

5 JAPANESE FOREIGN DIRECT INVESTMENT IN CHINA

FROM EXPORT-ORIENTED PRODUCTION TO DOMESTIC MARKETING¹

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INTRODUCTION

China's national development strategies have strongly influenced large multinational enterprises (MNEs) as well as small and medium-sized enterprises (SME) in Japan. The Chinese national government initiated policies to attract foreign direct investments (FDI) from the 1980s. These national policies have followed a cyclical pattern, consisting of four stages. From the first stage, the Chinese government set targets for economic development and Chinese delegations were organized to purchase manufacturing facilities and equipment to modernize factories in China, in order to attract Japanese engineering assistance. The second stage witnessed the active participation of Japanese, American and European multinational corporations to participate in bids for Chinese purchase orders. Negotiations also started between them at this stage. During the third stage, successful companies received orders and started factory production. The fourth stage was a period of retrenchment by the Chinese government, caused by its fiscal deficit and shortage of foreign currency. Payments by the Chinese government for technical assistance and imported factory facilities (i. e., transplants) were delayed considerably, leading Chinese politicians, such as Deng Xiaoping, to ask the Japanese government for official loans to help continue the existing projects.

¹ This paper is based on several research projects conducted in the Shanghai Waigaoqiao Free Trade Zone. The author would like to take this opportunity to express his appreciation to Japan Marine Industry Institute for allowing me to participate in 'The Research Project of Asian Economic Future and the Perspective for Logistics' led by Professor Toshio Watanabe in May 2002, and the Ministry of Education and Science Japan for supporting a research project in collaboration with Professor Kazuo Koike, Tokai Gakuen University, 'On the Research Methods of Management and Accounting Case Studies' in December 2002.

In the 1990s a handful of local governments in China began to take a greater initiative in the economic development policies of China. A typical strategy of the Chinese local government is a combination of tax holidays and exemption from import-duties in the Special Economic Zones. Above all, the 'unlimited supply of labour' was the cornerstone of economic policies to establish the necessary infrastructure for upgrading industries in China. Japanese companies responded actively to local government incentives, such as tax holidays and the establishment of industrial parks. Typically, a Japanese firm in China operates by bringing materials and components from Japan to an export-processing zone where they process and assemble them into products and then re-exporting them as finished products for third country markets, especially the United States and Europe.

Japanese FDI peaked in 1995 when the Japanese yen appreciated strongly during the 1990s. To survive, in the mobile phone industry, for example, some Japanese electronics companies acted as parts suppliers, exporting mainly to American and European companies. In addition, because the number of middle-income residents increased in Shanghai and the neighboring areas, Japanese companies began to target the domestic Chinese consumer market. Consequently, although the Japanese automobile industry has had a long history of alliances with Chinese domestic manufacturers since the 1980s, the consumer goods industries, such as beer and instant foods, appeared as prominent direct investors from 2000 onward.

Through the combination of state and local government trade and investment initiatives, Japanese FDI in China has led to the creation of three industrial agglomerations, or clusters. One is located around the Zhujian Kou delta, extending from Hong Kong, Shenzhen, Dongguan to Zhuhai in Guangdong Province. Another one is located in the area between Shanghai, Suzhou, Wuxi and Nanjin. The third agglomeration is in the North-East region of China and includes the corridor between Beijing and Dalian. The transition from export-oriented to market-oriented production and the subsequent rise of industrial clusters provides some insight to the twists and turns of the multinational corporations' country strategies. This paper briefly compares the Japanese FDI experiences in China between 1978 and 1990 with the period 1992 and 2001, and then examines how selected market (exchange rates) and non-market forces (national development policies) affect the overseas business strategies of Japanese companies over time.

CHINESE FDI POLICY AND JAPANESE RESPONSE: 1978–90

The term 'stop and go policy' refers to the period after the Second World War when the British government faced creeping inflation and stagnant economic growth. In contrast to the 'stagflation' in Britain, Chinese policy seems to pursue a cyclical pattern of 'go-and-stop policies'. When the Chinese government showed a go-sign in the 1980s, it became an advocate of 'reform', 'openness' and 'liberalization.' A stop-sign was indicated by public pronouncements expressing the need for 'adjustment' or 'coordination', or alternatively, when the government faced a 'budget deficit' or 'shortage of foreign currency reserves.' Nevertheless, the Chinese government displays a clear drive for economic development and it aggressively negotiates with neighboring governments for economic assistance during economic downturns to remain on track in rising up the economic ladder of development.

