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The Rise of Overseas Chinese Investment in China

Sawada Yukari

In the 1970s and early 1980s, Japan was the sole economic giant in Asia, preceding its regional neighbors in what has been called the flying geese pattern of development. But no longer; in what may be seen as indicative of an intensifying trend, the Pacific Century Group, headed by a young Hong Kong Chinese, Richard Li, the second son of Hong Kong Chinese tycoon Li Kashing, won in March 1997 a land development bid right in the heart of Tokyo. This plot of land in Yaesu, formerly owned by the Japan National Railways, is adjacent to the JR Tokyo Station, the main gateway to the capital. The unexpectedly high bid (¥86.9 billion) was not only an encouraging sign in the midst of a stagnant property market, it also impressed Japanese business circles with the might of the overseas Chinese (Kitahara 1997).

Today, the overseas Chinese are undoubtedly among the most important economic actors in Asia Pacific. There are approximately fifty-five million Chinese living outside mainland China, but the size of their population, which is close to that of France,[1] is not nearly as impressive as the size of their wealth. According to a report in the *Far Eastern Economic Review*, the World Chinese Entrepreneurs Convention estimated that the total assets of overseas Chinese in 1993 amounted to some US$200 million to US$300 million, nearly equaling the gross national product of Australia in the same year (Kubo 1994, 91).

However, an additional factor must be considered when we evaluate the overseas Chinese presence. The increasing importance of the overseas Chinese during the last decade stems from their ability to function as a bridge linking the People's Republic of China to the world economy. It was in part the hypergrowth of the Chinese economy that fueled the marked expansion to date of the overseas Chinese presence. Today, the overseas Chinese are the leading direct foreign investors in China, and their shared cultural background allows them to also serve as an important source of information. We must recognize that they are one of the key factors in doing successful business in China.

Here I will present an overview of the impact of overseas Chinese capital in China and suggest steps Japan can take to deal with this emerging force.

Overseas Chinese Contributions toward China's Economic Growth

Economic Growth in China

Since China adopted an open-door policy at the end of the 1970s, its rapid economic growth has taken world economists by surprise. From 1979 to 1992, China's gross national product (GNP) recorded average annual growth of 8.6 percent, and after a pivotal speech by Deng Xiaoping to mark the Chinese New Year in 1992, which encouraged the reforms and thus accelerated their impact, China marked double-digit annual growth in GNP for four consecutive years (Nomura Sogo Kenkyusho, Tokyo Kokusai Kenkyu Club 1993, 92; Inagaki 1997, 11).

The effect of the open-door policy was not limited solely to economic growth. As it restructured its economy, China became increasingly dependent on the world market. By 1995, China's external trade accounted for 45 percent of its total GNP. Foreign joint ventures played an important role in changing China's economic structure in this direction. In 1994, foreign enterprises held a 28.7 percent share of China's exports. As they invested, they introduced new skills to China and helped Chinese products gain access to the world market. In this sense, foreign investment undoubtedly contributed greatly to China's export-oriented economic policy. Chinese statistics show that direct foreign investment completed in 1994 totaled US$33.8 billion, or an estimated 6.7 percent of total GNP. Taking into account the direct foreign investment accumulated between the years 1979 to 1994, the cumulative total reached US$95.5 billion.

The contribution of foreign enterprise is even more impressive when compared to the state-owned sector, where more than half of the enterprises are heavily in debt. It was the non-state-owned sector, including rural industries and foreign joint ventures, that promoted China's exports and brought about its near-miraculous economic growth in the country's coastal regions.

Overseas Chinese as the Largest Investors and Major Trading Partners

There is little doubt that the overseas Chinese are the largest source of direct foreign investment in China. However, it is impossible to calculate from the official statistics precisely how much investment has been made by the overseas Chinese. Current statistical data is classified by country, not ethnic group. One cannot tell, for example, whether specific investments from the United States are Chinese American in origin or come from other sources.

Here I shall adopt Shu's estimate regarding overseas Chinese capital and assume that the total sum of direct investment from five member countries of the Association of Southeast Asian Nations—Singapore, Thailand, Malaysia, the Philippines, and Indonesia—and from Taiwan and Hong Kong may substitute for the overseas Chinese share. These countries were chosen because (1) the ethnic Chinese population comprises the majority in Taiwan, Hong Kong, and Singapore,[2] and (2) although Chinese are not the largest ethnic group in the four other ASEAN countries,[3] they control much of the economy. For example, even in Malaysia, where the government enforces a "Malay first" policy, 25 percent of the shares of the twenty largest listed companies are owned by local Chinese. By the end of 1992, ethnic Chinese enterprises accounted for an overwhelming amount of the shares of privately held domestic companies in the countries of residence of overseas Chinese.[4] Eighty percent of the privately held shares in domestic companies in Thailand, 75 percent in Indonesia, 60 percent in Malaysia, and 50 percent in the Philippines were owned by local Chinese (Shu 1995, 34).

Applying the above-mentioned method to calculate the ratio of overseas Chinese investment in China reveals that the overseas Chinese account for 70 percent to 80 percent of total direct foreign investment (Shu 1996, 11). Table 1 illustrates this.

