NRI Papers No.68 September 1, 2003

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China has been absorbing an enormous amount of foreign capital and accumulating large foreign exchange reserves. At the same time, however, it is fast starting to play a major role as a capital exporting nation. Chinese companies are showing signs of developing full-scale overseas investment along with the acquisition of foreign exchange and moves towards business expansion, both of which have been triggered by the recent economic growth.

Surveys conducted among companies in Shanghai and its outskirts have revealed the strong desire of Chinese companies to pursue investment opportunities in Japan. While the major reason appears to be the market scale, attention is also being given to Japan's substantial wealth of information related to leading technologies and the nation's highly skilled human resources. As the companies that responded to the surveys also rightly recognize the importance of experience as a global enterprise, corporate management techniques, and the establishment of core businesses, they singled out "Finding an appropriate business partner" as the most important prerequisite in making decisions to invest in Japan.

Under such a business environment, Japanese companies are required to actively participate in the corporate management of Chinese companies, and provide such techniques as an international division of labor and value chain management that Japan has accumulated based on its experience in other Asian nations. Moreover, Japan should promote investment in Japan by becoming a partner of Chinese companies intending to advance into the Japanese market.

I Current Status of Overseas Investment by Chinese Companies

1 Transfiguration into a Huge Capital Exporting Nation

As reported in the December 18, 2002 edition of the *Nihon Keizai Shimbun*, the United Nations Conference on Trade and Development (UNCTAD) announced that China would move past the United States and achieve for the first time in its history the world's leading recipient of overseas direct investment in 2002, attracting a total of approximately $50 billion in foreign investment. While Japan, Europe and the United States tend to see China as a huge country that absorbs overseas capital and accumulates vast amounts of foreign exchange, the fact that China is already becoming a major exporter of capital should not be overlooked.

Although China has long been continuing its record of high growth, this has been based on investment from overseas. Therefore, the nation's current status indicates that China's achievements in economic growth have merely stayed within the amounts of capital that have been invested from overseas. In other words, the nation's growth is confined to the typical patterns dependent on capital investment. In order to achieve sustainable growth, however, China needs to shift to an industrial structure in which invested capital gives birth to technological innovations and added value. In the future, efforts will be made to re-invest the mounting inflow of foreign capital in areas where more added value is created, and the government will take steps to support these moves through the establishment of appropriate systems to achieve these ends.

Some major company groups and municipal governments have already moved into overseas investment on a full-scale basis. The purposes behind these endeavors vary from avoiding trade friction, strengthening the competitiveness of state-owned companies, exploring overseas markets, developing overseas resources, to raising funds through listings on overseas stock exchanges.

2 History of Overseas Investment in China

(1) First phase

During the 30 years from 1949 to 1978 (i.e., since the birth of the People's Republic of China until just prior to the start of reforms and liberation), China took the initial steps to provide some aid to selected countries in Asia, Africa and Latin America in such fields as industry, agriculture and medicine, most of which cases represented grant-in-aid projects. At the same time, however, state-owned companies specializing in large-scale trade had established branches in Paris, London, Hamburg, Tokyo, New York, Hong Kong, etc., with government support. Companies in the transportation and financial industries also established trade centers in major ports and cities in the world. This represented the first phase of China's overseas investment.

(2) Second phase

Between 1979 and 1985, state-owned companies entered an evolutionary period in which they began to focus on a greater awareness of real markets. In November 1979, the Beijing Friendship Store established Kyowa Co., Ltd. in Tokyo through a joint investment with Japan's Maruichi Shoji, Inc. This was the first limited partnership involving overseas investment by Mainland China. While only 76 companies representing a total investment of some $50 million had been set up through 1983, the pace of overseas investment quickly started accelerating around 1984. This total grew to 119 overseas organizations in the two years of 1984 and 1985, with the total investment amounting to some $130 million and covering approximately 40 countries and regions. Overseas construction contracts and labor collaboration started to flourish.

