' web, in particular, adds complexity to the social relationship and is closely connected with mistrust concerning a parallel loyalty, the keeping of contracts, the transfer of relevant information, and financial aspects.

I do not like to rely on him. If he does himself he will fight his way...and I do not want to rely on him. Sometimes if he deals with these things I later have to...he makes something...and I have to...correct him. I have to be the trouble shooter. I would do better. (...) Some bad things happened (...). (A4C)

But it is still a dependency even if the Chinese colleagues have the same view as oneself. They get orders from above which they will not tell us. (...) There is going on a lot behind one's back. (V11G)

In terms of normative mistrust we evaluated incongruences concerning goals, expectations and values. They are perceived by Chinese as well as by German managers.

Concerning work we do not share the same values. Quality of work or thinking in terms of quality ...it is difficult for the Chinese to change that. (...) Therefore they stick to the level reached without changing anything. That is our advantage that we take the chance, talk about it for improving in any way. (V11G)

I think this is related to our goal to take more management responsibility. We started early to localise management here. And we had five German general managers here and I think now it is time that Chinese staff can take it over. (V16C)

On the layer of calculative trust, the representatives of both partner companies are keenly aware of the reciprocal dependency of their mother companies' on the inter-organizational level. Both Sino-German JVs were established in the 1980s. Due to governmental regulations at this time, IJVs were the only entry strategy for the Chinese market. In all cases investigated, the strategic aim of the German mother companies was to enter the foreign market. On the local side, it is mentioned by all companies that the German companies possess specific product technology or production process know-how which is actually not available in the host country, and which offers a gain of competitive advantage for the local partner against local competitors. From the Chinese perspective, the access to foreign capital seems also very important.

We want to do business in China and without the Chinese side we will not get into the market, no chance; it is simply no free market economy. (VIIG)

You know, now the local Partner is going down they have big losses ... but now with our new ability we can get step by step as we also have foreign customers. (A4C)

By questioning aspects of cognitive trust on the inter-organizational level, we found statements in the interviews concerning superior technology, advanced management systems and the good reputation of the partner company. It is astonishing that all of the German executives had mentioned mistrust towards the Chinese partner companies, whereas the Chinese managers seem not to mistrust the foreign partner companies.

But in the world, in the co-operation the brand of the foreign partner is quite popular - so for this I think it is a continuous co-operation. (A1C)

And that is why I trust the foreign partner. Also there are Germans: They have a very good understanding of the product and the quality. You must say this. (A10C)

Concerning internal payment e.g. if they have top pay 40 million they approach us two days later saying 'Sorry, we do not have the money - we cannot pay'. On the contrary they pretend to support us but the local partner is eager for impeding us in daily life. I have to admit that I do not trust anybody of the local partner. (A8G)

... and after we had approved the internal payment of the money they said okay we can do it but without a bill. We told them that we need a bill to prove where the money has gone to but they said no only without bill otherwise we will not support you. (A3G)

Elements of normative trust on the inter-organizational level could not be identified in our samples.

6. Discussion

The primary goal of our research was to explain how trust in cooperative relationships develops over time, how trust appears at the interpersonal and inter-organizational level, and how those two levels of trust are interrelated. We also explored how China's WTO entry influences the competitive position of both partner companies in Chinese-foreign JVs, and the strategic options for coping with that change.

6.1 The interpersonal working environment in German-Chinese JVs

In our interviews various expressions of trust between German expatriates and Chinese senior managers which we could fit into the layers of calculative, cognitive and, to lesser extent, normative trust could be identified. The theoretical assumption that calculative elements dominates the working place relationships at the beginning, was verified by the interviews. Especially in IJVs, in which boundary spanning agents are closely working together, it is first the knowledge about reciprocal dependency which gives them security to work, and not be distrusted by others. There is clear evidence from the data that all managers are aware of this reciprocal dependency. Whereas the German expatriate brings in his expert knowledge and his close relationship to the German mother company, the local manager possesses all the necessary information about the local staff, the local infrastructure and the relationship to the Chinese side. Both are also part of the larger network of their own ethnicity, with informal information sharing among their groups.

