NEGOTIATING ACROSS THE PACIFIC

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Bill Wright, vice president of US Fortune, had just finished a telephone conversation with Edward Tang, general manager of Asia-Pacific Consulting Group, during which Tang had informed him that their stalled negotiations with BBT could lead to an international lawsuit. Eight months earlier, Beijing Bio-Tech (BBT), an animal feed manufacturer from China, asked Tang to help locate a supplier of feed grade lecithin in the US. Tang working with Wright as intermediaries initiated negotiations between NutriNex, a US lecithin producer, and BBT. The negotiation had been long and very difficult and the transaction was not completed as planned.

The evening of July 16. 1997, found Bill reflecting on what had happened during the past eight months. He felt trapped and did not know what to do. but knew that he had to deal with the situation quickly. Edward had suggested to him that he should get the negotiation back on track, but Bill did not know if that was possible. However, Bill realized that if negotiations were not successful the Chinese might launch a lawsuit against him.

Background: Participants and Transaction

Asia-Pacific Consulting Group (APCG) was a Philadelphia-based company specializing in export management, cross-cultural training, and foreign language-related services such as translation. The company's clients were from all over the United States and a dozen foreign countries, especially in Asia. This was because APCG's two founding partners, Edward Tang and his wife Joyce, were originally from China and had maintained extensive relationships in Asia.

Beijing Bio-Tech Co. Ltd. (BBT) was a joint venture set up by a Taiwan-based multinational company and a Beijing-based company affiliated with China's Ministry of Agriculture. BBT specialized in research, development, and production of nutrition, feeding, and breeding products for aquaculture. Since its establishment in 1990, BBT had made substantial progress in product innovation and marketing, and became a leading aqua-biotech company in China. To recognize its accomplishment, the city government of Beijing named BBT a "Most Admirable Foreign-Funded Enterprise" for each of the last four years. Mrs. Ming Kuo, general manager of BBT, was featured in a publication as one of the "Outstanding Females in Contemporary China."

In November 1996, Ming Kuo contacted APCG and requested assistance in locating a supplier of feed-grade lecithin in the United States. The product was a core feed additive ingredient for fresh water fish and shrimp, which was BBT's main product line. In the past, BBT purchased lecithin from two sources, a Chinese manufacturer that operated in China, and a Hong Kong distributor that supplied US-made lecithin. BBT preferred the US

products because they had more consistent quality. However, involving the Hong Kong distributor made the price very expensive. The average price of lecithin in the market was $3,700 per ton, ranging from $3,500 to 4,300. As far as the Asian markets were concerned, margins for middlemen could be as high as 40%. BBT currently purchased about 50 metric tons of lecithin annually. It intended to increase the purchase by 100% in the next year, and then by 10% in the subsequent years. Eliminating the middleman and establishing a direct relationship with a US supplier were important goals for BBT.

On November 12, 1996, Ming Kuo wrote a letter to APCG explaining the company's criteria for selecting the supplier: “We are looking for a long-term relationship with a reliable supplier. This means that we would consider the first purchase as a trial, hopefully both sides will be satisfied and decide to continue the relationship.” While quality and price were important, on-time delivery was especially crucial. “Our season starts in late August and we must have the lecithin in our plants by that time,” Mrs. Kuo stated.

As Edward Tang and his wife Joyce read the letter, they became excited. APCG had been involved in about a dozen international trade deals, but only a few of them had come through. This time the Tangs not only knew the Chinese company’s reputation, they also interacted on several occasions with Mrs. Kuo and enjoyed a good personal relationship with her. In fact, it was the relationship that brought the business to APCG. As Mrs. Kuo stated: “As a Chinese, I like to do business with people I know.” Access to hard currency usually posed a major challenge to foreign finns selling to China. The Chinese currency was not convertible and Chinese importers had to purchase the foreign currency necessary for authorized imports, which was always troublesome. However, hard currency would not be a problem in this case because, like all joint ventures with investment from Taiwan, BBT was given a Sino-foreign joint venture status and therefore was allowed to retain foreign currency contributed by the “foreign” (Taiwanese, in this case) partner or earned by the joint venture. As the Tangs knew, BBT enjoyed a high credit standing and never had payment problems in international trade. The Tangs also realized this might be a big deal, and if this transaction did succeed, it could evolve into a continuous business.

