RESEARCH PAPERS IN MANAGEMENT STUDIES

UNIVERSITY OF CAMBRIDGE
Judge Institute of Management
cambridge's business school

'SINO-FOREIGN JOINT VENTURES' VERSUS 'WHOLLY FOREIGN OWNED ENTERPRISES' IN THE PEOPLE'S REPUBLIC OF CHINA

Daniel Yan and Malcolm Warner

WP 11/2001

The Judge Institute of Management Studies
Trumpington Street
Cambridge CB2 1AG

‘SINO-FOREIGN JOINT VENTURES’ VERSUS ‘WHOLLY FOREIGN OWNED ENTERPRISES’ IN THE PEOPLE’S REPUBLIC OF CHINA

DANIEL YAN

and

MALCOLM WARNER

Judge Institute of Management Studies
University of Cambridge
United Kingdom

October 2001

Keywords: Joint Venture; Wholly Foreign Owned Enterprises; China

I. THE ONGOING DEBATE

1.1 Introduction

Sino-foreign joint ventures (SFJVs) used to be the prevalent mode of operation for foreign companies in China. Since 1997, wholly foreign-owned enterprises (WFOEs) have begun to outnumber SFJVs. Factors such as Chinese partners' competence, joint venture (JV) management control, and frustration from JV failure examples, have been cited as reasons why a strict adoption of WFOE for conducting business in China might be preferable. This article argues that SFJVs and WFOEs have been influenced by a number of ongoing changes, for example, government policy toward foreign investment, indigenous management practices, human resource management (HRM) practices and the nature of investment. In its overview of the longitudinal changes in these four areas, it suggests that foreign investors do not necessarily make an either WFOE or SFJV decision when considering their desirable mode of operation in China. Meanwhile, it argues that multinational corporations (MNCs), which took part in JV operations in China but failed, should not fall by the wayside. Instead, they should take a dynamic approach to constantly re-position themselves as SFJVs in their business plans, so as to achieve the best results. Finally, this analysis sets out a preliminary *Dynamic Positioning Model* of these two modes of operation in China, which serves as a foundation on which further hypotheses can be built.

1.2 Entry Modes of Foreign Companies into China

MNCs going international can choose from a spectrum of options including *Export Trade*, *Licensing*, *Franchising*, *Joint Venture* and *Wholly Foreign-owned Enterprise* (WFOE) (Root, 1994). The final decision depends on both marketing factors and those factors inherent to the entering firms. We hope to illustrate the process of choosing between the above options, by examining its implementation in the People's Republic of China.

A World Bank report states that the nature of China's economic growth in the past twenty years has been both productivity-driven and input-driven (World Bank, 1997). Each of these two factors contributed around half of the 9.4 percent annual GDP growth rate for the period 1978 to 1995 and is likely to do so after these dates. The input factor is attributed to the significant increase in capital in which foreign direct investment (FDI) played an important role. Therefore, to sustain the growth momentum, China has to first pursue a breakthrough in improving productivity, for example, by deepening the on-going state-owned enterprise (SOE) and banking reforms, the encouragement of creating an entrepreneurial culture, more research and development (R&D) spending and so on. Second, China needs to continue to secure a critical input factor – high FDI (Liu, 2000). It already has one-third of the emerging markets' total stock of FDI (The Economist, 10 March 2001, P.25). Indeed,

> "The integration of China into the world economy has enabled its exports to industrialize the Chinese countryside, and pay for the import of new technology. The large inflow of foreign direct investments (FDI) has increased the export capacity of the country and enhanced its technological base. Many rigorous studies have confirmed that international integration has been an important reason for the acceleration of growth in China. Since partial integration has been so favorable for China, total integration will only increase the benefits." (Woo, 2000, P.1)

A recapitulation of China's FDI (see Figure 1 below) will help elucidate the decisions of foreign investors on the major operating-modes in the China business arena.

As shown, equity joint venture (EJV) has for some time been a popular choice for foreign investors entering China. The strong growth in the number of EJV (particularly at the start of economic reforms) has been in large part due to the preference of the China government, which believed that forming JVs with MNCs could facilitate both capital inflow and expertise exchange.

The figure also depicts the weakening popularity of EJVs in recent years. In 1997, the number of WFOE projects first exceeded that of EJV (see Figure 1) and has continued to do so. Meanwhile, the increase in number of WFOE apparently represents a new trend of preferred entry or operating mode of foreign investors. Many experts advocate that WFOEs are the recommended choice of MNCs in China business development, expecting that JVs will lose their attractiveness as time goes by. Yet, fairly recently the following statement was noted:

> "BASF, the world's largest chemical company, and Sinopec, the largest petrochemical firm in Asia, have announced a JV to build a US$2.6 billion integrated petrochemical plant in Nanjing …The new company will be a world-scale, state-of-the-art venture and very competitive. Its target is China's chemical market …"
>
> (South China Morning Post, 9 December 2000, Business Post, P2)

This example indicates that room for SFJVs still exists in an apparent fashion of WFOEs, and the scale of the SFJVs formed can be up to world standards. This article, while not denying the significant benefits and flexibilities of WFOEs to MNCs, proposes that the role of JVs is undergoing a *Dynamic Positioning Process* vis-à-vis the needs of doing business in China. Somehow, people preferring WFOEs were probably comparing the comparative disadvantages of infant JVs to the comparative advantages of new generation WFOEs. We shall review the development of JVs in China and try to give an explanation for this observation.

1.3 Joint Ventures

A *strategic alliance* is an investment entry-type denoted by the formation of a business unit between two or more partners, usually from different systems to conduct an agreed mode of co-operation (Root, 1994). A *joint venture* is a particular form of *strategic alliance* involving the formation of a new joint organization (Killing, 1983). The rationale of a JV is closely related to the benefits of risk-sharing, resource-pooling, assetprotecting, and timely responses to market-changes. This new entity is characterized by the partners' resource commitments in exchange for shared management, risks and rewards (Anderson and Gatignon, 1986). This should award to each partner sufficient advantages to offset the initial sacrifices (Beamish and Banks, 1987). JV formation in China shares similar rationales as stated above. Daniels et al (1985) describe the reasons foreign and Chinese firms chose the JV format in China (see Table 1).

The decision to form a JV in China was also contingent on instant incentive factors, like tax-breaks, competitive labour cost and low production costs. Thanks to the introduction of central and local governmental support like resource-allocation to Special Economic Zones (SEZs), the transaction costs incurred to the foreign partners were significantly reduced (Tse et al, 1997). The formation and introduction of new JV laws (Child, 1994; Xu and Chew, 1995) was arguably another factor that gradually inspired confidence in MNCs to form JVs in China.