(3) Third phase

The third phase dates from 1986 to 1992, when overseas investment by large and medium-sized companies in regional areas started to move forward. As government organizations in each city and province encouraged overseas direct investment by their affiliated trading companies and companies that provide services to foreign firms, the number of overseas companies in such fields as production, processing and resources rapidly increased. At the end of 1992, the total number of overseas organizations other than trade firms exceeded 1,360 companies, with 335 businesses established in 1992 alone. During this third phase, the number of overseas companies reached a total of 2,600, covering some 120 countries and regions, with China's total overseas investment climbing to more than $4 billion.

(4) Fourth phase

The period between 1993 and 1998 represented an adjustment phase. As the government was trying to bring the overheated economy under control during this period, it carefully examined and modified overseas investment projects as required and otherwise followed a strict approach in vetting new investment projects. As a result, the pace of overseas investment slowed considerably. Nevertheless, a total of 1,500 overseas companies were set up during this phase, recording $1.28 billion in overseas investment. Moreover, China's new investment policies required the establishment of factories in developing areas such as Africa, South America and Eastern Europe.

(5) Fifth phase

It can be considered that China entered its fifth overseas investment phase in 1999. The government promoted strategies to advance into overseas markets, and small and mid-sized companies as well as town and village enterprises and private companies started to participate in overseas investment projects. Rules entitled Regulations Concerning the Shift of Management Structures in State-Owned Companies were issued during the year, and overseas investment started to rapidly expand. This new impetus was partly due to the long-term results of Deng Xiaoping's famous tour of southern China in 1992, which had started to rekindle economic reforms. From 1999 to 2000, overseas investment rose substantially, and the overseas investment that had originally begun from processing trade in foreign countries now began to assume a major role in China's economic growth.

3 Current Status of Overseas Investment in China

According to the Yearbook of China's Foreign Economic Relations and Trade, China's net annual overseas investment in 2001 reached $707.54 million, and the annual increase continues to follow an upward trend year-by-year. In terms of the major recipients of that investment, Hong Kong and Southeast Asia alone account for more than 55 percent of the total, while investment in Japan represents a mere 0.02 percent (Table 1).

While it appears that the high costs required for investment in Japan are the main reason behind this hesitation at present, there is no doubt that the desire to invest in Japan is increasing, as indicated by the survey results described in detail latter. Although investment is now targeted mainly at developing countries—Africa in particular—due largely to the intensification of competition within China and attempts to avoid trade friction, the trend suggests we will see investment in developed countries on a full-scale basis in the future.

Incidentally, UNCTAD estimated China's total net overseas investment for the same year as $1.8 billion, which suggests that such projections in the case of China differ depending on the information sources. Professor Hideo Ohashi of Senshu University has noted that it is practically impossible to fully understand the scale of China's overseas investment, as such classifications as overseas investment by non-state-owned companies, re-investment of profits by overseas subsidiaries, overseas investment in financial and insurance fields, and projects other than those approved by the Department of International Trade and Economic Affairs (i.e., small-scale projects of $1 million or less implemented by some state-owned companies) are dropped from official statistics. Moreover, there are also a number of unofficial or unlawful cases involving the flight of unreported capital.

II Status of Overseas Investment among Companies Based in Greater Shanghai

As the reliability of statistical data concerning foreign investment is low, this paper will focus on companies in Shanghai and its environs to explore the actual status of overseas investment. Nomura Research Institute Shanghai (NRI Shanghai) conducted questionnaire surveys of companies in Shanghai and its environs from January to March in 2003 concerning their intentions regarding overseas investment, especially investment in Japan, and the problems they expect to encounter (Table 2). On the basis of these survey findings, we will take a close look at the actual status of overseas investment from a microscopic perspective.