In the absence of market signals, then, foreign investors pay careful attention to the "national strategies" of a host country (e. g., see Scott and Lodge 1985, chapter 2). China's national development strategy resembles Japan's 'industrial policy' approach to economic development. On the one hand, industrial policy is a phrase used to describe the way the national government promotes the upgrading of key industries. And sometimes, on the other hand, it refers to policies justifying the exemption of 'strategic companies or industries' from anti-monopoly regulations. Since politics in China is still dominated by the Communist Party, one can argue that applying the Japanese idea of 'industrial policy' to China may be misleading. However, similarities between the two countries can be observed. Horaguchi (1994) summarizes the meaning of industrial policy in Japan and notes the constraints on it, of which the most notable for our discussion here is the limitation of foreign currency reserves. Moreover, China shares not only this characteristic in its national development policies, but also the private companies' strong reaction to the economic targets set by the government. The role of national development strategies became more evident in 1992, when Deng Xiao ping showed his willingness to make progress on economic reform and advance an open-door policy in his famous 'Southern Talks' during a highly visible visit to the southern regions of China in January of that year. This speech gave a strong 'go-sign' to foreign and domestic investors and Chinese economic development has accelerated since then. Local governments used this green light to offer preferential treatment for foreign investments.

The starting point for the 'go-and-stop policy' story about Japanese direct investments in China, however, is 1978, as far as the electrical and electronics industries are concerned. Contrasting Japanese FDI in China

before and after 1992 sheds fuller light on the role of national development strategies. In this connection, Takashiro (1994) traces this history from 1978 to 1990. He begins in February 1978, when Chinese government officials and managers of state corporations came to Japan as a delegation to buy factories and equipment for the manufacture of cathode-ray tubes for color television sets. This trip came in the wake of the historic signing of the 'Japan-China long-term trade memorandum.' In July, the Japanese electronics giant, Hitachi, received approval from the Chinese government to build a factory for the manufacture of 14 inch and 22 inch cathode-ray tubes, with an annual target of 960,000 sets. Hitachi set the target launch date for December 1980.

In February 1979, one year before the launch date, the Chinese government informed the Japanese Ministry of Foreign Affairs that it would delay implementing the contract for transferring factory facilities from Japan to China (i. e., transplants). It is estimated that a total of 580 billion Japanese yen had been lost, affecting 30 projects. Negotiations over transplants restarted in April of that year and continued until December 1979. Finally, Hitachi received an order for about three billion yen. Meanwhile Matsushita Electric (Panasonic) and Japan Victor Corporation (JVC) also received approval from the Chinese government to build factories in China (Takashiro 1994, pp. 14–5).

In 1981, the Chinese government announced the cancellation of the contracts for the transplants and suspended factory construction for contracts signed between 1978 and 1979. The total amount cancelled is reportedly estimated at around 500 billion yen. American and European contractors were also affected. It is estimated that Japanese contractors alone would suffer a loss of about 320 billion yen from the breach of contracts. In March 1981, Deng Xiao ping and Aiichiro Fujiyama, a representative of the Association for the Promotion of International Trade, Japan, had a meeting in China. Deng subsequently met with Toshio Doko, the President of the Japan-China Economic Cooperation Association. It is reported that at these meetings the Chinese government asked for loans amounting to about 300–400 billion yen to continue factory construction. In April 1981, the Japanese government announced that it would provide loans of USD 2 billion, or about 400 billion yen over the next five years. The Export-Import Bank of Japan assumed responsibility for 250 billion yen of this rescue loan package (Takashiro 1994, p. 30).

From 1983 to 1984, the local governments in China actively introduced various foreign technologies through FDI and the purchase of factory facilities. This was implemented by acquiring from the national government a statutory status called Special Economic Zone. The first four Special Economic Zones were established at Shamen in Fujian, Shenzhen

in Guangdong, Zhuhai, and Shantou. In March 1984, Dalian was the fifth city to acquire the same status. In April 1984, the Chinese government decided to allow for 100 per cent foreign capital ownership, and it gave 14 cities, in a position to give favourable treatment to foreign firms, the status equivalent to a Special Economic Zone (SEZ). The fourteen cities are Dalian in Hebei, Qinhuangdao, Tianjin in Shandong, Yantai, Qingdao, Lianyungang in Jiangsu, Natong, Shanghai, Ningbo, Wenzhou, Fuzhou in Fujian, Guangzhou in Guangdong, Zhanjian, Guangxizhuangzuziqu Beihai (Beihai in the Guangxizhuang Autonomous Region). In December 1984, the Chinese government announced that Shanghai would be granted the statutory status of a Quasi-Special Economic Zone. These SEZs became one of the major channels through which the Chinese government implemented its national development policies.