As such, the basic formula of JV formation seemed to have created a ready-for-profit package for foreign investors. Successful JV stories in China are not unusual. For example, the *Shanghai Volkswagen Co. Ltd.*, the JV of *Volkswagen* and *First Automotive Works* in Shanghai, has maintained its position as the most successful overseas-funded industrial enterprise in China for the ninth consecutive year (Chinaonline, 2001). However, there are less successful or painful experiences of foreign partners in other cases that reflect the reality that JVs do not always lead to profits. The emergence of WFOEs in recent years seems to have shaken the position of SFJVs. Thus far, very little literature about the longitudinal positioning of JVs in China can be found. This article argues that a more dynamic view of SFJVs should be adopted, for not only a fairer justification of their value, but also a re-positioning of SFJV in the strategy of MNCs. We employed a qualitative methodology based on open-ended interviews with senior managers in both SFJVs and WFOEs, as well as citing cases in the existing literatures and past researches of the present investigators. The sections of this analysis shed light on how the developments of SFJVs and WFOEs rested on several key pillars in the past two decades – policy toward foreign entry policy, indigenous management, HRM practices and the nature of investment. We argue that these components are likely to change and so will have a major impact on the future path of SFJVs.

II. FACTORS AFFECTING CHOICES OF MODE OF OPERATION

1. Policy Toward Foreign Operation-Modes

1.1 Equity Joint Venture versus Wholly Foreign-owned Enterprise

This section aims to explain, as the reforms proceeded, the changing popularity of EJV vis-à-vis that of WFOE.

When the economic reforms were first launched in the early 1980s, JVs were welcomed by the Chinese government because it received a number of benefits. It saw the chance to acquire modern management know-how, marketing skills and technology transfer, create jobs and obtain access to export markets (Beamish, 1988). These were particularly attractive given the time-consuming nature of developing the above on its own and its deficiency of foreign exchange (Grub and Jian, 1988). Significant incentives were granted, therefore, to SFJVs, including tax holidays and import duty exemptions for essential production equipment and materials (Zhang, 1999b). On the other hand, China had adopted a protectionist attitude towards particular strategic 'core' sectors like the so-called 'pillar industries.' In these only JVs and local firms were permitted (Gomes-Casseres, 1988). The strong encouragement of the government therefore made SFJVs a distinct option of FDI during the early stages of the reforms.
Knowledge of local governmental issues, culture and market, is critical to both the Chinese and foreign investors in China business, albeit with different emphasizes for different areas (Si and Bruton, 1999). MNCs new to China business environment probably felt indifferent to the selection of business modes between SFJV and WFOE. The 'red-tape' involved when dealing with the Chinese government, further complicated

their workflow in China (Child, 1994). Meanwhile, facing competition (or rivalry-pressure), many MNCs could not afford to sacrifice the 'first-mover' advantage (Daniels et al, 1985). On the contrary, SFJVs could help MNCs overcome economic and political hurdles, and realize the sales-volume more rapidly than WFOEs (Davidson, 1987). Thus, subject to stringent government control and incentive offered by JV formation, many MNCs favored JV establishment (Yiu and Makino, 1997).

1.2 The Transition

Zhang (1999a) classified the pattern of FDI into the *Initial Stage* (1979 to 1985), the *Continuous Development Stage* (1986 to 1991) and the *High Growth Stage* (1992 onwards). The first stage, with a small number of SFJVs projects formed, simply reflected the 'wait and see' mentality of MNCs. As MNCs acquired certain experience, JV formation entered the second stage for continuous development. The highly publicized tour of Deng Xiaoping to South China in 1992 and his call for a 'speed-up' in economic reform boosted FDI growth (as well as SFJV's increase in number). However, the emergence of WFOEs after mid-1990s was seemingly not quite in line with the expected dominant position of SFJVs. The following section depicts these changes.

In the course of the economic reform, disappointment was not unusual in many SFJVs. For example, JV performance depended greatly on qualitative factors like individual personalities, organizational cultures, administrative style and management philosophy (Davidson, 1987), together with the 'One Bed, Different Dreams' symptom (Vanhonacker, 1997). These factors did not encourage the development of management systems the foreign partners wanted. In addition to Chinese partners' substandard performance, in many cases, there was another source of frustration for the foreign partners (Grub and Jian, 1989; Child, 1998a). The so-called large customer-bases of their Chinese partners were sometimes merely directories and their distribution-networks often proved to be sub-standard. Also, the Chinese partners' leverage was likely to be restricted to their own provinces; outside these relevant provinces, they might do no better than the foreign partners acting alone (China Joint Venturer, 1995b). On the co-operation side, the 'veto-power' of the Chinese partners was very often a stumbling block for the foreign partners in strategic decision-making. All these led MNCs to attach greater importance to gaining control in their ventures in China, especially after they gradually increased their confidence in running a business in China (China Joint Venturer, 1996b).

An interesting factor may also account for the popularity of SFJVs. A Senior Executive of a China municipality-level holding company in Hong Kong described to one author that 'round-tripping' investment (Zhang, 1999b) did exist. He considered that, to a certain extent, this helped contribute to the surge of JV project-numbers during the first ten to fifteen years of the reforms. He also indicated that some Chinese companies practiced tax evasion by forming SFJVs with Chinese-invested Hong Kong companies and inflating the in-kind capital contribution of the 'foreign-partners' to the SFJVs. Some top local managers might even form SFJVs to enjoy personal benefits.

Meanwhile, the JV laws first stipulated at the start of reforms created many areas of confusion between legal explanations and daily practices. It took more than 10 years to systematize these laws (Xu and Chew, 1995), which undoubtedly frustrated many foreign partners. As such, the birth of the new regulations in 1986 on WFOEs sparked positive insights in the eyes of MNCs. Regulations allowed WFOEs a full control over the entity and a better protection of intellectual property (Sutter, 2000), while enjoying similar incentives as EJV[1] (China Joint Venturer, 1995b). Therefore, the number of such enterprises grew rapidly from then onwards.

However, we still cannot say that EJVs in China are at a dead-end, or that WFOEs are a panacea for foreign investors. Child (1998b) admits the growing popularity of WFOEs but also reminds us of the relatively lower profitability of WFOEs when compared to EJVs. The success of *Lucent Technologies*' EJVs in China serves as a good example to demonstrate the workability of JVs (Podolny et al, 1999). Sutter (2000) argues that WFOE also has its downside in several areas. First, in sectors like consumer goods and high-technology hardware, Chinese firms are relatively stronger. In the absence of suitable Chinese partners, a WFOE can be handicapped in the competition by a lack of effective connections to handle governmental work. Second, high-tech companies may find having a competent Chinese partner useful in developing applications for the local market, in which the client-base is not yet ready either financially or technologically. Third, unless being qualified as a high-tech enterprise, a WFOE was by law 'required' to commit to exporting at least fifty percent of its output. This was recently changed to 'encouraged' (PriceWaterHouse, 2000). Last but not the least, WFOEs cannot pursue activities in a number of areas[2] (Zhao and Hu, 2000). Although China's World Trade Organization (WTO) accession may help release the constraints in some of these fields, it may take years for MNCs to become competitive enough to gain substantial market-share on their own. Therefore, the advantages of WFOE over SFJV are by no means absolute, but possibly industry-specific.