Table 1. Overseas Chinese Direct Investment in China (US$ billion)

	1993		1994		1995	
Hong Kong & Macao	$76.75	68.9%	$48.69	58.9%	$42.62	46.4%
Taiwan	9.97	8.9	5.39	6.5	5.85	6.4
Singapore	2.95	2.6	3.78	4.6	8.67	9.4
Thailand	1.07	1.0	0.78	0.9	0.64	0.7
Malaysia	0.76	0.7	0.62	0.7	1.06	1.2
Philippines	0.63	0.6	0.29	0.4	0.21	0.2
Indonesia	0.26	0.2	0.28	0.3	0.34	0.4
Subtotal	92.39	82.9	59.83	72.4	59.40	64.6
Japan	2.96	2.7	4.44	5.4	7.59	8.3
DFI total	111.44	100.0	82.68	100.0	91.92	100.0

Sources: Shu (1996, 11) and Inagaki (1997, 59).
Note: Values are based on contracts.

As for external trade, Japan became China's No. 1 trading partner in 1993, surpassing Hong Kong, which had previously occupied the top position. However, if we look at the main trading regions where overseas Chinese constitute the majority of the population, i.e., Hong Kong, Taiwan, and Singapore, the sum of investment from these three regions alone exceeds that of Japan (table 2). Hence we can assume, as is widely believed, that the overseas Chinese are China's principal transaction partners.

Table 2. China's Major Trading Partners, 1995 (US$10,000)

	Export		Import		Total	
1 Japan	$2,846,269	19.1%	$2,900,476	22.0%	$5,746,745	20.5%
2 Hong Kong	3,598,380	24.2	859,110	6.5	4,457,490	15.9
3 USA	2,471,133	16.6	1,611,823	12.2	4,082,956	14.5
4 Taiwan	309,811	2.1	1,478,391	11.2	1,788,202	6.4
5 South Korea	668,922	4.5	1,029,331	7.8	1,698,253	6.0
6 Singapore	350,064	2.4	339,798	2.6	689,862	2.5
7 World total	14,876,974	100.0	13,207,816	100.0	28,084,790	100.0
8 2+4+6	4,258,255	28.6	2,677,299	20.3	6,935,554	24.7

Source: Inagaki (1996, 22).

Small Investors as Pilot Boats

How did the overseas Chinese come to occupy this position? Why is their share larger than that of the developed countries? To answer these questions, we must examine the various stages of overseas Chinese investment behavior.

In the 1980s, it was primarily the small and medium-sized manufacturers from Hong Kong and Taiwan who were keenest on entering the Chinese market. By doing so, they helped establish guidelines for foreign investment at an early stage of the open-door policy, when the Chinese market was even more unpredictable than it is today. Other foreign investors observed the results of investment by small Hong Kong companies before they decided to enter China themselves. Thus small overseas Chinese companies acted somewhat as pilot boats, leading larger enterprises to safe water.

The main objective for small Hong Kong firms wishing to invest in China at that time was to utilize China as a production base in order to lower their labor costs, which were skyrocketing at home. Their major advantage during this period, compared to other foreigners, was, of course, their common cultural background with the Chinese at their investment sites. Their most obvious strength was the language. Some dialects in South China are so different from Mandarin, the official standard Chinese, as to almost be foreign languages. The level of Mandarin ability is usually lower in rural areas, which are attractive investment sites because labor costs there are much lower than in urban areas.

An even more important advantage, however, was the personal connections of overseas Chinese. The language barrier was not the only important factor in doing business in China. Problems often arose in the country's immature market economy that could only be solved by face-to-face negotiations. In the early 1980s, the open-door policy was an unprecedented experiment for most Chinese officials. They were unsure if it was acceptable to make profits with foreigners or what to do if problems arose. The foreign investment laws of the time were to be tested on many fronts. Under such circumstances, personal ties could to some extent substitute for a fragile legal system and encourage both the supplier and the recipient of foreign investment. This is where the overseas Chinese proved to be especially effective.

Let us take Hong Kong, the largest investor in the region,[5] as an example. More than 80 percent of Hong Kong residents speak Cantonese as their mother tongue, and most of them are immigrants from adjacent Guangdong Province, or second-generation immigrants. This means that they still have close relatives and friends across the border. In fact, many Hong Kong residents still maintain strong ties with their home villages and towns, often visiting relatives and offering donations there. The home-bound rush during the Chinese New Year and Qingming Festival—when families clean ancestral graves—is proof of these continuing links.

When China opened its doors and began seeking foreign investment in the late 1970s, small Hong Kong Chinese firms were the first to respond, while other foreign companies voiced doubts about whether this policy would be maintained. Japanese firms were no exception. Aside from specific large-scale national projects backed by sovereign guarantees, such as the Baoshan Steel Plant, Japanese companies were at first reluctant to involve themselves in China's economic activities. The risk was considered to be too high. But for these small Hong Kong firms, their personal hometown ties functioned as a form of insurance.

A typical example of this was the Huasheng Electronics Co. in Meichou, famed as the hometown of many Hakka, an ethnic group well-represented in Hong Kong. The founder of the company left Meichou in the 1970s to work in his uncle's factory in Hong Kong. While he was mastering the necessary skills in the factory, he realized that if he could transplant an old production line to China and hire cheap labor there, he could realize a profit as well as contribute to the development of his native region. He returned to his native village to look for a trustworthy partner, and he found his old classmate teaching physics in a local high school. He appointed him as a factory manager. They began to produce electronic components according to what is termed an outward-processing contract, in which the Chinese side provided the production site and the workers, but nothing else. The Hong Kong side arranged all other inputs, including bringing in the production line and raw materials, and accessing the export market. The Chinese side basically received only wages for workers and managers in return (Sawada 1994, 126).