In 1996 the United States was the leading supplier of lecithin in the world due to its superior technology as well as its abundant domestic soybean supplies. Although China had made an effort to develop its own lecithin production, its technology was far behind. More importantly, lecithin was produced from soybean, but there was little room for China to expand its soybean production in order to manufacture lecithin on a large scale. With limited arable lands, China had to concentrate on grains more suitable for human consumption, such as wheat and rice.

To locate sources of lecithin, the Tangs started with the US Department of Agriculture, trade associations. and published industry directories. Then, with a short list of potential suppliers, they began calling companies. It was not too long, however, until they realized that these companies did not like to deal with middlemen. They said that they were definitely interested but would like to communicate directly with the buyer. With this concern. Edward called Bill Wright.

Bill Wright and His Working Plan

Bill Wright was executive vice president and a director of US Fortune, an investment bank that had operations across the East Coast. US Fortune was a well-established company. Edward Tang had met Bill through a client who was Bill’s close friend. Bill Wright had been with US Fortune for over twenty years, and because of this, he was very well connected in the business community. As a senior executive, he currently had little involvement in the company’s daily operation and was able to develop other business interests outside US Fortune. Particularly, Bill held substantial stakes in several food and drug-related firms. To take care of these businesses, Bill frequently traveled to Europe. However, he had never dealt with Asian countries.

Bill Wright was thrilled with the opportunity. BBT was a reputable Chinese company and lecithin trade was a very profitable business. Most importantly. Bill had a long-time client, NutriNex. which happened to be a major manufacturer of lecithin.

NutriNex was located in the Midwest. It was a major player in the industry and had started exporting several years ago. Dr. Robert Fisher, NutriNex’s CEO, knew the huge potential of the Chinese market. The company had been looking for an opportunity to enter the market at that time. However, NutriNex had been unsuccessful thus far because of the difficulties of establishing contacts in China. Therefore, when Bill called. Dr. Fisher could hardly believe it. "I am delighted to help,” he said calmly. "Bill, just let me know what you want me to do." As they were talking, Bill already had a plan wherein he and the Tangs acted as middlemen between NutriNex and BBT (see Exhibit 1).

In practice, a middleman had two options in an export or import transaction. First, the middleman could work on a commission basis without taking title to the goods; his job was to provide a bridge between the buyer and seller. Second, the middleman could act as a real buyer and reseller and actually take title to the goods. In doing so, the middleman could be able to avoid the financial burden by means of back-to-back letters of credit (L/C). With this procedure, the buyer issued a L/C to the middleman who then issued another L/C to the supplier. The first L/C involved an amount larger than the second L/C; the middleman retained the difference as profits. Under the first option, the middleman's role was terminated after the buyer and seller were connected and a pre-determined amount of commission was paid to the middleman. Quite often, a middleman did not want the buyer and seller to interact directly so that they would depend on his mediation in any further transactions. This was the main reason why some middlemen, often the experienced ones, took the second option.

Bill sensed that the purchase of BBT was likely to become a repeat business. He did not want to just take a commission and go away. Over the phone, he told CEO Fisher that he would like to handle the transaction through the following process:

1. Bill Wright should negotiate with the Chinese buyer for a purchase agreement and appear in the agreement as the SELLER.
2. The Chinese buyer should issue a letter of credit to Bill Wright.
3. Upon receipt of the L/C from the Chinese buyer. Bill Wright should then issue another L/C to NutriNex.
4. NutriNex should make the shipment after receiving the L/C from Bill Wright.

In the next hour. Bill sent a fax to Dr. Fisher to confirm their conversation. "OK, if this is how you want to do it," replied Dr. Fisher over the phone.

Letters of credit (L/C) was a basic method of receiving payment for products sold abroad. A letter of credit added a bank's promise of paying the exporter to that of the foreign buyer when the exporter has complied with all the terms and conditions of the letter of credit. In a typical export process, only one letter of credit was necessary: the foreign buyer applied for issuance of the letter of credit to the exporter. The process specified in Bill Wright's working plan involved two letters of credit (see Exhibits 2 and 3).