Cognitive trust is based on continuous accumulation of information about the other. In this sense it is understandable that all participants in our

survey feel that they can trust the other, because they assume that they can anticipate the behaviour of the other. The statements given support our assumption that cognitive trust will emerge after an indefinite amount of time. It takes time to acquire detailed knowledge about the capabilities, the working attitude and the personality of the counterpart managers. Nevertheless, the data also indicates the emergence of trust towards the counterpart manager because of personal characteristics apart from the working place relationship, such as social background, hobbies, family etc.

Arguments for the existence of normative trust could rarely be found. We argue that this is because the development of normative trust will take much longer than cognitive trust. However, overseas assignments of expatriates are often limited in duration. As international assignments of German companies to China last in general between 3 to 14 months in the short term, and 3 to 5 years in the long term it is not surprising that the normative level of trust was seldom mentioned in the Chinese-German JVs investigated.

On the working place relationship it is primarily the German staff who expressed distrust in the survey about the working behaviour of their Chinese colleagues. They fail to bring the perceived bureaucracy, inefficiency and laziness into a motivational context. Without much reflection, they seem to project the traits of the 'modern' Western business culture onto the Chinese working environment. The Chinese managers, on the other hand, complained bitterly in the interviews about the behaviour of the expatriates as being culturally unsuitable. Expatriates generally see their role as being to introduce Western management expertise into Chinese-German IJVs, which does not allow for informal local management practices. In fact some Western management practices can cause difficulties in establishing relationships with the local counterpart in China, or the staff of the IJV. These include confrontation during meetings (leading to loss of face by local participants), and insistence on local managers assuming individual responsibility for actions which exert pressures on local staff. Both tendencies reflect insufficient intercultural training programs before assignment, resulting in negative impacts on trusting behaviour and performance.

6.2 The inter-organizational level of co-operation in German-Chinese JVs

Trust on the organization-oriented level of co-operation in German-Chinese JVs was seldom emphasized in our cases. Statements of the Chinese managers about the transfer of person-oriented trust towards the technical knowledge of the German expatriate due to organization-oriented trust towards the high technical standards of the German partner company, are mentioned. Consequently it might be especially in countries which display a lower economic development that a positive image of a successful, technological advanced partner company is responsible for the degree of trust displayed at the beginning of the co-operative partnership. However, if the trusting partner finds out through individual experience or occurring difficulties during the maturation of the IJV that his beliefs and assumptions are not correct, this initial trust will diminish.

In our interviews numerous statements of Chinese managers and expatriates indicate that the quality of work of individual employees of the partner organisation is transferred to the organization-oriented level. The German expatriates, for instance, do not normally consider *guanxi*, or face-saving, to be an acceptable norm of business practice. Within IJVs, the exercise of *guanxi* in China may require favouritism in the selection of new employees, or in the allocation of contracts for supplies, and it may embrace what foreigners regard as corruption. This kind of culturally insensitive or inappropriate individual behaviour of the expatriates leads to distrust on the foreign partners' organizational capacity from the local staff, because it is assumed by the Chinese that the German mother company has carefully selected its expatriates. It seems that neither the foreign nor the local values about work or interpersonal relations are controlling the situation in the IJV. Rather, uncertainty prevails as each group of managers seeks to impose its assumptions about human behaviour and proper work place practices upon the IJV. In addition to those clashes at the management level, the local employees reported in some cases that they were unsure as to what is expected of them. Should they do business as usual under customary local norms, or should they attempt to adapt to these sometimes strange and different German practices. Such an environment in an IJV is expected to be unstable, laden with distrust, and is likely to be ineffective.

We can therefore not confirm the assumption that organization-oriented trust derives from person-oriented trust. To demonstrate the insufficiency

of the assumption we need to have a closer look at the person-oriented level. It first appears that two statements of one and the same individual employee concerning trust towards his counterpart from the partner company were diametrically opposed, expressing a trust on the one side (“I am sure he also passes over all relevant information” (A3G)), followed by a statement containing distrust of the other (“If information concerns detailed information on the local staff he always suffers temporary Alzheimer’s disease.”(A3G)).