This outward processing type of investment became extremely popular in the early stages. As recently as 1994, in fact, more than 70 percent of Hong Kong's exports to China, over three quarters of Hong Kong's imports from China, 80 percent of China's exports via Hong Kong, and more than 40 percent of China's imports via Hong Kong were related to outward processing in China. The major benefits of outward processing were its flexibility and low risk. Formal joint venture projects take time before the contract can finally be signed. Because outward processing was not officially considered as foreign investment, the approval procedures could be realized much more quickly. Lower levels of the local administration were authorized to approve such projects, rather than the central government or the provincial government. There was no need to untangle bureaucratic red tape all the way to Beijing. It was also easier for companies involved in outward-processing production to retreat from China than it was for partners in formal joint ventures. For joint ventures, unlike in outward processing, because the initial capital was already tied up in the project, it took time to recover the money from the local enterprise.

Usually, *xiangzhen qiye*, which literally means the township-owned or village-owned enterprise, became a partner to the outward-processing contract. Aside from their access to an even cheaper labor force, these rural enterprises had a special advantage over state-owned enterprises: as a new kind of economic entity recognized during the reform process, they were operated independently of the state-run economy. They were not controlled by the central bureaus, but by the village and town authorities. Hence, good relations with the village head, or the town party secretary, could help investors eliminate many obstacles.

Because outward processing required negotiation with low-level cadres, relatives and friends of the Hong Kong Chinese played an essential role in building mutual trust between the foreign investor and hosts. The fact that Hong Kong investment is concentrated in Guangdong Province indicates the importance of personal networks. Even among large publicly traded Hong Kong companies, Guangdong claims dominant status as an investment site in China. In a survey conducted by a French insurance company in 1996, sixty-two listed Hong Kong companies stated that they planned to invest in China in the next three to four years, and 50 percent of the investment was to be channeled to Guangdong Province. This share overwhelmed that of Shanghai, the rising economic center of China, which only accounted for 15 percent (Shu 1997, 141).

Taiwanese firms have followed the same investment pattern. Their labor-intensive industries suffered from a rapid rise in labor costs and the appreciation of the New Taiwan dollar in the late 1980s. In order to remain competitive in the world market, Taiwan's light industries also crossed the Chinese border to sign contracts for outward processing with township- and village-owned firms. Umbrellas, sneakers, sandals, apparel, and simple electronic components accounted for the majority of Taiwanese production in China. The presence of Taiwan's light industries led to expanded trade crossing the Taiwan straits via Hong Kong.

Diversifying and Enlarging Their Businesses

Most of the small Hong Kong Chinese joint venture firms in China in the 1980s engaged in light industry. There were two main reasons for this. One was that light industry was the traditional focus of small companies in Hong Kong. Another reason was that China's open-door policy at that time stressed export-oriented industries and would not allow foreign investors to remain in China just to market their goods. Foreign firms were all expected to focus on production and, more importantly, to export as much as possible.

This was not an easy policy for the large firms in the crown colony to observe. Hong Kong did not and still does not have large manufacturers such as automakers in the territory, since the British colonial government, abiding by laissez-faire economic principles, refrained from promoting specific industries. The top enterprises in Hong Kong are primarily trading houses, property developers, infrastructure-related firms, and banks, reflecting the territory's status as an international trade and financial center. China's demand that foreign enterprises concentrate on production and exports was deemed almost irrelevant to their business. The major entrepreneurs thus maintained a cautious attitude toward investment in China. Most of them limited their involvement to supporting educational and cultural activities in their home regions. They were typified by such businessmen as Li Ka-shing, who donated some HK$880 million to Shantou University in 1981, Y. K. Pao, who conferred HK$20 million to Ningbo University, and Henry Fok, who established the Henry Fok Foundation to support sports activities in China (Shu 1995, 96).

The overall situation changed in the 1990s, when Beijing finally allowed foreign investors to cultivate China's domestic market. Small Hong Kong firms completed the first phase of transferring their production base to China by the early 1990s.[6] By then, larger enterprises had begun investing in Chinese projects. Their participation brought about a new phase in doing business in China.

Compared to their predecessors, these new China projects were often associated with larger and more long-term investments. In 1988, the average volume of investment for Hong Kong firms in China per contract was US$760,000. The average size had almost tripled by 1995, when the figure reached US$2.33 million (Shu 1997, 140).

In addition, unlike the small firms, large-scale Hong Kong investors have tended to involve themselves in real estate development and infrastructure construction. China's property boom of the early 1990s was partly caused by the rapid inflow of Hong Kong developers. For example, Li Ka-shing's Cheong Kong Group was involved in several major construction projects, including building a container terminal in Shanghai, the Yantian Port development project in the Shenzhen Special Economic Zone, the Yangpu Port development project in Hainan Province, and the Wangfujing Commercial District development project in Beijing. Peter Woo, the successor to Y. K. Pao as the head of the Wheelock Group, led his conglomerate in undertaking the comprehensive infrastructure construction plan of the Wuhan Municipality. In Shanghai, the New World Group, together with Sun Fung Kai and Henderson, joined the property development project for the city's commercial and residential area. The best-known of these examples, however, was Hopwell, led by Gordon Wu, which constructed a superhighway around the Pearl River Delta, connecting Hong Kong, Guangzhou, and Macao according to a build-operate-transfer agreement. Hopwell also initiated the construction of two power plants at Shajiao in Guangdong Province.

