

Setting up a joint venture in china



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FDI into China: Brief history

Before 1980, under the presidency of Mao Tse Tong, China was a country completely closed to the world with a rigid and communist government. After that date, Deng Xiao Peng and the post-Mao government established a new foreign economic policy and announced that “ China would open to the outside world” (Pearson, 1991). This new “ open-door” policy only allowed contractual JVs (as lower risks) and China provided foreign investors with a specific partner. In the first years of the country’s opening, only ¼ of contractual FDI were realized as investors were uncertain of this completely new environment. Moreover, many FDI were fraudulent (Fung, 2002).

From 1992, FDI doubled and China started to welcome western multinational enterprises in specific sectors: automobile, petrochemical, telecommunications... but only in selected zones of the country (SEZs: Special Economic Zones).

China has quickly become the fastest growing economy and possesses 25% of the world’s population. FDI to China represents more than \$80 billion in 2007 which shows that a decline in the economy is almost impossible (\$130 billion in 2009) – in comparison, FDI to India represent \$3 billion per year – (Lau, 2007).

China: the best place to invest?

However, despite the many attractive sides of China as a FDI destination, many western companies have faced failure when doing business in China. Indeed, in the case of JVs, the government provides a Chinese partner to the foreign investors that can face many different roadblocks: unfamiliarity with

the business environment, corruption... (Yallapragada, 2003). In front of the rapid and unique economic development of China, some investors have rushed into investing in this promising country that seemed to offer so many advantages, ignoring some essential facts, (that will be developed later in the study) critical for the success of an investment.

Since 1990, broad researches have been conducted concerning FDI and more particularly JVs in China and there is a good understanding of FDI mode decisions, the behavior to adopt to lead to a JV, inter partner concerns... More research needs to be done concerning the factors that lead to success or failure of JVs

Dissertation background

The main reason behind the topic selection is that it is an area of interest to the author who can research what makes companies chose China as an FDI destination but more specifically what should be looked at to avoid the multiple failures that foreign companies have faced by developing a JV with a Chinese partner. The author aims at giving a more definitive picture of the Chinese FDI environment and that behind the image of China as a very attractive place for FDI, there are complex laws, regulations and a multitude of other factors that are not necessarily looked at by foreign investors and cause failure.

Another reason is that this topic covers issues which are very relevant in today's business environment. It is a topic of interest for many business people and more and more academics around the world due to its unique development: 9% growth of the GDP per year since 1978 and 15% growth of

the foreign trade per year (Lau, 2007). There is a belief that China could become the world's largest economy in 25 years.

Aims and objectives

The overall aim of the dissertation is to study and critically analyse the foreign direct investment (FDI) environment of China by focusing on market-seeking joint-ventures (JVs) in a specific industry: food and beverage (soft). This study will be carried out using and appraising current academic literature and theories on JVs forming in China. Both secondary and primary research will be used.

This critical study will be carried by tempting to achieve the following objectives:

- Identify the motives and determinants of FDI, focusing on market-seeking joint-ventures (JV) in China
- Identify the environmental regulations that facilitate or slow JVs down in China
- Identify the barriers to JVs in China and the main causes of failure
- Identify the key success factors (KSF) of western companies forming JVs with a Chinese partner and how barriers can be overcome

The main focus will be on Western companies, especially French firms in the food and beverage industry.

Structure of dissertation

The study will be divided in 7 chapters:

Chapter 1 is an introduction to the dissertation, explaining the background of the topic, the aims and objectives

Chapter 2 is a review of the existing literature: journals, newspaper articles, books and Internet-based sources giving more insight into the topic of setting up an IJV in China

Chapter 3 explains the methodology that has been adopted to research and write the dissertation, including secondary and primary research methods

Chapter 4 provides with findings and analysis trying to answer the aims and objectives of the dissertation

Chapter 5 is a discussion of the findings

Chapter 6 concludes the study and gives some recommendations. The author will in this part develop a model for successful IJV setting up in China

Chapter 7 is a reflection on learning

Chapter 2: Literature Review

The following literature review is based on existing sources coming from a hybrid of academic books, journals, newspapers and credible Internet-based sources. This literature review will allow giving more insight into the topic and will also allow identifying any gaps in the existing literature to be covered in further primary research. The literature review will provide the author with a stronger base on which to develop a theory at the end of the dissertation.

