A Study on the Tendency of Sole Proprietorship for American-Funded Investment in China and Our Countermeasures

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Abstract
In recent years, many well-known foreign-funded enterprises have accelerated their pace of sole-proprietorship in China. Among them, American-funded ones occupy a large portion of the market share. By means of stock expansion, capital increase and internal acquisition, more and more American partners in co-invested enterprises have managed to control the whole business after years of operation. If we identify the tendency of foreign-funded enterprises toward sole proprietorship and grasp the essence of it, we will be fully armed to improve the quality of using foreign capital in China and strengthen the core competence of Chinese enterprises. Thus, I here present the paper on the tendency of sole proprietorship for foreign-funded enterprises in China, taking the American-funded ones as the specification of the analysis, with a view to providing our countermeasures from the global perspective.

Keywords: American-funded investment, Sole proprietorship, Self-development

1. American-funded enterprises’ inclination to sole proprietorship in China

The economic and trade relations between China and the United States have been developing steadily and rapidly. Till now, the USA is the largest export market and the second biggest trade partner of China (Note 1). Attributing to China’s entry to WTO and the improvement of domestic investment environment, foreign-funded investment has experienced a new upsurge in China. Currently, China is one of the major sources of overseas profits for American enterprises. In 2005, the enterprises invested by the United States in China have seen actual profits of 9.7 billion U.S. dollars. At the same time, American corporations have continued to expand their market share in China through investment. In 2005, their sales within the Chinese market amounted to 77 billion U.S. dollars (Note 2). By the end of October 2008, the accumulated American investment in China had established 61,352 enterprises, and actual investment in China exceeded 67.2 billion U.S. dollars.

The prominence of American investment in China is due to its intensive technologies and scale effect. Having realized the great potential of Chinese market large transnational enterprises as GE, Motorola, Wal-Mart, and GM (Note 2) rush for the hot pie. They re-layout their production base in China by undertaking some large projects here. Apart from increasing scale of investment, they also adjust their business strategies. With a goal of business promotion in China, more and more American-funded enterprises make every effort to break away the form of joint ventures and achieve sole proprietorship. This can be done by means of internal acquisition, capital increase, stock expansion, and weakening the function of Chinese partners. It has become a remarkable feature of foreign-funded enterprises investing in China recently. Take specific examples in the American-funded investment, Johnson & Johnson and UPS have respectively changed the joint ventures in China into their child companies with sole proprietorship in 2005. All 8 branches of AIG China have achieved sole-proprietorship during AIG’s 13 years in China in flagrant defiance of the WTO regulations. DuPont, the giant of US Chemicals, materials and energy Corporation, has increased its capital and expanded its stocks to achieve complete control of joint ventures’ operation in China.

2. Reasons for American enterprises to seek sole proprietorship in China

The tendency of sole proprietorship for American-funded enterprises is not an accident, but a result of the changing
investment environment in China. It is not only a strategic response to the macro-environment of China, but also the adjustments of global strategies and enhancement of world competition. To be specific, the reasons can be summarized as follows:

2.1 Improvement of investment environment in China

Entry of WTO marks a turning point for foreign investment in China. Since then, China has been trying to adjust domestic investing rules in accordance with that of international practices. Data from the States Economics and Labor Ministry suggests that the total investment of American will surpass 10 billion USD in 2008.

According to the Law of the People's Republic of China on joint Venture Using Chinese and Foreign Investment issued in 1979, the proportion of foreign capital in joint venture must be less than 50%. However, as time goes by, China has enacted laws and regulations to ease this condition in order to make better use of foreign capital. In 2002, the Catalogue for the Encouragement of Foreign Investment Industries canceled the discriminations to joint ventures and sole proprietorship in exchange rate and taxation, further weakening the restrictions on foreign investors' sole proprietorship (Note 4). Similarly, many restrictions on rate of localization and the proportion of export are gradually canceled by revising the Law of the People's Republic of China on joint Venture Using Chinese and Foreign Investment and other relevant laws. And this inspired the enthusiasm of American enterprises to seek sole proprietorship. From then on, they invest more in China, expand stocks to obtain the control of joint ventures or even establish sole-owned child enterprises. To name a few, Lancôme has shut down more than a dozen and Coca-Cola and Starbucks have bought out their Chinese partners. Unable to buy out its partner, HSBC is hedging its bets by pursuing local incorporation, investing more in China, expand stocks to obtain the control of joint ventures or even establish sole-owned child enterprises. To name a few, Lancôme has shut down more than a dozen and Coca-Cola and Starbucks have bought out their Chinese partners. Unable to buy out its partner, HSBC is hedging its bets by pursuing local incorporation, something only recently allowed. Besides, plus the accumulated information of Chinese economy and politics, American enterprises can schedule the operations in China independently without business support from their Chinese partners, which again decreases the advantages of American-China joint ventures. Due to the betterment of Chinese investment environment, American enterprises can thus expand their business scope.

