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The Surge of Japanese Investments in China Utilizing Taiwanese Managerial Resources

~ a viable business model? ~

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Summary

1. China's expanding market potential stemming from its high economic growth and entry to the World Trade Organization (WTO) is fueling a resurgence of China–bound investment by Japanese companies. In the course of such investments, there is a sharp rise in number of Japanese companies investing in China either with Taiwanese companies or through their subsidiaries in Taiwan. Given the common characteristic that these forms of investment utilize the managerial resources of Taiwanese companies and its own subsidiaries in Taiwan, investment in China using this format may be referred to as "Japanese investments in China utilizing Taiwanese managerial resources" (abbreviated hereinbelow as "JCT Investment(s)").
2. Despite the difficulty to assess the total volume of JCT Investment stemming from limitations in terms of source material, available sources reveal that there were 249 cases of JCT Investment by Japanese companies during the period from 1989 to the end of June 2004, of which 142 cases were established since 2000. This means that approximately 7% of affiliates in China set up by medium or large–sized Japanese companies were established by JCT Investment.
3. The recent surge of JCT Investment is driven by the automobile and auto parts industries. In the background is the full–fledged entry of Japanese and Taiwanese automobile set makers into China. Furthermore, the electronic parts and devices sector is also continuing to invest heavily in China using the JCT Investment model.
4. While the relationship of mutual trust stemming from Japan and Taiwan's long–standing economic relations and the human resources nurtured at Taiwanese subsidiaries provides a fertile source for JCT Investment, the major factor is the possession of "competitive managerial resources" by Taiwanese companies and subsidiaries which differ from those of Japanese companies.

5. JCT Investment provides Japanese companies with the following merits. Firstly, Japanese companies are able to mitigate the language and cultural barriers – serving as major impediments to business in China – through the assistance of the Taiwanese party. Secondly, there are various advantages deriving from the massive distribution, manufacturing and human networks of Taiwanese companies in China. For example, by selling products not only to Japanese companies but also to Taiwanese companies in China, companies seeking market entry into China would be able to achieve economies of scale and risk diversification. Mergers with Taiwanese companies possessing vast distribution networks in China would facilitate market entry into China. Moreover, Japanese companies would also be able to procure inexpensive and high quality parts by utilizing industrial clusters comprised mainly of Taiwanese companies in China. Companies also benefit in terms of information, stemming from the close and steadfast relations between China's local governments and Taiwanese companies.
6. By the same token, Taiwanese companies are seeking to invest in China by utilizing the high technological skills, brand recognition, distribution and export channels toward Japanese companies and bargaining power of Japanese companies toward the central government of China (the "Japan–utilizing model of investment in China").
7. Despite the merits of JCT Investment, this type of investment also has its demerits. As in the establishment of business ventures and sub–subsidiaries, the adjustment of differing views between investing parties requires costly efforts and may at times lead to serious clashes of opinion. In particular, the increase of cases where both the Japanese and Taiwanese parties establish more than one subsidiary in China is making it more difficult to harmonize gaps in opinion.
8. Looking forward, there are predictions that JCT Investment will gradually decline due to forecasts of the improvement of the investment environment in China and the accumulation of

business experience in China by Japanese companies leading to the progress of human resource development in China. Nevertheless, the odds are high that Japanese companies will continue to opt for JCT Investment as one of the most effective models for investment in China due to (1) the likelihood that it will still take more time for the improvement of the investment environment in China, (2) the persistence of language and cultural barriers even in the event the investment environment improves, (3) the difficulty to gather and accumulate Chinese business expertise and human resources with a deep understanding of China's language and culture in a short period of time, especially in the case of small and medium–sized companies, and (4) the ongoing potential of the distribution and manufacturing network of Taiwanese companies in China.