In July 1985, the Chinese government announced that it would allocate foreign currency for imported parts of colour television manufacturers only if they had attained 70 per cent of the parts and components from local suppliers (i. e., local content rule). In August, the government gave notice that it would stop promoting manufacturing technology transfers from Japanese electrical makers and motorbike manufacturers. Colour televisions, refrigerators, washing machines, air-conditioners, and motorbikes were among the 11 product categories affected. The reason the government gave was the over-supply of products and a shortage of foreign currency (Takashiro 1994, p. 47).

In August 1987, the Chinese government announced that all state-owned firms would introduce a Factory Manager Responsibility System by the end of 1988. The Factory Manager Responsibility System was initiated in May 1984, and 63.9 per cent of the Chinese state-owned firms in the manufacturing sector, numbering roughly 35,200, had already introduced the system. The wage system was also altered. In addition to hourly rates for labour, a piece rate system was also introduced. In early 1988, the government allowed wider autonomy in foreign trade for local trading companies. Thus some industries were allowed to keep 50–100 per cent of the foreign currency acquired (Takashiro, 1994, pp. 52–3).

By early 1989, Japanese firms were actively investing in China because the strong appreciation of the Japanese yen encouraged them to find low cost production bases. The Tiananmen Square incident, however, had a devastating effects on the business climate in China, virtually stopping the various business negotiations underway for a while (Takashiro 1994, p. 63).

JAPANESE FDI AND FOREIGN EXCHANGE RATE: 1990–2001

Japanese FDI in China gradually recovered from the Tiananmen Square incident after 1992 and reached a new peak in 1995. Table 5.1 shows a comparison between Japanese FDI in China and in the United States. The number of Japanese FDI projects in China was greater than the number in the United States in 1994 and 1995. The amount of investment, however, remained small compared to FDI in the United States, suggesting China was attracting investments from Japanese SMEs.

Table 5.1: Japanese FDI in China and in the United States

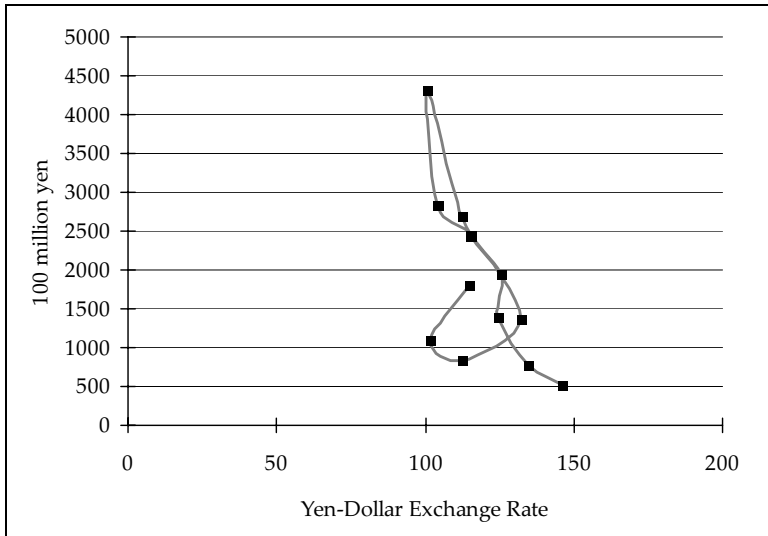
	China		United States	
	Projects	Amount	Projects	Amount
1989	126	587	2668	43691
90	165	511	2269	38402
91	246	787	1607	24671
92	490	1381	1170	17993
93	700	1945	882	16936
94	636	2683	509	18016
95	770	4319	510	21845
96	365	2828	581	24789
97	258	2438	582	25486
98	112	1363	318	13207
99	76	838	350	24868
2000	102	1099	272	13413
2001	187	1802	205	7970

Note: Unit: project = actual number; amount = billion USD

Source: Ministry of Finance, Japan (www.mof.go.jp).