1 Overseas Investment by Chinese Companies Based in Shanghai and its Environs

According to the Yearbook of China's Foreign Economic Relations and Trade, 190 companies that accounted for 82 percent of the total number of companies in China

Table 1. Overseas Investment by Chinese Companies (By Country and Region)

(Unit: $Million)

	1999		2000		2001	
	Number of Cases	Amount	Number of Cases	Amount	Number of Cases	Amount
Southeast Asia	26	71.96	51	108.44	40	187.59
Hong Kong	24	24.48	15	17.52	26	200.67
United States	21	81.10	15	23.14	19	53.71
Japan	1	0.54	2	0.26	6	1.67
Other	148	412.56	160	401.61	141	263.90
Total	200	590.64	243	550.97	232	707.54

Note: Southeast Asia includes Vietnam, Laos, Kampuchea, Myanmar, Thailand, Malaysia, Singapore, Indonesia, and the Philippines.
Source: Yearbook of China's Foreign Economic Relations and Trade (2002), compiled by the Yearbook of China's Foreign Economic Relations and Trade Editorial Committee.

making overseas investment in 2001 are located in the three areas of Shanghai, Jiangsu and Zhejang provinces, a combined region also known as Greater Shanghai (Table 3). In terms of monetary amounts, however, the total investment from these three areas came to only $107.29 million, or approximately 15 percent of the total. As noted previously, actual investment amounts are assumed to be higher in real terms.

We would like to focus in this section on the investment contents and the approaches of the companies involved, rather than discussing the overall numerical data. In other words, when investment in Japan is assumed, there is no doubt that companies in the Greater Shanghai area, which have a large weight in terms of China's overall industrial core, will naturally take the leading role. And it is considered that the intentions of companies in this region—which have close relationships with Japanese companies—will represent a consensus among Chinese companies to a large extent.

Table 4 outlines the investment situation in each area. Spinning and apparel industries constitute the nucleus of overseas investment by firms in Zhejang province, and such types of businesses as electronics, communications and machinery companies in Shanghai are advancing into overseas markets. Table 5 overviews recent major investment projects in the Greater Shanghai area.

Table 2. Outline of Questionnaire Surveys

Implementation period	January 10 ~ March 1, 2003
Survey coverage	Shanghai and its environs (Shanghai, Jiangsu and Zhejang provinces)
Type of businesses subject to surveys	Spinning and apparel, household electrical appliances and IT production, software and service, food and beverages, construction, financial services
Survey methods	Questionnaires sent via postal mail and some direct interviews
Survey targets	Companies ranked among the top 20 ~ 50 firms in each of the above industries located in Shanghai, Jiangsu and Zhejang provinces
Number of effective responses	51 companies (number of questionnaires sent: 478; response ratio: 10.7%)
Regional distribution of responding companies	Shanghai: 41 (80.4%); Jiangsu province: 4 (7.8%); Zhejang province: 6 (11.8%)
Format of responding companies	State-owned companies: 22 (43.1%); private companies: 16 (31.4%); listed companies: 8 (15.7%); joint ventures: 3 (5.9%); unlisted joint-stock companies: 2 (3.9%)

Table 3. Overseas Investment in Greater Shanghai

(Unit: $Million)

	Shanghai Proper		Jiangsu Province		Zhejang Province	
	Number of companies	Amount	Number of companies	Amount	Number of companies	Amount
1999	12	34.90	13	9.48	23	8.78
2000	35	26.17	23	13.82	107	15.14
2001	32	52.40	14	16.33	144	38.56

Source: Yearbook of China's Foreign Economic Relations and Trade.

Table 4. Actual Status of Overseas Investment by Chinese Companies in the Greater Shanghai Area

	Shanghai Proper	Jiangsu Province	Zhejang Province
Number of companies	32	14	144
Investment amounts ($Million)	52.40	16.33	38.56
Leading targets by type of industry	While activities in the past focused on spinning and light manufacturing, targeted industries have now been expanded to include electronics, communications, machinery, medical equipment and processing industries.	Machinery, electrical appliances, spinning and apparel, medical equipment and processing, wholesale and retail, building construction.	Spinning and apparel, light manufacturing, beverages.
Regional distribution	More than 40% in the Asian and Pacific-rim regions.	South America and Southeast Asia.	Russia, Europe and Africa account for the largest part.
Examples of major investment projects	• Spinning company in Mexico. • Jakarta TV tower in Indonesia. • Large-scale steel plant in Thailand. • Railway in Hong Kong. • Urban development in Hanoi, Vietnam.	• "Little Swan" established a branch in South America. • Jiangdong Group established sales agencies in Thailand, etc.	• Wanxiang Group established R&D Centers in the United States and Europe. • Apparel and light manufacturing in the Wenzhou area have made large-scale investment in Russia.