1. Introduction

There has been a resurgence of China–bound investment by Japanese companies from around the year 2000, fueled by China's expanding market potential stemming from its strong and sustained economic growth and market liberalization and improvement of the investment environment accompanying its entry to the World Trade Organization (WTO). In the course of the resurgence, there has been a sharp increase of Japanese companies investing in China through joint ventures with Taiwanese companies and its own subsidiaries in Taiwan. Given the common characteristic that these forms of investment utilize the managerial resources of Taiwanese companies and its own subsidiaries in Taiwan, investment in China using this format may be referred to as Chinese investments utilizing Taiwanese managerial resources in China ("JCT Investment(s)").

Given the sharp rise of JCT Investments, there has been a surge of press coverage on the subject. However, there is not much research in terms of the assessment of total investment because of the limitation of source materials (Note 1). Furthermore, in contrast to various discussions on the effectiveness of JCT Investment, there is a lack of research setting forth its demerits and costs in explicit terms.

Thus, the purpose of this paper is to gather as many examples of JCT Investment as possible on the basis of both written material and oral interviews and to analyze its merits and demerits in terms of effectiveness as a business model.

2. The sharp increase of JCT Investment

(1) Definition of JCT Investment

Investment in China referred to in this paper as JCT Investment may be classified broadly into the three following categories in terms of the entity or vehicle utilized for investment: (1) a Japan–Taiwan joint venture, (2) a Taiwanese subsidiary of a Japanese company, and (3) the "composite vehicle". The "composite vehicle" refers to joint investment in China including both by a Taiwanese company and a Taiwanese subsidiary of a Japanese company as investing parties.

(2) The total amount of JCT Investment

On the basis of press coverage mainly by Japanese newspapers, Internet websites and press releases of corporate enterprises, the *Kaigai Shinshutsu Kigyo Soran* (Japanese Overseas Investment) published by the Toyo Keizai, Inc. and interviews, we found at least 249 cases of JCT Investment during the period from 1989 to the end of June 2004.

Given the characteristics of the aforementioned source material, we do not think that the foregoing provides a full account of JCT Investment by small companies and joint ventures in which the Japanese party is a minor investor. Furthermore, it should be noted that Taiwanese corporations were required to make investments in

China via third countries or regions up until July 2002. This resulted in the establishment of Japan–Taiwan joint ventures in third countries and regions, which in many cases invested in overseas affiliates in China. The foregoing structure makes it difficult to assess accurately the actual state of investments within the scope of this research paper. Thus, while it is beyond doubt that the actual number of JCT Investment is far larger than the number ascertained in this research paper, we still believe that it covers quite accurately the scope of JCT Investment by medium–sized and larger corporations.

According to the Toyo Keizai's *Kaigai Shinshutsu Kigyou Soran* (Japanese Overseas Investment), possessing a similar scope of coverage, there were 3,476 overseas affiliates of Japanese corporations in China as of the end of November 2003. Taking this number as the parameter, the percentage of overseas affiliates in China established in the course of JCT Investment would be approximately 7%. As shown above, a considerable number of overseas affiliates of Japanese companies in China were established by JCT Investment.

(3) The sharp rise of JCT Investment since 2000 and major investing parties

In contrast to a mere 107 cases of JCT Investment during the 11–year period from 1989 to 1999, there were 142 cases during the four and a half–year period from 2000 to the end of June 2004 (**Chart 1**). This shows a sharp rise of JCT Investment in recent years.

a. The electric and electronic appliance industry

In terms of industrial sectors, the main driver of JCT Investment by Japanese corporations is the electric and electronic appliance industry. There were 55 cases during the period from 1989 to the end of June 2004. Although the major part of investment in the 1990s was comprised of relatively low–technology household electric appliances and information technology (IT)–related parts and components, the bulk has shifted to investment in higher technology

IT–related parts and components from 2000. We have also found scattered examples of investment in automobile–related electric and electronic parts and components (lights and batteries etc.).