The peak year for Japanese FDI in the United States was 1989, and the trend shows a continuous decline through the 1990s. Although the total amount of Japanese investment each year is much lower in China than in the United States, in recent years the gap has been closing both by number of projects and amount. It is sometimes inferred that the appreciation of the Japanese yen is a major motive for Japanese FDI to China and other overseas destinations. Figure 5.1 traces the fluctuation of Japanese FDI in China and the yen-dollar foreign exchange rate between 1990 to 2001.

Figure 5.1: Correlation between Exchange Rate and Japanese FDI in China: 1990–2001



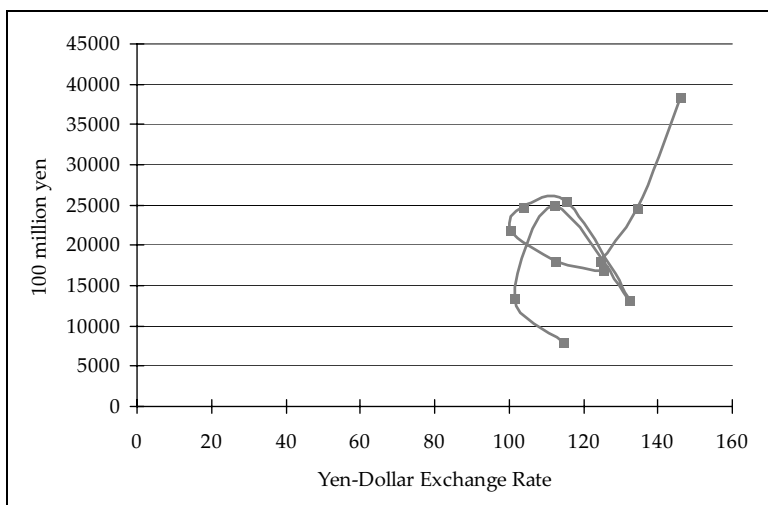
Source: Ministry of Finance, Japan (www.mof.go.jp).

One can see that Japanese FDI increased as the yen-dollar exchange rate moved towards 100 Japanese yen per US dollar, or when the Japanese yen appreciated strongly. From the standpoint of Japanese manufacturers, a strong appreciation of the yen leads to profitable exports from low labour cost countries rather than from Japan, as long as the destination is in the US dollar currency bloc. The correlation coefficient in Figure 1 of -0.64 suggests a strong appreciation of the Japanese yen is one factor motivating Japanese companies to shift production capacity from Japan to China.

Figure 5.2 shows that Japanese FDI in the United States, in contrast to the China case, follows a somewhat different tendency, yielding a correlation coefficient between FDI and the Japanese yen – US dollar exchange rate of $+0.38$.

There may be several reasons for this positive correlation. First, Japanese firms do not expect to achieve a cost advantage when they produce goods in the United States. Instead, they might attach importance to building a brand name or to adding value to their brand image. Second, Japanese FDI in the United States is prominent in the service sectors, such as trade, commerce, travel, and logistics. Consequently, even though

Figure 5.2: Correlation between Exchange Rate and Japanese FDI in the U.S.: 1990–2001



Source: Ministry of Finance, Japan (www.mof.go.jp).

Japanese manufacturers invest in the U.S., their main focus is developing their business support activities to round out their value chain. Third, Japanese FDI in the United States requires additional investment to sustain existing businesses. Thus, a fluctuation in the exchange rate does not directly affect the decision to invest abroad. Fourthly, the correlation may be an artifact of the data. During the 1990s, Japanese macro-economic conditions shifted towards deflation, based on capital loss of assets from the 'asset bubble economy.' In this regard, the correlation between FDI and the exchange rate shows some years of coincident decline.

It seems statistically that Japanese firms are sensitive to exchange rate fluctuations but how can we more concretely explain the difference between China and the United States as direct investment destinations? There are many factors involved, however, here we only explore one line of analysis: the role of the special economic zones in China's national development strategies. Table 5.2 shows the location choices of Japanese firms corresponds closely to the tax incentives given by the local governments. In Shanghai, granted a special statutory status, Shenzhen (Guangdong), and the other cities given special economic zones status are all high on the list in Table 5.2. In contrast, those local governments in regions without such authority receive significantly less FDI from Japanese companies.