2. 1 Chinese investment environment

2. 1. 1 China, the fastest-growing economy

The Chinese investment environment has been widely reported in the literature. Most of the authors agree that the Chinese government has made great achievements in terms of FDI since 1980. Lau & Bruton (2007) describe China as the fastest-growing economy which can be explained by greater economic liberalization and easier repatriation of profit by foreign investors.

Fung (2002) explains that the promotion of FDI by the Chinese government has been an important part of the economic reforms since the “ open-door” policy and made China the most important destination for FDI. The authors explain how China has gradually evolved in terms of FDI policy:

- Stage 1: Gradual and limited opening
- Stage 2: Active promoting through preferential treatment
- Stage 3: Promoting FDI in accordance with domestic industrial objectives

Ng & Tuan (2002), describe China as a “ FDI-friendly” environment that possesses very attractive environmental factors such as the size of the Chinese market, its potential to grow...

Argawal & Wu (2003) describe China as a key player in the global economy and that its high economic growth has transformed China into one of the world’s largest economy. The transition from a command economy to a market-based economy has been incredibly and remarkably successful.

Another factor that made China even more successful in terms of FDI is its entry to the World Trade Organisation (WTO). Fung (2002), Ng & Tuan
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(2002), Yin (2009), Hoa (2010) and many other authors agree to say that China has had many difficulties to become a member of the WTO. After 15 years of high improvements, by reforming its economy and trade to be more market-oriented, by reducing tariffs and non-tariffs barriers...China finally accessed the WTO in 2001. This accession gave remarkable benefits to China, who was promoted by the organization as a “ central stage in international trade”. The Chinese battle to enter the WTO is described as an example that other nations (eg Russia), could learn from in order to access this organization.

2. 1. 2 Problems

More and more authors in the literature insist on the difficulties to enter China. Being the fastest-growing economy does not mean that any MNE can enter the market easily and without any risk of failure.

In front of all the attractive sides of the Chinese investment environment, and after its accession to the WTO that gave trust to foreign investors, many western MNEs (eg: Pepsi) have rushed into entering China and have faced insurmountable problems such as corruption, absence of trust and transparency... (Yallapragada, 2003).

Zhang & Fu (2008) describe China as a stringent environment that can have a negative impact on FDI. They remind us that even if China is the first recipient of FDI, there is a high disparity in geographical distribution. It is important to determine which region the foreign company is to invest. Indeed, the remarkable economic development of China has developed major problems such as extreme pollution. Because of the environment

deterioration caused by FDI in certain regions, the government has put in place very strict laws that foreign investors are not necessarily aware of before setting up their business in China.

While many countries in the world are facing an economic downturn, China's economy is still expecting to grow by 11% in 2010. However, Tse (2010) explains that despite this fact, the Chinese market is really tough. He explains how the recent clash of Google and the Chinese government; the vulnerability of property rights; the remaining restrictions on foreign ownership... are good reasons that CEOs should take into account before deciding if entering China is a risk worth taking.

The authors explain that the decision to physically enter China must be taken really carefully; a lot of research must be followed and more importantly companies must be ready to compromise and comply with Chinese laws.

2. 2 Joint-ventures in China

2. 2. 1 Definition of a JV

There is no legal definition of a JV in the literature. A JV is commonly defined as a partnership between two or more companies who create a legal entity to undertake economic activities.

In this dissertation, the author focuses on international JV that necessarily includes two or more parties from different countries. Hollensen (2007) defines a JV as “ an equity partnership typically between two partners. It involves two ‘ parents’ creating a ‘ child’ acting in the market” (Hollensen: 339).