Source: "Going Out: Current Status, Problems and Measures," *International Economic Cooperation*, April 2002.

Table 5. Recent Overseas Investment Projects by Chinese Companies in the Greater Shanghai Area

	Type of Business	Name of Company	Overseas Investment Projects	Investment Amount ($Million)
Shanghai	Construction work	Shanghai Construction Group	Acquired 25% of the shares in each of two construction companies in Hong Kong.	200
	Spinning and textiles	Hua Yuan Group	Established a limited liability spinning company in Mexico with independent capital.	96
		Shanghai Textile Group	Established a spinning and apparel factory in Latin America.	13
	Pharmaceuticals	Shanghai Pharmaceutical Co., Ltd.	Established a factory in Africa.	—
	Electrical products	Shanghai SVA Group	Established a factory in South Africa in 1993 by using equipment within China. This was followed by the establishment of an R&D Center in Silicon Valley in the United States.	—
		Shanghai Electronics Development Holding Group	Actively planning the acquisition of Japanese companies through the Shanghai Assets & Equity Exchange.	—
		Shanghai Electronic (Group) Corp.	Established R&D facilities in the United States, etc.	—
	Automobiles	Shanghai Automotive Co., Ltd.	Established organizations specializing in design, research and development in Germany, etc.	—
			Acquired a 10% stake in GM Daewoo Automobile & Technology Corporation.	60
	Steel	Shanghai Baosteel Group	Acquired a 46% share in mining rights to iron ore deposits in Australia.	30
	Machine	SMEC	Acquired Akiyama Printing Machine Co. in Japan.	9
Jiangsu Province	Household electrical appliances	Little Swan Group	Set up production bases in South America, South Asia, etc.	—
Zhejang Province	Household electrical appliances	Holley Group	Established an R&D center in Silicon Valley in the United States.	3
	Machinery	Feiyue Group Co., Ltd.	Established sales companies in 16 countries including the United States.	70
			Established processing factories in Myanmar, Mexico, etc.	—

Source: "Going Out: Current Status, Problems and Measures," *International Economic Cooperation*, April 2002.

2 Chinese Company Views on Overseas Investment

(1) Intentions concerning target investment countries

Figure 1 shows that members of ASEAN (Association of Southeast Asian Nations) such as Vietnam and Thailand (45.1%) are ranked at the top among countries in which Chinese firms want to make investment, and are followed by Hong Kong (35.3%) and Japan (33.3%). Actually, the desire to invest in Japan is higher than anticipated, and the planned investment format mainly involves the establishment of Japan sales bases and R&D centers. The principal reasons for such investment are to collect information concerning markets and leading technology and to expand sales networks (Table 6).

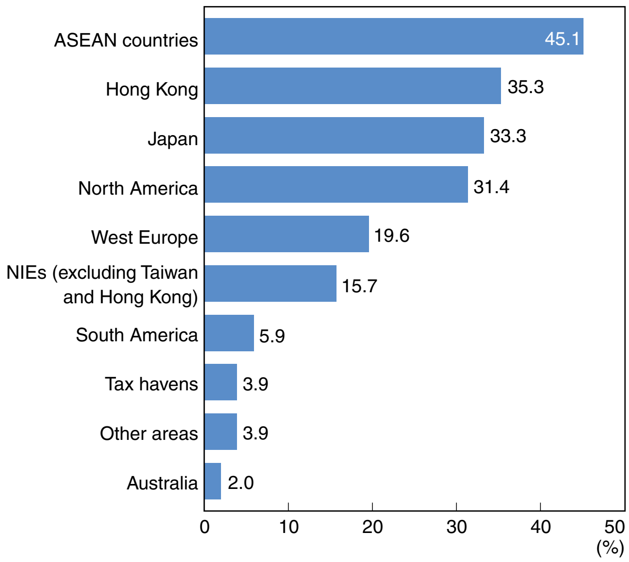
(2) Timing for overseas investment

Companies that indicated an intention to advance into Japan in the future are mainly those with a scale exceeding $50 million in annual sales. Most such respondents cited the planned timing at three to five years in the future.