Table 5.2: Regional Distribution of Japanese FDI in China

	Number of Employees in Japanese Firms in China	(%)	Number of Japanese Firms	(%)
Shanghai	105,477	18.3	663	26.3
Guangdong	100,887	17.5	327	13.0
Jiangsu	76,758	13.3	352	13.9
Liaoning	67,975	11.8	246	9.7
Tianjin	59,081	10.2	149	5.9
Beijing	42,276	7.3	252	10.0
Shandong	38,217	6.6	155	6.1
Zhejiang	20,232	3.5	90	3.6
Hebei	11,253	1.9	39	1.5
Fujian	8,945	1.5	51	2.0
others	46,140	8.1	201	8.0
Total	577,241	100.0	2,525	100.0

Source: Nagaoka (2002, p. 24), which is based upon Toyo Keizai Shimposha (2001).

In Shanghai, the Waigaoqiao Free Trade Zone (FTZ) deserves special attention to illustrate the role of local government in attracting Japanese and other foreign direct investors. The United Development Corporation was established in 1990 to manage the Waigaoqiao FTZ, and as of April 2000, consists of 5,300 companies of which roughly 11 per cent are Japanese companies. These companies can be classified into four types: trading companies, distribution centers, production facilities (manufacturing), and logistics. The following passages are based on the interviews the author conducted on 29 May 2002 at Japanese companies located in the Waigaoqiao FTZ.

The Waigaoqiao FTZ is different from an export processing zone or a development area in that it implements various unique schemes and privileges. Trading companies, for example, pay one per cent in income tax for the first and second years after setting up, ten per cent from the third to the fifth years, and 15 per cent from the sixth year. Production factories are exempted from paying tax for the first and second years, and then they are levied income tax at 7.5 percent from the third to the fifth years, and 15 per cent from the sixth year onward. There are conditions for setting up a corporation in the Shanghai Waigaoqiao FTZ: a corporation needs to invest paid-up capital of at least USD 200,000. A trading company needs to have more than 20 square meters of offices, and a production factory must occupy more than 400 square meters of land.

Shanghai's Quasi Special Economic Zone statutory status, under the national development policy, the Waigaoqiao FTZ is allowed to grant foreign capital six major concessions: (1) 15 per cent corporate income tax; (2) exemption from import duty for imported equipment, parts and materials; (3) exemption from export duty; (4) permission for sales on the Chinese market; (5) autonomy in employing workers, and (6) allow remittance of capital by foreign firms with more than USD 30 million of investment in technology and knowledge intensive operations. We can provide a preliminary assessment whether these national development policies affect the overseas strategies of Japanese companies as implemented through the United Development Corporation by taking the case of two Japanese companies I visited in May and December 2002 that are operating in the Waigaoqiao FTZ.

COMPANY A: DIGITAL VIDEO DISC PLAYER MANUFACTURER

Japanese Home Appliance Company 'A' produces digital video disc (DVD) players in the Shanghai Waigaoqiao FTZ. The proportion of investment is 55 per cent on the Japanese side and 45 per cent on the Chinese side. Company 'A' manufactures lower-priced, 'entry-model' DVD players in Shanghai. The product is sold at around USD 90 in the United States, whereas it is sold for the equivalent of USD 129 to 139 in shops in Japan. For the Japanese market, digital cinema systems, which enable a family to watch DVDs on a wide screen at home, are sold at around USD 400 to 500. Approximately 40 per cent of the product goes to the United States, 30 per cent to Europe, 12 per cent to Japan, and 10 per cent to Asian countries. The remaining 8 per cent is sold in China. Consequently, the fiscal concessions the Shanghai Waigaoqiao FTZ grants to company 'A' in the areas of tax holidays and exemption from import and export duties allow it to remain competitive on price against DVD makers from South Korea and other countries in the American and European market.

Company 'A's production facility was fully utilized in May 2002. Since the terrorist attack in the United States on 11 September 2001, the demand for DVD players has rocketed, creating a shortage of semiconductors for the assembly of DVD components. Consequently, when the author visited on 30 May 2002, the line at company 'A' had been stopped due to the shortage of electronic components. It had been operating at full capacity three days earlier, the manager explained. It was expected that Company 'A' would not be able to assemble DVDs for at least the following two weeks. Down time on the assembly line is costly, but companies in the Waigaoqiao FTZ have access to a skilled and flexible labor market. Taking advantage of the autonomy granted in hiring workers, Company 'A' em-

ployed workers on the production line mostly from vocational schools from rural areas. Their official employment status was considered a student internship. Thus, only a small number of employees were actually employed on a regular basis. When Company 'A' operates 24-hour shifts using four groups of workers, it can produce 10,000 DVD players per day, and employ up to 1,200 workers. When demand is low, the number of employees could fall to around 650 core workers. Eight Japanese expatriates worked in Company 'A', of whom two were involved in product development, and the other six in production management.