Perez et al (1995) pinpoint the critical success factors of MNCs in China. These are associated with their abilities in achieving effective co-ordination of external relationship and investment decisions, gaining control of JVs, coordinating multiple JVs and strengthening HRM. Such factors particularly apply to MNCs with multiple ventures in China. Hence, for those foreign investment enterprises (FIEs) having significant investments in China, the *Holding-Company Law* stands for an evolutionary milestone for them to manage their investments in China more effectively. The *Holding-Company Law* in China provides the means to fully integrate a MNC's JVs, by setting up a 'umbrella-company to co-ordinate and monitor its investments in China. Such an umbrella-company provides supports like HR leadership, marketing services, information system services, accounting services and technical services for its JVs. Equally important is that this 'umbrella-company' can also help channel investment into JVs, centralize product-training for JVs, hire local employees directly, and thus achieve a higher cost-effectiveness of the resources. As China is an arena of discrete sub-markets instead of a single huge market, this transfer of personnel between JVs means a more effective use of the competence of local (and expatriate) staff (Wong and Bökkerink, 1997).

To sum up, at the inception of the economic reforms, the China government intentionally packaged EJVs with preferential privileges, while granting WFOEs virtually nothing but regulations. This factor, together with MNCs' desire to be the first mover in order to realize the unprecedented market potential, constituted an *incentive-driven* and *government-preferred* option to boost the number of EJVs. As the reforms proceeded, MNCs became more aware of the need to have expertise in China business at the same time as they acquired knowledge from their JV counterparts. So, as the constraints on WFOEs were gradually loosened, MNCs became inclined to this option. Meanwhile, the failed examples of JVs reminded MNCs of picking the right entry-mode in China business. By 1995, the promulgation of *Holding-Company Laws* helped re-shape the investment framework in China (Sutter, 2000). The formation of such 'umbrella companies' was a likely vehicle to enable MNCs to centralize JV support services and fully integrate their JVs. This resulted in the birth of *rationale-driven* and *knowledge-driven* options for MNCs in deciding their entry- or development-mode.

2. The Chinese Management System

2.1 The Managerial Status Quo Ex Ante

Regardless of the entry- or operating mode, MNCs could always encounter difficulties when dealing with Chinese government officials, stemming from the mismatches between the management philosophies of both sides. MNCs should therefore pay attention to the evolution of an essential category – the Chinese management system.

The Communist Party took over the sovereignty of China after their victory in the Civil War in the late 1940s (Laaksonen, 1998). Since then, the archetypal Chinese management system (here mainly referred to that in SOEs) has gone through a series of winding steps (Warner, 1992; Child, 1994). In hindsight, the Party had exercised control in Chinese management for a long period, although their influence gradually faded away as the reforms proceeded (Child and Xu, 1991). Moreover, since the post-war stage, the Communists had made China's management system immersed in a relationship-oriented context, which emphasized more 'egalitarian' and 'co-operative' values (Laaksonen, 1988). The authority was centralized in the hands of the Communists, and consisted of managerial authority, responsibility, and superior-subordinate relationship in industrial and business enterprises. The deficiency of knowledge and the high level of illiteracy stifled effective communication, and resulted in a reliance on personal relationships (nepotism and *guanxi*). This, when added to the lack of training platform for Chinese managers (Warner, 1992; 1995), and fault-picking practices during the Cultural Revolution (Wall, 1990), led to a punishment- and authority-oriented system in which the decision-making process was sluggish. The skeleton of the management system at the start of the economic reforms was characterized by these traits.

2.2 The Transitional Process

The transition from old management systems can be seen in two areas, the Chinese government and indigenous managers. For the government, management had inherited authority-driven practices for decades. It is only in recent years that the management philosophy of the government has undergone change. Starting in the mid 1990s, the SOE reforms reflected the state's desire to seek effective management and make this suit the needs of a market economy through innovative operations and mechanisms. Thus far, the government still aims to reform the SOEs in the hope that the latter can stand on their own feet. In other words, the 'Iron Rice Bowl' (*tie fan wan*) is to be broken (Warner, 1995; 2000). Areas like corporate governance, entrepreneurship and internationalization receive more and more attention (Child, 1998a). To counteract the problem of surplus labour in SOEs, the state resorts to the *survival of the fittest*, resulting in downsizing in SOEs, or the massive '*xiagang*' [3] (Chinaonline, 2000).

The management style of Chinese managers, especially the working attitude of the new generation of Chinese managers, also shows a new face. In their research on 869 managers and professionals in SOEs, Ralston et al (1999) found that the new-generation of Chinese managers demonstrated a shift in work-values and had become increasingly individualistic. Despite their possession of the traditional Confucian values, they now appear to be more westernized vis-à-vis the current generation (managers of ages between 41 and 51 years) and old-generation (managers of ages 52 years or above). Bu and Xu's work (2000) reveals similar findings. In their research on work-related attitudes among Chinese employees in Shanghai, the conclusion is that although there is not yet an immediate and complete 'Americanization' of the Chinese management system, the new-generation of Chinese employees think that the Iron-Rice Bowl mentality is probably on the retreat.

A Chinese SOE manager we interviewed, who was assigned to take up a Deputy General Manager position in a SFJV, expressed the belief that nowadays, Chinese managers value new opportunities. He suggested that remote assignments without substantial salary increment, for example, JV assignments in other provinces, were considered 'golden opportunities' to climb-up the echelon. This was especially the case when a Chinese manager needed to return to the parent company upon finishing the assignment. Such assignments could also equip the managers with the modern know-how to capture outside opportunities in future. This helps shed light on the new generation Chinese's increasing degree of adoption of the western management philosophy.

To summarize, the Chinese management system appears to be moving step by step from the traditional authority-oriented and party-oriented system in the direction of western management, albeit with a long way to go.

3. The Chinese HR System

3.1 The Old Personnel System

From 1949 to the pre-reform time, Chinese firms seemingly did not have an HR function, but only personnel management (*renshi guanli*). The so-called HR unit was merely doing paperwork-processing, rather than placement-strategy. After 1949, Chairman Mao's clear missions were to feed every one and stabilize the society, while the profitability of enterprises was swept under the carpet. The first critical HR challenge subsequent to the Civil War was to fill the managerial positions of SOEs. Facing the lack of capable candidates, the Communists resorted to four sources – ex-managers of enterprises, Communist Party members, graduates of universities and institutions, and the People's Liberation Army (PLA) (Laaksonen, 1988). The first category, ex-managers of enterprises, although competent enough, might not share the doctrine of socialist ideology. This lacuna inevitably hindered the selection of 'suitable' managers from candidates in this category. The second category, the Communist Party, was ideologically compatible but managerially incompetent. They, however, became one of the first generation of managers to emerge after a minimal degree of training. University graduates formed the third source of managers. However, even in 2001 the proportion of university-educated people in China is very small and even lower than that of India (Hsieh et al, 1999), let alone in 1949. Besides, their thinking was considered different from the ideology of communist. The final group, the PLA, was considered competent enough and ideologically compatible in the light of their experience in leading guerrilla troops and their decision-making skills under different situations during the warfare time. Hence, many army officers became managers of enterprises.

Employees in China formerly were in the same authority-driven system and shared the same punishment-oriented practices. Employment in China was kept in the 'cradle-to-grave system' (Warner, 1995). Only recently did labour change from being merely an employment system, in which each employee had a *dangan* (personal file) kept in his/her *danwei* (working unit). Labour-force recruits of relatively high quality, like the university-graduates, upon their graduation, had to await job-assignments by the State. This denoted an inactive labour-flow between enterprises, as SOEs could impose stringent control on the mobility of their staff by locking-up their *dangan*. As such, SFJVs born under such conditions might have to accept whichever personnel their Chinese counterparts assigned to them, rather than recruit competent candidates in labour-market.