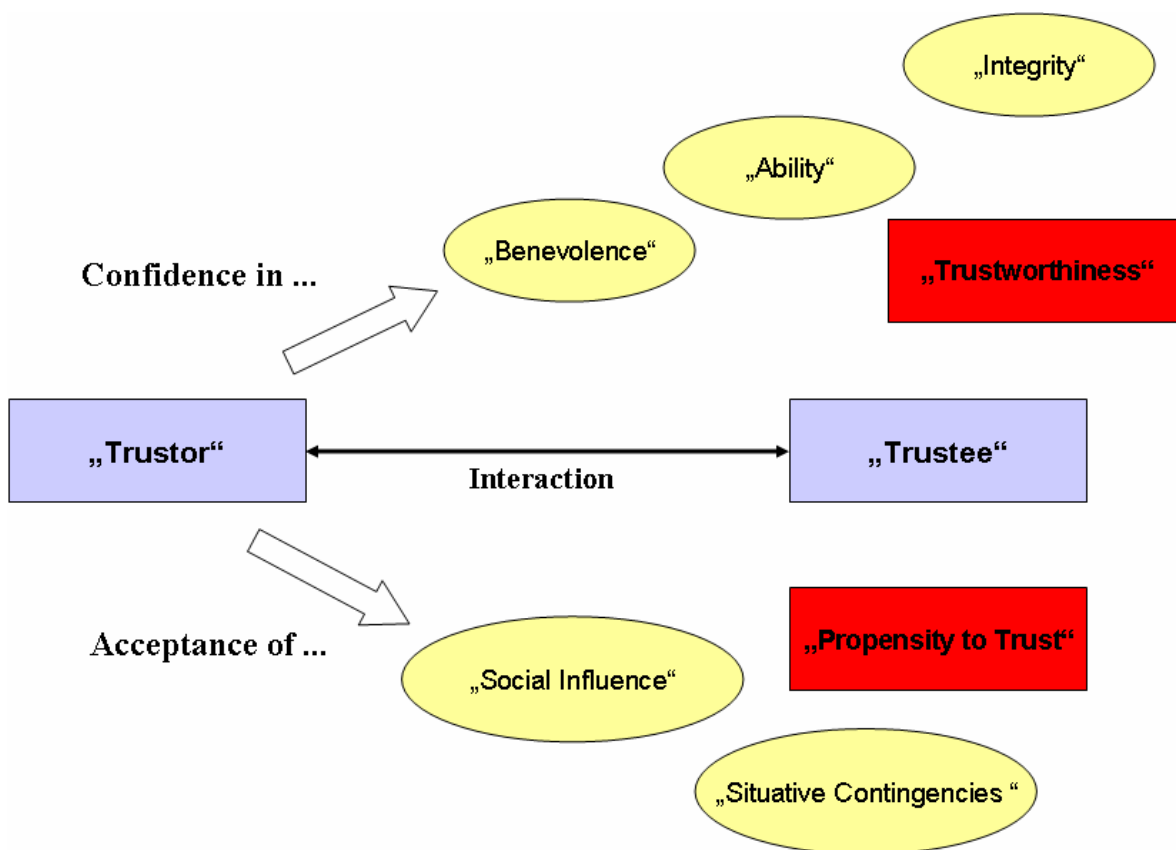


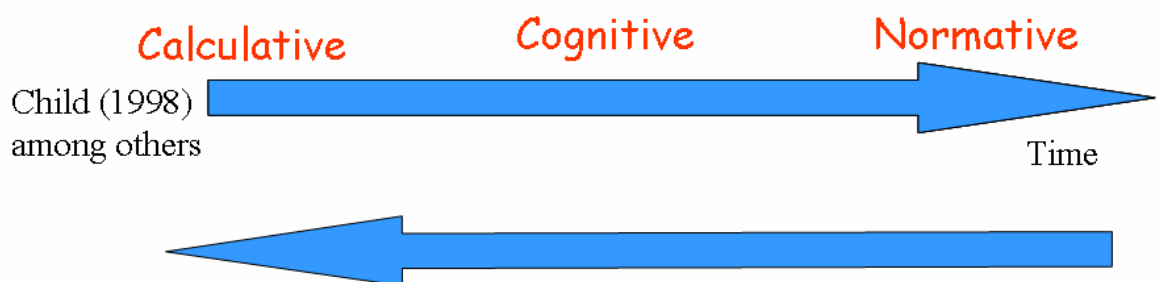
Figure 1: Trust-relationships in IJVs

Analysing this bewildering phenomenon, we need to take the following variables into account – a parallel loyalty of the managers and the temporary character of an expatriate’s assignment –. Loyalty is directed towards the counterpart manager as well as towards one’s own ethnic group from the company of origin. Regarding temporary cooperation, loyalty towards one’s own ethnic group is naturally the stronger tie. Problems arise if a strategic goal incongruence effects the personal relationship from the top management in either the German or the Chinese partner company. As claimed in the interviews, interpersonal agreements or oral contracts

between individuals have to be readjusted frequently due to organisational constraints. With regard to theoretical considerations, we first assumed that such cases will lead to a climate of lower trust or even distrust. After turning into distrust a reestablishment of trust might even be impossible.

However our findings do not support this assumption. Breaking individual contracts and agreements did not automatically lead to distrust on the person-oriented level. To understand the rationale, one must remember the close distinction between confidence and trust. While breaking of trust is attributed internally, the consequences of unsuitable confidence are attributed externally. Von Rosenstiel (1988) describes the determinants of an individual's actions as being to be not only dependent upon one's ability and intentions, but also upon the social environment and situational factors. Obviously the manager affected by a breaking of an agreement takes these factors into account, are attributing the problem externally. Over time, a kind of continuum is developed. This includes elements of trust and distrust in the same working place relationship, regarding external factors that determine the counterpart's behaviour in a specific situation.

- ◆ Be aware of the multilateral dependencies arising from the guanxi web of your partner. From his perspective, breaking trust with an insider may result in severe consequences, while breaking trust with an outsider might have no consequences at all.



- ◆ A tendency for a negative relationship between time and especially inter-organizational trust exists. This contradicts the widely held assumption that trust is build up over time.

