National Situation in China and its Implications to China Business

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Abstract. Based on an analysis of the Chinese WGI, we found that the Chinese government has improved its government effectiveness, regulatory quality, and rule of law after entering the WTO in 2001 whilst trading-off its double-digit economic growth with a tolerance of rent-seeking activities to compensate for a unique political environment characterized by a single opinion up to 2010. Nevertheless, the changing course of a double-digit to a single-digit economic growth starting from 2010 may imply that the Chinese government may now look for a quality rather than a quantity economic growth within a tighter control of corruption which calls for a well balance between establishment of \textit{guanxi} with government officials and practices of dominated cultural ritual such as gift-giving.

Introduction

China was not considered a significant global player \cite{12, 4} until Fishman \cite[p.10]{10} recognized that it is “a new industrial power” challenging the western dominated global governance structure led by the United States. Studies of the Chinese governance system and its implications to Multi-national Enterprises (MNEs) often begin their analyses by benchmarking succinct attributes of its governance system to that of the US. In doing so, they end by telling what the Chinese governance system lacks instead of conceiving a holistic approach on how MNEs function more effectively within it \cite{15}.

Arguments on how the Chinese government influence its governance system and the cultural impact emerged from this system on business continue. For instance, Boisot and Child \cite{3} posited that the Chinese government is in a dominant position to allocate strategic resources to help insider Chinese firms generate organizational performance. In many occasions, however, the Chinese government’s intervention on these insider firms substantially reduced their operational efficiency \cite{5}. By contrast, Sheng, Zhou and Li \cite{21} argued that China’s accession to the World Trade Organization (WTO) in 2001 has shifted its government’s role from guiding to facilitating economic activities and therefore business invention from the Chinese government should be minimal. Inconsistent comments also exist at business interactional level. For instance, Guthrie \cite{14} and Fewsmith \cite{9} recognized that \textit{guanxi} (personal relationship) may lose its thrust because the Chinese governance system becomes more transparent after its accession to the WTO. Yan \cite[p.67]{24} disagreed and posited that MNE managers need to establish a firm understanding on China’s “national situation” to conceive effective business strategies in order to generate their company performance. Also, Gu, Hung and Tse \cite{13} reconfirmed the idiosyncratic influence of \textit{guanxi} in China.

This preliminary study attempts to provide a perception of China’s unique national situation through analyses of its governance system and generates some recommendations to address the business issues embedded within it.
Objectives

This preliminary study carries the following important objectives:

1) Generate a perception of China’s current national situation through analyses of its governance system;
2) Conceive important issues within this governance system from MNE’s business perspective;
3) Provide recommendations to MNEs.

A Perception of China’s Unique National Situation

The World Governance Indicators (WGIs) generated by the World Bank provide insight to the national situation in China [16]. The WGIs have been tracking the governance status of 215 countries according to six major composite dimensions, namely, Voice and Accountability, Political Stability, Government Effectiveness, Regulatory Quality, Rule of Law, and Control of Corruption. By utilising and combining 30 widely known data sources, these indicators are able to reflect the views and experiences of citizens, entrepreneurs, and experts in the public, private, and non-government organization (NGO) sectors from around the world regarding the quality of various aspects of governance. An indicator score of 100 stands for good quality or “impartiality” [22, p.14] and a score of zero stands for bad quality or a totally unpredictable government. The explanations of Kaufmann et al. [16] of the six WGIs are listed below:

Voice and Accountability. This captures perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free press. An index of zero means that there is no freedom whereas an index of 100 indicates complete freedom.

Political Stability. This captures perceptions of the likelihood that the government will be destabilized or overthrown by unconstitutional or violent means, including politically motivated violence and terrorism. An index of zero means that a country is extremely unstable whereas an index of 100 means that a country is very stable.

Government Effectiveness. This captures perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies. An index of zero means that a country is extremely ineffective in terms of government administration whereas an index of 100 means that a country is extremely effective.