Chart 1: JCT Investment (number of cases by industrial sector and timer period)

(Cases)

Industrial sector	～1999	2000～	Total
Electrical and electronic appliances	23	32	55
Automobiles and auto parts	11	30	41
Machinery	16	21	37
Chemicals	12	20	32
Food and beverages	8	8	16
Rubber and leather products	8	5	13
Textiles	11	2	13
Metal products	4	6	10
Precision instruments	4	4	8
Ceramic, stone and clay products	3	2	5
Miscellaneous manufacturing products	1	3	4
Iron and steel	4	0	4
Others	2	9	11
Total	107	142	249

Source: Compiled by MHRI on the basis of various data and material.

Although Taiwan's principal industrial sector is the computer and peripheral appliance manufacturing industry, JCT Investment for the purpose of product assembly is very rare. The common practice is a division of labor where Japanese companies place orders for OEM/ODM services with Taiwanese companies, which in turn manufacture and deliver products utilizing their factories in China. This is due to the product characteristics of computers and peripheral appliances.

Computers and peripheral appliances are characterized by their "open–modular architecture" (Note 2). The standardization of interface design in an open–modular architecture enables highly independent modules. Under such an environment, even a motley collection of modules will result in a properly functioning appliance. Computers and peripheral equipment also have a short product cycle.

Thus, there is very little incentive to monopolize technology and to reduce the uncertainty of transactions by means of direct investment. On the contrary, Japanese companies tend to opt for consignment production by Taiwanese companies in order to avoid the costs and risks accompanying direct investment. This, we believe, is the underlying reason for the extremely small number of JCT Investment for the purpose of assembly of computers and peripheral appliances.

b. The automobile and auto parts industry

The second largest sector in terms of JCT Investment following the electric and electronic appliance industry is the automobile and auto parts industry. Moreover, the rapid expansion of JCT Investment in the automobile and auto parts industry from around the year 2000 makes it a close runner up to the electric and electronic appliance industry. This stems from the full–fledged market entry and launch of new models by Japanese and Taiwanese automobile manufacturers into China from around the year 2000. For example, China Motor Corporation of Taiwan, an affiliate of Mitsubishi Motors, merged with South East (Fujian) Motor Co., Ltd. of China in 1999. Subsequently in 2000, the Aeolus Motor Co., Ltd. was established through a joint venture between Yulon Motor Co., Ltd, of Taiwan, an affiliate of Nissan Motor Co., Ltd. and Dongfeng Motor Co., Ltd. of China. These ventures themselves are examples of JCT Investment. In addition, Japanese automobile manufacturers have been expanding and upgrading their production sites in China from around 2002.

Following the trend among set makers, Japanese auto parts manufacturers are speeding up their investment activity in China in business ventures with Taiwanese subsidiaries of Japanese companies or Taiwanese business associates of Japanese companies.

Unlike computers and peripheral appliances, automobiles are characterized by their “closed–integral architecture”. In the case of passenger vehicles, only 10% use general–purpose parts of uniform industrial standards for both the vehicle and interface (in contrast to more than 30% in the case of household electric appliances and more than 50% in the case of personal computers). Furthermore, it is said that up to 60~80% of parts of new car models are comprised of parts made exclusively for such new models (Note 4). Given the necessity for rigorous approximation and adjustment in their planning and manufacture, companies tend to resort to direct investment instead of OEM/ODM services as in the case of computers and peripherals.

c. Machinery and chemicals industries

We also found examples of JCT Investment in both the machinery industry (37 cases) and the chemicals industry (32 cases). In either sector, the bulk is comprised of raw materials, parts and machine tools for IT appliances and automobiles. Apart from the foregoing, we found scattered examples of investment related to elevators, sewing machines and resins.

d. Food and beverage manufacturing industry

The food and beverage industry is also an industrial sector where we found a large number of cases of JCT Investment (total: 16 cases). More specifically, many are joint ventures with the Tingsin Group and the Uni–President Group, both of which are Taiwanese corporate groups that made a head start in the Chinese market around 1990, ahead of other foreign corporations. Both groups have a dominant presence in the Chinese food and beverage market and possess extensive distribution networks within China. Japanese companies are forming joint ventures with Taiwanese foodstuff manufacturers – the representative examples being the two groups above – in a bid to utilize the their know–how and distribution networks in order to tap the Chinese market (Note 5).

