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The Strategic Challenge of Chinese Organisations
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Key Findings

- The institutional context of Chinese industry creates complicated and long decision processes. This has powerful consequences for the ability of Chinese business organisations to coordinate, motivate, and adapt.
- Complex institutional influences in complex supervisory structures increase the coordination challenges, often compounded by lack of transparency. Chinese business organisations therefore are shot through with coordination failure, and there is reason to believe that where coordination does not fail, coordination costs are high.
- Chinese business organisations also appear hampered in their ability to motivate actors, align their incentives and thereby solve the problem of assuring cooperation between actors. The attention to the motivations of a large number of external actors appears to make aligning incentives difficult, and the shift from political to economic and firm-level rewards supposedly makes the task of assuring incentive alignment more challenging.
- Finally, Chinese business organisations tend to promote stability and refinement over adaptation and innovation. The design of Chinese decision making structures in and of itself suffices to explain some notable weaknesses, e.g. in innovative activities.

¹ We are grateful to Dr. Jamie MacIntosh for comments on an earlier draft as well as Professor Jim March for comments on some of the major issues. A conversation with a former PLA General helped illuminate some of the concerns about transparency in organizations. Of course, none are responsible for any remaining errors. In writing this paper, we draw on the academic literature on business organizations and business strategy in order to try and develop an understanding of decision making in Chinese organizations, as well as articles in the security and foreign policy area and government documents on China. Where possible, we have included links to the electronic versions of the publicly available government research.

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The Strategic Challenge of Chinese Organisations: Understanding Decision Making in Chinese Organisations

Mie Augier, Markus Becker & Thorbjørn Knudsen

Introduction: Why Decision Making in Organizations Matters

"Nothing is more fundamental in setting our research agenda and informing our research methods than our view of the nature of the human beings whose behavior we are studying."
– Herbert Simon, 1985

The nature of human decision making and organizations are central to the functioning of all modern societies (Simon, 1991, 1985). Decision making is shaped and constrained by organizations. Organizations are the basic vehicles for collective social action, and building blocks of our societies. Organizations pool resources and facilitate collective action (Simon, 1947), essential features in accomplishing large-scale and complex tasks. Organizations provide most goods and services in modern societies, and more than 80% of the people who work in an industrialized society work inside organizations (Simon, 1991). Organizations, in turn, are shaped by the cultural and large societal context in which they operate (Crozier, 1964). Thus, organizations represent and embody cultural elements that also shape strategy making.

As these observations suggest, understanding organizations is essential if we wish to comprehend the forces that shape strategic interaction within and between modern societies. Briefly put, understanding strategy requires a good understanding of the organizations that are engaged in producing and implementing strategies. Strategic decisions are taken in organizations, and organizations shape and constrain decision-making in important ways. Strategic decisions are also implemented through organizations. Organizational features thus shape and constrain how strategic decisions translate intended aims to action. The military context is probably where this is seen most clearly. No strategic decision is taken outside and certainly not implemented without organizations. It follows that a neglect of organizations will undermine our understanding of strategy-making, and cause serious liabilities in situations of conflict.²

Superior knowledge about the way organizations shape strategy formulation and implementation is therefore of central importance. To fix ideas, consider the main features of strategy formulation and implementation.

Strategy formulation. Strategy formulation refers to formulating intentions. It involves issues such as:

- Information gathering (using information to identify alternative strategic options)
- Evaluation (assessing the attractiveness of alternative strategic options under different environmental conditions)

² Organizations, of course, are not just traditional hierarchical systems; but also include networks, non state actors, and other systems (indeed, one can see religions as being organizational-like systems).

- Decision-making (selecting a strategic option to be implemented)
- Adapting intentions to experience (adapting what to expect to experience).

Strategy implementation. Refers to how intentions are translated into outcomes. To do so involves challenges such as:

- Generating and providing the appropriate resources
- Employing resources in the appropriate manner – critical aspects include coordination, knowledge conditions and setting incentives.

Developing an understanding of how organizations influence strategy formulation and strategy implementation involves (1) a description of the essential features that characterize organizations (their structure, information flows, process for accomplishing their task, etc.), (2) drawing on theories of organization for propositions on how such features shape and guide behaviour, and (3) applying such knowledge to the processes in which strategy formulation and implementation take place, as identified above.

In the following we extract knowledge on Chinese business organizations that begins to shed light on these aspects of strategy processes. Our work is mostly descriptive and there is a long way to go before we have gathered a comprehensive body of knowledge that can inform these issues in a comprehensive way.

The Strategic Challenge of Chinese Organizations

“Observe calmly; secure our position; cope with affairs calmly; hide our capacities and bide our time; be good at maintaining a low profile; and never claim leadership”
- *Deng Xiaoping’s 24 Character Strategy*

In the following we build on a diverse set of well established research traditions to elucidate important aspects of Chinese organizations and decision making. Rather than exposing a detailed picture on a small fraction of Chinese organizations (e.g. use of IT), we think it is useful to assemble a view on the broader picture. For this reason our analysis straddles multiple disciplines and areas within disciplines.