MNCs aiming merely at establishing Representative Offices in China were not in any ways better in the topic of HRM (or *renli ziyuan guanli*) [4]. By law, MNCs could not even recruit their own staff for their Representative Offices, but had to resort to the paid-services of the Foreign Enterprise Service Corporation (*FESCO*) (China Joint Venturer, 1996a). The staff thus recruited came from SOEs but their payrolls were with the FESCO instead of the MNCs. The quality of work of these staff was, therefore, not unusually found to be sub-standard, and their loyalty and competence were often questionable.

Noting these HRM practices, the foreign partners of SFJVs often became suspicious of their Chinese partners' values and even questioned the justification of having JVs in China.

3.2 A Transitional Phase

During the 1990s, HRM practices in China gradually move in a market-driven direction. The establishment of companies, like *China International Intellechtech*, and *China International Enterprise Corporation*, stood for competition with *FESCO* (China Joint Venturer, 1996a). Foreign executive-search companies started to establish their footholds in China. Some breakthroughs in staffing of Representative Offices were also seen[5] (China Joint Venturer, 1995c; 1996a). Basically, both SFJVs and WFOEs benefited because of the changes in HRM practices. Yet, SFJVs probably found it hard to capture this benefit, as HRM was usually handled by the Chinese partners (Child, 1994).

The late 1990s initiated a new era for HRM in China (see Warner, 1995; 2000; Ding et al, 2000). HR departments of Holding-Companies and Representative Offices became very actively involved in helping pursue business goals (Melvin, 2000). Yet, the labour market in China can be described as both high labour-supply and low labour-supply, albeit addressed to different categories (see Warner, 1992; 1995). High labour-supply generally refers to non-skilled and surplus technical labour, which is simply a nationwide-burden (China Daily, 1999). The local managerial and executive staff group constitutes the low-supply category. It has been found that the expatriate failure-rate is often quite high, while the cost to the MNC of having an expatriate is almost five times that for a local executive (Goodall and Warner, 1997; Goodall and Burgers, 1998). This cost differential then induces a great demand on the limited local managerial staff labour-supply. Certainly, MNCs and SFJVs are free to recruit qualified and competent candidates at their own discretion. Besides, on the supply-side, competent graduates and experienced executives may not even need their *dangan* when applying for new jobs, as MNCs and SFJVs can evaluate the potential candidates directly themselves. However, the Managing Director of an international executive-search company acknowledged that supply is still tight. There had been a six-fold increase in the demand of senior executives during 1994 to 1998, especially for general management and marketing disciplines (Choi, 1998).

Second, Chinese MBA graduates, particularly those trained in the US, recently form an increasingly popular source of competent managers (Chen and Martin, 1996). Nonetheless, supply seems to be lagging behind demand and the latter continues to grow at an even higher speed (Goodall and Warner, 1997). The Executive-Search company Korn/Ferry predicted a 400 percent increase in demand for local executives in this decade. Every qualified Chinese candidate usually has ten managerial positions to choose from (Goodall and Burgers, 1998).

Third, as labour-supply in China moves in the direction of a free-market, the HRM practices are being transformed. On one hand, MNCs need to accelerate localization plans and fully train their local staff (Perez et al, 1995; Heish et al, 1999), for instance, by setting up training-centers, independently or in partnership with local universities. On the other hand, they have to endeavor to retain good staff (Heish et al, 1999) and be cautious of the threat of staff poaching by existing or new players (Melvin, 2000). These challenges will become acute after China's accession to the WTO.

To summarize, Chinese HRM is being transformed gradually and must move step by step into the nascent labour-market, while awaiting an increase in supply. Both SFJVs and WFOEs are chasing the still limited supply of good managers. Having said that, MNCs with JV operations – particularly those with multiple JVs scattered throughout China, through the operation of Holding Companies – stand a better chance to explore competent local staff to realize their localization-plan. On the contrary, being able to exercise full control of the business entities and being highly flexible in implementing necessary HRM measures, WFOEs may have the advantage in recruiting and retaining good staff. The clear message is that the new creators of SFJVs need to be forward-thinking and tailor their HRM to the emerging conditions.

4. The Nature of Investment

The nature of investment has greatly shaped the structure of the China market. Here we discuss two key factors, the nature of FDI and the possibility of WTO entry, which are playing important roles.

4.1 The FDI Pattern

As mentioned earlier, FDI has been a significant factor in the growth of the Chinese economy. Luo and O'Connor (1998) evaluated the structural changes of FDI in China and concluded that foreign companies gradually increased their resources and financial investment in China. They described a number of diverse approaches used by companies to an increasing commitment – *Opportunistic Experimenter*, *Strategic Investor* and *Dominant Local Player*. *Opportunistic Experimenter* is an approach of a group of foreign companies with a low level of corporate commitment, who merely aimed to learn how to conduct business in China. *Strategic Investor* is the approach characterizing the majority of foreign companies that have aimed to enjoy the early-mover benefits, possibly by building a broader multi-regional or national presence through marketing or establishing facilities. The final category, *Dominant Local Player*, describes companies with a high level of corporate commitment to investing in China. Companies in this latter group usually have had a highly localized management system and aimed to secure dominant market positions within their own industry sectors. Going alongside this categorization of approaches is the increase in proportion of FDI on WFOE vis-à-vis EJV since the mid

1990s, an equally significant observation of FDI. One argument is that as foreign companies keep acquiring practical experience in China, they are increasingly likely to 'go it alone' to pursue success in the China market.

4.2 World Trade Organization

China signed a bilateral agreement on China's accession to the World Trade Organization (WTO) with the US on November 15, 1999 and with the EU on May 19, 2000 (TDC, 2000). The China-US agreement stands for an opening of markets in Industry, Agriculture and Service within a pre-set period (WTO Special Report, 2000). China is expected officially to become a WTO member, probably by the end of 2001 or early 2002. This step is seen as a breakthrough for China in international trade. Furthermore,

> "It must be recognized that WTO membership is, in essence, a commitment to become a normal private economy integrated into the international division of labour. WTO is a much more influential and powerful organization than the World Bank and the International Monetary Fund. WTO is set up to regulate trading among market economies. WTO not only specifies what kinds of economic institutions a member country could have, it also enforces these institutional norms on the member country. By signing to become a member of WTO, China has agreed to the convergence of all its key economic institutions to the norms of economic institutions in the developed countries, especially to the institutional forms of its capitalist East Asian neighbors – Japan and Korean (Woo, 2000, P.1).

Generally speaking, thanks to the creation of a 'level-playing field' resulting from China's accession to WTO, foreign companies will have more opportunities to enter the business arena in China. Already, it is estimated that MNCs have stakes in ten percent of the Chinese economy: commentators suspect that, "With WTO membership, the proportion could easily double" (The Economist, 10 March 2001, P.26). Through the lens of China, WTO accession will help China in many ways, namely to create jobs that will ease its labour surplus, to speed up the promulgation of a legal system and to achieve further integration into the global economy (WTO Special Report, 2000). However, this development is also likely to fuel the demand for scarce competent local managerial staff.