As agreed upon by Bill Wright and Robert Fisher. NutriNex would arrange shipping of the goods from its manufacturing facility directly to Xin Gang, the Chinese port where BBT would pick up the goods. At NutriNex factories, the lecithin would be loaded in a container, which then was carried by a truck to a port in California. At the port, the container was put on an ocean carrier. In normal situations, it took three to four weeks for a container to get from a US port to China. At the Chinese port, BBT unloaded the goods to trucks. It took about an hour from the port to BBT's facilities in Beijing by trucks.

The Tangs had no problem with the arrangement. The only question was: Should they tell Ming Kuo everything? They knew that Mrs. Kuo intended to deal with a manufacturer, but they also knew that Bill did not want the buyer to establish direct contact with the supplier. In the end, the Tangs decided not to complicate the situation. "While the goods are not from Bill. Bill knows NutriNex's president. We should be OK." they said to each other. They did not tell BBT that the ultimate supplier was not Bill Wright but NutriNex.

Economic and Cultural Environment in China

Bill Wright's past overseas experience was largely limited to Europe. He felt that he needed to gain a broad perspective about what was going on in China. He called the Tangs with many questions. He realized that China had been one of the fastest growing economies in the world in recent years. This dynamic growth could be attributed largely to China's policy of reforming its economy and opening up to the outside world, which began in 1979. One of the most striking features in the changing economic system was the steady growth in the number of foreign-funded enterprises. He was aware that BBT. which was his Chinese counterpart in the transaction, was one of many enterprises jointly owned by Taiwanese and Mainland Chinese companies.

Bill Wright had heard that China's rapid economic growth and bold reform measures pointed to enormous market potential in China, and particularly that the Chinese had a high regard for American products. However, he just now realized how large the Chinese market for American manufactured lecithin could be. According to the Tangs, the Chinese consumers, with increasing purchasing power, had been demanding more and better products from the aquacultura! sectors. Because of this, a number of aqua-biotech companies had recently emerged in the areas of research and development, production

of nutrition, feeding, and breeding products for aquaculture. These Chinese companies, however, had to face a major challenge posed by China's limited per capita natural resources. For instance, with scarce arable lands the Chinese had used soybean mainly for direct human consumption. Coupled with lack of advanced technologies, currently and probably in the foreseeable future, the Chinese aquabiotech companies had to rely on imported lecithin to meet the growing needs for quality feed additive.

Having talked to the Tangs, Bill realized that the Chinese people had a cultural system that was quite different from that in the US and other Western countries. In conducting business, Chinese paid much attention to building *guanxi*, that is, the intricate and pervasive network of personal relations. The Chinese culture also emphasized "face," or a person's credit, honor, and reputation. Embarrassment, failure, or contradictions lead to loss of face. Importantly, the Chinese concepts of *guanxi* and face were not universal, but highly situational and reciprocal. When a Chinese acted, he normally anticipated a return. And a Chinese would deal with a party as that party dealt him. The Chinese would say: "If you are good to me, I will be ten times better to you; but if you are bad to me, I will be ten times worse to you!" Hence, Chinese were morally justified to either repay or retaliate upon another person depending how that person treated him.

Similarly, face could be traded. A person doing a favor for someone was said to be giving face and the person who had received a favor was expected to give face in return. The notions of *guanxi* and face were evident in a Chinese business negotiation context. As observed by many Western negotiators, the Chinese took longer to make decisions. They apparently were more concerned with long-term associations and invested time in building a good working relationship. Because of this, they attached great importance to sincerity and reputation on the part of the foreign party. The Chinese seldom used the word "no," because they tried to save face for both parties. They proceeded cautiously and slowly at the negotiation table, because they tried to avoid mistakes that would embarrass them.

Bill was especially amazed by the Chinese attitude toward legalistic approaches in business. Consistent with their attention to human relations and face. Chinese traditionally shunned legal considerations. Instead, they stressed the moral principles of everyday living and carefully managed relationships in business settings and among social groups. Even in today's international business environment, the Chinese preferred not to have lawyers involved in the negotiation process. To a large extent, they relied on personal trust instead of legal documents as the foundation of business relationships. For the Chinese, negotiation was an ongoing process and did not end with a signed contract. When disagreements occurred, they often sought compromise and consultation through a third party who was trusted by both sides. Legalistic measures were used only as a last resort.