Why Chinese organizations? Why is it interesting to understand behaviour in Chinese organizations and decision making? There are many reasons why not just scholars, but also analysts and policy makers might be interested in understanding China and its organizations. In the global scene, China is an increasingly important player; yet there is little knowledge about China (relative to our knowledge of other countries).³ There is also some ambiguity as to whether we are in cooperation or competition with China and some talk about “The End of the China Love Affair” based on our (economic) relationship with China (Anderson, 2005). The West has no clear history of cooperation or competition with modern China – unlike the case of Russia, where, shortly after the cold war ended, it is fairly easy to distinguish periods of cooperation from periods of competition. But just because we are not in direct competition with China at present does not exclude future conflict. Certainly there has been a significant upgrading of Chinese military capabilities in key strategic areas.⁴

Compared with other global players – in particular opponents and partners that we have

³ Our relative ignorance of China ranges from language barriers, to unknowledge about strategic ambitions and rates of growth. For some estimates, see the Central Intelligence Agency “World Fact Book”, <https://www.cia.gov/library/publications/the-world-factbook/geos/ch.html>

⁴ Richard Lawless, former Deputy Undersecretary for Asia-Pacific Affairs, in his 2007 testimony to the armed service committee is among those who have publicly noted concern over China’s military build up. Also see the 2007 annual report to Congress of the US - China Economics and Security Review Commission: http://www.uscc.gov/annual_report/2007/annual_report_full_07.pdf

engaged in the past – there are similarities as well as notable differences in our relations with China. Economically, China has stronger ties to the West than Russia had, and a mutual economic dependency creates strengths as well as weaknesses (some of those weaknesses have been evident during the recent world financial crisis). And certainly there is little doubt about China's status as a rising power, in particular given that China seems to be emerging out of the economic crisis faster than in the West, and some China observers project China's return to the number one largest economy in the world.⁵

But while our knowledge of Russia has built up over time, we know little about Chinese society, military organizations, culture, business organizations and other institutions (compared to Russia and other players), and their Comprehensive National Power (CNP) score (Pillsbury, 1997).⁶ In addition, the lack of language specialists reinforces our inability to advance our understanding of the military, political, economic and cultural dynamics in the Chinese context. Since China's economic and military positions both appear to gain strength, there is an obvious need to understand the organizational basis for China's future development.⁷ How do Chinese organizations function, individually and jointly? What aims are important to Chinese organizations, how are these aims realized, and what are the strengths and weaknesses of Chinese organizations? In short, how do Chinese organizations function and what are the strategic implications for Western pursuits?

While the West has been busy on numerous fronts in recent decades, China has become a major competitor in some areas although sometimes silently; upgrading of military, technological, economic and educational capabilities may lead to further upgrading of capabilities to compete in key strategic areas (Pillsbury, 1997, 2005). A Chinese White Paper issued on the first day of Obama's presidency emphasizes their continuing capacity for both small and big wars.⁸

But with some exceptions, scholars and researchers haven't paid much attention to the potential challenges from Chinese development; first focused on Russia, then the demise of Russia, now different threats (including terrorism). This makes us vulnerable to Chinese strategies of expansion and their possible global scope. How do we begin to understand the strategic challenge of China in the face of so many uncertainties and unknowns?

This note offers a small piece of the big picture that is populated by Chinese organizations. Chinese organizations are the basis for China's advances. They are different from western organizations in important ways and their role in advancing Chinese strategies may be very different, too. There is much to be gained from upgrading our knowledge on Chinese organizations, even if the task is truly enormous.

The problem is that extrapolation of existing knowledge is probably less useful. We cannot simply use our own mindsets and deduce that Chinese organizations are similar to the organizations we are familiar with. Indeed, one of the important lessons from studying Russia was that their mode of decision making and operation was quite different from ours. As Andrew Marshall noted:

⁵ There are of course differences in those estimates of when and whether China will be the leading power; but see for instance Yeh (2001), and Madison (1998).

⁶ CNP is an indicator Chinese use to indicate the sum of powers/strengths of a country in economy, military affairs, science and technology, education and resources, human capital, etc.

⁷ The growth of China's military spending and industry is beyond the scope of this paper but see for instance Pillsbury (2005)

⁸ The paper is available here: http://www.gov.cn/english/official/2009-01/20/content_1210227.htm

“Soviet calculations are likely to make different assumptions about scenarios and objectives ... perform different calculations, use different measures of effectiveness, and perhaps use different assessment processes and methods. The result is that the Soviet assessment may substantially differ from American assessment” (Marshall, 1982: 48).

Thus, to understand the strategic significance and the ‘strategic organization’ of China, let alone make an informed assessment of its capabilities, we must first understand the fundamentals. What is the nature of Chinese organizations? What are their most important strengths and weaknesses? As we upgrade our knowledge on the nuts and bolts of Chinese organizations, we may also come to understand how they influence and shape the strategies and actions that characterize the way Chinese organizations interact with western organizations, business as well as military. Understanding Chinese organizations may also provide deeper insights into China’s larger strategic priorities and longer term goals.

Part of the strategic challenge of understanding China is our lack of knowledge and understanding about Chinese strategic objectives that often seem ambiguous at best. At the most basic level, it has been argued that we don’t even know if the Chinese have a grand strategy for their position in the Asian Pacific (Christoffersen, 1996). Moreover, regarding our unclear understanding of Chinese objectives and intentions, Aaron Friedberg noted that “China’s Long Term Strategic Intentions are not only unknown they are also, at this point, unknowable” (Friedberg, 2007: 1). And the 2007 Annual Report to US Congress mentioned that China’s actions in some areas “increasingly appear inconsistent with its declaratory policies” and that the “lack of transparency in China’s military affairs will naturally and understandably prompt international responses that hedge against the unknown”. The 2009 report on China’s military power to congress also notes the uncertainty of China’s aspirations:

“China’s rapid rise as a regional political and economic power with growing global influence has significant implications for the Asia-Pacific region and the world. The United States welcomes the rise of a stable, peaceful, and prosperous China, and encourages China to participate responsibly in world affairs by taking on a greater share of the burden for the stability, resilience, and growth of the international system. The United States has done much over the last 30 years to encourage and facilitate China’s national development and its integration into the international system. However, much uncertainty surrounds China’s future course, particularly regarding how its expanding military power might be used.⁹”

Thus, research focused on understanding Chinese organizations that make strategic decisions is urgently required. We need to improve our understanding of the behaviour of the Chinese in general, and understanding the organizations where important strategic decisions are situated is one first step towards such understanding.