4.3 The Transition

At a first glance, the combined impact of FDI changes and China's WTO accession seems to favor WFOE formation. However, the situation can be multi-faceted. First, the nature of the China market is industry-specific. For example, JV may appeal to companies entering the petrochemical industry in China in the light of the potential advantages provided by the Chinese partner (see South China Morning Post, 16 December 2000, P1). Thus, Root's advice (1994) of having a thorough evaluation of the product, the market situation and the strengths of a company when considering entry into a new country must be needed. These factors detract from the advantages of WFOEs.

Moreover, while acknowledging the advantages of WFOEs, Vanhonacker (1997) argues that the entry strategy is not simply a WFOE or EJV decision, but probably a mix of both. He advises foreign firms aiming at WFOEs to note three issues. One, China is still a *guanxi*-dominated society (Luo and Chen, 1996), which signals the advantages of having Chinese partners/companies[6]. Two, as the Chinese generally do not want foreign companies to take advantage of China, questions about cultural and economic sovereignty may evolve. Three, although China's WTO accession demands an opening of distribution-rights for foreign companies, the latter may find it difficult to develop their own distribution in the first place. It will still be advantageous for foreign companies to try to collabourate with Chinese companies in order to have leverage on the latter's facilities. Given all these concerns, Vanhonacker offers several suggestions for foreign companies aiming at the China market:

1. Set up WFOE production-centers and surround them with EJVs (with competent local partners) to distribute the products through the local's channels;

2. Set up an EJV in the first place, operate it for a fixed period and finally take over the assets from the Chinese partner and run the company as a WFOE;
3. Set up an EJV in the first place and surround it with WFOE(s) for distribution, so that the operation works like a WFOE. (MNCs are not currently allowed to develop distribution-networks)

Second, Gomes-Casseres (1989) argues that JVs can be a possible solution for MNCs, allowing them to capitalize on the technical labour-force in China. For instance, MNCs can form JVs with Chinese companies to carry out R&D functions in China or even complement this approach by establishing local training centers. The so-called 'Motorola University' and the 'ABB China Business School' (Hsieh et al, 1999) are examples of this approach.

Third, China's accession to WTO may have a less profound effect than people are expecting (Perkins anb Shaw, 2000). The reason is that industries like consumer products and electronics already exist in a highly competitive environment. For other high-tech markets like telecommunications, the China government has been driving a rapid growth policy for some time, leaving little room for new foreign investors. However, Perkins and Shaws (2000) reckon that in the fields like insurance and banking, it may be wise for foreign investors to identify capable Chinese partners and build on their existing facilities.

Fourth, one of China's next important targets is to speed up the exploration of its Western regions. Although MNCs may have acquired significant experience in running business in the coastal or central areas in China, the location, infrastructure and business practices in Western China may present totally different challenges to MNCs. SFJVs may stand a better chance of success in such an environment.

Fifth, the increase in the number of foreign companies entering the China market will heighten the fight for competent local staff, resulting in high turnover, high salary demanded by the staff, and the likelihood of encountering applicants that provide false references. Similar effects were observed in the late 1990s when many MNCs executed their localization plans. When MNCs enter China after the WTO accession, a recurrence of the 1990s experiences is very possible. MNCs should proceed with cautions in view of the likely shortage of competent labour-force.

In short, the nature of investment in China has been a major force in shaping the changing role of SFJVs toward a market economy particularly vis-à-vis WTO entry. In the new era, WFOEs and SFJVs will still satisfy different evolutionary needs. They are both likely to continue to exist.

III. DISCUSSION AND EVALUATION

The previous discussion has covered areas like changes in government policy, indigenous management, HR practices and the nature of investment, which in turn have been favorable to SFJVs, WFOEs or both. Table 2 attempts to set these out schematically (see table 2).

A model is then developed out of our findings. It is intended to illustrate the relative weights of various factors affecting the choice of ownership-mode at different times in five assigned dimensions. The five dimensions are set out alongside the topics discussed previously (Figure 2) and consist of: – '*Purely SFJV operation vs Purely WFOE operation*,' '*Purely Traditional Chinese Management Style vs Purely Westernized Management*,' '*No HR market vs Free HR Market*,' '*High risk aversion factor vs Low risk aversion factor*,' and '*Hierarchy – Free Market*.' The first three respectively refer to the relative tendency of new entities formed as SFJVs, what the Chinese general management system looked like, and the direction of HRM practices in China. The fourth dimension refers to the likelihood of MNCs taking risks with respect to the degree of business experience they have acquired in China. This point is closely related to the afore-mentioned change in FDI pattern. Similarly, the fifth dimension depicts the level of the Chinese business arena as a free market, which in the current discussion, is influenced by China's potential WTO accession and the degree of opening of the China market.

In the past few years, advantages of WFOEs in China have emerged and the growing number of these firms has become a substantial focus of research (Luo and O'Connor, 1999). However, this analysis questions whether this means there is a loss of importance of SFJVs in China. In reality, JVs remain one of the most popular forms of China's FDI (China Daily, 2000). It may be more appropriate to expect that SFJVs will occupy a dynamically defined niche in the future. The success of Arthur Andersen in synergizing the benefits of SFJV and WFOE by incorporating these two setups into its China operation serves as good example [7] (China Joint Venturer, 1995a).

The report of AT Kearney (2000) also noted some findings favoring JVs in their survey on 1000 companies, which accounted for 70 percent of total global FDI outflows in 1998. Fifty percent of the largest Japanese firms were found to believe JVs presented the best opportunities for FDI in emerging markets. Although American firms were least likely to invest in JVs even in emerging markets, overall sixty percent of the CEO respondents from all countries preferred JVs for expansion into foreign emerging-markets. In emerging markets, JV was thought to be a better option for foreign firms to enter industries like heavy manufacturing. These findings remind us that JVs still represent an important option for MNCs in the years to come. Nonetheless, MNCs probably need to adopt a clear mind and judge the values of SFJVs in their macro-scale business plans. It should be borne in mind that making a right decision in China is a journey to an end, not the end *per se*.

IV. CONCLUDING REMARKS

This article has suggested that the dynamic situation in China means that it would be unwise for MNCs to make once-and-for-always decisions about the form their investments into China should take. We have also tried to generate insights within the black box of the *Dynamic Positioning Model* (see Figure 3). On the basis of this dynamic picture we have suggested the basis for a new model of decision-making about modes of business ownership, addressing the main factors involved in the decision-making process. The decision about modes of operation should ideally rest on a consideration of the four factors we have discussed at length earlier. The model, however, may need to be developed in future by incorporating the economic policy changes in China, the sizes of MNCs (entering China), the locations of WFOEs and/or EJVs in China, the experience of MNCs in China business, and their experience and knowledge. Further work is needed in all of these areas, at least, to establish a truly dynamically positioning model of SFJVs in China. (See figure 3).

