

CHAPTER ONE

INTRODUCTION

1.1 AN OVERVIEW

China represents an increasingly attractive opportunity for trade and investment. “China fever” has gripped international business, including Malaysian interests. There is an element of “gold rush” mentality about it all. Widely held to be the world’s largest developing country and fastest growing economy, China is attracting high levels of foreign direct investment.

China’s vast population of relatively untapped consumers and its race to modernize its industries and infrastructure, combined with economic reform promoting free trade practices, make China alluring, if not irresistible to foreigners.

1.2 POPULATION

With a population of more than 1.2 billion, China is the market of tomorrow. A recent survey by Ernst & Young, of senior executives from 230 companies in the world’s top 100 companies by turnover, found that 64% were targetting China for the future.³¹ There is a frenetic pace of activity as trade missions,

politicians and companies from North America, Europe and South East Asia comb the Chinese countryside looking for opportunity.

1.3 ECONOMIC FUNDAMENTALS

Traditionally and historically, China has practised a closed-door policy, preferring to have minimal or no dealings with the “Kwai-Loh” or foreign devils. However with the 1978 official opening of China to the world, when economic reform was first introduced, China’s transformation over the last twenty years has been remarkable. A quiet upheaval has taken place in China’s economy that is benefitting millions of Chinese and thousands of foreign companies.

Since then, China’s economic reforms have generated double digit growth (10%) while state-owned and operated enterprises are collapsing.²⁰ In 1992, China’s economy grew at an average annual rate of 9%, whilst growth in GDP in 1993 was recorded at 13.2%, and estimated to grow at 11.5% in 1994.³⁶ However China’s economic success and high growth rates was accompanied by spiralling inflation.

Far from being a centrally planned economy, private, cooperative and foreign invested enterprises now account for just over 51% of China's gross industrial output. Although up-to-date statistics are difficult to come by, 1993 World Bank figures indicate that FDI into China totalled \$15 billion whilst Chinese statistics showed \$26 billion and the trend was continuing in the first half of 1994 with \$14.7 billion finding its way into China.³¹ Undisputedly, China was the largest recipient of foreign direct investment among the developing countries.

Aside from industrial output, consumer sales also attained double digit growth in 1991. China's rural industries soared 23% in 1991. Living standards which had doubled in the 1980's continued to rise³¹.

China in the 1990's finds itself in the ranks of the world's top ten exporters. Total trade, having tripled in ten years, is one-fourth of China's GNP. Both imports and exports rose at double digit levels in 1991. There was a substantial trade surplus (\$8.1 billion) in 1991, solid foreign exchange reserves (about \$30 billion) and a modest debt-service ratio (10%).²⁰

Market forces are being applied to more and more segments of the economy.

The pricing of more and more goods and raw materials is being determined by

the market. Import and export subsidies have been removed, forcing factories and trade organisations to become more efficient.

Wholesale markets in commodities (wheat, corn and timber) have opened and will be expanded. Shanghai, Guangzhou and Shenzhen now have modernized stock exchanges; other cities are expected to follow soon.²⁰

Experimentation goes on with transforming state-owned companies to shareholder ones. The emerging concept of landownership bears an uncanny resemblance to Hong Kong's colonial system of long-term land-use leases. Even the multi-tiered pricing system governing trade is being eliminated and China's currency is being floated freely.

The almost two decades of economic reform introduced by the late Deng Xiao Ping have moved China into a new era, to ensure that China's position as the next Asian economic superpower is no longer just a vision but a foreseeable reality.

1.4 THE POLITICAL REALITIES

Today it is almost as if there are 2 Chinas. The China of steel-fisted Communist party rule and the iron-rice bowl is still there. It remains uncompromisingly harsh on political dissent and other overt challenges to its authority. But it is being progressively whittled down by forces unleashed during nearly two decades of economic reforms. Another China has emerged - and is expanding day by day. It is a free-wheeling society. Almost unimaginable ten years ago, it is a China where ordinary citizens not only have a wealth of choices, but can take legal action if wronged. In short, after nearly half a century of Communist rule, a civil society has begun to take shape in the world's largest nation. With Communism virtually dead as the nation's guiding ideology, more and more Chinese are seeking their futures in the civil society.

A trend encouraging to foreign businesses is the emergence of provinces and large coastal cities as increasingly strong willed, autonomous entities. The standard image of China as a monolithic entity controlled entirely by the totalitarian whims of an aged group of hard liners is an increasingly simplistic one. Although the leadership continues to hold immense power and continues to be backed by the Chinese army (at least for now), it is evident that the centre is inexorably being eclipsed. The process of decentralization shows up in ways large and small. Governors are at the forefront of pushing reforms ahead and provincial leaders vetoed the previous Five Year Plan (1991-1995) several times

in its development stages until it left them sufficient room to manoeuvre around it.

Major trade and investment decisions have devolved to the cities and provinces. Enterprises large and small are making their own management and marketing decisions. Beyond the confines of the Beijing beltway, people are making their own plans, invoking a classic phrase out of China's past, "*The sky is high and the emperor is far away.*"²⁰

1.5 AN EXPANDING LEGAL FRAMEWORK

Over the past dozen years, vague legal guarantees have evolved into an extensive group of laws and regulations that provide increasing assurance that commercial rights will be protected. Even foreign law firms have been given the right to practise in China.

Supportive regulations were introduced in recent years to facilitate the establishment of wholly foreign-owned enterprises, modify the joint venture laws to allow greater foreign control and longer terms of duration, and to establish a unified tax code standardizing foreign income taxes. The 1988 "Personnel Opinion on Further Implementation of the Right of Autonomy of Joint Ventures," are of benefit to investors as it allows Joint Ventures to

conduct their employment affairs independently and in accordance with international practices.

International businessmen are also becoming more optimistic about China's protection of intellectual property rights, which had traditionally been a sore point. Steps were also taken to extend stronger protection to US producers of pharmaceuticals and agricultural chemicals and to promulgate trade secrets legislation.

The above examples and other agreements underline China's commitment to foreign participation in its economy as well as its growing willingness to recognize and abide by the rules of international commerce, thus inviting foreign investors. With ever-increasing trade and political links with the rest of the world, China has realized the need to enact statutes codifying business and legal practices.

However, bearing in mind the fact that "Rule by Man" has a considerably longer tradition than "Rule by Law", the enforcement of these laws is not yet uniform nor at a standard to which Westerners and other foreigners are accustomed to. Seemingly arbitrary rulings against particular foreign companies or even entire countries still occur, however, with no ready recourse available.³¹

1.6 OBJECTIVES OF THE STUDY

The primary objective of this study is to determine why Malaysian companies are attracted to China as a business destination. I would like to test the following research question :

- Is the potential offered by the vast Chinese consumer market the main determinant for Malaysian business involvement in China?

The secondary objective of this study is to evaluate the risk factors that may inhibit success for Malaysian companies in China. I would like to test the following research question :

- Are the legal framework and financial constraints the main risks faced by Malaysian business ventures in China?