Developing a general framework for understanding of Chinese organizations includes study of diplomatic traditions, culture, economy, etc. in an integrated and interdisciplinary way (Pillsbury, 1997; Twomney, 2005). This will involve improving our understanding of trends, demographics, identifying asymmetries and their consequences, etc. Only if we understand the fundamentals of Chinese society, culture and organization can we make assessments of *specific* areas (such as navy and space). This will also involve a detailed understanding of Chinese history (and historical understandings of the political, cultural, social, economic and other issues), especially because the shadow of the past seems to be an important influence on current and likely future Chinese behaviour.

⁹ Report to Congress the 2009 report available here:
http://www.defenselink.mil/pubs/pdfs/China_Military_Power_Report_2009.pdf

While Chinese policies may change relatively fast, cultures, traditions and organizations are deeply embedded in a society that is unlikely to respond quickly to changes in policy decisions.¹⁰ A particular challenge for the western mind is to understand how the emphasis on kinship influences the behaviour of decision making and organizations in China, being both a culture and a practice that introduces a kind of 'natural hierarchy', ranking people by features such as generation and age; and how China uses social interaction often as a way to create and strengthen relationships (to create and maintain *guanxi*) in ways quite different from western interaction styles.

Thus, a more general understanding of behaviour of Chinese organizations will provide a useful and necessary foundation for increasing our understanding of the formulation and implementation of Chinese military strategy. Building on such general understanding, it is particularly important to study the political and military organizations that play essential roles for formulating and implementing strategy. Such an endeavour seems particularly promising because much can be learned about strategic behaviour from understanding how strategy formulation and implementation are organized. It is also both urgent and promising because very little is known about these organizations yet, and the marginal benefits of information about them will initially be large. The task is formidable and we only provide a first small step in this direction.

Decision Making in Chinese Business Organizations

Little is known about the functioning of Chinese organizations - government and business. It is therefore natural to examine how decision making takes place in Chinese organizations; what rules and practices they have, etc., and how they differ from ours. For example, Chinese business organizations are often characterized by giving their employees relatively high amount of job safety (e.g. the famous "iron bowl") since in particular small firms keep their employees for a lifetime and maintain a culture and mode of operation that is characterized by relatively closed networks. The Chinese small family owned firm has been seen as the exemplar of 'Confucian capitalism' with inter-firm interaction being more frequent and creating a closed culture that serves as substitute for the strong intra-firm networks that western firms often rely on (see for example Yao, 2002). The advantages of such kinship based organizations may include a higher degree of trust in and among parties in the social network; greater commitment and organizational identification; and greater dependability and reliability (Simon, 1991).

Boisot and Child (1988) analyzed Chinese organizations, which they characterize as a fief-like system that relies on more traditional methods for effecting transactions and minimizing the accompanying risks, namely through personal loyalties and relational contracting on a localized (fief-like) basis. In later papers, they explain how the Chinese economic order has subsequently developed towards 'network capitalism' (Boisot and Child, 1996), and how they can be understood as adaptive systems in such complex economic orders (Boisot and Child, 1999).

The following discussion draws on these and other sources to extract knowledge about Chinese business organizations in order to sketch out a picture that may inform other kinds of organizations. To extract knowledge about Chinese business organizations, we apply two angles. First, we consider how Chinese business organizations were shaped by political reforms. Subsequently, we then focus on the two essential challenges of organizations:

¹⁰ An example is the one-child policy and the resulting perception of baby girls as undesirable which has resulted in huge gender imbalances in Chinese society. Even as the government has recently changed the policies and encourages Chinese families to have baby girls, the norms and practices of aborting, offering for adoption or even abandoning girls are still widespread. This also illustrates how policies may change overnight but cultural practices do not.

coordination and motivation, and identify the features of Chinese business organizations in providing them. We finally use the insights gathered in these two steps to identify features of Chinese business organizations that will have an important impact on decision-making in such organizations.

Institutional Influences on Chinese Business Organizations

Cycles of reform

Yuan Lu's (1996) survey and in-depth study of Chinese business organizations provides a number of useful observations for understanding decision-making in such organization. Yuan emphasizes the importance of reforms in having shaped Chinese business organizations, and thus starts his analysis by looking at the impact of the reforms on them. He notes that Chinese enterprises (and society) have experienced cycles of reform where the pendulum has swung from centralization and rigid control towards decentralization and autonomy – and then back again. Since the first reform attempts in the 1950s, these cycles have followed a predictable schedule along the following flow/spiral movement:

Centralization → Rigidity → Complaints → Decentralization → Economic disorder → Re-centralization

As managers protest against tight control, a new decentralization scheme is attempted. But the decentralization schemes lead to economic chaos and waste of resources. In consequence, the central authorities counter by recentralization and tighter controls.

This picture is also confirmed by other studies (Zhu & Warner, 2004; Warner, 2003; Child & Yuan, 1990) that add further detail on how the reforms have impacted Chinese business organizations and decision-making. For instance, by 1988, 'decisions on labour and personnel issues (though not organization), production and work allocation, purchasing and customer priority tended to be delegated further. For example, the selection and appointment of new workers was now typically decided by the heads of labour departments, namely functional managers, while the promotion of production worker to the position of workgroup leader (supervisor) was also often decided by the manager of the workshop. In 1985 these decisions had more often been confined to the level of vice-director, usually one level higher in the hierarchy. Decisions on the allocation of work, on the machines and equipment to be used, and sometimes those on work methods could now be taken by the workgroup leaders, whereas previously they had more often been retained by the workshop manager at the next level up' (Child & Yuan, 1990: 336). Child & Yuan (1990: 338) conclude that 'the main change in the overall distribution of decision-making had occurred in the relation between the enterprise's higher authority and its director', without doubt prompted by the contract responsibility system'.