When China enters the WTO as now seems on the cards, the choice of MNCs' entry-mode into China in future will be critical. All things considered, as we have argued, WFOEs may be the preferred choice but SFJVs may still retain advantages. In some cases, *hybrid* entry-modes may carry certain advantages and it would be unwise to reject out of hand the strategic choices that consist of either one pure form (EJV or WFOE) or mixes of options. Since many uncertainties remain regarding China's entry into the WTO, it is likely most multinationals have their strategic options open at this stage.

Notes:

1. After 1986, EJVs and WFOEs gradually enjoyed similar (or even the same) taxation privileges and corporate liabilities, followed similar foreign exchange rules and comparable import/export regulations for licensing, quotas and duties. Compared to EJVs, WFOEs also take less time to establish and do not require the establishment of a Board of Directors.

2. E.g. news media, broadcasting, movie making, tourism, education, medical services, post and telecommunications, construction and operation of most infrastructure projects, mining of certain minerals, etc.

3. Companies with an Investment Nature by Foreign Investors Tentative Provisions.

4. An off-duty arrangement where a SOE laid-off employee is called "off-duty" for up to three years, during which he or she still receives subsistence stipends and awaits a new job. If there is no job for him/her after three years, he or she is deemed officially unemployed. Recently, the China government even announced that it decided to accelerate the SOE reforms by abolishing the *xiagang* system by 2003. That is, the surplus employees are to be classified as 'unemployed' immediately after they are laid-off, rather than using any euphemisms.

5. Before or at the outset of reforms, MNCs entering China without forming JVs usually established Representative Offices for daily liaison-work to set the path for future entry.

6. E.g. FESCO could hire the targeted staff identified by the Representative Office on behalf of the latter or the latter's JVs, or transfer its well-trained staff to MNC's JVs or holding companies.

7. E.g. Negotiate on foreign companies' behalf to help purchase necessary production materials or get services.

8. The co-existence of *Arthur Andersen (Shanghai) Business Consulting Co. Ltd.* (a WFOE in Shanghai) and *Arthur Andersen – Hua Qiang* (a JV in Beijing with Ministry of Finance) supplement each other in providing a complete service-package of international quality to their customers in China.

Table 1

Foreign firms	**Chinese firms**
• China is a new foreign market	• Government objectives *: - To attract foreign investment - To increase efficiency - To create jobs
• Big potential market	• Access to technology and skills *
• Already have presence in other parts of the world	• Modern management skills *
• Competitor pressure	• Export opportunity *
• Sales in China help business lines in other countries	

Source: Daniels et al, 1985

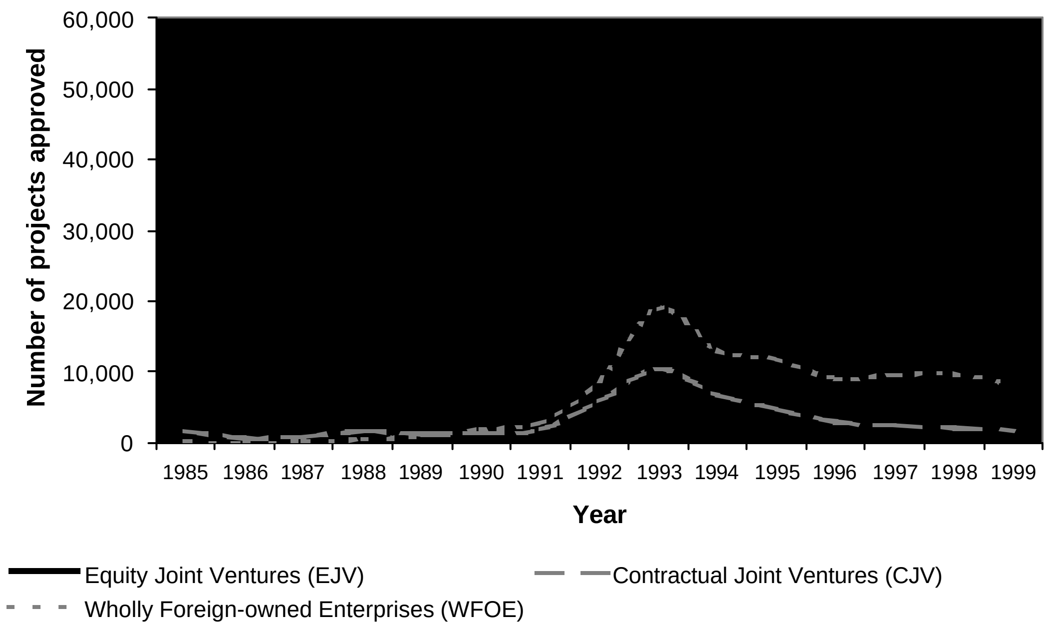
Table 2

	Mode of Operation					
	SFJV			**WFOE**		
Factors	Early 1980s	Early 1990s	Late 1990s	Early 1980s	Early 1990s	Late 1990s
Government Policy	++	++	++	--	- to N	N to +
Chinese Management Practice	++	+	N to +	-	- to N	+
Chinese HR Practice	+	--	N	N	+	++
Nature of investment	++	+	N	-	N	+

Legend (whether the factor favors, stands neutral or goes against the mode of operation):

++ Highly favored + Favored N Neutral - Against -- Highly against

Figure 1. Mode of Foreign Direct Investment in China



(Source: China State Statistical Bureau, 1985-1999)