(3) Factors to be considered in investing in Japan

The most attractive feature regarding investment in Japan is, quite naturally, the large market size. Negatives include the high costs with respect to human resources, land, construction and company operations (Figure 2). What should be noted is that in addition to entering the Japanese market, substantial expectations are placed on gathering information on leading technologies and

Figure 1. Intended Overseas Investment Targets by Chinese Companies in Greater Shanghai



Note: ASEAN = Association of Southeast Asian Nations; NIEs = newly industrializing economies.
Source: NRI Shanghai.

securing specialized human resources. Moreover, Chinese companies are fully aware of that they themselves are not yet fully equipped with the management techniques and experience that can properly respond to globalization. As many large and mid-sized companies within China have now been entering a business expansion phase, these findings suggest circumstances in which expectations and concerns are mixed.

(4) Necessary prerequisites

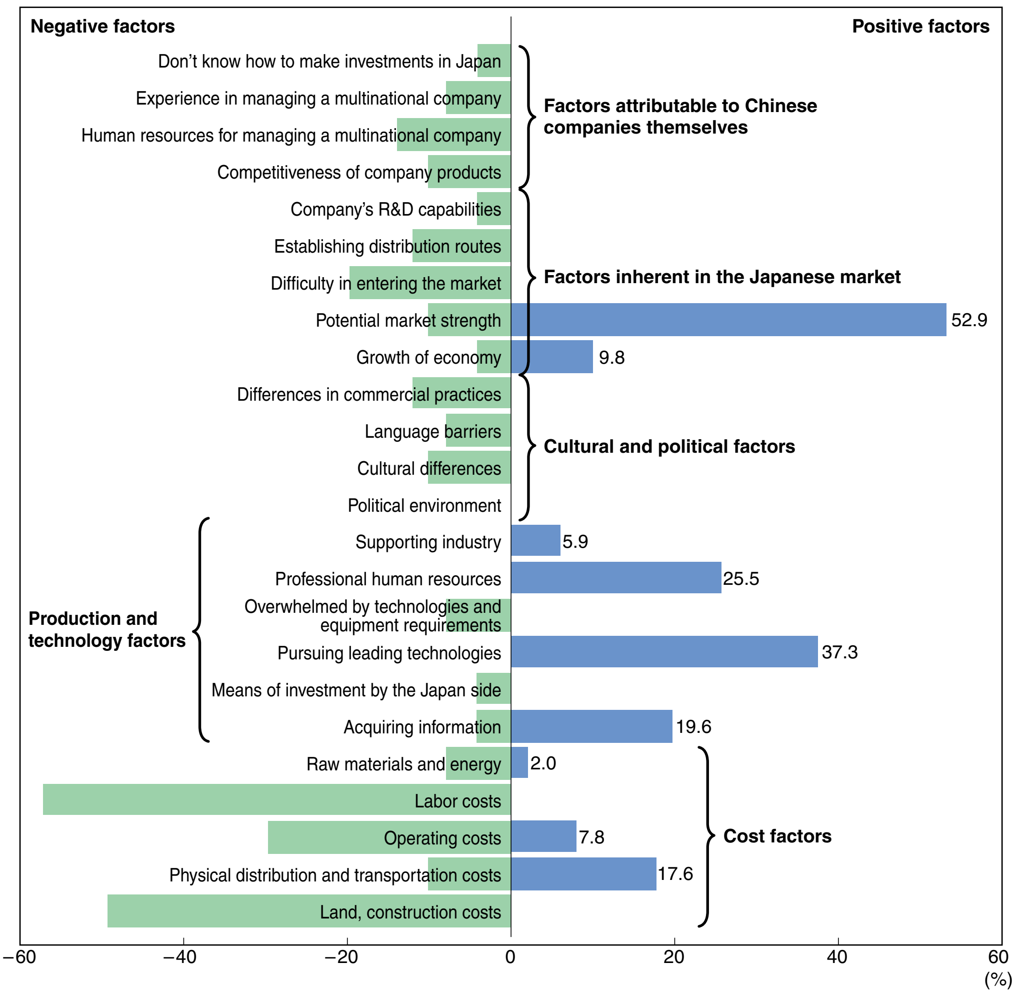
Table 7 outlines the issues that Chinese companies consider as prerequisites in entering the Japanese market.