As can be seen from these examples, the business practices of the large firms were new in the sense that they invested outside their home regions in south China. Although Guangdong Province continued to be the top destination for Hong Kong Chinese investment, large companies crossed the Yangtze River to the north. Their partners in China were not limited to rural enterprises, but instead tended to be state-owned enterprises.

The momentum of Hong Kong Chinese investment in China somewhat lagged during 1995 and 1996, when Beijing's new economic austerity policy dampened their former enthusiasm. The introduction of a value-added tax, restrictions holding foreign investment shares to less than 50 percent in construction projects for railways and telecommunications, and a cap on profits that held returns to 12 percent were all warnings that Hong Kong capitalists should not put all their investment eggs in one basket (Sawada 1995, 40).

This does not mean that overseas Chinese investment from all regions has slackened. In fact, investment in China from ASEAN is booming (table 3). Since Singapore and Indonesia normalized diplomatic relations with China in the late 1980s, ASEAN's China investment has increased rapidly. In the case of Charoen Pokphand (CP), Thailand's giant agribusiness, their first China investment was back in 1981 when, together with the American company Continental Grain, CP began production of poultry and chicken feed in the Shenzhen Special Economic Zone. However, since the late 1980s, they have diversified their business activities with a variety of production projects, including a joint venture with Heineken to produce beer in Shanghai, and a contract for technology cooperation with Honda for manufacturing motorcycles in China (Inoue 1994, 187–188).

Another typical example is Robert Kuok's Kerry Group from Malaysia. They opened the Shangri-La Hotels in several major Coastal cities, collaborated with Cheong Kong in real estate development projects in Beijing and Shanghai, and constructed an oil refinery.

Indonesia's largest conglomerate, the Salim Group, began full-scale activities in China when its founder, Sudono Salim, visited Beijing in September 1992. By the end of that year, Sudono decided to participate in industrial estate

Table 3. Direct Investment in China by Overseas Chinese (US$ billion)

	1993		1994		1995	
Singapore	$2.95	52.0%	$3.78	65.7%	$8.67	79.4%
Thailand	1.07	18.9	0.78	13.6	0.64	5.8
Malaysia	0.76	13.4	0.62	10.8	1.06	9.7
Philippines	0.63	11.1	0.29	5.0	0.21	2.0
Indonesia	0.26	4.6	0.28	4.9	0.34	3.1
Total	5.67	100.0	5.75	100.0	10.93	100.0

Source: Shu (1996, 11) and Inagaki (1997, 59).
Note: Values are based on contracts.

development with a Singapore enterprise. Because Sudono was originally from Fujian Province, it was reported that his company's projects were mainly concentrated in Fujian. They included establishing a polyethylene plant in Amoy with a Taiwanese company, Dongdishi, and a joint banking project with the Bank of China in Fuzhou. The Salim Group's international business headquarters is the First Pacific Group, based in Hong Kong (Maruya 1994, 65–68).

Patterns of Overseas Chinese Investment

From the above examples, we can summarize the key features of overseas Chinese investment in China as follows.

Cultural Background

A common language (or dialect) and shared background with local people helped to foster a friendly atmosphere and environment at the initial stage of investment. It may appear somewhat irrational for overseas Chinese to invest in an area just because it is where the founder was born. But offering donations to hometown educational and medical facilities or supporting local development plans is a highly efficient means of achieving a good reputation, thus smoothing local personal relations. We may assume that a common cultural background is an important factor in making the first move in China successful.

Collaboration via Personal Networks

The overseas Chinese attach great importance to individual relationships, so they try to become acquainted with local key figures as well as with other major investors. However, overseas Chinese firms are better able to incorporate native Chinese as part of their executive staff because of the shared cultural background.

This includes *taizidang*, or sons and daughters of high-ranking Chinese cadres, or the mayors of host cities of their business investments as nominal advisors.

The overseas Chinese themselves also accept honorary citizen status in the host cities, as in the case of Cheng Yu-tung in Guangzhou. The Chinese government has already appointed distinguished ethnic Chinese businessmen from all over Asia as advisors for Hong Kong affairs. Aside from such Hong Kong Chinese tycoons as Li Ka-shing, Lee Shau Kee, Cheng Yu-tung, Henry Fok, and Run Run Shaw, many big business leaders from ASEAN also became either advisors or members of the Hong Kong Special Economic Zone's Preparatory Committee. Thai tycoon Dhanin Chearavanont of Charoen Pokphand; Robert Kuok of the Kerry Group (Malaysia); James Riady, the third son of Mochtar Riady, who heads the Lippo Group (Indonesia); and Chatri Sophanpanich, the second son of Chin Sophanpanich, the founder of Bangkok Bank, all hold positions allowing them to offer their opinions regarding future Hong Kong government (Hiizumi 1996, 2).[7]

Cautious Moves, Quick Decisions

Overseas Chinese entrepreneurs, with the exception of those operating large conglomerates, typically initiate their China business with short-term, small investments in their hometowns, then gradually extend their business activities, as can be observed with Hong Kong manufacturers. Recently, some Hong Kong companies have even become listed on Hong Kong stock exchanges as a result of their successful operations in China.

They also utilize their personal networks to promote joint investment, in order to lower the risk. This is especially true for large enterprises involved in long-term projects. In addition to the examples mentioned previously, many overseas Chinese companies have entered into joint ventures, like the Lippo Group of Indonesia, which established a joint venture with a Taiwanese entrepreneur to implement a comprehensive infrastructure construction project in Fuzhou.

Their business caution is reflected in the way they avoid concentrating investment in one place. The New World Group of Hong Kong has often been said to have declared that the value of their investments in China will not surpass 20 percent of their total assets.