The general manager of Company 'A' spent 10 years in Singapore from 1978 to 1988, moved to Malaysia for six years, and was then sent to Shanghai in 1994. When he was posted in Shanghai at Company 'A', the performance among the overseas subsidiaries of the Japanese parent company was very poor. He said international competition had become fierce since China joined the World Trade Organization (WTO). The general manager's motto is to practice 'management that captures a giant fish with a small boat.' For example, he used the duty exemption on imported machinery to buy second-hand IC chip machines in Singapore from another Japanese company in order to make cheap IC chips on the printed circuit boards in Shanghai. The automation ratio was deliberately limited to 95 per cent so that the production line could utilize the low cost labour force. In Japan the ratio was more than 98 per cent. Locating in the Shanghai Waigaoqiao FTZ provides Company 'A' with labor and machinery cost advantages not found in Japan or other production bases in East Asia, allowing the general manager to reorganize and rejuvenated Company 'A'. As a result, he was posted to the Beijing factory in July 2002, where Company 'A' assembles video cassette recorders, TVs, and plasma displays. Through these incremental measures, Japanese companies have been deepening their direct investments in China.

COMPANY B: POLARIZE FILTERS MANUFACTURER

A Japanese electronic parts manufacturer 'B', operating in the Waigaoqiao FTZ, produced polarize filters for liquid crystal panels. About 70 per cent of the polarize filters are installed in mobile phones. The Japanese parent company actually started as an adhesive tape manufacturer and then diversified into polarize filter production when high demand for liquid crystal panels emerged in the electronics goods sector. Company 'B' highlights a basic characteristic of the competitive strength of Japanese companies: the ability to develop new products by either diversifying within its industry (i. e., producing increasingly sophisticated products) or diversifying across industries. In the case of company 'B', using its

adhesive tape know how and applying it to the manufacture of polarize filters. Low cost overseas production bases, like the Waigaoqiao FTZ, fit into this competitive strategies when Japanese companies are no longer able to reduce costs (i. e., rationalization) in Japan for products that still have a high market demand.

Company 'B' obtained permission to operate in China in 1994. Company 'B' was attracted to the Waigaoqiao FTZ because it allows trading activities for foreign subsidiaries. Even though merchandising activities are strictly regulated in China, the Waigaoqiao FTZ allows foreign subsidiaries to import goods and resell them on the Chinese market without adding value. An additional advantage is that value-added tax is not applied in the free trade zone. This national development policy granted to the Waigaoqiao FTZ fits well with the Japanese company's strategy for entering a host country through its sales and after-service business functions. As a company learns and acclimates itself to the host country, the justification for building manufacturing facilities becomes justified by the growth in local or third country demand. After seven years in China, Company 'B' seems to be moving beyond its initial phase in its direct investment strategy in China by opening its second factory in May 2001 and in December 2002 it started producing flexible circuit boards. Company 'B' seems to be gaining confidence in its business plan for China. In recent years it has established a new factory in the Suzhou industrial park to manufacture wide-angle liquid crystal panels for large flat screen television monitors and 15 inch personal computers.

Company 'B' leases the factory in the Waigaoqiao Free Trade Zone and the optical division of the parent firm provides technological support. There are 241 employees in the manufacturing group with 54 in quality assurance, 21 administrative staff, and one Japanese expatriate. Between 1995 to 1996, there used to be three Japanese foreign expatriates at the factory who provided support in the finance department and in factory management. Company 'B' decided to reduce the number of expatriates since the living expenses for foreign expatriates are high. Since the products of Company 'B' are sold to mobile phone companies, which requires continuous cost reduction, it had to improve cost competitiveness by reducing the high cost of maintaining Japanese expatriates in China.

There are 760 Chinese workers in the first and second factories. Like Company 'A', Company 'B' is realizing cost savings from employing workers provided by vocational schools in China. Company 'B' sometimes recruits openly, but in the Waigaoqiao FTZ an employment service company usually acts as an intermediary between Company 'B' and the vocational schools. Other Chinese employment agencies help in finding office clerks. The monthly wage for the operators at workshop, often

referred to as direct workers, is about RMB 960 at entry level, or about USD 150. Most of the employees commute on foot. Company 'B' offers a RMB 300 allowance for workers who have passed the First Certificate of Japanese Proficiency. Further cost savings are realised by employing three-shifts and operating 24-hours five days a week with Saturday and Sunday off.