Figure 2 The Changes of Factors affecting the choice of ownership

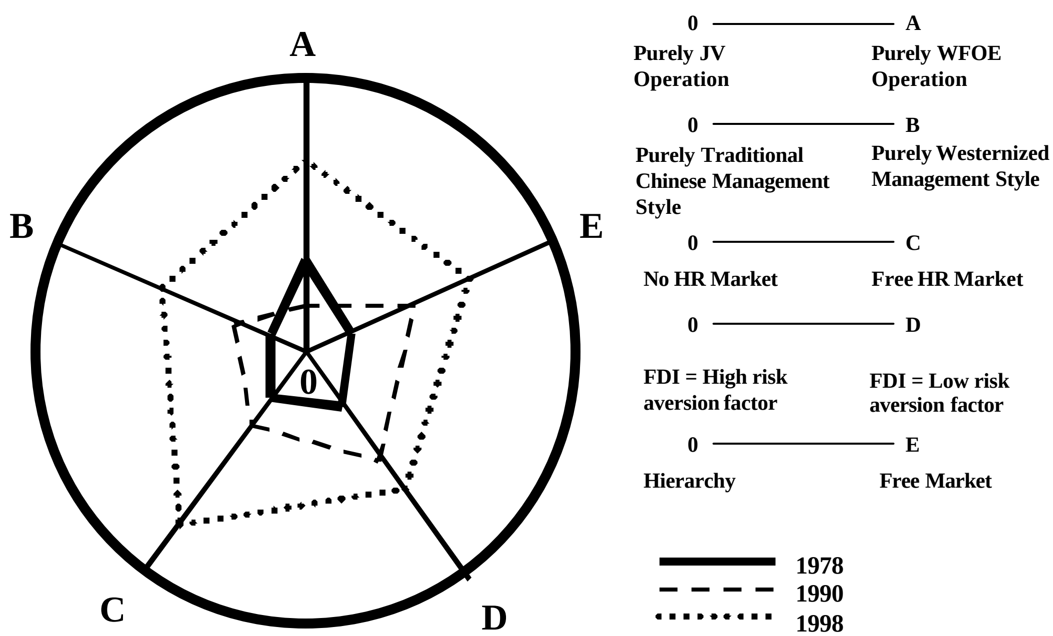
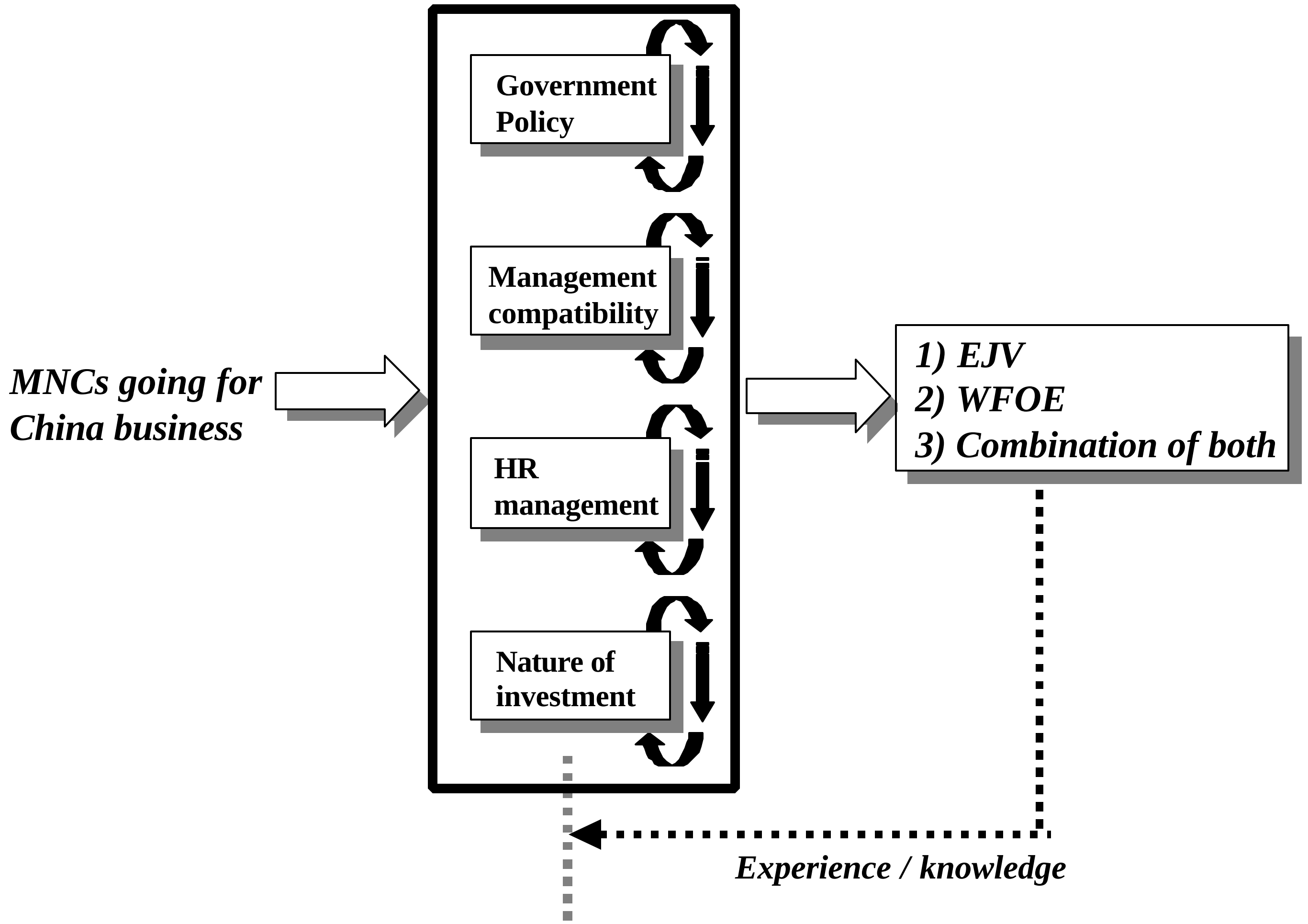


Figure 3 Model of Decisions on Operation-modes



REFERENCES

Anderson, Erin and Gatignon, Hubert (1986). Modes of Foreign Entry: A Transaction Cost Analysis and Propositions. *Journal of International Business Studies*, Vol. 17, Fall, pp1-26.

A.T. Kearney (2000). *FDI Confidence Index, Global Business Policy Council*. January 2000, Vol. 3, Issue 1.

Beamish, Paul W (1988). *Multinational Joint Ventures in Developing Countries*. Routledge.

Beamish Paul W. and Banks, John C (1987). Equity Joint Ventures and the Theory of Multinational Enterprise. *Journal of International Business Studies,* Summer, pp1-16.

Bu, Nailin and Xu, Ji-Liang (2000). Work-Related Attitudes among Chinese Employees, in M. Warner (ed) *Changing Workplace Relations in the Chinese Economy*. London: Macmillan, pp185-204.

Chen, Min and Martin, David. W (1996). Mountains of Gold. *The China Business Review*, May-June, 1996, pp26-29.

Child, John (1998a). *Management and Organisations in China: Key Trends and Issues*. Chinese Management Centre CMC, School of Business, The University of Hong Kong, Working Paper: CMC1998-004-01, September.

Child, John (1998b). PRC Investment Control: Exploding the Myths. *China Direct Investor*, August, pp10-15.

Child, John (1994). *Management in China During the Age of Reform*, Cambridge University Press.

Child, John and Xu, Xinzhong (1991). The Communist Party's Role in Enterprise Leadership at the High-Water of China's Economic Reform. *Advances in Chinese Industrial Studies*, Volume 2, pp69-94.

China Daily (1999). *New jobs important for China's future,* New York, 13 November.

China Daily (2000). *JVs attract foreign capital*, New York, 26 November.

China Joint Venturer (1995a). Arthur Andersen launches two-pronged attack. *China Joint Venturer*, September, Volume 2, Issue 1, pp16-19.

China Joint Venturer (1995b). Do You Need a Partner in China? *China Joint Venturer*, October, Volume 2, Issue 2, 1995, pp3-5.

China Joint Venturer (1995c). Using Your Rep Office to Staff JVs. *China Joint Venturer*, October, Volume 2, Issue 2, pp10-11.

China Joint Venturer (1996a). From FESCO Contract to Direct Employment. *China Joint Venturer*, June, Volume 1, Issue 2, pp20-23.

China Joint Venturer (1996b). Foreign partners strive for complete control. *China Joint Venturer*, September, Volume 2, Issue 1, pp1-6.

China State Statistical Bureau (1985-1999). *China Foreign Economic Statistical Yearbook*. China Statistical Publishing House. (in Chinese)

Chinaonline (2000). *No work, no pay: China to end subsidized off-duty status for laid-off workers by 2003*, July 24.
http://www.chinaonline.com/issues/…l/currentnews/secure/C00072006.asp

Chinaonline (2001). *Shanghai-VW is again No. 1 on charts of top-500 foreign firms*, January 10.
http://www.chinaonline.com/topstories/010110/1/B101010849.asp

Choi, Alan (1998). Local recruitment seen as critical to success. *South China Morning Post*, August 13, Business Post, pp3.