Moreover, they are cautious about the political environment. Unlike other foreign investors who were affected by the diplomatic protests from home over human rights issues and the Tiananmen Square massacre, political risk for overseas Chinese does not appear as high on the surface. They continued investment, even immediately after the "June fourth incident," winning trust from Beijing. However, the tragic history of anti-Chinese sentiment and uprisings in Southeast Asia has never left their memory. They worried that the image of overseas Chinese remitting their wealth back to China would upset those in their countries of residence. In fact, the World Chinese Entrepreneurs Convention reacted quickly to this issue.

At the first assembly in 1991, Lee Kuan Yew pointed out that the overseas Chinese were the engine driving China's future development. But at the second assembly in 1993, he softened his tone, as he stressed that the overseas Chinese should give priority in their economic activities to the country in which they reside. Lee Kuan Yew refrained from attending the third assembly in 1995, as did such prominent tycoons as Dhanin Chearavanont and Chatri Sophanpanich. The Indonesian government prohibited the Chinese in Indonesia from attending the second assembly of the World Chinese Entrepreneurs Convention; hence the fourth assembly in 1997 will be held in Vancouver instead of Jakarta, as originally planned (Hiizumi 1996, 4–5).

This cautious approach means the overseas Chinese are ready to retreat quickly should an unexpected incident arise. The quick decision-making procedures of overseas Chinese are made possible not only by strong family ownership but also because of this careful hedging of risk.

Business Relations between Japanese and Overseas Chinese in China

Japanese Investment Patterns in China

China became Japan's top overseas investment destination in Asia in 1993, leaving Indonesia, the former No. 1 destination, far behind. By the year 1995, Japanese direct investment in China was 2.8 times the total investment in Indonesia. What's more, China surpassed the United Kingdom that year to become the second largest recipient in the world of Japanese foreign investment. According to the Ministry of Finance, 8.7 percent of Japan's direct foreign investment for the year 1995 went to China, second only to the United States, which held the lion's share of 44.1 percent of the total (Inagaki 1997, 27).

However, until the late 1980s, Japanese and overseas Chinese had little to do with each other in the China market, compared to their interaction with other major economic players. Let us first explore the reasons for this on the Japanese side.

Japanese Investors Concentrate on Northeast

Northeast China has always been the favorite investment site for Japanese investors. Geographical proximity, historical ties, and local government policy have all attracted Japanese businesses to cities surrounding Bohai Bay, especially Dalian. I once conducted a personal interview with Japanese businessmen stationed in Beijing, and found out their great preference for Dalian was largely due to language considerations. As it was under Japanese occupation since immediately after the Russo-Japanese War in 1904 up until the end of the Second World War, Dalian still preserves high standards in Japanese-language training. In addition, there are many Japanese who were born and brought up in Dalian before the war, and they consider the city to be their second hometown. Therefore, just as with overseas Chinese investing in their hometowns, Japanese nostalgia tends to guide investment projects to Dalian.

Japan's preference for Liaoning Province, where Dalian is located, can be observed from the statistics. Whereas only 5.4 percent of the total Chinese investment by the United States, 3.7 percent by Hong Kong, and 1.9 percent by Taiwan went to Liaoning during 1987–1991, Japan channeled 29.0 percent of its investment funds to the northeastern province. As a result, nearly half, or 49.6 percent of the cumulative total figure of Japanese direct investment between the years 1987 to 1991, went to the Bohai Bay Coast. By comparison, Shanghai accounted for only 11.6 percent of Japanese investment outlays and Guangdong, the destination of 53 percent of Hong Kong investment capital, received a mere 14.4 percent of Japan's total investment. If we compare these figures with the United States, the picture is even clearer. The United States has directed 29 percent of its China investment to Bohai Bay, while pouring 27.3 percent into projects in the Yangtze River Delta and 37.3 percent to South China (Mitsubishi Sogo Kenkyusho 1994, 60).

Although small-scale cooperation with overseas Chinese by Hong Kong and Taiwan subsidiaries did exist, as we shall see later in this chapter, as a whole, during the 1980s, large Japanese investors had little contact with overseas Chinese companies in China. Japanese and overseas Chinese investment tended to coexist separately in the North and South, respectively, of China's vast mainland, so the two sides had little chance to collaborate in the same region.

Small Chinese Population in Japan

A distribution map of overseas Chinese tells us that Japan has attracted a relatively small number of Chinese immigrants compared to North America and Southeast Asia. There are six million overseas Chinese residing in Indonesia, five million in Thailand, 4.7 million in Malaysia, two million in Singapore, nearly two million in the United States, about one million each in the Philippines and Vietnam, and 800,000 in Burma, but only 200,000 in Japan. Overseas Chinese account for 0.2 percent to 0.3 percent of the total population in Japan (Yu 1995, 8–9).

In addition, the majority of these residents arrived in Japan after China adopted its open-door policy. In 1985, the overseas Chinese population in Japan totaled only slightly over 70,000. So, unlike the United States, where many early commercial ventures in China were led by Chinese-Americans, Japan could not expect that a large number of the Chinese in Japan would act as trailblazers. Japan's negative policy against foreign immigrants kept the overseas Chinese away.