In short, China's national development policies, as implemented through its Special Economic Zones, opens a window for foreign companies to enter China. The rapid growth in FDI is due to fewer 'stop-policies' after 1992 than in the 1980s. Nevertheless, our brief discussion of the United States suggests that Japanese FDI may not expand beyond labor-intensive products into business support functions and higher valued products until market forces replace national policies in attracting FDI.

CULTIVATING THE MIDDLE CLASS: A CASE OF MARKETING FOOD IN SHANGHAI

Ajinomoto is one of the biggest food corporations in Japan². In my interviews with Mr. Kitamura, a vice-president at Ajinomoto, in Japan, he stated they have been planning to sell Japanese cuisine in China (Horaguchi 2003). Ajinomoto's strategy is based upon the growth of the middle class in a metropolitan city, Shanghai. The consumer market in this city appeared to demand not only automobiles but also other consumer goods for everyday life. Since the traditional product associated with Ajinomoto is monosodium glutamate (MSG), it teamed up with Mr. Seto, a general manager at House Foods, who was seeking to enhance the market for curry, based upon his experience of running a curry restaurant in Shanghai.

House Food is a big brand in Japan, which offers various instant food products. The House-Ajinomoto joint venture in China decided to sell curry products in plastic pouch bags. Consumers simply put these plastic pouch bags in boiling water to warm up the curry and when it is ready they cut open the bag and pour it over rice. Ajinomoto itself has the technology to produce curry in plastic pouch bags, but it chose House Foods as a partner to cultivate this nascent consumer market in China. Ajinomoto has already established a strong dealership network in China, and House has a relative advantage in producing curry. House Foods also operates two Japanese-style curry shops in Shanghai. This paper summarizes an interview survey conducted in Shanghai in December 2002.

² The following passages are based on the author's interview on 19 December 2002 at Shanghai House-Ajinomoto Foods Limited Corporation.

Ajinomoto established Shanghai House-Ajinomoto Foods Limited Corporation in September 2002 as a joint venture with the House Food Corporation in Japan. Five per cent of the shares in Shanghai House-Ajinomoto Foods Limited Corporation is held by Ajinomoto, the Japanese parent company, 65 per cent by Ajinomoto Limited Corporation, China, and 30 per cent by House Food Corporation, Japan. House Food is responsible for production and Ajinomoto Japan is responsible for distribution. The organization of the factory consists of a general affairs department, a production department, and a development and quality assurance department. The Director of General Affairs is a Chinese, who had been working for Ajinomoto Limited Corporation, China. There are 55 operators who were provided by a recruiting agency. Single shift production was adopted.

On 24 September 2002, Shanghai House-Ajinomoto Foods Limited Corporation held an inauguration ceremony. It assembled more than 20 media reporters from Japan, including NHK, Tokyo Channel 12, and Nippon TV. In addition, the mass media from 15 Chinese organizations attended, including newspapers such as the 'Shanghai Commerce' and 'Liberation Daily' and TV stations came to the ceremony. The general managers of Japanese companies in the Shanghai area, Chinese bankers, insurance companies, and construction companies were also guests. A press release was issued at 1:00 p.m., and the opening ceremony started at 3:00 p.m. A factory tour and curry tasting followed, and then the participants moved to the Garden Hotel for a cocktail party. The presidents and executive directors of House Foods and Ajinomoto attended the ceremony from Japan, and high-ranking officials of the Communist Party and the Chinese government also participated. A Chinese-style lion dancing was performed as part of the celebrations and fire-works and firecrackers were set off to make an auspicious start.

The Shanghai House-Ajinomoto Foods Limited Corporation plant started trial operation on 9 September, and by 14 October it started supplying the product for distribution to the market. On 17 October, 'boil-in-the-bag curries' were sent to retail stores. The name of the product was 'Weidudu Curry.' The House-Ajinomoto staff explained to me that the name did not have a meaning, but a local Chinese advertising agency coined this name for its symbolic brand value. They intended to build a new brand image with the use of 'Weidudu', and the name was deliberately chosen because it sounds appealing and is easy to remember, especially by children. The Chinese characters for 'Weidudu Curry' include the character for 'mouth' in each of the five characters, which is intended to remind consumers of their appetite. House-Ajinomoto hopes to establish a strong brand in China, with favorable impression and price from

customers. The retail price of 'Weidudu Curry' products ranged from RMB 5.8 to 9.5. Compared to the average lunch price of about RMB 5 to 7, the image of the 'Weidudu Curry' as a luxurious meal eaten at home is meant to appeal to the rising middle class market segment residing in the city.