Yuan Lu (1996) points out that failure of early reforms happened because decentralization was administrative (local versus central government) and not economic (lack of decentralization of power and responsibility to enterprises). Later reforms in the 1980s were informed by earlier failures and therefore combined administrative and economic decentralization (contract responsibility systems with increasing use of market mechanisms).

Yuan (1996) in particular notes the effect of the 1988 reform to smash the three "irons": iron bowl (permanent employment), iron chair (a manager always stayed in office), and iron wages (permanent wages). The implication was that all employees in the future would have contract-based employment, and their wages would be determined by performance assessment. Other studies support and complement Yuan's observations, by analyzing human resource practices and their influence on Chinese organizations (e.g., Warner, 2008, Ding, Ge & Warner, 2004).

But despite the clear aims, there were many problems in implementation. Many workers felt betrayed and frustrated because they believed that life-long employment (iron bowl) was an advantage of socialism, whilst unemployment was the result of capitalism. While the reforms seem to have significantly increased autonomy in Chinese enterprises, there remains a number of structural and cultural constraints which give rise to curious (but predictable) organizational behaviour (e.g. working around demands to lay off employees).

Moreover, while a number of decisions had been decentralized to enterprises, 'this decentralization had not, however, been matched by a corresponding *net* redistribution of decision-making further down the management structure' (Child and Yuan, 1990: 338). As Child and Yuan (1990: 340) argue, 'while the authority to take decisions had largely passed to management, its powers of implementation could still be significantly constrained'. As a consequence, enterprise directors were burdened by excessive workload (Child and Yuan, 1990). As the result of their empirical investigations in Chinese enterprises, other authors identify reluctance to delegate that goes hand in hand with a personalized management style as a cause of such consequences of decentralization (Boisot & Liang, 1992).

Evidence points to two types of causes for rigidity: institutional forces (macro), and behavioural dispositions (micro). It is interesting to examine how rigidities in the economic institutional setting in China continue to define the context of decision-making in Chinese business enterprises. Institutional forces still seem particularly strong sources of constraints in decisions.

This can be seen in a study of six directors of Chinese enterprises in the late 1980s which documents the strong influence of higher-level institutions on the behaviour of the directors (Boisot & Liang, 1992). According to that study, 58% of the activities undertaken by the directors were undertaken on another's initiative, nearly 30% of the paper that lands on the desk of those directors originates in the supervising bureaucracy, and directors spend 27.4% of their verbal contact time with government representatives and hierarchical superiors (as a comparison, the number that Mintzberg found for Western managers was 7%) (Boisot & Liang, 1992).

It is also interesting to excavate deep cultural forces and assess how they continue to shape decision-making in Chinese enterprises. Central in that regard are the notions of *li* (maintaining social position through rite and propriety), *guanxi* (network of reliable and trusted personal relations outside the immediate family), and *mianzi* ("face", social standing and reputation).¹¹ The Confucian concept of *li* captures a traditional respect for age, hierarchy and authority. For example, the high degree of centralization of Chinese decision-making is perfectly consistent with the cultural norms that are expressed by the concept of *li*.

Chinese culture promotes a unique web of stable social relations. Central to this dynamic is a deep-seated cultural trait that promotes an ideal of harmony (and compromise) within families and personal networks. Chinese view the family as the essential social unit and it is imperative to maintain a harmonious relationship among family members. Conflicts remain private whilst only the positive is expressed publicly.

¹¹ Literally, the Chinese term *guanxi* means "connections", "relations", or "relationships". (Chen, 2004). It is often defined as the existence of direct particularistic ties between two or more individuals (Jacobs, 1980; Tsui & Farh).

A similar code of conduct (and loyalty) is extended to a network of close relationships (*guanxi*) among people with a common background (birthplace, lineage, surname or experience). That is, clan norms dictate that members of a network cultivate harmonious relationships in a way that allows the group to maintain a positive external face. Although *guanxi* is non-instrumentalist and utilitarian in nature, it is essential as an instrument in politicians building electorates; businessmen building businesses, etc. (Sandgren, 1984; Farh et al, 1998).

Guanxi is used to exchange information, negotiate with planning authorities and speed up decision-making processes. The concept implies that decisions are never just based on market (price) exchanges and values and are always embedded in social relations and cultures and institutional forces which shape and change behaviours and organizations. But note that we need to get a much more fine-grained understanding of what *guanxi* is (Chen, 2004). For example, there seem to be significant differences between *ascribed guanxi* (nephew and hometown fellow) and *achieved guanxi* (schoolmate and close friend), with the former having a negative effect on trust but the latter having none (Chen, 2004). This distinction was shown to be important in a recent study of 120 Chinese MBA executives enrolled in a strategic human resources management (HRM) class at a northeastern metropolitan university in China. When HRM decisions are based on *guanxi*, employees may view management as less trustworthy (defying equal treatment), in particular when *guanxi* is ascribed rather than earned (Chen, 2004).

The concepts of *mianzi* (face) and *guanxi* (relations) tend to be mutually reinforcing. For example, the concept of *mianzi* is useful in recruitment decisions (Yuan, 1996: 99): "If a person is introduced by a friend or relative you trust or know well, it is better for future management control. The referee will later play a role in helping you to supervise the employee's behaviour. In most cases the employee will do well, for the sake of the referee's *mianzi*."

It is quite possible that we see footprints of *mianzi* and *guanxi* in the broader structures of the Chinese economy and society. For example, the failure of the Chinese government to concentrate financial and policy resources on a few key firms in the Chinese automotive industry can in part be explained as reluctance to make decisions that would strongly disfavour particular firms and local authorities. As a result, not only has the Chinese automotive industry failed to achieve economy of scale, the industry has become more fragmented over time, in sharp contrast to the Korean automotive industry in the 1970s and 1980s (Huang, 2002). Thus, China is a rather extreme example of an auto industry plagued by scale diseconomies (see also Nolan, 2002, and Nolan, 1996, for the more general point).