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Figure 2: Equity & Non-equity JVs by Hollensen (2007)

A non-equity JV is defined by Hollensen as a strategic alliance between partners who do not commit equity or invest into the alliance. It is also called Contractual JV and does not involve the creation of a third entity. This form of JV will not be taken into account in this dissertation. Fung (2002) mentions that CJV were the vehicle of choice in the early opening of the Chinese market as it lowers the risks for the foreign partners.

An EJV is a third entity formed by firm A and B. Both firms contribute equity to firm C. This form of JV allows international marketers to access complementary skills and resources, share risks and costs (Clarke & Wilson, 2009).

According to Hollensen (2007), the JV can be:

- resource-seeking and based on upstream collaboration (R&D and production)
- market-seeking and based on downstream collaboration (marketing, distribution, sales, service)
- Both upstream and downstream-based collaboration

2. 2. 2 JVs in China

It is widely reported in the literature that JV has been, from the opening of the Chinese market, a vehicle of choice.

Yallapragada et al (2003) define JV in China as a sort of arranged marriage as the government provides a Chinese partner to the foreign investor. The authors mention that most of the JV failed and sustained huge losses or just

abandoned the project because of the lack of understanding of the Chinese partner.

EJV became increasingly important from 1987, representing more than 60% of all FDI. This tendency is now decreasing as the government encourages FDI in the form of wholly foreign-owned enterprises (Fung, 2002).

The literature insists on the cultural differences leading to failure when forming a JV in China. However, there are many other factors to consider, the main important one being the law. The JV laws and regulation are different in China and in Western countries. Indeed, if we take the example of Europe, the regulations are different from a country to another: in France, a JV exists if a new juridical personality is created, has means and capital. In Anglo-Saxon law, a new created entity does not necessarily have juridical personality but is however considered a JV (ChinaOrbit. com).

The country of origin of the foreign partner is an important determinant of success or failure of a Sino-foreign JV (Osborn & Hagedoorn, 1997; Lin, 2004).

Several case studies in the literature give example of the importance of country of origin as a determinant of IJV success in China. Those studies will be used as examples by the author to answer objectives 3 and 4 of the dissertation. The case studies include giants in the F&B industry: Coca-Cola (Datamonitor, 2009; Mok, 2002), Pepsi-co (Yallapragada, 2003), Danone-Wahaha (Dickinson, 2009), Carrefour (Child, 2006).

2. 3 Doing business with China

2. 3. 1 The cultural gap

The unique culture of China is widely reported in the literature as being the main cause of failure for Sino-foreign JVs. It is really important to understand the Chinese culture before investing in China (Stark et al, 2005). Chinese business people are described as being extremely “tough” negotiators. Some authors in the literature think that negotiating is an art for Chinese business people (Pye, 1982; Lee & Lo, 1988; Graham et al 1994).

China has a really unique view of the world and if the foreign partner is ignorant of the other parties’ views of the world, it will create a major problem in the negotiation process (Stark, 2005). For example, Tuttle et al (2009) explain that business in China is more to serve the interest of the state rather than the owners of the business.

Mc Kenna & Sun (2007); Woo (1999); Herbig & Martin (1998); Trombly (2006) and many other authors explain different aspect of Chinese negotiation such as the issues for women to participate in negotiations, the saving-face concept of China, the attitude to adopt when negotiating business (eg: building trust as a first step)... The authors are only describing the Chinese way of doing business. In the framework of this dissertation those information can be used as tips for foreign investors willing to invest in China.

Katz (2006), founder of Leadership Crossroads has had a successful experience in productive cooperation across cultures. He has interacted in China with employees, customers, outsourcing partners... Katz describes in

his book the best ways to negotiate international business with China. His study is based on his experience but also on the work of Trompenaars (1997) who divided culture into seven dimensions (Appendix 1). Once again the author describes the unique Chinese culture and the best ways to approach it in a business environment. Using both author's theories together with Hofstede cultural differences, the author will consider whether western culture, especially French culture give the firms an advantage in dealing with the Chinese as many studies show that cultural misunderstanding causes major problems in IJVs.