Employing Overseas Chinese Networks

Approaching the Overseas Chinese

While Japan showed little interest in accepting foreign residents, it did not mean that Japanese companies had no need for business partners. On the contrary, a survey conducted by the Japan Export Import Bank in 1996 indicated that Japanese companies prefer to have a local partner, especially in developing countries.[8] While nearly 70 percent of Japan's overseas affiliates in the United States and the European Union are wholly owned, 70 percent of affiliated companies in ASEAN and China are joint ventures with other companies (Japan Export Import Bank 1997, 23).

Japanese trading companies started to pay attention to the overseas Chinese network in Asian newly industrializing economies (NIEs) and Southeast Asia in the late 1980s. General trading companies (*sogo shosha*) began to set up "overseas Chinese research teams" in the early 1990s. For example, in 1993, the Mitsubishi Corporation head office instructed its branches and representative offices in Southeast Asia to collect data regarding overseas Chinese of Hakka origin. Mitsui & Co. Limited put the issue of dealing with overseas Chinese on the agenda of a conference of their Asia branch heads. Sumitomo Corporation established an overseas Chinese information center around the same period (Kubo 1994, 91). In 1989, Itochu Corporation's Hong Kong branch manager asked me how to approach Japanese researchers specializing in the study of overseas Chinese enterprises.

Using Hong Kong and Taiwan Subsidiaries

It was only natural for Japanese traders to target overseas Chinese enterprises in Southeast Asia, since they had already established certain business relationships with them during the 1960s and 1970s. At that time, Chinese firms in Asian NIEs were beginning to diversify their business activities. Before the Second World War, they tended to engage in commercial activities such as exporting and currency exchange. Starting in the 1960s, they branched into manufacturing, starting with textiles and food processing, but gradually moved into more complex production, including the machinery, automobile, and electronic industries. Similar phenomena could be observed in Southeast Asia during the 1980s.

Japanese companies established joint ventures with overseas Chinese to provide components, technology, and management skills for the manufacturing sectors. Japanese trading companies first engaged in exporting machinery and industrial products such as cement, automobiles, and electric appliances to these countries. They later set up agency offices, and finally started local production with large local enterprises, which tended to be operated by ethnic Chinese. The rapid appreciation of the Japanese yen after September 1985 also accelerated the move to transfer production bases to other parts of Asia. Hence by the late 1980s, Japanese companies had already cooperated with local Chinese business communities through their overseas subsidiaries.

The first step taken by the Japanese firms eager to enter the China market was to utilize their personal connections with these overseas subsidiaries. Hong Kong is probably still the most popular place for mobilizing subsidiary companies to invest in Guangdong Province. When Toko Electric first sought a less expensive production site in the mid-1980s, one Hong Kong manager introduced his brother living across the border as a partner. Thanks to this Hong Kong–Guangdong personal network, Toko successfully signed an outward-processing contract in a small town just outside the Shenzhen Special Economic Zone. In another instance, a Japanese affiliate dispatched its Hong Kong Chinese manager to his hometown in China to negotiate with a local junior high school principal to secure a stable supply of young female assembly workers.

In 1991, Sumida Denki used its Hong Kong subsidiary, Sumida Electric, to invest in Dongguan City, and in 1988 First Precision, the Hong Kong subsidiary of Citizen, the Japanese watch-maker, invested in Jiangmen City in the Pearl River Delta. In both cases, Hong Kong subsidiaries functioned as agents in investment.

As Sung pointed out, "Many multinational companies tend to test the Chinese investment environment through investments from their Hong Kong subsidiaries because Hong Kong has the required expertise. If such investments are successful, then the parent company will also invest in China" (1995, 240).

Taiwan-based subsidiaries were another early choice for Japanese companies hoping to do business in China. One example was the investment in China by Taidi Industry, a manufacturer of sewing machines for domestic use. This is a subsidiary company of Japan's Brother Industries Ltd. established in Taiwan. Taiyo Wing, the Japanese sports apparel maker, used Taiwan Nanyang Industry, its overseas joint venture in Taiwan, to invest in Dongguan City (Japan External Trade Organization 1993, 25).

The New Overseas Chinese Connections

Just as large overseas Chinese companies expanded both their geographic range and their range of business activities after entering the China market, Japanese enterprises also sought efficient ways to further develop their investment. Trading companies approached large overseas Chinese firms by drawing upon their prior business connections in ASEAN and the NIEs. The Chinese side also welcomed such moves, as they could take advantage of Japanese companies' technology and financial promise. This raised mutual expectations for collaboration in the 1990s.

An outstanding example of this cooperation was the joint venture announced in 1994 between Asahi Breweries, Itochu, and Sinar Mas. The Sinar Mas Group, Indonesia's second largest business group at that time,[9] had already set up a headquarters in Hong Kong for investment in China. Oei Hong Leong, the second son of the founder of the Sinar Mas Group, Eka Tjipta Widjaya, took over a Hong Kong-based company in 1991 and established China Strategic Investment (CSI) to reorganize China's state-owned enterprises through financial takeovers. First CSI would purchase 51 percent of the capital of the targeted Chinese state-owned enterprise, to assume control of management. Then CSI, like a surgeon, would excise the enterprise's less competitive operations. China Strategic Investment is reported to have purchased more than two hundred state-owned enterprises in China.

CSI's typical reorganization procedures included (1) reforming the accounting and salary systems, (2) streamlining projects that were in debt, (3) introducing efficient production facilities from overseas, and (4) dispatching engineers and managers. CSI formerly drew on its own resources to reorganize state-owned enterprises, but in 1994 CSI had a Japanese partner acquire the state-owned enterprise after they completed their reorganization.