(4) The historical background generating JCT Investment

As shown above, a considerable number of Japanese corporations are actively utilizing the managerial resources of Taiwanese companies and/or the Taiwanese subsidiaries of Japanese companies. Among the various underlying factors, the long history of economic ties between Japan and Taiwan may be cited as an important basis for JCT Investment.

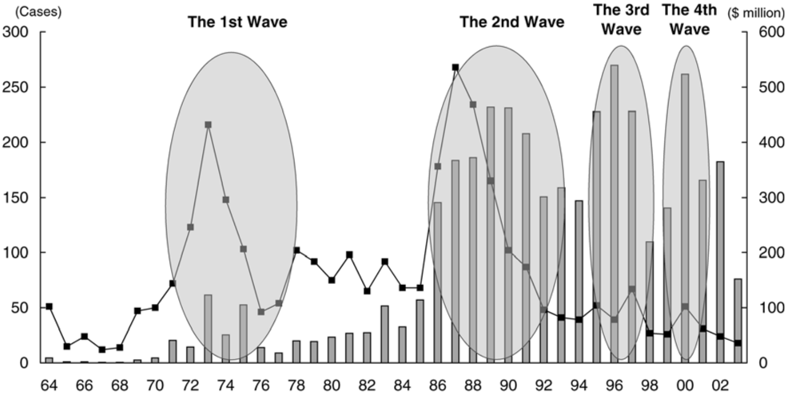
Since the end of World War II (WWII), Taiwan has played an important role as a major production site for Japanese corporations striving to shift their production sites overseas. Investment in Taiwan by Japanese corporations after WWII started in 1952, the year after the Japanese government authorized outward direct foreign investment and the year in which the Taiwanese authorities opened its doors to the inflow of foreign direct investment. The period from the late 1960s to the early 1970s generated a Taiwan investment boom among Japanese corporations mainly among labor-intensive industries and the electric and electronic appliance industries amid the rise of production costs in Japan and the sharp appreciation of the yen (**Chart 2**). From around the mid-1980s, the appreciation of the yen following the Plaza Accord led to the rise of investment in Taiwan among industries such as electric and electronic appliances and precision instruments. Furthermore, the Taiwanese authorities' deregulation of investment by foreign automobile manufacturers spurred the entry of both set makers and parts makers into the Taiwanese market. In the ensuing period in the mid-1990s and around the year 2000, the strength of the yen has triggered a resurgence of investment in Taiwan.

Thus, as of the end of November 2003, there were 888 affiliates established in Taiwan by middle-sized or larger Japanese companies. In numerical terms, this ranks sixth place in the world after the US, China, Thailand, Hong Kong and Singapore (Note 6), underscoring the importance of Taiwan in the global strategy of Japanese corporations in the division of labor.

Japan has also played an active role in technological licensing to Taiwanese companies. **Chart 3**, setting forth Japan's Asia-bound technology export in terms of geographic regions, shows that Taiwan has consistently held the top four positions from the early

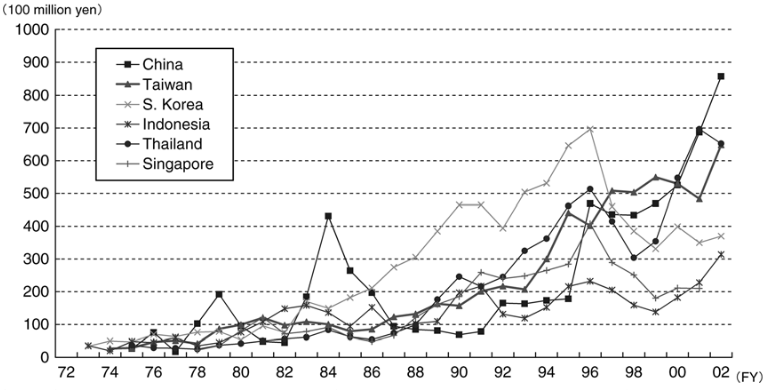
1970s to the present. Driven by direct investment and technological licensing activity, trade between Japan and Taiwan has also grown, with the percentage of trade with Taiwan in Japan's total trade figure (mainly exports to Taiwan) following an upward curve. As of the year 2003, Taiwan is the fourth largest trade partner for Japan (percentage of total trade: 5.3%).