Shanghai House-Ajinomoto Foods Limited Corporation also produced TV commercials, which were broadcast during the prime times of 7:30 a. m. and 7:30 p.m. on all major Chinese TV channels. The main target for the 'Weidudu Curry' is child, but it is housewives who buy the product. Thus, the main concept behind its commercial is to convey the link between mother and child. House-Ajinomoto delivered 250,000 free samples in the Shanghai area through its existing distribution network. The traditional product for Ajinomoto is monosodium glutamate (MSG), and Ajinomoto had already established a distribution network in China over the years. Ajinomoto Limited Corporation China is now assisting in establishing curry a distribution network.

The strategy of Ajinomoto and House Foods is a typical example of 'co-option' strategy, proposed by Doz and Hamel (1998), where a strategic alliance acts as a barrier to newcomers.

Although both Ajinomoto and House could have been able to penetrate into the Chinese market by introducing curry products, they preferred not to have fierce head-to-head competition because the two Japanese companies foresaw that Chinese local competitors would soon emerge. Price competition is a common phenomenon in the Chinese consumer market and the two Japanese companies wish to get a sound return on investment. Ajinomoto is specializing in marketing and House Food is concentrating in production. Thus, this is considered as a typical example of 'co-specialization' in which two companies specialize in their area of greatest competence in order to compete with others.

CONCLUSION

Japanese companies have created industrial agglomeration partly to avoid business risks upon entering the Chinese consumer market by sharing information among Japanese companies. Tax incentives offered by Chinese government explains why certain areas absorbed huge amount of foreign investment since the 1990s in China. Indeed, to date, these national development strategies have been relatively successful in attracting FDI. Beyond the Waigaoqiao FTZ, today there are a number of industrial agglomerations in China. One of the agglomerations is located around the Zhujian Kou delta, from Hong Kong, Shenzhen, Dongguan to

Zhuhai in Guangdong Province. The second area covers Shanghai, Suzhou, Wuxi and Nanjin. The third is in the North-East and includes Beijing and Dalian. If these agglomerations of Japanese companies follow the Waigaoqiao FTZ case, we would expect to see more Japanese products in the Chinese market in the future.

Up to the 1980s, however, Japanese FDI in China has sometimes caused repercussions in the Chinese economy. Chinese 'modernization', 'reform', and 'open-door' policies were 'go-signs' to attract Japanese FDI. Japanese subsidiaries suffered from inflation in the Chinese economy, and from a shortage of foreign currency. Political protests such as the Tiananmen Square incident also affected the business environment. Curbing inflation and tightening money market conditions affected the management practices of Japanese firms, and Japanese managers felt that Chinese policy changed frequently. In the 1990s, Japanese firms invested heavily together with their competitors exhibiting a herd-like behaviour. One can also say that Japanese FDI was excessive compared to the potential markets in China, one being internal demand, and the other being the market for capital goods to help growing export production.

When the yen exchange rate was high in 1994–95, Japanese FDI in China reached its peak. This was partly because Japanese investors lost opportunities to invest in Japan after the asset bubble burst. It was partly induced by Chinese local governments, giving various incentives to foreign companies. In China during the 1990s, jobs were created, electrical goods became more widely used in Chinese households, and urban living took on new forms. This may be an effect of 'globalization', which spread from Japan, the United States and Europe. There will probably be a reaction to the 'globalization' either in political or in economic form (see Horaguchi 2002). It is well known that after a country passes a phase of 'unlimited supplies of labour', it develops a significant middle-class, which then calls for democratic policy-making.

Chinese business has been, and still is attractive to Japanese firms, but the business conditions bring risks in various forms. A tendency towards herd-like behavior by Japanese firms has resulted in the excess direct investments in China. This may also contribute to higher risks of sustaining operations in China. While Japanese companies have learned many lessons for using China as an export platform from the past few decades, the next few decades it seems will see Japanese companies turning their attention to the local consumer market. In this respect, Japanese companies need to clarify whether or not the Chinese internal market is growing steadily and what new lessons they must learn to reduce such business risks. This is an exciting agenda and further research is definitely needed.

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