Together with Itochu Corporation, one of Japan's top trading companies, and Asahi Breweries, China Strategic Investment launched a joint project to take over the Hangzhou Beer Factory. The Hangzhou Municipal Government in Zhejiang Province originally owned the company. In mid-1993, Hangzhou Beer became a joint stock company with CSI financing 55 percent of the capital and the Hangzhou Municipal Government financing the rest. Then CSI established CSI Brewery Holdings, which succeeded 55 percent of Hangzhou Beer Inc., and in January 1994, sold 75 percent of the 55 percent stock share to Itochu Corporation and Asahi Beer (Maruya 1994, 69–70).

As a result, Asahi Beer and Itochu acquired 45 percent and 30 percent, respectively, of the capital of the renamed Asahi CSH Beer Holdings, with CSI Brewery Holdings retaining the remaining 25 percent. Asahi CSH Beer Holdings Limited is undertaking capital participation and technical assistance activities in the Chinese beer industry, and it acquired management rights in January 1994 to Hangzhou (Hangzhou Zhongce Pijiu) and Jiaxing (Jiaxing Pijiu) breweries in Hangzhou and a brewery in Quanzhou, Fujian Province (Quanzhou Zhongce Pijiu).

In September 1994, Hangzhou Beer Inc. began marketing an original brand, Nippon Asahi Pichu, the first jointly produced Japanese-Chinese beer in the Chinese market. The production of Nippon Asahi Pichu also began in Quanzhou

Zhongce Pichu in April 1995. In December 1995, Asahi and Itochu acquired a 45 percent and a 30 percent share, respectively, of China Brewery (Holdings) Limited Hong Kong, a holding company for China Strategic Holdings Limited, thus obtaining management rights to both Beijing Zhongce Beijing Beer Co., Ltd., and Yantai Zhongce C.S.I. Brewery Co., Ltd., and further bolstering Asahi's network in China (Asahi Breweries 1997).

Asahi's rival, Kirin Brewery Company Limited, formed a business alliance with Mitsubishi Corporation and the Kerry Group of Malaysia (Inagaki 1997, 126). In April 1995, Kirin entered into a licensing agreement with China Resources (Shenyang) Snowflake Brewery Company Ltd., of China, for the production and sales of Kirin Beer. China Resources is a PRC enterprise set up in Hong Kong[10] (Kirin 1996). In December 1995, Mitsubishi again cooperated with Kerry to establish Shanghai Jusco, a branch of Jusco, the Japanese supermarket, in Shanghai. The Shanghai Jusco store opened in September 1996. Jusco had already started Guangzhou Jusco via its Hong Kong subsidiary and a local Guangdong department store in July 1996. This tripartite investment in Shanghai gives the partners entree into the largest consumer market in China (Jusco 1997).

Similar examples can be found in the automobile industry. Mitsubishi Motors, for instance, signed a large-scale joint venture contract with Mitsubishi Trading, the Malaysia China Investment Corporation, Aviation Industries of China, and the China Aerospace Automobile Industry General Corporation on August 26, 1996. China's Prime Minister Li Peng and Prime Minister Mahathir of Malaysia attended the signing ceremony.

Mitsubishi Motors, which has maintained a long-standing partnership with the Malaysian automaker Proton, acted in cooperation with the Malaysia China Investment Corporation, a company affiliated with Proton. Both Chinese enterprises are affiliated with the Chinese army. The joint ventures were intended to further China's policy of converting its weapons industry into private businesses.

The parties established two joint ventures: Harbin Dong-An Mitsubishi Motors Engine Manufacturing Limited, located in Harbin, and Shenyang Space Mitsubishi Motors Engine Manufacturing Limited in Shenyang. The former is scheduled to produce 1300-cc gasoline engines and transmissions by 1998, the latter 2000-cc and 2400-cc gasoline engines and transmissions by 1999 (Mitsubishi Motors 1996).

Other recent agreements were for technology cooperation. The CP Group of Thailand allied with Honda in 1985 to produce motorcycles in Shanghai (Nicchu Keizai Kyokai 1996, 75). Honda itself began operations at a joint venture, Dongfeng Honda Auto Parts Company Limited, in Guangdong in November 1995. All parts produced here will be exported to Honda Cars Manufacturing (Thailand) Company Limited (Honda Motors 1996).

Benefits and Difficulties of Collaboration

As time goes on, Japanese are rapidly changing their expectations concerning the benefits of cooperating with the overseas Chinese. When they first started joint business activities in Southeast Asia, the main purpose for the Japanese side was to let their overseas Chinese partners negotiate with local officials for import licenses, permission to establish offices, and land acquisition. Japanese companies seldom had personal ties with the local government, and their staff was often unfamiliar with local business customs. The overseas Chinese partners' personal connections helped the Japanese companies clear the initial cultural obstacles.

The Japanese enjoyed these same sort of benefits from overseas Chinese companies operating in China throughout the 1980s. Their partners' personal ties with local officials and their flexibility in decision-making supported the Japanese in the middle of tough negotiations.

Recently, as the overseas Chinese have developed their businesses with more global activities, their personal networks have expanded internationally. Today, Japanese not only expect them to be middlemen at the local level, but they regard them as a source of unique project ideas, rapid information transmission, and fund-raising in Asia Pacific.

Japanese companies are also transforming their role from that of simple industrial product supplier to technology and component provider and distributor in joint projects. They also function as a kind of hedge against risk. Through cooperation with Japanese business, the project takes on more international dimensions, and this is expected to increase the project's invulnerability to China's domestic political problems.