Table 6. Chinese Companies' Intentions Concerning Overseas Investment in Target Countries

Popular Areas for Overseas Investment	Major Investment Format	Investment Objectives
Hong Kong	Investment-type companies, sales-type companies	• Forming nominal "Three Funds Enterprises" (equity joint ventures, contractual joint ventures and wholly foreign-owed enterprises) by controlling the shares of affiliated companies through Chinese subsidiaries in Hong Kong. Doing so ensures preferential treatment in terms of policies, such as taxes, increasing the ease of procuring financing and capital exports, and reducing tax burdens.
North America	Sales-type companies, R&D centers	• Making preparations to explore local markets. • Attracting leading technologies and human resources.
Developing countries in Southeast Asia (such as Vietnam)	Production bases	• Securing low-cost local labor and potential market strength.
South Africa	Production bases	• Securing local labor and potential market strength. Also entering markets in advanced countries by using such bases as footholds.
Russia	Production bases	• Pursuing potential market strength and at the invitation of the Russian government.
Japan	Sales-type companies, R&D centers	• Creating the foundations to explore local markets. • Taking advantage of Japan's global sales networks. • Focusing on Japan's technologies and research and development capabilities.

Source: NRI Shanghai.

Figure 2. Positive and Negative Factors Regarding Investment in Japan



Source: NRI Shanghai.

Table 7. Top Five Prerequisites for Investment in Japan

Required conditions	Importance	Selection Ratio
Finding an appropriate partner	★★★★★	60.4%
Securing the core competitiveness of the company itself	★★★	31.3%
Opening financing routes to overseas companies	★★	22.9%
Clarifying the direction of the economy	★★	22.9%
Relaxing various restrictions in the labor market (for example, using foreign workers)	★★	20.8%

Source: NRI Shanghai.

Table 8. What Is Expected from the Japanese Government and Related Organizations (Top Five Expectations)

Expectations	Importance	Selection Ratio
Providing information on the current status of the economy and the development situation in each region in Japan	★★★★★	66.7%
Creating an information network for investment in Japan	★★★	22.9%
Providing manuals for investment in Japan	★★	16.7%
Establishing a center to promote investment in Japan	★★	14.6%
Training personnel stationed in Japan and providing service for entering and exiting the country	★★	14.6%

Source: NRI Shanghai.

As Figure 2 also suggests, many Chinese companies give the greatest importance to thoroughly examining appropriate partners at the Japan side in entering the Japanese market. As advancing into the Japanese market means jumping into a highly cutthroat environment known for its intense competition and advanced marketing techniques, Chinese firms considering such a move realize that their own core competencies must also be firmly established.

(5) What is expected from the Japanese government and related organizations

As Chinese companies are aware of the fact that commercial practices in Japan are considerably different from those in China, they realize they need to look to the Japanese government and related organizations for information and clerical support (Table 8). From what the authors learned in interviewing some Chinese groups in Japan in preparing this paper, there still is much to be desired with respect to the information gathering capabilities of Chinese firms.

III Advances into Japan by Chinese Companies and Responses by Japanese Companies

1 East Asian Economy Pulling World Economy

According to recent reports by US banks and other sources, Chinese companies accounted for some 20 percent of total M&A transactions in Asia (excluding Japan) in 2002, and this raises the possibility that large Chinese companies in such areas as natural resources, production, information and communications may play the leading role in Asian M&A cases in the future.

Although the Southeast Asia region—which mainly consists of NIEs (newly industrializing economies) and ASEAN members—experienced a setback due to the Asian economic crisis, it still demonstrates the world's leading potential in terms of economic growth. Although China was not considered part of this community in the past, the biggest challenge for the future is how coexistence and co-prosperity with China can be achieved as the PRC dramatically promotes economic liberalization.