2.3.2 GUANXI

In the literature, some authors insist on the "Guanxi" concept when establishing business relationship with China. Zhu & Zhang (2007), define Guanxi as "the need to establish a relationship" either with someone or something (e.g. a brand-name). Guanxi mainly is a relationship building and according to the authors, it takes into account several notions:

"Jianli ganqing": developing connection between people

"Jiao pengyou": making friends

"Yanxing touzi xingwei": continual investment behaviour

Chinese business leaders such as Mr. Chang and Mr. Cao, CEOs of telecommunications companies based in Zhengzhou and Xi'an indicate that the action word for developing Guanxi is "Jianli" meaning establishing the connection with people but not forcing it by dishonest means.

For some Chinese business people, Guanxi is an essential element when doing business in China and is strongly related to the Confucian tradition and collectivist culture (Xin & Pearce, 1996). However, other authors in the literature have reported that even if Guanxi has long been the best approach to successfully set up an IJV in China the effect of Guanxi are not only positive. Rahman (2008) explain the risks that exist when establishing a Sino-foreign IJV based on Guanxi (high performance, resource and trade-off risks). The author reminds that Guanxi is necessary when collaborating with a Chinese partner but not sufficient. When a Western company chooses a local Chinese partner according to the size of its Guanxi, it will be beneficial for the company's short term goal of market entry, but its long term goal of succeeding in the IJV will encounter problems.

Gu et al (2008) define Guanxi as “ the durable social connections and networks a firm uses to exchange favors for organisational purposes”. The authors draw the benefits and risks of Guanxi and show that Guanxi can be necessary but does not always matter. Even if personal networks are popular all over the world, the authors insist on the uniqueness of China who has distinct ways of operation.

2. 4 Critical literature conclusion

The literature widely mentions that JV in China fails because of the huge cultural differences between China and the western partner. However, there is a gap in the literature as there are many other aspects that can cause failure and that are not deeply taken into account in the literature: law, bureaucratic roadblocks, corruption, management control...

The literature tends to concentrate on Sino-American/ Japanese/ British JVs, there is a lack of information about Sino-French JV and the primary research of this dissertation will mainly aim at filling this gap by focusing on the food & beverage sector which is not widely reported in the literature. Moreover, the literature describes that ignorance of the other parties' culture, regulations, the non-establishment of Guanxi... are main causes of failure but fails to explain how a two-way dialogue can be established between Chinese and Western leaders to make the JV successful. The dissertation will also point-out what makes cross-cultural relationship successful as it is not clear in the literature.

Chapter 3: Methodology

3. 1 Data requirements

To recap, the overall aim of the study is to acquire a better understanding of the Chinese business environment for a Western company to successfully set a JV up with a Chinese partner.

After examining the literature review, the author has identified key research questions that will be answered in chapter 4 of the dissertation to meet the objectives stated in chapter 1:

- What makes a western MNE chose to deal with a Chinese partner to set up a JV in China?
- What factor is the most determinant: political, economic, demographic, labour (cost, productivity, education level), ease of access (market, suppliers) etc?

- What western investors should be aware of before setting up a JV in China in terms of legislation and regulation?
- Will the JV be private or state owned?
- What are the positive factors of setting up a JV in China (law, regulation, policies)?
- What are the negative factors that investors must be aware of to be best prepared?
- Why culture seem to be the main cause of JV failure?
- What western investors must know about the Chinese business culture?
- Does Guanxi always matter?
- How to overcome the cultural differences and set-up a two-way dialogue?
- What were the main causes of failure and KSF of Sino-French JVs?
- What contribution is put by each party in the JV?
- How each party value the JV?
- Is it more beneficial for the French firm to own more than the Chinese partner?

To answer those questions, the author will analyse the existing academic literature, including articles and case studies that will be used to provide issues and/or solutions that exists in the food and beverage industry. Case studies such as PepsiCo, Coca-Cola, Carrefour, etc. will be analysed.