Regulatory Quality. This captures perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development. An index of zero means that a country has extremely low regulatory quality whereas an index of 100 means that a country’s regulatory quality is extremely high.

Rule of Law. This captures perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence. An index of zero means that government agents do not have the ability to implement the rule of law whereas an index of 100 means that agents have complete ability to implement the rule of law.

Control of Corruption. This captures perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as “capture” of the State by elites and private interests. An index of zero means that a country’s use of public power to generate private gain is commonplace and serious and an index of 100 means that a country’s control of the same is extremely successful and corrupt activities are non-existent.
To establish its governance performance, we obtained the WGIs and the economic performance of the Chinese economy from the World Bank database for a 14-year period ending in 2014 as shown in Table 1 below.

Table 1. A summary of China’s Governance Indicators (WGIs).

<table>
<thead>
<tr>
<th>Year</th>
<th>Voice and Accountability</th>
<th>Political Stability</th>
<th>Government Effectiveness</th>
<th>Regulatory Quality</th>
<th>Rule of Law</th>
<th>Control of Corruption</th>
<th>GDP (Trillion US)</th>
<th>Economic growth %</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td>5.4</td>
<td>29.6</td>
<td>66.3</td>
<td>45.2</td>
<td>42.8</td>
<td>47.1</td>
<td>10.355</td>
<td>7.3%</td>
</tr>
<tr>
<td>2013</td>
<td>5.2</td>
<td>27.0</td>
<td>54.5</td>
<td>43.5</td>
<td>39.8</td>
<td>46.9</td>
<td>9.491</td>
<td>7.7%</td>
</tr>
<tr>
<td>2012</td>
<td>4.7</td>
<td>28.4</td>
<td>56.0</td>
<td>43.5</td>
<td>38.9</td>
<td>39.2</td>
<td>8.462</td>
<td>7.8%</td>
</tr>
<tr>
<td>2011</td>
<td>5.6</td>
<td>27.8</td>
<td>59.2</td>
<td>44.1</td>
<td>43.7</td>
<td>35.1</td>
<td>7.492</td>
<td>9.5%</td>
</tr>
<tr>
<td>2010</td>
<td>5.2</td>
<td>25.0</td>
<td>57.9</td>
<td>44.5</td>
<td>45.5</td>
<td>32.4</td>
<td>6.040</td>
<td>10.6%</td>
</tr>
<tr>
<td>2009</td>
<td>5.2</td>
<td>30.8</td>
<td>58.4</td>
<td>45.9</td>
<td>45.5</td>
<td>34.9</td>
<td>5.059</td>
<td>9.2%</td>
</tr>
<tr>
<td>2008</td>
<td>5.8</td>
<td>29.7</td>
<td>59.2</td>
<td>51.5</td>
<td>45.2</td>
<td>35.4</td>
<td>4.558</td>
<td>9.6%</td>
</tr>
<tr>
<td>2007</td>
<td>5.3</td>
<td>28.4</td>
<td>59.7</td>
<td>51.0</td>
<td>41.1</td>
<td>33.5</td>
<td>3.523</td>
<td>14.2%</td>
</tr>
<tr>
<td>2006</td>
<td>6.3</td>
<td>28.4</td>
<td>57.1</td>
<td>48.5</td>
<td>37.3</td>
<td>37.1</td>
<td>2.729</td>
<td>12.7%</td>
</tr>
<tr>
<td>2005</td>
<td>7.7</td>
<td>31.3</td>
<td>53.2</td>
<td>50.5</td>
<td>37.8</td>
<td>31.7</td>
<td>2.269</td>
<td>11.4%</td>
</tr>
<tr>
<td>2004</td>
<td>7.7</td>
<td>32.2</td>
<td>59.0</td>
<td>44.6</td>
<td>38.8</td>
<td>34.6</td>
<td>1.942</td>
<td>10.1%</td>
</tr>
<tr>
<td>2003</td>
<td>7.2</td>
<td>27.9</td>
<td>57.1</td>
<td>42.6</td>
<td>40.2</td>
<td>43.4</td>
<td>1.650</td>
<td>10.0%</td>
</tr>
<tr>
<td>2002</td>
<td>6.3</td>
<td>32.2</td>
<td>55.1</td>
<td>33.3</td>
<td>39.2</td>
<td>33.7</td>
<td>1.461</td>
<td>9.1%</td>
</tr>
<tr>
<td>2001</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>1.332</td>
<td>8.3%</td>
</tr>
<tr>
<td>2000</td>
<td>11.5</td>
<td>35.1</td>
<td>53.7</td>
<td>36.3</td>
<td>35.9</td>
<td>50.7</td>
<td>1.205</td>
<td>8.4%</td>
</tr>
</tbody>
</table>