2.2 The conflicts between partners in joint venture

In the early days, American enterprises, just as most transnational enterprises, have chosen joint venture as their form of investment. For one thing, American enterprises can learn the cultural and economic environment from their Chinese partners. For another, the joint venture can benefit from local governments' favorable policies on taxation and land. When American Johnson & Johnson has entered Chinese pharmaceutical market in the year 1985, because of unawareness of Chinese investment and operation rules and activities, they have chosen Shanghai Pharmaceutical Corporation, the largest production base for medicine in China, and Xian-Janssen, the biggest sales center in China to construct a joint venture. Then, as Johnson & Johnson is engaged in Chinese market, it makes best use of channels hold by Shanghai Pharmaceutical Corporation to market its health products and achieves a great prosperousness. From then on, Johnson & Johnson begins its more than 20-year legend in China. In this sense, the joint venture has played a significant role in the early days of American-funded investment in China.

However, the inherent characteristics of joint venture and the inevitable conflict between the two partners have somehow foreshadowed its finishing destiny. On one hand, American partners hope that the joint ventures in China can well serve their global operations while Chinese partners focus on their regional interests. On the other, American enterprises prefer to control the joint venture but they are not familiar with the taste of Chinese customers. In most cases, they introduce top managers from the US into the joint venture but the new administration usually can not work in China. As a result, they fail to win the heart of Chinese partners. This in turn triggers conflicts. As the partners have different opinions for administration and control, plus different cultures and languages, the conflict will escalate into fierce competition and then to separation. No matter what it is the prosperousness and decline of Sino-trans, the conflicts between the Chinese partners and American-funded enterprises are prominent, which speeds up the death of joint ventures.

2.3 Requirements of technological monopoly and secrecy guarding

From the above examples and analysis, we may draw a simple conclusion that most American-funded enterprises in China are large-scale manufacturers. Up till late 2007, 76% American-funded enterprises in China are in the industry field, especially in electronic and transportation; chemical and machinery manufacturing industry come next.

In the industry field, technology is the most competitive advantage for American-funded investment in China. And technological monopoly is what they are aiming at. Nowadays, global resources are more and more integrated for American enterprises and investment structure in China is optimized gradually. Under this condition, American enterprises are able to transform from labor-intensive ones initially to capital-and-technology-intensive ones with high added-values. Because technology is the competence of the latter product, it is the key to win global competition to
government should also make best use of relevant rules of WTO to protect the infant industry against harms from sole
proprietorship. Besides, we should adjust the foreign investment to protect the independence of China economy by
manufacture, and chemical industry. Because of it, American enterprises might drive Chinese enterprises in relevant
industries out of business. Therefore, China government should constitute the law of anti-monopoly, avoiding American
means of restricting foreign sole proprietorship as much as possible in the backbone industries (such as military,
machinery, electronics, petroleum, and chemical industry) that can affect economic safety and national economy. At the

In order to survive in the severe market competition, enterprises have to invest more capital to input more in product
differentiation, to enlarge the scope of products, and to increase the functions of products, all of which demand for
amounts of capital. Despite the fact that China has become far more open legally because of commitments made to
WTO as a condition of membership, its hunger for foreign investors has been sated. The availability of labor and land
has fallen, domestic capital is abundant, the local market is now understood to be among the most attractive in the world
and sentiment has become more nationalistic and self-satisfied. So there is less interest in providing access to foreign
partners.