While describing Chinese negotiation styles, the Tangs tried to illustrate some of the salient differences between the Chinese and Americans. Compared to Chinese emphasis on personal relationships, Americans took a factual approach toward negotiation and considered it as a place simply for problem solving. Unlike their Chinese counterparts, American negotiators separated people from issues and felt comfortable with confrontation. During the negotiation process, they were expected to give and take and even engage in hard bargaining. However, when a legal contract was signed, the negotiation reached the endpoint that both sides had to follow. Tire approaches toward conflict resolution were also different between the two people. While a typical Chinese approach was emotion-confounded, situational, and sometimes circuitous, a typical American approach was factual-based, legalistic, and generally straightforward.

The Ball Was Rolling . ..

It did not take long for Bill to draft a purchase agreement. The only difficult part of the job was to determine the amount of commissions. In this transaction, there were two intermediaries: APCG and Bill Wright. Bill wanted to build in $20,000, which would be split equally between APCG and himself.

The total cost for a 40-foot container of lecithin, including insurance and freight, was $56,000. Edward figured that a commission over one-third of the sale-price, exactly 38%, was too high to be acceptable and expressed his concern immediately. After listening to Edward, Bill replied: "Well, this is the normal way we do business in this country. The best price is the maximum you can charge yet the buyer is willing to pay. Who knows, maybe the Chinese will think it's okay!" "What if the Chinese think it's too expensive?" asked Edward. He was afraid that this price would scare BBT away. He then suggested to reduce the commission and give a more generous offer that he believed would signal goodwill to the Chinese buyer. "I understand that," Bill insisted, "but why don't we just start with this price. We can always back off some if BBT thinks our price is too high."

On February' 16, 1997, APCG sent a fax to inform BBT of the price quoted by Bill Wright. Four weeks passed, but there had been no answer from BBT. Edward decided to call Mrs. Kuo. Mrs. Kuo first apologized for not responding and then said: “You should know how I feel—when a price quote seems way too high, we don’t believe the seller is serious.”

Edward felt embarrassed and said: “I am sorry, but 1 thought you might know how Americans start a negotiation. Believe me, they are really serious about this transaction.” “Why should 1 know how Americans negotiate, Edward? Ming Kuo replied. “You went to American school, but I didn’t. So you have better understanding on how they deal with these matters than 1 do. Well, since you’ve said that, 1 don’t mind giving them a try. But please—tell them this time is for real. By the way, 1 am now thinking of a 20-foot container, not the 40-foot. Do you think they will do that?” Edward replied: “Ok, let me talk to Bill.”

“How can they change from a 40-foot to 20-foot container, and why did it take them a month to respond!” Bill was upset while talking to Edward over the phone. Edward replied: “Bill, I told you that we should lower the price to be real. Now, if you listen to me this time, this is what we should do—get back to them as quickly as possible, agree to take an order for a 20-foot container, and lower the price. What I’m suggesting is that we show them that we are flexible and try vety' hard to work with them. Remember I told you that BBT is not just looking at this single deal, they are trying to find a partner to work with for a long time.”

On April 2, Bill sent a fax to Edward, informing him that Dr. Fisher from NutriNex agreed to take an order for a 20-foot container. Bill also agreed to quote a low'er price to BBT. w ith the total commissions being reduced to $6.000. Edw'ard was pleased with the news and sent a message to BBT on the same day. Twenty-four hours later, Ming Kuo called Edward. She was grateful for the effort made by APCG and agreed with the price. She promised that she would ask her Import Manager. Rong Zhang, to proceed immediately.

However, another week passed before Edward received the response from Rong Zhang of BBT. Mr. Zhang apologized for the delay and explained why. Since the tariff on lecithin w'as very high to manufacturing firms like BBT, the company had been negotiating with a licensed foreign trade company. Beijing International Trading Co. Ltd., to handle the import process. Under the Chinese government’s import/export regulations, this trading company would pay lower tariffs for importing a product like lecithin than would BBT.