All Chinese WGI indices except for the index of government effectiveness have scores of less than 50. Three indices, namely, Voice and Accountability, Political Stability, and Control of Corruption, have been operating at low level whereas the other three indices, namely, Government Effectiveness, Regulatory Quality, and the Rule of Law, have improved since 2001. These trends indicate that accession to the WTO in 2001 was able to motivate China to generate a more open and transparent governance system in terms of its Government Effectiveness, Regulatory Quality, and its Rule of Law, but the governance performance in the other three dimensions has been distinctively different from the aforementioned three indices. In particular, the low Voice and Accountability index indicates that the Chinese government needs an unquestionable support from its people. Also, the 911 incidence has exerted tremendous pressure on the Chinese Government to tighten up its political control in order to resist outside influence and unexpected external impact on its political system. Also, the Chinese government has been trying hard to control corruption but its effectiveness may not be optimal in a vast geography. Ehrlich and Lui [7] concurred that a bureaucratic government must maintain “balanced growth” between economic development and corruption in different stages of a country’s development to stay in power.

When we compare the other three indices, namely, Government Effectiveness, Regulatory Quality, and Rule of Law, with China’s Gross Domestic Product (GDP), the Chinese Government has been able to slightly improve the effectiveness of its government, alleviate social anxiety in terms of higher regulatory quality, and raise investment confidence based on an improvement in the rule of law in an extremely high growth economy (an increase of 800% in the 14-year period ending 2014). This remarkable economic phenomenon has necessitated a concerted and seamless collaboration among insider firms such as State-Owned Enterprises, domestic Chinese firms and foreign invested companies.

Liu and Sun [18] surveyed 1,160 public limited companies (PLCs) in China and found that the Chinese Government ultimately controlled 84% of the PLCs, 8.5% directly and 75.5% indirectly by pyramid shareholding schemes. A subsequent study conducted by Liu [19] also identified a similar pattern of control. In general, the State-owned and local-government-owned firms perform better than the privately owned counterparts. To regulate such a large-scale collaboration, the Chinese Government needs enormous courage to balance certain rent-seeking activities by insider managers with economic growth to assure the accumulation of bureaucratic power [7]. Indeed, China exhibits
an exceptional case in that a noticeable level of corruption has persisted alongside its vigorous economic growth, suggesting that rent-seeking has not been a significant barrier to economic growth [11]. The current crackdown on corruption initiated by President Xi Jinping may temporarily reduce the incidence of rent-seeking activities but the economic momentum is likely to continue in China. Wedeman [24] concurred that corruption is a by-product that occurs alongside the high economic growth in an emerging economy such as China.

The above analysis shows that the Chinese Government has used a complex yet very dynamic governance mechanism to regulate social and economic activities. The Chinese government will need support from its citizens, political members, and organizations to produce a single opinion. To maintain this single opinion, the Chinese Government has allowed a certain degree of rent-seeking activities to take place to compensate for its political instability to support its economic development. Given the legacy of Chinese communism and its political structure, corruption, together with the threat of punishment for corruption and the selective enforcement of this threat, serves as a method of compensation that both satisfies the political objectives of the Ruling Party and provides an effective inducement to local bureaucrats to promote economic reform.