Daniels, John D., Krug, Jeffrey and Nigh, Douglas (1985). U.S. Joint Ventures in China: Motivation & Management of Political Risk. *California Management Review*, Volume XXVII, No. 4, Summer, pp46-58.

Davidson, William H (1987). Creating & Managing Joint Ventures in China. *California Management Review*, Vol. XXIX, Number 4, Summer, pp77-94.

Ding, Daniel Z., Goodall, Keith and Warner, Malcolm (2000). The 'End of the 'Iron Rice Bowl' which Chinese HRM?', *International Journal of Human Resources Management*, Vol. 11, No. 2, pp217-236.

The Economist (2001). Enter the Dragon, *The Economist*, 10 March, pp25-27.

Gomes-Casseres, Benjamin (1989). Joint Ventures in the Face of Global Competition. *Sloan Management Review*, Spring, pp17-26.

Goodall, Keith and Burgers, Willem (1998). Frequent Fliers. *The China Business Review*, May – June, 1998, pp50-52.

Goodall, Keith and Warner, Malcolm (1997). Human Resources in Sino-Foreign Joint Ventures. *International Journal of Human Resource Management*, Vol. 8, No. 6, pp569-594.

Grub, Phillip D and Jian, Hai Lin (1989). Open Door or Squeezing through the keyhole: U.S. Joint Venture Experience in China. *The Mid-Atlantic Journal of Business Review*, Volume 25, Number 2 & 3, January, pp21-33.

Hsieh, Tsun-yan., Lavoie, Johanne and Samek, Robert A. P (1999). Think Global, Hire Local. *The McKinsey Quarterly*, Number 4, pp93-101.

Killing, J. Peter (1983). *Strategies for Joint Venture Success*. New York: Praeger.

Laaksonen, Oiva (1988). *Management in China during and after Mao*. Walter de Gruyter.

Liu, Zhiqiang (2000). The Nature of China's Economic Growth in the Past Two Decades. *Post-Communist Economies,* Vol. 12, No. 2, pp201-214.

Luo, Yadong and Chen Min (1996). Managerial Implications of Guanxi-Based Business Strategies. *Journal of International Management*, Vol. 2. No. 4, pp293-316.

Luo, Yadong and O'Connor, Neale (1998). Structural Changes to Foreign Direct Investment in China: an evolutionary perspective. *Journal of Applied Management Studies*, Vol. 7, No. 1, June, pp95-109.

Melvin, Sheila (2000). Human Resources Take Center Stage. *The China Business Review*, November – December, pp38-49.

Perez, Javier., Meier, Johannes and Woetzel, Jonathan (1995). MNCs In China. *The McKinsey Quarterly*, Number 2, pp21-33.

Perkins, Anthony and Shaw, Stephen. M (2000). What the WTO really means for China, *The McKinsey Quarterly*, Number 2, pp128-131.

Podolny, Joel., Roberts, John and Chen, Xiao (1999). *Lucent Technologies in China*. Case study (S-1-18) of Graduate School of Business Stanford University. (in Chinese)

PriceWaterHouse (2000). Revised WFOE Law and CJV Law. *China Tax/Business News Flash*, 24 November.
http://www.pwcglobal.com/extweb/manissue.nsf/DocID/15E11C8FA3DE5939852569A100331864

Ralston, David A., Egri, Carolyn P., Stewart, Sally., Terpstra, Robert H. and Yu, Kaicheng (1999). Doing Business in the 21st Century with the New Generation of Chinese Managers: A Study of Generational Shifts in Work Values in China. *Journal of International Business Studies*, 30, 2, Second Quarter, pp415-428.

Root, Franklin. R. 1994. *Entry Strategists for International Markets.* Lexington Books.

South China Morning Post (2000). *Chemical giants sign deal after years of talks*, December 9, Business Post, pp2.

South China Morning Post (2000). *Citic Pacific unit in talks on mainland telecoms service*, December 16, Business Post, pp1.

Si, Steven X. and Bruton, Garry D (1999). Knowledge Transfer in International Joint Ventures in transitional economies: The China experience. *The Academy of Management Executive*, Feb, Vol. 13, Issue 1, pp83-90.

Sutter, Karen (2000). Investors' Growing Pains. *The China Business Review*, November-December, pp14-21.

TDC (2000). *WTO Accession*. Hong Kong Trade Development Council, http://www.tdctrade.com/main/china.htm#7

Tse, David K., Pan, Yigang and Au, Kevin Y. (1997). How MNCs Choose Entry Modes and Form Alliances: The China Experience. *Journal of International Business Studies*, Vol. 28, Issue 4, Fourth Quarter, pp779-805.

Vanhonacker, Wilfried (1997). Entering China: An Unconventional Approach. *Harvard Business Review*, Mar/Apr, Vol. 75, Issue 2, pp130-136.

Wall, James A., Jr (1990). Managers in the People's Republic of China. *Academy of Management Executive*, Vol. 4, No. 2, pp19-32.

Warner, M (1992). *How Chinese Management Learn*, London: Macmillan.

Warner, M (1995). *The Management of Human Resources in Chinese Industry*, London: Macmillan.

Warner, M (ed) (2000). *Changing Workplace Relations in the Chinese Economy*, London: Macmillan, pp3-4.

Wong, John and Bökkerink, Marcus. B (1997). *Executing to Win in China*, The Boston Consulting Group, Inc.

Woo, Wing Thye (2000). China: Facing up to WTO Membership. *HKCER Letters*, No. 62, Nov/Dec., pp5.

World Bank, 1997. *China 2020: Development Challenges in the New Century*, Washington, DC, The World Bank.

WTO (2000) Special Report: The Real Work Begins. *The China Business Review*, January-February, pp17-27.

Xu, Xiangmin and Chew, Celina (1995). Foreign investment enterprises in China: A comprehensive guide to approval issues – Part I: Approval hierarchy, approval procedures and related problems. *East Asian Executive Reports*, Washington, November 15, Volume 17, Issue 11, pp9-13.

Yiu, Daphne W. and Makino, Shige (1997). *A Choice between Joint Ventures and Wholly –Owned Subsidiaries: A Test of Transaction Cost Theory and Institutional Perspective.* The Asia-Pacific Institute of Business, The Chinese University of Hong Kong, Working Paper: WP-98-03, December.

Zhang, Xiaoguang (1999a). Foreign Investment Policy, Contribution and Performance. In Wu, Yanrui (ed.) *Foreign Direct Investment and Economic Growth in China*, pp11-41, Edward Elgar.

Zhang, Zhaoyang (1999b). A Comparative Study of Foreign Direct Investment in China and Vietnam. *American Asian Review*, Vol. XVII, No. 2, Summer, pp117-151.

Zhao, Winston and Hu, Zaichi (1998). Perfect solitude: foreign investors go it alone. *China Direct Investor*, August, pp19-23.