While it is clear that the context of Chinese industry promotes indecision (by complicated and long decision processes), it might be illuminating to invoke the notions of *mianzi* and *guanxi* to examine the extent to which the curious failure to concentrate the Chinese automotive industry is rooted in deeper cultural forces.

The basis for *guanxi* is defined as a base which "two or more persons [have] in commonality of shared identification" (Jacobs, 1979: 243). The existence of a *guanxi* base does not guarantee the development of *guanxi*, only facilitate that it may develop. The different bases for *guanxi* include locality, dialect; kinship (educational, industry wise), friendships, social clubs, etc. The value of *guanxi* and how close it is depends on the degree of affection in the relationship; thus it is not a static concept but changes over time, and maintaining *guanxi* requires social interaction, cultivating relationships, visits; maintaining *guanxi* also depends on ongoing demonstration of reliability and trustworthiness.

Towards enterprise autonomy

Reforms have aimed to transform Chinese enterprises into independent business units. But

how much has been achieved remains questionable (Yuan, 1996). Even if bureaux' power over enterprises had clearly declined in 1993, they still retained power over three areas: 1) assessing enterprise performance and setting targets (e.g. profit targets); 2) appointing enterprise director and Party secretary; and 3) controlling strategic activities such as acquisitions, formation of joint ventures, exports and cross-regional investment.

Yuan Lu (1996) provides a useful assessment of management-decision making in Chinese enterprises after the reforms in the 1980s:

- Purchasing decisions (operational): enterprises enjoy far more autonomy after reforms (1988). Decision-making processes can be quick, but whenever a planning authority was involved it could become complex.
- Pricing decisions (strategic): greater autonomy to enterprises, but pricing decisions continued to be complex because of interference from 1) ministries or bureaux or 2) functional authorities (most important constraint).
- Recruitment decisions (operational): were the ones in which enterprises had most autonomy. Role of bureaux confined to provision of information, communication and coordination.
- Organizational change (strategic): complex issue because managers had little power relative to bureaux or Party organizations within enterprises. Organizational changes within enterprises caused by external social-political pressures.
- Investment decisions (strategic): remained the most centralized even after the reforms. The decision making process post-1985 grew lengthier and more complex because of involvement of functional authorities.

In a detailed examination of the investment decision process at the three major stages of initiation, design and detailing, and final authorization, Child and Yuan (1996) show that the decision process remains heavily dependent upon higher authorities. They identify two sources of such dependence: constraints on enterprise decision making due to institutional control and resource dependency. Child and Yuan (1996: 64) identify three types of institutional dependency: (1) *material*, in the form of requirements for the investment funding itself, for access to operating resources, licences, and so forth; (2) *relational*, in the form of personal ties between managers and higher officials which provide channels for mutual support and reciprocal favours, including support for the authority of managers who were originally appointed from above. (3) *cultural* in the sense that dependency is maintained by a shared sense of what is appropriate which both managers and higher officials have derived from social norms, including those of the politico-economic system.'

This assessment suggests that enterprises have gained autonomy in operational matters (recruitment and production) whilst ministries, functional and local authorities maintain decisive power over strategic decisions (pricing, organizational change and investment). In their study of decision making in Chinese enterprises, Yuan and Heard (1995) found that enterprise managers had to devote considerable efforts to liaising with, and securing the support of, external agencies. Child and Yuan (1996) argue that despite the possibility of decentralized authorization under the economic reform, the decision process actually became more complicated, which presumably also means more such liaison efforts. It would be interesting to gain further detailed information about developments over the last two decades. Have Chinese enterprises gained more autonomy or is the above a valid description even today?

Chinese Business Organizations and the Two Central Challenges of Organization

Organizations enable accomplishing large/multi-scale tasks that involve many actors by addressing two challenges: coordination (aligning actions), and cooperation (aligning incentives).

Coordination

Chinese enterprises are shot through with coordination failure. Before the economic reforms and the systematic promotion of enterprise autonomy, management was confined to the operational task of following instructions and commands issued as a result of state plans (Yuan, 1996). Rather than leading the business enterprise, managers were likely to focus on reconciling conflicts between planning authorities, Party, workforce, and other external units (suppliers and sellers). In effect, the need to compromise among many external interests caused coordination failure. The result was ineffective planning, which resulted in shortcomings, conflict between different interest groups (industrial ministries, local government, management, etc), lack of incentives for management of enterprises to increase efficiency, and lack of incentives for workers (Yuan, 1996).

It appears that Chinese enterprises have a notable weakness as regards coordination and efficiency. Even if relieved through reforms, this problem remains after 1993 because external forces such as Party, bureaux, functional and local authorities can influence decision-making in enterprises (in particular relating to strategic issues such as pricing and investment decisions). Even after the reforms in the 1980s, profit targets were calculated by central authorities. Three bureaux (industrial bureaux, Municipal Bureaux of Finance, and Municipal Labour Bureaux) fixed premium profit as a contractual basis and then added annual growth rates for the next 3-4 years. The bureaux determined budgets for wages, salaries and innovative projects. In most cases, intensive bargaining took place between enterprise director and bureau officials before a contract was finally signed. Any subsequent changes needed approval from all three bureaux. If an enterprise failed to complete its targets, it had to hand over its retained funds and halt pay rises.

The influence of external forces can be described in terms of a matrix supervisory structure between the enterprises and the bureaux, whereby managers had to report to two bosses – the enterprise director and the staff or executive heading of the department in the bureau. This matrix structure was usually called “corresponding management” (*duikou guanli*). The matrix structure linked enterprises to the bureaux and engendered relationships between departments in the enterprises and their counterparts in the bureaux. This network structure created a basis of coordinating effort that made change difficult, even if the mode of operation is rather inefficient. Whilst the power of bureaux is weaker after the reforms, the actual matrix relationships before and after reform are not very different (Yuan, 1996).