Soap and consumer products titan Procter and Gamble used the joint venture to launch its Chinese operations in 1988.
The US group began with a stake of 69 percent but restructured the deal in 1997 to take ownership of 80 percent. The
separation was largely because of litigation between P&G and its original partner Hutchison Whampoa Limited (HWL).
The focus of the litigation was that whether P & G had the right to extra-charge tech-support fees to improve its
research and development and strengthening its laundry service. P&G then paid 1.8 billion US dollars to buy out its
partner in its China business. The company has taken full ownership of the venture by snapping up the remaining 20
percent stake. In fact, Chinese companies are happy to receive money and technology, but do not want to be mere
adjuncts to foreign firms; in many cases they have large, often global, ambitions of their own. Too often the allocation
of profits and investments was unclear, leading to endless squabbling. Therefore, the enhancement of market
competition adds to the ambition for American-funded transnational enterprises to take the full ownership of their
China-based companies.

3. Countermeasures of China in face of the tendency

The technology-intensive US-funded enterprises in China serve as one of important sources of high technologies.
However, once they step into the road of sole proprietorship, the American partners will enhance the control of
technology, what will significantly block the Chinese enterprises’ way of learning advanced technology from the US.
Besides, as those enterprises centralize their resources in China and try to achieve efficient operation, sole
proprietorship of foreign-funded investment might result in squeezing out Chinese medium-and small-sized enterprises
in relevant industries and forming market monopoly and industrial control.

In face of the tendency of sole proprietorship for American-funded investment in China and the negative effects it
brings, we can do something to respond in order to improve the quality of foreign capital utility in China and strengthen
the core competence of Chinese enterprises. To be specific, Chinese government and enterprises should work hard at the
following aspects:

3.1 To revise laws and regulations on foreign-funded investment

Obviously, American enterprises possess strong competence in fields of electronics, transportation, industrial machinery
manufacture, and chemical industry. Because of it, American enterprises might drive Chinese enterprises in relevant
industries out of business. Therefore, China government should constitute the law of anti-monopoly, avoiding American
enterprises’ industry monopoly in the process of sole proprietorship and potential hurts to domestic enterprises. The
government should also make best use of relevant rules of WTO to protect the infant industry against harms from sole
proprietorship. Besides, we should adjust the foreign investment to protect the independence of China economy by
means of restricting foreign sole proprietorship as much as possible in the backbone industries (such as military,
machinery, electronics, petroleum, and chemical industry) that can affect economic safety and national economy. At the
same time, we should encourage foreign investors to invest more in modern manufacture, service industry, and high-tech industry, helping the development of Chinese enterprises.

3.2 To invest more on R&D and encourage technological innovation

“Science and technology are the primary productive forces.” As a result, Chinese government should invest more on the self-development of native enterprises. Similarly, enterprises are suggested to set up R&D institutions, improve the capability of self innovation, and develop new product with self intellectual property to confront the compact from American technological monopoly. The essence here lies on the consciousness of self innovation. Furthermore, Chinese enterprises should transfer from the Origin Entrusted Manufacture to conceptual innovation in production. If Chinese enterprises can form their own core technology, brands with complete intellectual property will drive the upgrade of domestic industrial structure.

3.3 To enhance the strategic alliance

Empirical study suggests that modern competition usually takes place between large corporate groups. In order to occupy a world position and compete with those transnational enterprises, Chinese domestic enterprises should enhance the strategic alliance. A successful example of strategic alliance is that of home appliance, when TCL established alliance with Sony to produce and manufacture LCD in 2003. By this way, domestic enterprises can integrate the separate resources in China and push the technological communication and innovation in alliance. Besides, it can help to achieve economies of scale and improve the comprehensive competence of Chinese industry, enhancing domestic enterprises’ strength to fight with foreign capital giants. The sole proprietorship of American enterprises does not mean a separation between American enterprises and domestic enterprises. They just adopt a more flexible way to choose their cooperate partner. Strategic alliance will serve as an ideal mode for Sino-US cooperation, which can help enterprises sustain flexibility in operation mechanism and high effectiveness in resources utility. Chinese enterprises should make best use of strategic alliance and absorb American enterprises’ advanced technologies, business management, and brand strategies in cooperation to enhance their capability of self-innovation and core competence.

References


Characteristics and Trend of Recent American Investment in China, 2008(3).


Notes


Note 2. Speech made at the China-US Trade and Investment Cooperation Seminar by Mme. Ma Xiuhong, Vice Minister of Commerce.