Figure 2: Notion of trust and social influence in Chinese-foreign IJVs

The astonishing emergence of distrust on the cognitive level towards the Chinese partner companies in this research might be explained by the fact that they are still state-owned enterprises. The German expatriates claim that the Chinese partner companies are still providing a broad spectrum of

social services ranging from housing to medical care to funerals. These practices of human resource management are transferred to the IJV, which results in a bloated payroll, sometimes unnecessarily high-wage payments, problems with overstaffing and difficulties in personnel recruitment. All these factors contribute to the image that the foreign investor has to provide the 'iron rice bowl' for the employees of the IJV, and to some extent to the personnel of the Chinese mother company too. To choose an IJV partner from the new emerging private enterprises might require a partner selection strategy to cope with these problems.

6.3 Strategic implications of China's WTO entry for Chinese-foreign JVs

China's WTO membership is certain to seriously effect many industries, in which Chinese-foreign IJVs are already active. According to v. Keller, Mönter and Drinkuth (2000) the impact correlates for IJV management on the one hand with the globalisation of the industry, which simply translates into: Can the world markets offer better and cheaper products of equal quality to Chinese-foreign JVs manufacturing domestically? On the other hand it is a matter of the extent of current protectionist tariff and non-tariff barriers, which will be torn down due to WTO accession. The pressure and the implications will be especially felt in those industries where protection is not only strong for end products, but also for the entire value chain, and where the local suppliers have been protected from international competition through local content requirements on tariff and non-tariff barriers, as for example in the automotive industry. Highly affected industry sectors will come under immediate price pressure, as lower tariffs and abolished non-tariff barriers will make imported products more competitive and attractive for the Chinese consumers, especially if the quality or the branding of the products perceived as being better than that of locally manufactured products.

