Introduction

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At the start of the new century, China is probably the most interesting but also the most risk-laden market in Asia. The reasons for this lie in the interaction between various economic, social and political factors. Since 1980 China's economy is growing at 8–10% per year – an unprecedented achievement even in East Asia.

The foundations for this economic development were laid in the economic and political reforms of the late 1970s and a more open attitude towards the rest of the world. In recent years, the economic dynamism has been spurred by foreign direct investment and the increase in trade that this has initiated. The Chinese government continues to rely on increasing public investment, which also stimulates growth. Joining the WTO has brought further impetus to this development.

China is not a consistently uniform economic area. Manufacturing, commerce and buying power are concentrated mainly in the coastal regions, where virtually all leading multinational companies have established a presence. In the North-East lie the old heavy industry areas. The modern technology and service centre Shanghai is developing in the East and, since the formation of the first special economic zones, the dynamic economy of the southern regions is developing along the lines of the former British Crown Colony, today the Special Administrative Region, Hong Kong. Personal income is rising, particularly in the industrial centres, and new groups of buyers with a lot of money to spend need to be supplied with high-quality consumer goods. Both Western and Japanese companies trading on a global basis can no longer leave China as a production base and as a market out of their strategies.

New forms of business organization and logistics systems along with changes in market requirements and international competition environments have been the key factors behind the changing patterns of geographical organization in globally active Japanese companies. These companies have established sophisticated models for production based on various technologies. Ever widening product ranges, increasing numbers of variants, the establishment of system suppliers, decreasing manufacturing penetration and accelerated market consolidation through mergers and strategic alliances are characteristic of development at the beginning of the 21st century – also in China. Development, which overall is speeding up, is particularly apparent in the shrinking life cycle of new products in the Chinese market. No major Japanese company can seriously afford to neglect the Chinese market in the long-term if it wants to maintain its position in global competition.

It is clear that the two most important economies in East Asia are Japan and China. Despite the dynamic growth of its economy over the last 20 years, China still has a long way to go to catch up with Japan. In industrial and technological terms, Japan is still the dominant economy in East Asia, although China closes the gap somewhat each year. The Sino-Japanese political, economical and cultural relationship has a long history, which has not always been free of tension. Particularly in the 20th century, the relationship between the two nations went through difficult periods and even led to military confrontation.

At the beginning of the 20th century, China was made to feel Japan's superior strength in its desire for regional dominance. Japan made territorial claims and asserted rights of sovereignty. The goal of Japan's policy in the 20s and 30s of the last century was to subjugate its neighbour and exploit the abundance of raw materials, beginning in 1922 when troops were dispatched to Shandong, continuing with the establishment of the Manchukuo puppet state and finally erupting into open war against China in 1937.

As Japan expanded aggressively into China, Japanese businesses invested in production and service facilities in order to profit from the rich resources of the country. In this phase of entrepreneurial interest in China, the Chinese market was not the crucial attraction for Japan. From a business point of view, the priority was to create the conditions for meeting the demands of the Japanese market which were determined to a not inconsiderable extent by the consequences of Japanese expansion. With its catastrophic defeat in August 1945 Japan had to withdraw from the Chinese mainland. All investment was lost. After World War II, there was no reconciliation between the two countries. On the contrary, the tensions between China and Japan continued. For Japanese businesses, China appeared to be closed as a market and as a supplier of resources for many years, if not decades to come. Particularly for Japan, with its dearth of raw materials, this important source for rebuilding seemed no longer accessible. Japanese companies had to realign; the United States of America became a valuable and reliable partner in the recovery of Japanese companies and the Japanese economy.

China took a different path. Having become communist in 1949 it aligned itself with the Soviet Union with which it signed a friendship and assistance treaty directed against Japan in 1950. With the San Francisco Peace Treaty (1951) and the security agreement signed at the same time with the USA, Japan was locked into a bilateral alliance. The outbreak of the Korean war intensified the confrontation between the Communist and the non-Communist camps considerably. Japan established diplomatic relations with Taiwan, but not with the People's Republic of China (PRC), which was not a signatory to the San Francisco peace treaty.

The U.S. policy of containment for China was circumvented by the Japanese business community as early as the 1960s. Resourceful Japanese companies recognized early on the opportunities offered by business relationships with Chinese companies. China was again seen as a business proposition. Private trade relations in the interests of both sides were revived. In 1964, this entrepreneurial activity even resulted in the unofficial opening of trade bureaus, which Japanese policymakers did not refuse to approve. At this early stage in the renewed business rapprochement, the state did not provide collateral for business relations nor did it guarantee loan commitments.