Note 3. List of foreign investment enterprises in China.


<table>
<thead>
<tr>
<th>Name of transnational enterprise</th>
<th>Enterprises acquired by transnational enterprise</th>
<th>Original proportion of stocks hold by foreign investors</th>
<th>Present proportion of stocks hold by foreign investors</th>
<th>Time of acquisition</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>American DuPont</td>
<td>Dongguan DuPont</td>
<td>50%</td>
<td>87%</td>
<td>1995</td>
<td></td>
</tr>
<tr>
<td>American DuPont</td>
<td>Shanghai DuPont</td>
<td>30%</td>
<td>100%</td>
<td>1996, 1998, 2005</td>
<td>55%, 70%, 100% respectively in three years</td>
</tr>
<tr>
<td>American DuPont</td>
<td>Dongying DuPont</td>
<td>85%</td>
<td>100%</td>
<td>2006</td>
<td></td>
</tr>
</tbody>
</table>

Figure 1. American DuPont’s capital increase and stocks expansion in China


<table>
<thead>
<tr>
<th>Year</th>
<th>number of projects</th>
<th>contract amount($10 thousands)</th>
<th>real amount($10 thousands)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>USA</td>
<td>the whole</td>
<td>weight%</td>
</tr>
<tr>
<td>1996</td>
<td>2517</td>
<td>24555</td>
<td>10.25</td>
</tr>
<tr>
<td>1997</td>
<td>2188</td>
<td>21001</td>
<td>10.42</td>
</tr>
<tr>
<td>1998</td>
<td>2238</td>
<td>19799</td>
<td>11.3</td>
</tr>
<tr>
<td>1999</td>
<td>2078</td>
<td>16918</td>
<td>11.99</td>
</tr>
<tr>
<td>2000</td>
<td>2609</td>
<td>22347</td>
<td>11.67</td>
</tr>
<tr>
<td>2001</td>
<td>2696</td>
<td>26140</td>
<td>9.97</td>
</tr>
<tr>
<td>2002</td>
<td>3363</td>
<td>34171</td>
<td>9.84</td>
</tr>
<tr>
<td>2003</td>
<td>4060</td>
<td>41081</td>
<td>9.88</td>
</tr>
<tr>
<td>2004</td>
<td>3975</td>
<td>43664</td>
<td>8.99</td>
</tr>
<tr>
<td>2005</td>
<td>3741</td>
<td>44001</td>
<td>8.05</td>
</tr>
<tr>
<td>2006</td>
<td>3206</td>
<td>41473</td>
<td>7.73</td>
</tr>
</tbody>
</table>

Figure 2. American-funded investment in China (1996-2006)

Figure 3. Catalogue of American investment in China

Notice: Some enterprises in this table fall into more than two sorts.

<table>
<thead>
<tr>
<th>Industry</th>
<th>Joint venture</th>
<th>Sole proprietorship</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tools, Industry, Equipment Manufacture</td>
<td>89</td>
<td>71</td>
<td>160</td>
</tr>
<tr>
<td>Electronics, Transportation</td>
<td>108</td>
<td>53</td>
<td>161</td>
</tr>
<tr>
<td>Chemical Industry, Medicine</td>
<td>91</td>
<td>32</td>
<td>123</td>
</tr>
<tr>
<td>Service Industry</td>
<td>25</td>
<td>56</td>
<td>81</td>
</tr>
<tr>
<td>Agriculture, Food</td>
<td>14</td>
<td>9</td>
<td>23</td>
</tr>
<tr>
<td>Agriculture, Environment Protection</td>
<td>34</td>
<td>38</td>
<td>72</td>
</tr>
<tr>
<td>Textile, Leather, Ornament</td>
<td>7</td>
<td>12</td>
<td>19</td>
</tr>
<tr>
<td>Information technology, Office Appliance, Toys</td>
<td>15</td>
<td>9</td>
<td>24</td>
</tr>
<tr>
<td>Art works, School Appliance, Precision Machine</td>
<td>14</td>
<td>5</td>
<td>19</td>
</tr>
<tr>
<td>Paper, Package Industry</td>
<td>10</td>
<td>13</td>
<td>23</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>407</strong></td>
<td><strong>298</strong></td>
<td><strong>705</strong></td>
</tr>
</tbody>
</table>