Child & Yuan (1990) describe the complex relationships of Chinese enterprises with bureaux and other government agencies after the reforms, including local regulatory bureaux, known by the Chinese colloquially as ‘Mother-in-Law’ that have the right to impinge directly upon enterprises over matters within their special regulatory purview. Child & Yuan (1990) conclude that decision-making in Chinese enterprises is located within a network of interlocking relationships that are constraining to enterprises. In combination, they also sometimes pose ‘fundamental contradictions for enterprise directors who are expected to reconcile economic with ideological criteria and to embody the interests both of the State and of the enterprise as a corporate social group’ (Child & Yuan, 1990: 325). The strong power of bureaux was also responsible for slowing down decisions in the enterprises. Child and Yuan (1996: 70), for instance, report examples where an auto firm had to ‘collate 13 documents from bureaux into its feasibility study draft containing detailed comments on matters such as foreign exchange implications, environment, labour recruitment, source of funds, and capital

budgeting. In another case, the final report which secured approval of Pharmaceutical's project in 1989 contained no less than 46 seals from different authorities.' Clearly, such a setting requires complicated and long decision processes, and therefore likely to promote indecision.

If we further consider the notion of *guanxi*, it is conceivable that tight networks of personal relations can promote continuation of weaknesses in achieving effective coordination. A number of mechanisms may be in force. One is the relation between managers and workers. In China, social security and welfare to a very large extent is provided by enterprises.¹² That is, enterprises have a responsibility to take care of the social needs of its employees. When managers hire new employees, they are particularly concerned about an applicant's performance record, behaviour, and, more importantly, his/her relations with colleagues. So personnel managers search for the right person through their network of friends and other personal relations (*guanxi*) because "personal relations are more reliable". This is an effective procedure in hiring employees that fit into the social order. On the other hand, the use of *guanxi* implies a huge responsibility towards employees. For example, when Chinese enterprises were ordered to cut down on the workforce in the 1980s, they sent their employees to training and then hired them again after completion of the training programme – they were true to their social obligations.

Another mechanism is the personal relations between enterprise managers and representatives from external authorities at higher levels. The notable coordination failure in the Chinese automotive industry is a case in point (Huang, 2002).¹³ It is curious that the Chinese automotive industry has persisted in being populated by smaller-than-optimal firms despite the government's effort at restructuring the industry. Huang (2002) points to two kinds of coordination failure in developing countries trying to launch an ambitious industrialization programme. The first is the familiar market failure story in which there is underinvestment because of market imperfections. Governments seeking to overcome this kind of failure respond by a combination of trade protection and direct subsidies.

However, these policies create rents and invite rent-capturing activities, which can lead to excess entry and diseconomies of scale. This is exactly what has happened in the Chinese automotive industry. In order to remedy this (second kind of coordination failure), the Chinese authorities must implement policies that would concentrate activities in a few enterprises. To be effective, such policy response must be backed by strong policy capacity and strong institutions.

However, such policies would necessarily shift benefits among Chinese firms (a potential source of conflict). By contrast, the first kind of coordination failure can be remedied by shifting benefits from foreign to domestic firms. In light of the Chinese preference for avoiding conflict in tight relations, it is no surprise that governmental policies have mainly aimed to remedy the first kind of coordination failure. The Korean automotive industry is a remarkable contrast to the Chinese in that regard (Huang, 2002).

Put simply, it is conceivable that the Chinese government has weak institutional support and policy capacity when new policies clearly favour some enterprises, regions, or organizations over others. Are the same weaknesses present in the policy environment that regulate military organizations?

A lack of transparency in Chinese organizations compounds such coordination challenges

¹² It is indeed one of the challenges in China's modernization to put in place a wider social security network, something the government is well aware of. It is a potential for social conflict also since it widens the gap between rural areas and the cities where firms are.

¹³ Although there is some evidence that the Chinese automobile industry has fared better in the financial crisis; see for instance: <http://www.prlog.org/10199939-report-of-chinese-automobile-industry-under-international-financial-crisis-2009.html>

further.¹⁴ Such lack of transparency is not just a problem for outsiders. Chinese organizations also struggle with lack of a tradition for transparency. Intra-transparency facilitates corruption, and corruption does indeed seem widespread in China. Some of the examples that have hit the media recently include a former official for the Chinese Navy (economic crimes); a vice mayor of Beijing; and a scandal in 2006 that involved several party members and high level officials.¹⁵ Whereas the ongoing reforms in China aim to reduce corruption and increase transparency, the process of change itself opens the door for corrupt or semi-corrupt ways, in particular as old ways of doing things are being disregarded as new ways and rules are yet to be perfected.¹⁶

International joint ventures can be seen as an additional probe of the claim that Chinese enterprises are challenged by coordination problems. Research into international joint ventures in China provides an observation that is consistent with this. Newman (1992) shows that small focused joint ventures between Chinese and foreign companies appear to be successful under the following circumstances:

"Highly flexible, participative, democratic management is not the key [to successful foreign/Chinese joint ventures]. Instead, "focused joint ventures" have these characteristics: 1) highly prescribed operations, 2) narrow product line, 3) sustained commitment of partners, 4) top-down motivation of employees, 5) strict performance standards for local suppliers. It is these tightly managed organizations that are producing goods up to world-class standards while keeping cost in line (Newman 1992, p. 6)."

A puzzle of considerable importance is how the traditional Chinese culture is meshed with the culture of the foreign partner. Is it so that the focussed organizational form relieves the coordination problem of the Chinese enterprise, while benefiting from stability and loyalty of the workforce? Or do the Chinese simply see the joint venture as a useful practice model that they can imitate and adopt? As the claims regarding focussed joint ventures were offered in 1992, more recent evidence is perhaps available.