During this period, the Japanese government upheld the principle of separation of politics and business (*seikei-bunri*) towards the PRC. Japanese companies were intended to profit from the relations with China, but without acknowledging the politics of the Chinese leadership. A change in Japanese policy towards China only took place at the beginning of the 1970s, when in July 1971, the American President Richard Nixon travelled to China and revived the political dialogue between the USA and China. The political leadership in China was also interested in settlement with Japan. Since the 1950s, Japan had been achieving high rates of economic growth; some of the Japanese companies were about to become world leaders. China saw in Japan a potential source of advanced production technology and modern items of equipment for the development of its own technology and economy, which could only be exploited if relations were normalized. Official development aid (ODA) by Japan, which China implicity understood as a form of compensation, perhaps even as a kind of tribute, was only available after the political relationship between the two countries improved. The aid from Japan was not considered as voluntary support but was seen in relation to the Japanese war debt. As China had foregone formal reparation under the peace treaty of 1978, for the atrocities carried out by the Japanese during the war in China.

From the Chinese point of view, the Japanese development aid and the associated influx of private investment capital are welcome. However, the Chinese government regards the Japanese commitment to co-operation with a certain amount of scepticism, assuming that Japan is trying to make permanent the foreign trade and technological dependency relationship that exists between Japan as an industrialized country and the developing countries of East Asia. From the Japanese point of view, the interests of Japanese companies in the development aid are served by profitable exports and direct investment. From an economic point of view, Japan's interests lie in a peaceful relationship so that the economic interaction between Japan and China can continue to develop. It should not however be forgotten that the different assumptions and interests associated with the Japanese development aid to China only removed tension between the countries temporarily. Indeed, the aid was in many cases the source of bilateral conflict.

The high point of the normalization policy was the signing of a joint declaration by the Heads of Government of Japan and China, Kakuei Tanaka and Zhou Enlai, on 29 September 1972. With this declaration Japan recognized the PRC as the only legal Chinese government and both sides agreed to exchange ambassadors. This was a big step diplomatically, which was intended to have long-term positive effects on the economic relations between the two countries. After 23 years, diplomatic relations were resumed with the Chinese mainland. Japanese-Chinese relations underwent further normalization on 12 August 1978 with the signing of a peace and friendship treaty. Japanese and Chinese companies also profited from this political development.

With the establishment of diplomatic relations in 1972 and the signing of a long-term trade agreement, which followed, an expansion in trade volume rapidly became apparent. Economic development in the last 20 years has been favourable to the development of trade on both sides. Also the Declaration on Building a Friendship and Co-operation for Peace and Development in 1998 was import for the development of the Sino-Japanese relationship. Although development of bilateral foreign trade is subject to periodic fluctuation, the increase in exports and the intensification of financial and technical co-operation show that there is considerable economic potential on both sides. This applies both to opening up the Chinese market by Japanese companies and to the growing competitiveness of Chinese products in Japan or in other Asian markets. There is a clear trend: the increasing integration of the two economies. Japanese and Chinese companies are the driving forces behind this development. They face each other across a changing competitive environment, which is posing new challenges to corporate creativity and ability. How do Japanese companies react to the challenges and opportunities offered by China?

In Chapter 1, **Jörg Raupach-Sumiya's** article "Chinese Firms as Emerging Competitors of Japanese Firms" provides a comprehensive overview of China's growing international competitiveness in manufacturing and of the possible implications for Japanese management and for Japanese industry as a whole. It explores the key question of "What are the potential competitive advantages of Chinese firms vis-à-vis Japanese firms?" By applying Michael Porter's concept of "National Competitive Advantage" in his analysis, Jörg Raupach also investigates the question of which sectors of industry will experience increased competitive pressure with China's continued involvement and looks at the issue of potential strategies that Japanese companies can develop to respond successfully to the changes in the competitive environment.

Economic and technological competition between businesses and, viewed from a broader angle, between countries, plays a crucial role in the economic development of a country. It results in new product and process innovations, stimulates advances in management thinking and in the development of successful competition and market strategies. However, co-operation also forms a fertile base for economic development. The relationship between China and Japan in the area of economic, technological and scientific collaboration has also revived since the mid-1970s. Foreign direct investment was a driving force behind the rapid economic development in China in the 1980s and 90s. However, this investment should not be considered in monetary units alone. At the same time, it is an important source of technology and knowledge transfer, one of the main reasons why China was opened up after the collapses, the upheavals and depredations of the Cultural Revolution.