The immediate results of such an increase in import competition will be a lowering of prices for locally manufactured products. If imported products are of higher quality, the price decrease for locally manufactured products must be greater than the decrease in import duties. This effect should not be neglected given the present Chinese quality standards. Already locally manufacturing IJVs will be forced to close the quality and technology gap between imported products and domestic production. This may in turn

make new investments necessary, especially for those foreign investors who went into China a couple of years ago with product concepts, some of which were already outdated at the time. Foreign investors can no longer act according to the conviction that for Chinese consumers the previous product generation is just right as it is less sophisticated, certainly cheaper and requires less investment when setting up domestic production lines. Today, the latest models of consumer products are flooding onto the Chinese market, such as mobile phones, DVD recorders, digital cameras or PCs – often before European markets have seen them. The same process has already started and will gather momentum in other industries, like automotive, machinery and pharmaceuticals, as soon as WTO regulations are put into effect.

As many IJVs with state owned Chinese partner companies operating today are not breaking even, a strategy of cost reduction and product improvement within the old bureaucratic structures is no easy task. Those IJVs which are still enjoying high margins, will be forced to cut prices and to give up their current comfortable margins. The management of IJVs has at least the following options to cope with the new competitive situation in order to survive WTO accession: (1) To increase productivity in manufacturing. (2) Consolidating production lines and redundant sales organizations, and the subsequent reduction of employment in administration and other non-productive departments. (3) Passing on the cost pressure to their suppliers.

(1) Productivity of foreign and domestic firms operating in China is, according to a survey by Roland Berger & Partners, typically between 50 and 70 % lower than the average productivity in comparative sectors in Europe, Japan or in the United States (v. Keller, Mönter and Drinkuth 2000). Even though the hourly rates for labour are comparatively low, the disadvantages in productivity partly compensate or even over-compensate for the cost advantages of manual labour. To realize productivity gains, IJVs have to optimise their production processes. Quality training and the reduction of scrap rates, which are higher in China than anywhere else, play an important role in restructuring activities. As already mentioned above, careful introduction of western style management methods such as quality related incentive systems, as well as productivity related payment systems, is another possibility for increasing productivity.

(2) One of the results of the waves of investment in China during the 1980's and 1990's was that many of the investors are today active with

several JVs in different regions across China, sometimes with overlapping production and distribution networks and sub-optimum logistics or inefficient warehouse operations, and multiple administration and accounting structures (v. Keller, Mönter and Drinkuth 2000). Streamlining and restructuring these operations – especially the non-productive functions like purchasing, logistics, accounting, administration and distribution – is necessary to consolidate business activities in China. Foreign partner companies in IJVs have to start work on these issues, even though it usually takes some time to convince the Chinese JV partners that these measures are inevitable.

(3) The third option for IJVs who are already manufacturing locally, is to pass on the cost pressure to their local suppliers, or to reconsider the purchasing policy in order to realize cost advantages. The latter will be possible as the requirements of local content will increasingly be relaxed and finally abolished through the WTO agreement. Many components may then be purchased more easily, at higher quality and more cheaply from abroad, specifically those components which are easy to handle from a logistical point of view, and are relatively small in number. If the purchasers do not want to lose their Chinese suppliers, they have to exert price pressure, not in a lethal way, but the time for relatively comfortable profit margins is definitely over – as seen from the perspective of the end consumer.

Among the contractual agreements for China's WTO accession is the elimination of sales and distribution related non-tariff barriers. They are particularly important because they have an impact on all sectors of foreign investment, and they will enable foreign companies to gain direct access to their customers or to go into completely new fields of business activity. Until now, even domestic manufacturing IJVs, with few exceptions, have had limited possibilities to run their own sales and distribution networks or to organize and maintain business under their ownership. Only Chinese companies were eligible to be licensed for such activities. Under WTO membership China has now agreed that within the next three years foreign firms will be treated equally, and will be allowed to run trading and maintenance activities under their own ownership and without any geographical limitations. These amendments will give foreign IJVs partners the option of switching from their Chinese sales partners to their own sales and distribution organizations and/or maintenance network. Another strategic option is to keep the existing Chinese sales partners, but to amend the relationship so as to allow the build up of a parallel sales organization

as a second sales channel. It might also be possible, as a third option, to either buy in or buy out the Chinese sales partner and take over their sales operation and organization. The advantage of such a move is that some of the considerable investments in training and technical support, which many firms have undertaken to secure a reliable and functioning sales network, can be recouped.

