International Journal of Business and Management
www.ccsenet.org/journal.html
Vol. 4, No. 9
September 2009

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 77billion 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.

Insert Figure 1 here

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.

Insert Figure 2 here

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, 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.

Insert Figure 3 here

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 protect technology. Form of joint ventures will hardly avoid sharing technology with Chinese partners, thus harming American monopoly.

When it comes to technological competence in product, the development and research center is the front of enterprises. Since 2000, American enterprises have begun to build R&D institutions in China. Intel, the head of high-tech industry, has acquired stakes in more than 70 companies on the mainland and in Hong Kong. The company established a $200 million fund for China in 2005, which has already been fully invested. This year, Intel Corp's venture investment arm created a $500 million fund on April 7th, 2008, to invest in China's technology start-ups, in a fresh move to expand in the country's booming hi-tech sector (Note 5). UPS, the world number one in logistics and express delivery, spent $180 million before the Olympics to relocate its intra-Asian logistics hub to Shenzhen given the growth in shipping along the southern rim of China. Many other American enterprises have successively set up research and development centers, including GE' mobile telecom high-tech center, SAP (China) coordinated commercial program center, Microsoft's MSIT-China research and development center in Shenzhen, GM's research and development center in Shanghai.

As intellectual right and secrecy is vital in technology, sole proprietorship is a better way for American transnational enterprises investing in China. Therefore, American-funded enterprises in China have tried to seek sole proprietorship or achieve stock-controlling by means of capital increase, internal acquisition, and stock expansion. If not in the form of sole proprietorship, technology secrecy may be released by partners or intellectual property may not be guaranteed.

2.4 The enhancement of market competition

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.

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Notes

Note 1. *China statistical yearbook*. (1990-2007). National Bureau of Statistics.

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.

Note 4. Cui, Riming. (2005). *Transnational Enterprises. Operation and Management*. Beijing, China Machine Press.

Note 5. Yang Xunwen. (2005). Intel Integrates market in China. *Economic Observer*, July 14.

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

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

Resource: Jiang, Zhujin. (2007). Transnational Enterprises' Strategies of Investing in China, Beijing, China Financial & Economic Press.

Year	number of projects			contract amount($10thousands)			real amount($10thousands)		
	USA	the whole	weight%	USA	the whole	weight%	USA	the whole	weight%
1996	2517	24555	10. 25	691576	7327642	9. 94	344333	4172552	8. 25
1997	2188	21001	10. 42	493555	5100353	9. 68	323915	4525704	7. 16
1998	2238	19799	11. 3	648373	5210205	12. 44	389644	4545275	8. 58
1999	2028	16918	11. 99	601611	4122302	14. 59	421586	4031871	10. 48
2000	2609	22347	11. 67	800089	6237952	12. 83	436389	4071481	10. 77
2001	2606	26140	9. 97	751487	6919455	10. 56	443322	4687759	9. 48
2002	3363	34171	9. 84	815647	8276833	9. 85	542392	5274266	10. 28
2003	4060	41081	9. 88	1016147	11506999	8. 83	419651	5350467	7. 86
2004	3925	43664	8. 99	1216516	15347895	7. 93	394005	6062996	6. 50
2005	3741	44001	8. 05	1351150	18906398	7. 15	306123	6032469	5. 07
2006	3206	41473	7. 73	1204364	19372734	6. 22	288509	6302061	4. 55

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

Resource: Directory of American Investment in China. (2006), Trade Promotion Office of the Embassy of USA, Beijing.

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

Figure 3. Catalogue of American investment in China

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