Chart 2: Japan's Taiwan–bound investments



Note: The bars (right scale) represent the value and the line (left scale) represents the number of cases.
Source: Ministry of Finance, Japan.

Chart 3: Japan's technological exports to Asia



Source: Compiled on the basis of data disclosed by the Statistics Bureau, Ministry of Internal Affairs and Communications of Japan.

Companies of Japan and Taiwan have built relations of mutual trust and confidence through close economic and business relations. Furthermore, the Taiwanese subsidiaries of Japanese corporations have also contributed to the increase of Taiwanese employees gaining knowledge of Japanese corporate culture, know–how and technological expertise. There is no doubt that this has served as a fertile ground for the growth of JCT Investment. The long history of economic and business relations between Japan and Taiwan has helped nurture JCT Investment in the electric and electronic appliance and automobile and auto parts industries – both of which have a history of active investment and technological exports to Taiwan.

3. The merits of JCT Investment

(1) Complementation of the "competitive edge of managerial resources"

Nevertheless, the long–standing relations between Japan and Taiwan alone are insufficient to explain the direct cause for JCT Investment.

A foreign firm comes across various handicaps when investing directly in foreign countries. For example, foreign companies in general are at a comparative disadvantage to local companies in terms of their access to and interpretation of information on the local business/economic environment, language, laws and political affairs. In order to succeed in foreign direct investment, a foreign company must have a "competitive edge in managerial resources" surpassing their handicaps (Note 7).

From the foregoing perspective, JCT Investment may be construed as an attempt to supplement one's own "managerial resources" by utilizing the managerial resources of either its Taiwanese subsidiary or business partner. What, then, are the merits of JCT Investment in comparison to investment in China on an independent basis by a Japanese company? In the following sections, we shall discuss the merits of JCT Investment, shedding light upon the "competitive edge of managerial resources" of Taiwanese companies and Taiwanese subsidiaries in the context of China–bound investments.

(2) Support toward clients expanding into China from Taiwan

Among the various motives, one of the primary incentives for companies to invest in China in the form of JCT Investment is the assistance of Taiwanese companies or subsidiaries in Taiwan toward companies in Taiwan wishing to expand into the Chinese market. In this respect, it is beyond doubt that investment in China utilizing Taiwanese subsidiaries provides a far smoother way of doing business in comparison with the case of investment on an independent basis by the Japanese parent company. This stems from the access and utilization of personal relations, customer information and existing supply chains built by Taiwanese subsidiaries through their transactions with clients.

(3) Facilitation of the establishment and operations of Chinese affiliates

JCT Investment provides investors with the merits of facilitating the establishment and operations of Chinese affiliates through the utilization of the Taiwanese employees of the Taiwanese subsidiary or Taiwanese business partner.

a. Language and cultural barriers

Chart 4 provides a brief list of the major problems faced by Japanese corporations investing in China regarding their operations of Chinese affiliates. The Chart reveals that the major issues center around personnel and labor management, relations with government agencies and legal/policy affairs. Close communications with local employees and local government parties are necessary in order to mitigate or solve these problems. However, the differences in language, culture and behavioral patterns serve as barriers to resolve the problems. In fact, in a questionnaire survey by the Economic Information Department of the Japan External Trade Organization (JETRO), 34.6% of Japanese corporations considering market entry into China said that they "lack in–house human resources who are competent in terms of language abilities" (Note 8). Furthermore, in a questionnaire survey of Japanese manufacturers expanding into China conducted by the Ministry of Economy Trade and Industry in February 2004, 41.8% of the respondents cited the "difficulties in communication" as the "current challenge in business operations in China".

