CHAPTER FIVE

DISCUSSION ON FINDINGS

5.1 GENERAL PROFILE

The respondent companies in the survey were mostly private limited companies in the restaurant, retail and commercial sectors, mainly involved in joint venture operations with extent of business involvement in the range of RM 1,000,000 to RM 4,999,999, with involvement in the business from 1 to 3 years.

5.2 CHINESE CONSUMER MARKET AS THE MAIN DETERMINANT OF MALAYSIAN BUSINESS INVOLVEMENT IN CHINA.

The research findings infer that the potential offered by the vast consumer market is the single most influential critirea determining Malaysian business involvement in China.

Market potential rather than a proper business climate has become the top priority for investors in Asia and nowhere is this more true than in China, according to a report by the Political Economic Risk Consultancy. The report noted that China had received a level of investment which far exceeded every other country in Asia despite its ranking at the bottom for ease of doing business.

It cannot be denied that China's massive population of over 1 billion consumers represents a marketer's wildest dreams come true. This is attested to by Ron Cromie[31] in "Doing Business in China" where he states that according to the State Statistical Bureau, there are now well over 30 cities with population exceeding one million. The population of Southern China is over 300 million, comparable to The European Union. Guandong Province has 63 million, Beijing 11 million and Shanghai 13.5 million.[39] According to him, these are the priority markets to concerntrate on. China's economic reforms also had their greatest impact in Beijing, Shanghai, Guangzhou and the coastal cities. But he strongly stresses that their influence is spreading north and inland, bringing opportunities to second-tier cities.[31]

More than a million households now have annual incomes exceeding $100,000. And the number of Chinese approaching the threshold of a middle class lifestyle is expanding daily. Already some 100 million families earn more than RMB1,000 a year, the level at which consumer spending begins to accelerate. On current trends, their ranks could triple by year 2000.[31]

In Shanghai, Ghangzhou and the coastal regions that lie between the cities, Ron Cromie points out that average household income of anywhere between $2,500 - $4,000 is not unusual.[31]

The new found affluence is clearly relected in China's retail sector. By the year 2000, China's annual retail sales are projected to reach $600 billion. Department stores display a wide array of consumer goods such as personal care products, packaged food products and electronic and household products. Traffic through many of China's big stores is well over 100,000 daily.[31]

While incomes in China may seem low by Western standards and in comparision with the more developed economies in Asia Pacific, the proportion of disposable income is high and so are savings. Private savings equate to approximately 1/3 of the average worker's annual income. Basic living costs such as transport, rent, education and medical care, for most Chinese are heavily subsidized and such living expenses take up only 5 per cent or less of family income in China. And in addition, very few Chinese individuals pay any sort of direct income tax.[31]

Therefore it is in urban China where one finds real consumer spending power and hence tremendous market potential, at least in most product categories.

Chinese consumers are also becoming quality and status conscious and this can be linked to the more traditional attribute of Chinese consumer's preoccupation with "face", message, image, public expression of owner's success and standing in society. In the past Chinese were contented with "Flying Pigeon" bicycles and "Butterfly" sewing machines. Today the rising middle class settle for

Matsushita, Compaq, Rolex, Cardin and Channel. Foreign and joint venture products are perceived as quality items with significant status value, and often fetch double or triple the price of goods produced solely by Chinese firms. Since 1990, national retail sales have reisen by 11% annually, hitting the $2billion mark in 1995.[31]

Of significance is also the fact that China's population is still relatively young, with the nationwide average age being barely 28. These young urbanites are incredibly forward looking, confident, optimistic and risk takers, willing to try new product concepts and brands with a tendency to leapfrog the product experience of their counterparts in the more mature market. For these young consumers, especially from Southern China, Hong Kong and Taiwanese lifestyles and products provide critical role models whereas in more sophisticated Shanghai and Beijing markets, overseas styles and culture provide more important cues for consumer behaviour.

However, the author is inclined to concur with Ron Cromie that approaching China as one big monolithic market is a mistake. Altogether there are some 30 provinces or administrative regions in China, and it would more prudent to view it as a patchwork of local and regional markets, each a consumer market in its own right. The reason being the population is widely dispersed and there are pronounced regional variations in factors such as culture, dialect, way of life, climate, fashion, population, income levels, purchasing power and diet.