It was not until late May when Bill Wright and BBT could start serious discussions on the contractual terms. After several rounds of negotiation on items such as product name and packaging, the contract was finalized. Bill Wright signed the contract as “Executive Vice President, US Fortune, Inc.” The contract followed rather standardized format in international trade. It stipulated “Shipment within 30 days upon receipt of Buyer's Irrevocable, Transferable L/C issued from a reputable international bank or equivalent.”

.. . But Finally Dropped

On June 9, 1997, Bill faxed the signed contract to BBT. BBT signed the contract and faxed it back to Bill two weeks later. On July 3, BBT opened a L/C from Bank of China. On July 7, Bill received the copy of the L/C.

As he called on NutriNex to arrange delivery, Bill could hardly believe what he heard from Dr. Fisher. He was told that the delivery time requested couldn’t be met because something had happened, which was outside the control of NutriNex. According to Dr. Fisher, there had been heavy rains, which caused a serious flood in the mid-western states. The flood created delays in transportation and ultimately slowed down the manufacturing of lecithin. At that time the company was experiencing a backlog of orders. “When you first talked to me about the deal, I said we would ship the goods to the buyer within three weeks. Now. it is going to take at least two months,” said Dr. Fisher. Bill said he understood the situation but insisted NutriNex should figure out a way to make the delivery. “I am sorry. Bill,” replied Dr. Fisher. “But there is no way my company can deliver this time.” He pointed out that if there was a signed contract between Bill and NutriNex, they would have had to ship the goods on time, but there was no contract.

Listening to Dr. Fisher. Bill was shocked by the plain fact that he. not NutriNex. was obligated to make the delivery according to his contract with BBT. In the contract, he himself was the seller. “Why did I dare to sign the contract?” he asked himself. Yes, he had the verbal promise from Dr. Fisher and he believed his friendship with Dr. Fisher provided the assurance, but he didn't have a signed contract with Dr. Fisher and NutriNex did not have to deliver.

Bill took the corporate jet to visit Dr. Fisher at NutriNex’s headquarters. He believed that Dr. Fisher was able to help if he wanted to: NutriNex was so big that it should have no problem to fill a 20-foot container. However, Dr. Fisher offered no help.

NutriNex's new delivery schedule was two months and even this delivery time could not be guaranteed until "We've received the order," said Dr. Fisher.

No Way Out?

When Bill came back to his office from the trip, he had several messages from Edward on his answering machine explaining that BBT had been waiting for the delivery. Bill sent a fax to BBT, informing the Chinese of the inevitable delay. He explained how the production was delayed by the weather and proposed to amend the contract with a new delivery time schedule.

It took only one day for Bill Wright to receive a fax from BBT. "We understand the difficulty due to the natural disaster," the fax stated. "However, our manufacturing season is approaching and we cannot afford a delay."

Bill Wright was now desperate, and decided to visit Dr. Fisher again. However, nothing had changed and NutriNex could not deliver to China at the moment. Bill sent another fax to BBT. indicating that he simply could not deliver on time.

BBT returned a fax to Bill the next day. It stated that Bill had violated the contract and caused the Chinese company a loss amounting to $13,450, as a result of an emergency purchase and the fund lockfee for the L/C in the bank. BBT therefore asked Bill to: 1) apologize for the mistake, 2) compensate them for the loss, and 3) provide details of the amendment.

On July 21, Bill replied with a fax. He first stressed that the delay was unavoidable because of high demand and the rains and then gave another reason for the delay: "As you know, we have been dealing with you through our associates at APCG. . . . They have been out of town.... I did not feel that it was proper for me to contact you directly until I had spoken to them," and finally apologized for the delay. He suggested making an amendment to the original shipment time, 40-60 days instead of 30 days after receipt of an updated L/C from BBT. He did not mention the loss compensation issue.

Edward received a phone call from Mr. Zhang. He said Mrs. Kuo was very upset by Bill's response, he then asked Edward to pass the following message to Bill: BBT would initiate a lawsuit if it could not get a fair solution with Bill Wright.