China's opening occurred after Deng Xiaoping announced a new economic policy at the end of 1978. Step by step, Chinese cities and regions were offered as attractive locations for foreign investment. Over the last 20 years, the regional distribution of Japanese foreign direct investment has shifted focus. North America and Europe now receive less, East Asia has gained. Within East Asia there have also been changes. First it was the NIEs, then the ASEAN states and later increasingly China forms the centre for Japanese direct investment abroad. These regional shifts within East Asia are in line with the flying geese model in which the comparative advantage moves from more developed countries to countries which are in the process of catching up. This is a standardized sector-based development pattern from import to export, typical for an industrial catch-up process. When production starts, protected in the early stages against competing imports, the proportion of imports to domestic market supply fall continuously, possibly until the country can meet domestic demand itself. As soon as an adequate level of international competitiveness has been achieved, the country starts exporting, allowing the companies to build up more production capacity which is accompanied by economies of scale and contributes not inconsiderably to strengthening their competitiveness. In a dynamic correlation, the countries also "flying" in the flock of geese on the one hand force the leading countries out of the traditional sectors, whilst on the other hand they lose their own position to their pursuers. This is a very dynamic process in which benefits conferred by location and the availability of competitive advantage in the sectors involved are not fixed, but move from country to country. The economic and technological operations of many Japanese companies in China has not exactly slowed down China's path through the "flying countries". In the early 1990s, the Japanese indulged in a real China euphoria, which was demonstrated by the very high sums Japan invested directly in China peaking in 1995. However, in the second half of the 1990s this entrepreneurial euphoria faded away. Even before the Asian crisis in 1997–98, business success in the Chinese economic arena was assessed with caution. A fall in direct investment indicated scepticism. Factors contributing to economic restraint included practical and legal problems in day-to-day business activities in China, rising costs, profits on the low side and doubt whether all the necessary reforms in state-run businesses and in the banking system could be successfully concluded. Despite these reservations, China remains for the mid and long-term one of the most promising target regions for Japanese companies. As a matter of fact China's entry into WTO gave once more rise to a forceful upswing of Japanese direct investment in China.

Japanese businesses have in recent years subjected their strategies to review. The strategy they had pursued for years – to use China mainly as a cheap location for production – seems to have reached its limits. Japanese businesses are focusing increasingly on the Chinese consumer market. Business efforts are no longer directed at the mass market; specific niches frequently seem to promise more.

In Chapter 2, "Japan's Manufacturing FDI in China – Its Characteristics in Comparison", **Shigeki Tejima** examines the development of Japanese direct investment in China in the 1990s. He analyses the particular characteristics of this development and draws comparisons with other target regions for Japanese business. He also investigates the question of how shifting production out of Japan will work in the future. In this context he looks at the hollowing out problem (*kūdōka*). *Kūdōka* will become increasingly acute as more and more industrial production is moved to China. Manufacturing abroad is a fixed component in international Japanese companies allowing them to remain in global competition. Hollowing out in manufacturing (*monozukuri no kūdōka*) is seen as a particular problem in Japan in the last decade. Koizumi's government is attempting to counteract this development, making efforts to attract foreign investment to Japan in order to strengthen the home manufacturing base. The goal is to double direct investment within five years and make Japan an attractive location for foreign companies. Foreign business is seen as the key to reviving the domestic economy.

The establishment of new dynamic businesses in fast-developing economies such as South Korea, Taiwan, Hong Kong and Singapore together with the increasing presence of businesses operating on a global basis from Japan and other Western industrialized countries are examples of the rapid changes the corporate world has undergone in recent years. The collapse of the planned economies in Eastern Europe, the economic re-alignment of the PRC and the evolution and consolidation of large unified economic entities such as the European Union (EU), the North American Free Trade Agreement (NAFTA) and the ASEAN states have all drawn new features on the economic map of the world. Key words such as internationalization, globalization and interculturality now characterize this process, which is challenging management anew to maintain or gain competitive advantage. It makes demands on the strategies and organizational concepts of international companies, but also offers numerous opportunities for entrepreneurial creativity.