5.3 LEGAL FRAMEWORK, TECHNOLOGICAL STANDARDS AND INFRASTRUCTURE AS INFLUENTIAL CRITERIA FOR MALAYSIAN BUSINESS INVOLVEMENT IN CHINA.

From the research findings it is evident that the Malaysian companies involved in China are of the opinion that the legal framework, technological standards and infrastructural facilities in China leave much to be desired. As such it can be concluded that their business involvement in China is influenced by these factors.

5.3.1 LEGAL FRAMEWORK

It is a generally well established fact that a major complaint among foreign investors is China's weak and rather ambiguous legal system. Prior to 1978, there were not many laws in the history of China. It was not until China adopted its open door policy that economic laws were introduced from 1979. "As a result until today the concept of commercial law is still weak in the minds of many Chinese officials as they have not been exposed to such developments" explains Zhuang Zhongzi, General Manager and Director of China Legal Service (HK) Ltd. in an interview last year with a local magazine "Malaysian Industry".[23]

The matter is further compounded by the fact that China is such a large country with the largest population in the world. Hence actual conditions and the cultural developments vary from province to province, likewise the level of understanding of the various legislation are also different, thus making enforcement of laws tougher than in other countries.

According to Zhung of China Legal Services[23]there is confusion among investors on the definition of law in China. He says laws are those established by the National People's Congress while regulations & rules are those drawn up by the Administration Councils and the departments of the provincial governments. As such the author is of the opinion that the rules and regulations must be consistent with the national laws, if foreign investors are to be attracted to do business in China.

Since China ended its closed door policy, its volume of export trade has rapidly increased. The administration of foreign trade established in the days of the planned economy has not completely changed, however. State-owned foreign trade enterprises still control imports and exports, implement government policies and hold "official trader" status. In addition the Chinese government pursues some trade protectionist measures under the pretext of protecting national industries under the guise of the Custom Duties and Import Permit System.

5.3.2 TECHNOLOGICAL STANDARDS

There is still so much room for the development of technological standards in

China. Although they prefer to acquire it in the context of joint ventures, the Chinese continue, to import technology in the form of licensing, technical services, co-production and technical consulting services. Outright purchases of technology have been sporadic in recent years. China which is indeed a backward Third World economy, which as it races to enter the age of the microchip and information highway, has barely begun driving into the age of the auto, according to Arne J De Keijzen in "China: Business Strategies for the '90s".[20]

Karl Shoenberger[17] reports that despite its drawback, China is proving irresistibly attractive to the world's most advanced technology companies, such as Motorola, Northern Telecom, Philips, Ericsson and many others. These companies believe in the prospect of an enormous shift in the high tech world's centre of gravity, sometime in the 21st century to China.

President Jiang Jemin, hand-picked successor following the demise of Deng Xiao Ping, is a Soviet-trained electrical engineer who understands the critical importance of technology to China's future prosperity. However, in the end China's place in the global high-tech hierarchy will depend on its ability to restructure its inefficient economy. But it also hinges in no small part on the size and nature of the investment made by the foreign powerhouses now hurrying into this promising but risky new territory.[17]

5.3.3. INFRASTRUCTURAL FACILITIES

Arne J De Keijzer, in "China:Business Strategies for the '90s" again deals China a further blow when he points out that transportation services in China are still rudimentary. Transport services here include railways, highways, water and aviation. He further reiterates that China's antiquated telecommunications infrastructure is a serious impediment to broad scale modernisation. And although significant advances have been made by the government, nevertheless growth has been unable to keep pace with the demands made by the advancing economy, creating some serious bottlenecks to future growth.

The author is of the opinion that the success of the economic reforms ultimately depends not only on a strong agricultural sector and a productive industrial base, but on the ability of China's leaders to adequately exploit latent energy and raw material resources and develop a transportation and communications infrastructure that ties them all together.

Hence the Chinese government needs to intensify its efforts to upgrade the infrastructural facilities, raise the technological standards and accelerate its efforts to formulate laws which are more acceptable and conducive to foreign business involvement in China.