Cross-Cultural Agent at Work

Edward translated the message very carefully when he talked to Bill on the phone, but he did not mention the word "lawsuit." He still hoped Bill could realize the seriousness of the situation: "No matter what happened, the contract had a delivery date and you didn't deliver," said Edward. "Ed. you know what? When you first talked to me like this, I kind of blamed myself too, then 1 said wait a minute, if they moved reasonably fast when we started the negotiation, there wouldn't have been a delay," Bill argued. "Please understand that when we began this process, it was over 4 months ago. At that time shipment was 2 to 3 weeks after placing an order. As you know all commodities are subject to supply and demand forces." Finally. Bill replied: "Ed, I am sorry for their loss and I have apologized for the delay. But I have no control over the weather and I didn't ask them to lock funds at the bank."

While disappointed with what Bill had said, the Tangs decided to save the deal at any cost. That night, Joyce Tang called Mrs. Kuo at home. She told Mrs. Kuo that the responsibility was definitely Bill Wright's. However, she suggested that Mrs. Kuo try to get some good out of the bad since things had already happened: "See, you've already borne a loss. If you quit here, you've got nothing. Although this season's gone, if you don't give up. I am sure they will work very hard to deliver on time for your next season. Think about the time and money you've already spent. As long as their lecithin is good that means that you did not waste all your money, and I promise to help you work with the manufacturer directly next time."

After a long silence, Mrs. Kuo replied: "Well, you're probably right; but we just think this American is too arrogant, he's made a mistake but blamed the flood. You're asking me to look forward, but I haven't received a true apology from Bill Wright! He needs to change his attitude if we are to continue doing business together. By the way, Joyce, you should have told me if I was dealing with a real seller or not!"

Having talked with Mrs. Kuo, Edward was more frustrated than ever. He knew that for the problem to be settled. Bill had to do something. However, Bill was not listening to him. Edward decided to make a dramatic move as he started dialing Bill's phone number in the middle of the night.

"Bill, we need to talk. I know you're upset. You know this is not just your problem, don't you? I'm on the phone all the time and I realize I've already lost face with Mrs. Kuo. But I try to say to myself, 'things already happened, you've got to face it.' Now, no matter what really caused the problem, the fact is that we didn't deliver, so that means we broke the contract. Bill, I don't want tell you this, but I was told BBT is preparing a lawsuit."