In summary, Chinese business organizations appear to have a weakness regarding coordination. The most important sources of that weakness are continued external influences by political authorities, intransparency and various sources of inflexibility such as the reliance on personal relations or the structure of the social security system.

Cooperation

Chinese business organizations seem to be quite different from Western business organizations when it comes to motivation and aligning incentives. The orientation towards oneself versus the others, rooted in Chinese culture, seems to have important implications for the incentives of actors in Chinese organizations, and how such organizations can align incentives.

The common observation is that the Chinese culture promotes a moral of adequate contribution to collective effort and political rewards. For example, political loyalty has been the most important criterion for job promotion until reforms forcefully introduced contractual obligations and enterprise autonomy in a fairly wide range of operational decisions such as

¹⁴ The lack of transparency includes business organizations and banks; an issue that has recently been discussed, see for example a 2005 article by the Federal Deposit Insurance Corporation available here: <http://www.fdic.gov/bank/analytical/banking/2005nov/article1.html>

¹⁵ A recent report from the Carnegie Endowment for International Peace focuses on the corruption aspect of China's future: <http://www.carnegieendowment.org/publications/index.cfm?fa=view&id=19628>

¹⁶ A former PLA general in conversation points to precisely this as one of the greatest challenges in China's current processes of change (personal conversation, November 2009).

recruitment and procurement.

The assumption underlying the link of culture to individual-level motivation is that culture is expressed in decisions made by individuals. This assumption receives broad support from empirical studies. According to Bailey et al. (1997), there is ample theoretical and empirical reason to assert that culture is among the most powerful determinants of psychology, so much so that in some domains the two are functionally indistinguishable (Bond, 1994; Schwartz, 1994).

As regards comparisons between Western and Asian managers, there are reliable differences between the sources they draw on to resolve routine and novel problems (Peterson, Smith, Bond and Misumi, 1990; Smith, Peterson and Misumi, 1994; Smith et al. 1996). There are also notable differences relating to beliefs about ability and performance. Thus, Earley (1994) found that self-focused training had a greater impact on individualists than collectivists, and conversely that group-focused training had a greater impact on collectivists than individualists. Other studies (see Erez and Earley (1993), for a review) have found that those from individualist cultures perform in order to gain recognition, whereas those from collectivist cultures perform in order to benefit the larger group. Further, according to Bailey et al. (1997: 608-9):

"...although generally not considered as prototypically collectivist as Japanese, there is considerable evidence that the Chinese too attribute performance causality to meet the expectations of significant others as opposed to extolling or protecting individual virtue [Crittenden 1989, 1991]. Yang and Ho [1988] have argued that the Chinese attributional pattern for individual success focuses on social explanations like the intervention of a significant other, strong personal bonds or coordinated effort. Failure attributions are also social in nature, but implicate socially undesirable qualities such as a lack of effort, perseverance, popularity, or modesty. Modesty norms (keqi or qianxu) in particular have been linked to attribution. Bond, Leung and Wan [1982] found that Chinese subjects admired those who made humble attributions following a success more than those who made more self-serving or self-enhancing attributions. The influence here is such that in order to display modesty, Chinese are less likely to take pride in their successes than are Americans [Stipek, Weiner and Li 1989]. To the extent that self-effacement is an impression management tactic [Wan and Bond 1982], it would also allow one to maintain face (mianzi or lian), which deals with managing the reputational aspects of oneself. Because reputation in China is largely a function of social relationships [Bond and Hwang 1986; Hwang 1987], attributions are designed to further group harmony, not to distinguish oneself."

Bailey et al. (1997) conducted a study that yielded surprising evidence relating to the motivational expression of Chinese culture. They examined whether Chinese, Japanese and American individuals were more likely to be motivated by failure than by success. Their study included 216 individuals (77 from the US, 57 from Japan and 82 from the People's Republic of China). The American participants were part-time MBA students at a large northeastern public university. The Japanese participants were recruited from four organizations under conditions of anonymity to protect the identity of both the participant and the organization. The Chinese participants were trainees in management programmes offered by a northeastern Chinese university. These participants were from medium-sized companies in a variety of industries including mechanical machinery, metallurgy and chemical production.

The findings supported a hypothesis that the Chinese were similar to the Japanese in that they were more concerned with failure feedback than Americans. This is viewed as an important extension of Japanese findings regarding self-effacement (Shinkanai 1983; Takata 1987; Yamaguchi 1994), and supports the idea (and previous research) on the importance of modesty norms in China (Bond et al. 1982; Crittenden 1989, 1991; Stipek et al. 1989; Yang and Ho 1988). Yet the Chinese results were inconsistent with the other hypotheses.

"First, no differences emerged between China and the US regarding desire for success feedback and initiative. Second, Chinese perceived that their job environment provided more feedback than did Americans. Third, the Chinese were found to be similar to or different from both Japan and the US depending on the variable. What is most striking is that although the Americans were tilted towards desire for success feedback and the Japanese towards failure feedback, the Chinese were highly concerned with both."

These findings are explained as revealing a tension between modernizing and traditional forces in China. The desire for failure feedback is consistent with traditional norms of modesty and self-discipline, whereas desire for success and feedback initiative fits the new reform ideology. The job environment in newly reformed Chinese business organizations is to a large extent based on contractual obligations that reward success (e.g. meeting profit targets). A shift from political to economic (and organization-level) rewards has thus taken place. Moreover, it is possible that traditional notions of face (*mianzi* or *lian*) in China interact with modernizing forces.