If the 500 million people in NIEs and ASEAN are combined with the 1.3 billion in China, a huge economic bloc that represents fully one-third of the world's population will emerge. Chinese companies operating in Southeast Asia and the mega-corporate groups in Hong Kong and Taiwan have already been expanding their business activities such as M&As in the China arena. As moves towards overseas investment by the Chinese government and Chinese companies are accelerated, this bloc will constitute a major power in the future development of the Asian economy in parallel with Japanese firms and Japanese-owned companies.

2 China's Investment in Japan Strengthens Japan's Competitiveness

Through their considerable investment mainly in East Asian manufacturing industries since the 1970s, Japanese companies have accumulated a wealth of experience and solid achievements in promoting an international division of labor and establishing a global value chain. This group of Japanese companies operating in East Asia has expanded their fields of business targeted at Japan, Europe and the United States. This know-how remains stored in these Japanese companies, in particular in manufacturing industries and trading firms.

Japanese companies must now move forward by taking advantage of the historical process towards growth in Japanese business enterprises and the Japanese economy, as well as investment experience in Asia. This can be done by sharing business opportunities with the major company groups (including those with Japanese capital) in China and East Asia that are expected to play major business roles throughout the world. Accordingly, we would like to conclude this paper by suggesting the following three points.

(1) Working towards active management participation in Chinese companies (beyond mere production consignments and technology transfers)

Chinese companies consistently bring up the matter of introducing technology and/or technical transfers when they discuss the establishment of partnerships with Japanese firms. However, the technologies that can be provided by Japanese companies are not limited to production technologies that they actually see on the site, but also involve comprehensive management techniques that extend to technology, production processes, and human resources in many cases. Because of this gap between the perceptions of both parties, it is often difficult to reach an agreement in negotiating licensing fees. Another point that makes Japanese companies cautious is the issue of intellectual property rights, especially the highly unstructured matter of "know-how."

Accordingly, Japanese companies should pursue opportunities by taking a step forward towards investments that may also involve equity risks through participating in the actual management of Chinese companies, and should embark on a quest towards sharing the fruits of growth together with their Chinese partners.

(2) Providing international division of labor and value chain strategies accumulated by Japanese firms

Although China is a growing market, it is not giving birth to new products. Instead, many cases involve a shift in production and/or human resources from Japan and other Asian areas. This means that the experience accumulated by Japanese companies in ASEAN, etc., must be efficiently applied and effectively utilized in China. Even if production bases and R&D centers are shifted to China, we must not forget the huge market scale represented by Japan, Europe and the United States. Accordingly, links with these countries including Japan will surely become indispensable in value chains that lead to final product consumption.

In the future, businesses targeted at consumption within China can be expected to further increase. Therefore, it is worth providing corporate management techniques that have already been developed and successfully employed in Japan and other markets.

(3) Responding to signs of Chinese interest in investing in Japan

Compared to Japan's overseas investment of $38 billion and the $114 billion overseas portfolio of the United States (estimates by UNCTAD), China's overseas investment totals are still low at several billion dollars.

However, the desire for globalization by top-ranked companies in China will become extremely strong in the next few years. As indicated from the previously reported survey data, Chinese companies are overcoming the handicap of high costs and developing strong intentions to invest in Japan. This thinking was echoed in the interviews we recently conducted with government officials in Shanghai.

Rather than the purely funding aspects, however, the major issues facing Chinese companies considering investment in Japan come from analyses of information on the Japanese market and the search for appropriate Japanese partners. Even in the case of Chinese companies that have developed into huge enterprises, Chinese managers lack both the perspectives and experience for global business operations. As a result, there are not a few companies with an interest in Japan-like corporate management techniques in which the entire company functions as a team, rather than simply following orders from the top.

The Japanese government and Japanese companies must not overlook these signs, as the expansion of Chinese investment in Japan will lead to Japan's assuming the initiative in the East Asia economic bloc, and will eventually promote the reform of Japan's industrial structure.

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