The increasing speed of globalization will have a substantial effect on the way Japanese companies do business. Against the background of this development, the Chinese market presents Japanese businesses with many challenges and opportunities. From the Japanese SME point of view, the best place to which to relocate manufacturing processes seems to be in North East China (Manchuria). Greater Shanghai and the region around Beijing and Tianjin have also met with interest on the part of Japanese management in recent years. Particularly in North East China, the potential labour force required by mechanical manufacturing processes is available on a sufficient scale. Due to the size of the population in the North Eastern provinces of China, real wages are unlike to rise as quickly in the mid-term as in other economic centres in China. Furthermore, North East China is geographically closest to Japan. It comes as no surprise therefore that the north of the country became the preferred location for investment for Japanese SMEs in the 1990s.

In Chapter 3, "Sōgō Shōsha Quo Vadis? The Strategies of the Japanese General Trading Houses in the Chinese Market", **Hanns Günther Hilpert** is looking at the activities and strategies of the Japanese general trading houses entering the China market. Since the *sōgō shōsha*, which is a special type of firm unique to Japan, are shaken by structural change and are fighting for survival in the transforming Japanese and the globalizing world market, their activities in their in strategic terms foremost important foreign market, have a wider meaning. Hanns Günther Hilpert is first presenting the rationale of the *sōgō shōsha* within the framework of institutional economics and then analysing their China business, namely its foreign trade, investment, infrastructure development, retail and wholesale activities. He concludes that the *sōgō shōsha* do adapt to a changing world first by vertical integration into trade, second by becoming a more specialized company, third by focussing on investment and fourth by localization abroad. All these moves can be notably observed in China. The actions mentioned above make the *sōgō shōsha* become more and more an investment holding company and thus increasingly resembling to a western firm type. However, by virtue of their integral trading function, the sōgō shōsha is likely to differ permanently from the Western firm types.

In Chapter 4, **Shōichi Itō** deals with the "Human Resource Management in China". One of the key factors for business success in China is focused human resource management, orientated towards the specific requirements of the competitive environment. Shōichi Itō examines human resource management in Japanese subsidiaries in China, including how various types of employees are recruited and developed. In his analyses and accounts, he refers to investigations that he carried out in Japanese companies in Beijing and Shanghai.

In Chapter 5, "Playing the China Card: The China Strategy of the Taiwanese Electronics Industry and the Japanese Response up to 2000", **Douglas B. Fuller** examines the emerging strategies for China in the two largest segments of Taiwan's electronics industries (personal computers and integrated circuits). In this contribution Douglas B. Fuller focuses on the challenges and opportunities that these emerging strategies represent for Japan's own electronics industry. The Taiwanese and Japanese strategies for dealing with competition and using technology are compared.

In Chapter 6, "Risk and Motivation in Sino-Austrian Joint Ventures in China", **Christian Hirt** and **Ursula Schneider** analyse different models for external trade and their implications for joint ventures involving partners from both developed and emerging economies. They ask in how far experience in Sino-Western joint ventures, which are discussed in detail in their article, are relevant for Japanese companies operating in China.

Chapter 7 contains a detailed discussion of "Japanese-German Business Collaboration in Third Markets – The Case of China" by **René Haak.** The Chinese market is open and growing rapidly offering promising opportunities for German and Japanese businesses. Under these circumstances, German and Japanese management needs to decide whether a strategy based on co-operation can enable them to succeed in one of the most difficult markets in Asia. The central question is whether third market collaboration offers a promising basis for Japanese and German companies to work together, particularly in the dynamic and difficult markets in China. Entering the market in the form of a business collaboration between a German and a Japanese company represents just one possible approach, but one which can be promising under certain framework conditions and provided certain requirements are fulfilled.

Chapter 7 will provide the reader with an understanding of the complex theoretical context in which Japanese-German business collaboration takes place and investigate the reasons German and Japanese management give for working together. The article also focuses on the question of where areas of conflict arise in working together and on determining the role played by trust in Japanese-German third market collaboration. In order to answer these basic questions, René Haak analyses and evaluates the theoretical dimensions of collective internationalization strategy, especially third country collaborations and findings from research on Japanese-German business collaboration in China.

In Chapter 8, "The Trust Factor in Chinese-German Joint Ventures: Implications for Japanese Co-operative Ventures in China", **Harald Dolles** and **Niklas Wilmking** discuss the role of trust in international joint ventures. The particular challenge for research here is how trust is established and maintained in the relationships between international joint venture partners and their staff. Based on a detailed theoretical examination of the phenomenon of trust in international joint ventures – they differentiate between the roles of calculative, cognitive and normative trust in international joint ventures – they look in detail at the special role of trust in China and educe the implications for research in this subject area from their investigations.