To feel the gap in the literature, the author will also implement “ real world” researches to have an in-depth understanding of the Chinese culture and also, to have a better understanding of Sino-French business relationships as

it is not widely reported in the literature. By this mean, the author will be able to collect major primary data provided by experts that have experience in doing business with China.

3. 2 Research Design

3. 2. 1 Review of the fundamental research methodologies

3. 2. 1. a: Exploratory, causal and descriptive research

Wrenn et al (2007) states that there are three main categories of research design: exploratory, causal and descriptive, the can use both qualitative and quantitative methods.

An exploratory research design is used to gain more insight and understanding into a topic. It is described by some authors as a “ detective work” when the author as to look for clues to find out what happened or is currently taking place. It required the author to adopt a very flexible attitude to collecting information. Wrenn et al (2007: 34) state that “ an insatiable curiosity is a valuable trait for exploratory researchers”. This type of research is needed when the author has an objective of depth interviews, one of the best ways to acquire desired insight, clarifications... Exploratory research is a type of qualitative research.

A Causal research design is used when there is a need to determine whether two or more variables are causally related and to what extent. When using causal research, the researcher manipulates the independent variable, measure the dependant variable and control other variables that could have an impact on the dependant variable. This type of research requires the use

of quantitative research methods such as statistics (Chi-square analysis, correlation, regression tests...).

A descriptive research design seeks to describe a phenomenon. It is used when the researcher has an objective of describing the characteristics of a specific group, estimate the percentage of the population that act, think...the same way, make specific predictions (Wrenn et al, 2007). Descriptive research is the most rigid research design and needs to be very structured. This type of research implicates that the author already have a major knowledge of the topic or research. Descriptive research uses quantitative research methods.

3. 2. 1. b Qualitative v. Quantitative

Qualitative research is defined by Schimdt & Hollensen (2006) as an investigation to help understanding and answering questions by collecting evidences. This type of research method allows conducting exploratory researches and requires the use of:

Observations: observing and analysing behaviours in their usual contexts

Focus groups: group discussion to collect effective data about a group of individuals having the same cultural norms

In-Depth interviews: usually individual face-to-face interview to understand what is in a specific person's mind about a specific topic

Qualitative research allows the researcher to collect open-ended data and develop themes from the data collected.

Quantitative research can be both descriptive and causal. Aliaga & Gunderson (2002: 1) define quantitative research as “ explaining phenomena by collecting numerical data that are analysed using mathematically based methods (in particular statistics)”. Because quantitative research involves numbers, statistics it is seen as a more realist research method. Quantitative methods are good at looking at cause and effect relationships between two or more variables.

The majority of researchers talk about “ paradigm war” when it comes to differentiate qualitative and quantitative methods. They are seen as incompatible (Muijs, 2004). However, more and more commonly, researchers use mixed-method approach. It is a more pragmatic way to collect data, using both quantitative and qualitative research methods. In order for a mixed-method approach to be efficient, the researcher needs to consider all the relevant characteristics of both quantitative and qualitative methods.

Table 1: Comparison of quantitative, qualitative and mixed methods

QUANTITATIVE

QUALITATIVE

MIXED METHOD

General Framework

Aim at confirming a hypothesis about a phenomenon

Predetermined

Rigid style of categorising responses to questions

Structured methods : questionnaires, structured observations, surveys.

Aim at exploring and understanding a phenomenon

Emerging

Flexible style of categorising responses to questions

Semi-structured methods : participant observation, depth interviews, focus groups

Both exploring and confirming a phenomenon

Both predetermined and emerging

Both rigid and flexible

Both structured and semi structured methods

Objectives of type of research

Descriptive: To describe and quantify a phenomenon

Causal : to predict causal relationships

To describe the characteristics of a population

Explanatory : To explain a phenomenon

Exploratory : to describe and explain relationships

To report individual experiences

To both quantify and describe a phenomenon

To both causal and exploratory

To both describe a population and an individual

Question type

Closed-ended

Open-ended

Both closed and open-ended questions

Format of data

Numerical data (statistical, assigning values to responses) : performance, attitude, observational and census data