Furthermore, the Chinese economic system also had an influence on motivation of individuals, and on the task of aligning such motivations that Chinese business organization face. Traditionally, as explained above, the system required managers of business organizations to focus on reconciling conflicts between planning authorities, Party, workforce, and other external units (suppliers and sellers) (Yuan, 1996). The demand for attention to external actors and their motivations should, in principle, make it more difficult to align them with the motivation and incentives of employees. Finally, problems with corruption indicate weaknesses regarding the design of incentive structures, monitoring and compliance, transparency, and the alignment of incentives.

In summary, Chinese business organizations appear hampered in their ability to motivate, align incentives and thereby solve the problem of assuring cooperation. The attention to external actors makes aligning incentives more difficult, and the shift from political to economic and firm-level rewards supposedly makes the task of assuring incentive alignment more difficult: the attention of individuals is still focused on political incentives also, potentially interacting with economic incentives. Moreover, Chinese culture seems to have an important impact on this challenge due to different emphasis on the self versus other than in Western culture. A lack of transparency compounds the problem. These issues point to research questions such as: How does the group-orientation of the Chinese impact how organizations align incentives?

Decision-Making in Chinese Business Organizations

Yuan Lu (1996) provides a detailed mapping of formal decision structures relating to industrial governance in the Chinese urban industrial sector, transaction relationships, internal management systems, and particular decisions relating to pricing and recruitment. Decision-making before and after the reforms in the 1980s are described in great detail, and important characteristics are extracted. First, it is clear that the reforms complicated decision making because they introduced more external partners and more uncertainties (e.g. relating to securing inputs). Second, decisions after the reforms generally took longer and interference from authorities usually promoted conservation of the status quo.

A proposal has to pass many bureaucratic layers in order to be approved, and it is unlikely that many proposals will survive in this process. Put differently, the structuring of decision making in Chinese enterprises will tend to promote stability and refinement over adaptation and innovation. While there may be a cultural underpinning to a preference for the status quo, the design of Chinese decision making structures in and of itself suffices to explain a notable weakness in innovative activities.

Unless the institutional structure is changed or selected enterprises are buffered from it, Chinese enterprises will continue to have a comparative disadvantage in innovative activities. A critical issue would be the extent to which Chinese enterprises are allowed (or commanded) to direct funds towards innovation without the usual process of bureaucratic vetting.

Closing & Future Research

Understanding organizations is essential for understanding the forces that shape strategic interaction within and between modern societies. In this paper, we have made a first step towards extracting knowledge on some of the features that characterize Chinese business organizations, and on relating those to decision making in such organizations. So far, very little is known about these organizations. The task is formidable and we only provide a first small step in this direction.

From studying open sources about Chinese organization, we have some preliminary insights to offer. They point towards some of the weaknesses, challenges, and interesting issues of Chinese organizations. They bear repetition in this closing section:

The institutional context of Chinese industry creates complicated and long decision processes. Important institutional influences are exerted by a matrix supervisory structure between the enterprises and the bureaux, complicating decision making because it introduces more external partners and more uncertainties. This has powerful consequences for the ability of Chinese business organizations to coordinate, motivate, and adapt. Complex institutional influences in complex supervisory structures increase the coordination challenges, often compounded by lack of transparency. Chinese business organizations therefore are shot through with coordination failure, and there is reason to believe that where coordination does not fail, coordination costs are high. Chinese business organizations also appear hampered in their ability to motivate actors, align their incentives and thereby solve the problem of assuring cooperation between actors. The attention to motivations of a large number of external actors make aligning incentives more difficult, and the shift from political to economic and firm-level rewards supposedly makes the task more challenging: the attention of individuals is still focused on political incentives, and political incentives potentially interact with economic incentives. Finally, Chinese business organizations tend to promote stability and refinement over adaptation and innovation. The design of Chinese decision making structures in and of itself suffices to explain a notable weakness in innovative activities, independently of any cultural underpinning to a preference for the status quo. Strong insertion in a tight institutional network structure also makes change difficult.

We have in this paper focused mainly on identifying features of Chinese business organizations that can help understanding decision making in such organizations. Overall, it appears that Chinese business enterprises have considerable weaknesses. Poor motivation, low productivity and lack of discipline have been reported to be problems in Chinese enterprises in the 1980s. Have these problems been solved by reforms?

There is high institutional fragmentation in China with many external forces imposing complex and conflicting demands on business enterprises (Yuan, 1996). The result is a delay in decision making, a tendency to seek compromise and a resultant failure to provide clear guidelines and loss of efficiency. How widespread is the tendency towards fragmentation?

There is a high probability of coordination failure even in stable environments. Even if relieved, this problem remains after 1993. To what extent is coordination failure present in Chinese organizations? Are there systematic differences between business organizations and military organizations?

Another factor is the high probability of proliferation of divisions within large enterprises (to relieve coordination costs). This is a likely effect that should remain in the present day. The implication is loss of efficiency relative to organizations with less coordination costs (e.g. straight divisional structure without external interference in decision making processes). Can this be confirmed?

The Chinese authorities' interference with business enterprises is unlikely to fade away. This means that the weaknesses relating to coordination problems would remain significant in a foreseeable future. How does the institutional framework of business and military organizations differ?

Difficulties persist in securing investments for projects that have no proven value. This observation would reinforce imitation over innovative activities. Could changes in investment policies in and of itself increase (useful) innovative activities?

In China, social security and welfare are provided by enterprises. This observation has significant implications relating to organizational flexibility. It would seem very difficult to shift a large portion of the workforce from one enterprise to another. It is therefore reasonable to assume that Chinese enterprises (and the overall economy) are rather slow in adapting to new challenges and external shocks.

Strategic decisions (pricing, investment and organizational change) are complicated and take a long time in China. This observation reinforces a belief that there is a good deal of inertia in Chinese enterprises. That is, Chinese enterprises would have significant difficulties in adapting to changing external demands.

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(Cheney, "Remarks during visit to Australia")

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