However, there are several difficult issues remaining for long-term cooperation. As Kubo has pointed out, overseas Chinese entrepreneurs are often frustrated by the slow decision-making procedures of their Japanese counterparts. They complain that Japanese managers lack language ability, which is essential not only for intensive negotiations but also as a means of forging personal relationships. Furthermore, as overseas Chinese firms have matured, many large multinational enterprises have established their own financial expertise, and they may seek out European or American companies to sell them advanced technology (Kubo 1994, 94).

On the other hand, Japanese companies often complain that the overseas Chinese partners only pursue short-term profits, they don't involve their partners in negotiations, they give priority to their family business, and they sometimes obstruct efforts to raise technology standards in the joint venture. I have encountered one Japanese property developer who wished to break off with their overseas Chinese partner in Hong Kong. Initially, the Japanese company badly needed the personal connections of the Hong Kong counterpart, who introduced his relatives in his hometown near Shanghai. But as the joint venture in China grew satisfactorily and they developed their own personal ties with local businesspeople, the Japanese side began to feel that they were remitting profits to the Hong Kong counterpart without receiving any benefits. They grumbled that the Hong Kong company had no skills of any value and that they were exploiting their project.

Conclusion

We have observed the process of Japanese enterprises developing cooperative relations with overseas Chinese firms in China by using the business ties they had previously forged in Southeast and East Asia. In the 1990s, a new pattern of collaboration emerged between large corporations looking to cultivate China's domestic market, in which the partners combined the technology, management skills, and financial resources of the Japanese side with the personal network and operating experience in China of the overseas Chinese.

Today, the cooperation between Japanese and overseas Chinese companies is again nearing a new stage. Technology or personal ties alone will no longer be sufficient for forming an alliance that can withstand the global competition occurring inside China. The growing numbers of joint ventures does not guarantee the continuation of existing cooperation. Rather, the abundant choices will lead to greater competition between companies and a growing ability for companies to refuse incapable partners.

What the Japanese side must do is to adjust its management practices to suit the global business environment. Japanese companies should speed up their decision-making procedures, letting overseas offices take more responsibility and providing more promotion opportunities to local employees. This is not an easy task. Even in the prewar era, Japanese companies were weak when compared with European firms in using local talent, such as the "compradors," the native agents of China and Southeast Asia. One fundamental reason for this is that Japan still maintains a relatively closed social system that is intolerant of alien elements.

Japan should consider the implications of this tradition more seriously. Although geographically remote from China, the United States attracts more overseas Chinese talent than does neighboring Japan. The United States accepted 800,000 new Chinese immigrants from the mid-1970s through the end of the 1980s. Canada and France[11] each took in 200,000 such immigrants, and Australia accepted 180,000 (Yu 1995, 31).

At present, the United States is prepared to receive a brain drain from Hong Kong. It passed the Immigration Act of 1990, which enabled Hong Kong employees working for American companies to apply for special U.S. visas without actually leaving the territory until the year 2002. On top of that, the United

States has always been one of the favorite destinations for overseas Chinese students wishing to study abroad. Figures for 1991 showed that 12,000 Hong Kong students were enrolled that year in more than seven hundred American colleges and universities (Muir 1991, 95–96).

As a result, the second generation of overseas Chinese entrepreneurs shares the experience of earning MBA degrees in the United States, and they speak a common economic jargon. Thus intellectuals in major Asian cities are following an American style of business. This will become even more explicit when the first generation retires. In spite of Japan's proximity, the overseas Chinese, including new immigrants from mainland China, are "Japan-passing" in this sense.

Even though it is unrealistic to insist that Japan immediately replicate American ways, it is also true that the so-called Japanese-style management system faces challenges from the outside world. To promote reform, a necessary first step for Japanese institutions is to create a desirable environment for foreigners to study and work in Japan.[12]

Endnotes

1. The population of France is fifty-eight million.
2. The Chinese share of the general population in the year 1986 was 98 percent for both Taiwan and Hong Kong and 75 percent for Singapore (Inoue 1994, 28).
3. The Chinese share of the general population in the year 1986 was 30 percent for Malaysia, 10 percent for Thailand, 4 percent for Indonesia, and 2 percent for the Philippines (Inoue 1994, 28).
4. This excludes state-owned enterprises and foreign capital.
5. Hong Kong's investment in China as of the end of September 1996 is estimated to total $93 billion (Hong Kong Government 1997).
6. Labor costs in Hong Kong's manufacture sector began to fall as a result.
7. Historically, there have been instances in which the Chinese government assigned overseas Chinese to high political positions. China's National Peoples Assembly also maintains seats for overseas Chinese delegates. Yet it is clear that by appointing overseas Chinese tycoons and their successors to Hong Kong political bodies, China expects to maintain Hong Kong as a business center for overseas Chinese capital.
8. The Japan Export Import Bank sent questionnaires to 722 companies with more than three overseas affiliated companies, out of which 432 returned the questionnaires to the bank (Japan Export Import Bank 1997, 20–21).
9. Sinar Mas was ranked as the second largest business group in 1993, but it dropped to third largest and the Astra Group recovered second place in 1994 (Inoue 1994, 206).
10. Sales of 500,000 cases are projected for the first year. Also during 1995, Kirin opened representative offices in Guangzhou (in January) and Shanghai (in April).
11. Out of 200,000 Chinese, 120,000 are from Indochina.
12. For instance, allowing foreign students to take university entrance examinations without actually coming to Japan will decrease the costs and the risk of studying in Japan.

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