Textual data from interviewees, observations, case studies analysis, video/audio tapes

Multiple form of data drawing on all possibilities : Statistical and text analysis

Flexibility of each

methods

The response of participants does not influence which question is to be asked next

The design of the study remains stable

Subject to statistical assumptions and conditions

The response of participants influences which research question to ask next

Some aspects of the study are flexible : wording (addition or exclusion) of a particular interview

Data collection and research questions are adjusted according to what is learnt

Can be both flexible and rigid

Table 1 has been realised following two authors theories: Creswell (2003) and Bernard (1995). According to them, it is useful to first consider qualitative and quantitative possibilities for data collection before selecting one, to which the dissertation's author has added mixed-method approach.

3. 2. 2 Choice of research method and justification

Desk research has first been used to collect information that already exists in the literature. This information was both internal and external to organizations and help having an in-depth understanding of the subject.

Primary research has then been used to fill the gap that secondary research cannot fill. Quantitative methods have not been used as the author wants to explore the topic in depth. According to Muijs (2004), quantitative methods fail when an in depth understanding is needed, when the author wants to really get under the skin of a problem. Moreover, quantitative methods require the author to define the variables to be studied whereas in the author's topic area, unexpected variables can emerge.

The author chose to use qualitative research only. Indeed, the dissertation topic requires to specifically knowing what is going on in people's mind, what are their views and opinion about doing business in China.

More specifically, exploratory research has been used as the author needs to gain broad inside into the dissertation topic and achieve a better “ feeling” when investigating.

According to Schimdt & Hollensen (2006), the most used qualitative research method is focus-group. However, the author chose to make use of individual depth interviews as current information is needed by directly asking questions to specific persons.

Depth interviews allow the respondent to openly talk about his/her experience of doing business with a Chinese partner. Depth Interviews can be:

Non-directive: the respondent is given freedom to answer by staying within the bounds of the topic

Semi-structured: a specific list of topics is covered.

The author is looking to establish the meaning of Sino-western/French business relationships from the views of experts. Indeed, in order to understand those relationships better as the literature fails to explain it in depth, the author seeks to listen to different individuals who have experience in the topic area and build an understanding based on their ideas.

3. 3 Research Approach

Conclusion & Recommendation

Diagram 1 shows the plan followed by the author.

In stage 1, the author research academic literature in accordance with the topic and develop research questions.

Stage 2 is an in-depth analysis of the existing literature to help answering the research questions developed in stage 1.

Stage 3 is what the author called “ real world” analysis. This stage will allow the author to collect primary data to fill the gap of secondary research and bring a creative thinking input to the dissertation.

Stage 4 consists of an analysis of the theoretical findings and “ real world” findings. By combining both secondary and primary research, the author will be able to answer the research questions and to meet the dissertation’s objectives. Those findings will then be discussed and the author will conclude by providing western investor with recommendation by drawing a model including all the variables to take into account to successfully set a JV up in China.

3. 4 Data collection methods and analysis

As mentioned above, the author chose to use exploratory qualitative research only. In exploratory research, the main methods of data collection that is potentially suitable for collecting data are observations, focus groups and depth interviews.

Observation is used to understand a phenomenon by observing it in its natural setting. The topic area does not belong to a phenomenon that can be observed by the author.

Focus group involves a group of persons that discuss a subject under the direction of a moderator. The author is willing to distinguish individuals as opposed to groups and have the opinion of individuals.

The author has selected in-depth interviews as the only method for data collection. As mentioned earlier, this method involves conducting intensive individual interviews with a small number of persons. The reason is that the author wants detailed information about doing business with a Chinese partner, the different stages in the JV forming, the advantages, difficulties... Acquiring detailed information about a specific person's opinion, behaviour, will allow the author to explore new issues in-depth.

The sample is divided in two categories and includes:

Individuals having experience in doing business with China: executives from French MNEs having formed IJVs in China, Juniors working in China for a French company.

Chinese business people.

The author has divided the s