5.4 THE ROLE OF THE GOVERNMENT AND GOVERNMENT POLICIES AS INFLUENTIAL CRITIREA FOR MALAYSIAN BUSINESS INVOLVEMENT IN CHINA

From the wide disparity of responses to the nine statements indicated in this cluster of the survey findings, it is quite apparent that the above factors were somewhat neutral as critirea in determining the respondent companies decision for business involvement in China.

It has been often quoted that power, geography, energy, transportation, and communications are the raw ingredients for development, the foundation of economic growth. Yet in the end, progress is largely a function of how the raw ingredients are drawn together, arranged, and distributed. In China these are still decisions often made not by the market, but by the political system.

On paper, power is divided between a government and a party structure. In practice they are inexorably intertwined. In reality, power in China is not institutional but personal.[20] Institutions owe their power to their leaders. As leaders come and go, so does the power of the bureaucracies they control. As long as the current leadership can still deliver economic improvement and social stability, it is likely to remain in power.

With China's open door policy, institutional and legal changes were made to decentralize the foreign trade bureaucracy, to protect the interests of foreign investors, and facilitate borrowing fron abroad. Special economic zones (SEZs) were established, joint venture negotiations begun, and trade policies liberalized. But progress, while truly impressive, has not come without periods of uncertainty and pain, in the past, for foreign investors. Three times during the 1980's , periods of liberalization and rapid change were followed by stiff retrenchment. As analyst Arlene Wilson[20] and others have pointed out, each reform period (1979-80, 1984, and 1987-88) was characterized by expansionary monetary policy, increased investment spending, liberalized measures for exports, imports and foreign investment, decentralization of foreign trade decisions and the granting of special dispensations to cities and special economic zones to encourage market economics.

However when buying binges created a foreign exchange crisis, and easy credit mixed with a shortage of supplies created inflation, the government had retracted some or most of its reforms, tightened credit and recentralized foreign trade and investment policy .

But no matter how liberalized foreign trade and investment policy have become and no matter how important foreign participation is to the growth of the economy, foreign trade and investment remain for now creatures of government policy. Quotas, tariffs, licensing, and other administrative measures are used to ensure the fulfillment of a centrally -directed-and-controlled economic plan. And history has proven that the Chinese government would not hesitate to reverse the reins if necessary. For instance strong austerity measures were imposed in !988 to regain control over the runaway economy which had pervaded the earlier year. The reform program was stalled.

To compound it further, the tragic events of June3-4, in 1989 in Tiananmmen Square appeared to be the *coup de grace* to economic reform altogether.[20] The reaction of businesses to Tiananmmen took varied forms, some clsed their door completely, a few never returned. Others carried on business as usual. Many took a wait-and-see attitude. The author can only conclude that one can never be certain of the continuity in the government's policies and its role.

5.5 RANKING OF THE RISK FACTORS

The findings of the survey indicate that the most important risk factors were financing constraints (which was ranked first) and aspects pertaining to China's legal structure, namely a still developing and changing legal framework and the existing laws which are either conflicting or ambiguous (which was ranked second).

5.5.1 Liquidity problems and financing constraints.

From comments given during the survey, the respondents indicated theat they faced liquidity problems and financing constraints. According to them a sizable number of FIEs have experienced working capital shortages, not only in foreign exchange but also in Chinese Yuan. They attributed this to four main reasons:

a) Extending credit to customers is a widely used practice and a primary marketing tool in the Chinese business environment. Accounts receivable that are more than 100 days old are not uncommon, and in recent years the average age of accounts receivable has tended to increase. Tight monetary policies by the governmant also compounds the problem. This credit- granting practice has its roots in Chinese culture, which emphasizes the maintenance of harmony and nurturing of personal relations.

b) Many investors, both foreign and local, often rely on loans and are reluctant to invest much of their own money, either out of a sense of opportunism or in an attempt to reduce risk. Debt-to-equirty ratio of 4 to 1 are not uncommon among FIEs, according to the respondents.

c) The expansion of operations and production capacity needed to meet the increasing demand drains available financial resources and contributes to the FIEs liquidity problems.

d) Chinese authorities, mindful of inflation risks, have resorted to a tighter monetary policy after each a two or three year period of rapid expansion. (This finding complements with the role of the government outlined earlier by the author in 5.4 above). A banking credit squeeze is reflected in the delays experienced by a number of FIEs in receiving both foreign exchange and Chinese Yuan under existing loan agreements.