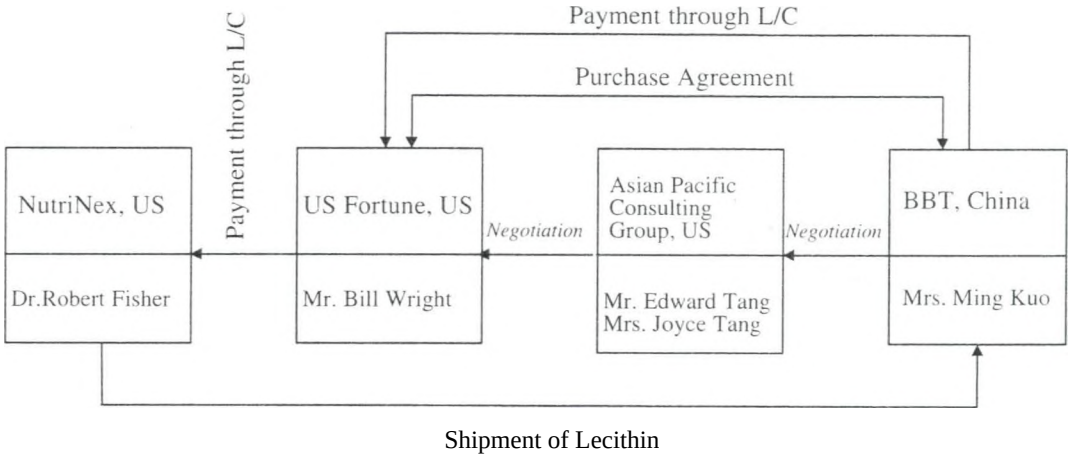

Exhibit 1 Bill Wright's Working Plan

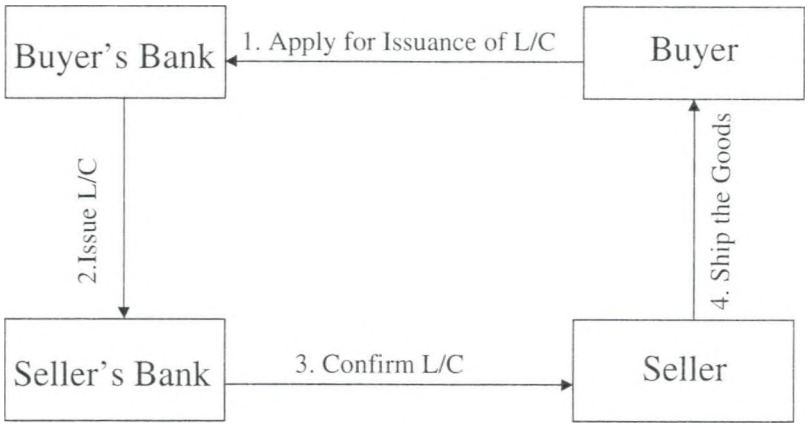

Exhibit 2 Export Process Involving L/C

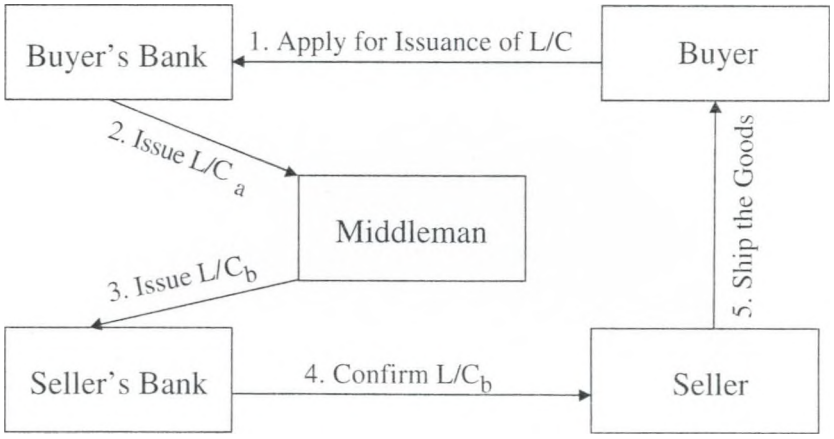

Exhibit 3 Export Process Involving Back-to Back L/C

Note: These charts include only key paths: actual transactions can be more complicated.

"Fine. Tell them I will see them in court!" Bill reacted immediately.

"Wait a minute, Bill. You know I'm here to help. Remember I told you before that the Chinese don't like to go to court? I really don't believe Mrs. Kuo wants to take this step. What they want is a real apology, don't you ever understand this, Bill? Please! You've probably never dealt with the Chinese before. If you can show them that you are sorry about their loss and want to do something, you can calm them down and many times you'll make friends out of such situations. Bill, are you there?"

After another uncomfortable pause. Bill said, "Well, what exactly do you want me to do, Ed?"

"You know Bill, we are a team, and I made mistakes too. I'm thinking that we can offer to sign a new contract for next season. In the next contract, we could reduce the price, basically the commissions, yours and mine. Then we can say, 'Look, we're really sorry for what happened. We can't compensate you at this time, but we will help you by dropping all commissions in the new contract. We know this won't be enough to cover all your losses, but that's what we can do to help. We will work very hard to make sure things like this won't happen again in the future. And we would like to have a very productive working relationship.' I think that by doing this it would stop them from going through with the lawsuit."

Lawsuit... Impossible?

Bill Wright was shocked to hear that BBT was going to sue. According to his notes, the Chinese culture deviated from a legalistic mentality. In resolving disagreements, Chinese used courts only as a last resort. "Are they really going to sue me just for this amount of money?" Bill asked himself. As this question came to his mind, Bill rushed to find the copy of the purchasing agreement. In the agreement, there was no mention of possible court procedures. Yet, the agreement stated that the seller should not be held responsible for any losses sustained by the buyer due to natural causes. Remembering all of this, Bill did not believe that BBT could win the case if they went to court in the United States. So, if BBT wanted to enter a lawsuit and win, they had to appeal to a court in China. If Bill did not agree to appear in a Chinese court, then the lawsuit would not take place.