From the above-mentioned considerations, it becomes clear that the strategic implications for Chinese-foreign manufacturing IJVs and for Chinese-foreign distribution IJVs will be dramatic. With WTO accession, the days of legal protection from competitive threats to China are gone. The strategic choices of the foreign partner companies depend on their core competences and competitive position, as well as on their relative bargaining position towards their Chinese JV partners. We can conclude that, (1) if the value the Chinese side can add to the company is restricted more or less to an equity participation and a good network of personal relationships with the government and local administration, a possible buy out of the Chinese partner should be examined, (2) if the core competences of the Chinese JV partner play a major role in the success of the IJV, and if this core competence advantage is sustainable under the changing competitive environment, the foreign partner should be careful that it does not become the minor partner, and should try to lock the Chinese partner in or, if that is not possible, prepare for a possible power struggle.

7 Conclusion

China's accession to the WTO portends dramatic changes for the management of IJVs in China. Over the last two decades China has established new standards for sustained growth and dynamic resource allocation by a large economy, and further Chinese domestic and external liberalization will redefine China's market place in ways that are only beginning to be understood. For a foreign company that is interested in maintaining a stable long-term IJV even after WTO accession, our findings clearly suggest that goal discrepancies on the future mission of the IJV should be avoided, and compatibility in operational and technical capabilities should be desired.

The German companies mentioned in our research are gaining a strategic position in the Chinese market. The attraction of the domestic market and the opportunity for long-term profit are their main strategic objectives. In

contrast, the Chinese companies are seeking technology transfer, production techniques and management expertise. Such differing goals and objectives might be the critical issue for necessary renegotiations in the Chinese-German IJVs investigated. In both cases the contribution of the Chinese partners is closely linked to operational networks, such as domestic sales, supplies, human resource management and infrastructure. However, during the time of operation, both foreign partner companies progressively gains sufficient access to local knowledge. As far as reciprocal dependency on the calculative level of trust is concerned, this implies that the Chinese bargaining power gradually diminished, depending on both the criticality of that knowledge and how fast the Germans learned their lessons.

The present and future potential of the Chinese market is the key factor which affects foreign companies' decisions to enter China. Therefore, with the future improvements of the investment environment in China due to WTO accession, the stronger the need for foreign companies to follow their competitors, the more they will use high control and resource commitment modes such as IJVs or wholly foreign owned enterprises (WFOE) to enter, expand and develop in the Chinese market. According to a survey by the Delegation of German Industry and Commerce Shanghai 70 percent of the German companies in China asked would now prefer to set up a WFOE, if they had the chance again (Delegiertenbüro der Deutschen Wirtschaft Shanghai 2002). Only 16 percent of the companies would still opt for the IJV again, as it is still difficult to get reliable data on the Chinese market, to adapt products to local requirements and to negotiate with Chinese customers. For those companies in the initial stage of entering the Chinese market, careful planning to get the basic calculus for the IJV correct is extremely important. This includes strategic decision making by the foreign companies concerning partner selection criteria, the appropriate level of technology, use of capital and the local reputation of potential Chinese partner companies. This careful planning takes time and leads to the necessary trust at the organization-oriented level, when the IJV starts to operate.

Careful partner selection and time consuming negotiations also provides an opportunity for a degree of mutual confidence and respect to develop between the main negotiators at the interpersonal level. Especially within the context of a local culture which attaches high value to transactions based upon personal relationships such as in China, trust-sensitive management of co-operative ventures should also include the person-

oriented level. This might be possible through careful selection of personnel and intercultural training on negotiations in the initial stage. When the IJV starts to operate in addition longer assignments or a policy of human resource management in which repatriated managers could be left in charge of questions dealing with 'their' overseas IJV should be considered. Without continuity at the top management level, there is the risk of 'corporate amnesia' (Inkpen and Beamish 1997; Turpin 1993), which is characterized by the way that executives in both parent companies forget their original motivation for this international co-operative alliance, as well as past lessons from their personal relationships. This widening of the trust sensitive management of IJVs increases the likelihood that the more important goals of both partners, and IJV profitability can be achieved.

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