In response to the ever-changing business environment, the Chinese governance control mechanism works in an “ad hoc” manner or very similar to a pendulum that may swing from one side to the other [2]. The Chinese Government may from time to time implement more stringent regulatory controls. For instance, when gifting activities [25] reach an unbearable limit, the Chinese Government may “kill a chicken to scare the monkeys” [21, p.19] by catching some offenders to show the vigorous implementation of its rule of law. The arrest of the four Rio Tinto Chinese employees is a classic example [17].

To conclude, the Chinese Government has improved its government effectiveness, regulatory quality, and rule of law to reduce social instability and to help boost its economic activities. Nevertheless, a unique governance structure due to a single political ruling has made insider relationship networks a very important aspect of conducting business in China [8]. The Chinese Government has improved its legal system to cater for a more open socialistic market economy as predicted by Guthrie [14]. However, this improvement has not been substantial enough for its governance system to change course in favour of a more transparent governance mechanism. As a result, insider relationships will take precedence over legitimate decisions based on law or regulations [20].

Implications to Multi-national Enterprises (MNEs)

The Chinese economy has been going through a cyclical pattern with a double digit now down to a noticeable single digit growth as shown in Table 1. Specifically, the double-digit economic growth from 2003 to 2010 came with a decline in corruption control during the same period. In other words, the Chinese government may render a high economic growth with less control on corruption. Nevertheless, the Chinese government may now seek a medium high economic growth as evident in the single digit economic performance after China becomes the world second largest economy. In saying that, its current tightening on corruption control may continue from a perspective of seeking a high to a medium-high economic growth. Alternatively speaking, the Chinese government may now look for an economic growth which is based quality rather quantity growth. MNEs must be vigilant and acutely aware the implications of gift and hospitality practices in China. Also, the new focus of the Chinese Anti-corruption Bureau to target whose offering the bribes (the supply side of the bribes) put tremendous pressure on MNE managers’ gifts and hospitality practices in China [6].

MNE managers should note that improvements of the Government Effectiveness, Regulatory and Rule of Law in the Chinese governance system have generated a more transparent corporate governance system within a Chinese governance system that has been characterized by a single opinion and a dominated government structure. MNE managers are more effective to adapt a collaborative approach whenever they negotiate new projects with their Chinese counterparts within the Chinese government dominated economic trajectory.

A Chinese government dominated economy generates a tremendous pressure to MNEs. In other
words, MNEs have to establish *guanxi* with the government officials in a more tightened corporate governance economic structure. How to maintain a balance between cultural practices such as gift-giving and good corporate governance remains a challenge to these MNEs.

**Conclusion**

An analysis of the governance structure in the Chinese economy provides a perception of the national situation in China. In saying that, the Chinese governance system has been attempting to control the areas of Voice and Accountability, Political Stability and Rule of Law while improving its Government Effectiveness, Regulatory Quality and Control of Corruption. MNEs must note that this governance structure is distinctive and need tremendous courage to adapt their business practices in such a context. In addition, the change of a high growth (quantity) to a medium-high growth (quality) economy calls for a well balancing act between establishment of *guanxi* with government officials and dominated cultural business practices such as gift-gifting.

**Future Research Directions**

The Chinese governance system is a dynamic mechanism and needs continue monitoring its implication to business practices. Future business research should generate a surveillance system that bridges the WGI indicators and business practices. Another area of future research should concentrate on the establishment of *guanxi* with the Chinese governance officials which calls for a balance between a good corporate governance system and a government dominated economy. Finally, the Chinese economy is now looking for quality instead of quantity economic growth. Future research should call for a business model that aims at generating profit with an important objective to build a Quality Chinese economy.

**References**