The respondents pointed out that priority in new loans is given to ventures that produce exports or bring in advanced technology. And unless one gets approval from the Central Government, it would be difficult to secure financing from the Bank of China, accoding to the respondents.

Their advice to FIEs facing working capital shortages is to explore the following possibilities:

a) Currency trading in foreign exchange swap centre, where foreign currencies can be bought against Chinese Yuan or vice versa.

b) Short term loans from various sources including specialized banks (bank of China, Industrial and Commercial Bank of China) as well as nonbank financial instituitions (international trust and investment corporations).

c) Loans from parent firms, increases in equity contributions or increases in retained earnings.

d) Obtaining financing by issuing corporate bonds or stocks, currently subject to the approval and supervision of the State Securities Excahnge Commission, as well as the Securities Supervision and Administration Commission.

They also pointed out that financial reforms undertaken by the Chinese authorities entered a new phase on January 1, 1994 with the unification of the official and swap exchange rates. This was good news for FIEs since the single rate greatly simplifies the FIEs financial dealings, especially by allowing them to use it in their investment decisions and for profit repatriation purposes.

Perhaps Malaysian investors should take note, that after a recent visit to Malaysia by China's Deputy Minister of Finance. Xie Xuren in April 1997, Deputy Minister of International Trade & Industry, Kerk Choo Ting announced the opening of a Bank of China branch in Malaysia later this year. This could assist Malaysian businesses to increase their investment in China.

5.5.2 LEGAL FRAMEWORK

Information gathered from respondents during the interview revealed that China obviously does not share the West's history of legal tradition and that there is a lot of confusion amongst foreign investors on the definition of law in China.. This is complementary to information gathered from other secondary sources. These respondents say that China has signed a series of bilateral treaties with foreign countries (including the US), providing for the mutual protection and promotion of investment.

As to the legal code, they further added that there are five types of law applicable to foreign companies that invest in China:

a. National Legilslation promulgated by the National People's Congress, the State Council, and other organs of the central government. Frequently such legislation, they say, are termed "Provisional" or "Interim" to suggest its experimental nature.

b. Legislation at the municipal and provincial level which supplements (but may or may not be consistent with) national provisions. Additional laws are often passed to guide and control foreign investment at this level.

c. Legislation applied by analogy. According to the respondents, where no specific implementing regulations apply, Chinese officials have applied other laws by analogy.

d. Regulations which are internal and unavailable to foreigners, but which are nevertheless applied. Sometimes these are "trial balloons" for forthcoming laws, at other times they seem to be created and applied in an arbitrary manner to cover uncertain circumstances.

e. Models, such as sample contracts for joint ventures, have also been created. These provide a common structure upon which negotiations can be based.

Many of the respondents re-echoed sentiments expressed earlier in this study that laws varied from province to province, that understanding and interpretation of the various acts was subjective making enforcement very difficult. Some went on to elaborate that even if local authorities approved certain projects, it does not mean it would be approved when it reaches the higher levels.

The above sentiment was expressed by Deputy International Trade and Industry Minister, Kerk Choo Ting(*23), especially in reference to the failures experienced by Malaysian companies in the gaming sector in China, such as the gaming operations proposed by Magnum Corp. Bhd, Mycom Bhd., Talam Corporation Bhd. For example Talam Corporation lost RM29 million in

China.

The Deputy Minister also advised those interested in investing there to first conduct a study of the legal and financial matters before making inportant decisions .

A few of the respondent companies mentioned that if and when in doubt, Malaysian investors could refer to either the Ministry of Foreign Relations and Economy or to the China Legal Service (HK) Ltd. (CLS) which is the only legal service instituition in Hong Kong set up with the approval of the Ministry of Justice of the People's Republic of China. Its objective is to serve the interests of investors and clients by providing a complete range of China legal services. According to these respondent companies, since CLS has close relations with judicial departments, notarial instituitions and law firms in Hong Kong, China, Taiwan and other countries, it can secure timely and up-to-date information concerning releated issues in China and offer accurate consultation on China legal affairs related to economic, civil, administrative and criminal litigation and non-litigation matters.