Chart 4: Difficulties faced by Japanese corporations investing in China in the

(%)

Difficulties		Rate of response
Personnel and labor management		91.2
Training (① management-level, ② worker-level, ③ sales staff)		85.0
Recruitment & retention (①difficulties in recruitment of professionals、② headhunting and job-hopping)		82.5
Compensation system (① evaluation system、② compensation structure)		78.2
Benefit package & housing (①burden of expenses、②undeveloped framework)		71.2
Relations with labor unions		16.4
Relations with government organs and agencies		83.8
Implementation of laws and policy measures	Uncertainty (sudden changes & implementation, ambiguous grounds)	72.7
	Unfair (different treatment of different companies and regions)	53.9
	Irrational (arbitrary implementation)	24.6
Licensing procedures	Cumbersome and complicated procedures	69.3
	Uncertain standards	49.2
Difficulties regarding laws and policies		77.6
Customs matters		55.7
Tax matters		51.0
Foreign currency controls		36.9
Restrictions upon foreign corporations (management scope and authorization procedures)		20.5
Labor issues		18.1
Sales and marketing		69.3
Difficulties in debt collection		52.8
Sluggish sales		34.7
Others		21.1

Note: Multiple answers (as of December 2001). Time period of questionnaire survey: Apr~Jul 2002.
No. of responding firms: 403.
Source: Japan-China Investment Promotion Organization [2002], pp. 7~8.

b. The mitigation of problems in communications with Chinese employees and Chinese government officials

One of the significant advantages of JCT Investment for a Japanese company is the utilization of the Taiwanese employees of Taiwanese subsidiaries or its Taiwanese business partner with a good understanding of Chinese culture and language as well as manufacturing technology and production management. In fact, many of the Japanese corporations opting for JCT Investment are utilizing these personnel as "linguistic, cultural and technological translators", placing them in operational positions requiring daily contact with Chinese employees and local government staff. In many cases, the Taiwanese employees of Taiwanese subsidiaries and Taiwanese business partners play important roles in (1) the establishment of Chinese affiliates which require consultation and negotiations with various government agencies, (2) labor matters and personnel management after the establishment of a Chinese affiliate, (3) production management and (4) negotiations with government agencies in matters such as customs.

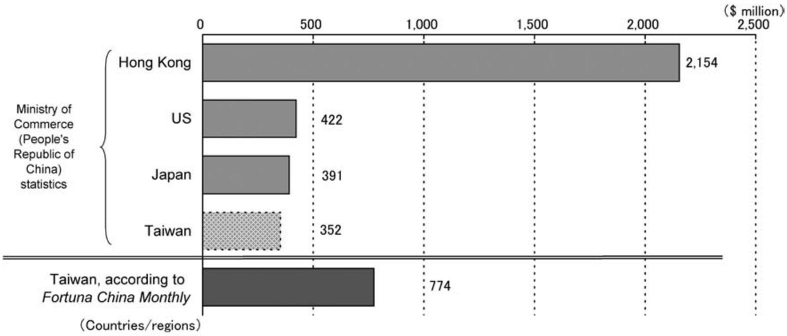
(4) Facilitation of business operations targeting Taiwanese affiliates in China

Furthermore, the utilization of the Taiwanese employees of Taiwanese subsidiaries and Taiwanese business partners serves to facilitate market expansion targeting Taiwanese corporations in China. In addition to smooth communications between the Taiwanese, this stems from the utilization of the local network of Taiwanese corporations and residents.

a. Active investment in China by Taiwanese corporations

Taiwanese affiliates do in fact have a large presence in the Chinese economy, making Taiwanese affiliates in China an attractive sales target. Their volume of China–bound investment by Taiwanese corporations indicates the scope of their presence. According to statistics on inward foreign direct investment of China's Ministry of Commerce, the amount of direct investment from Taiwan (on an actually–used basis) totaled $35.2 billion as of the end of June 2003, coming in at fourth place after Hong Kong, the US and Japan (**Chart 5**). These statistics, however, underestimate the actual volume of investment in China by Taiwanese corporations.

Chart 5: Inward foreign direct investment of China (actually–used basis)



Note:The cumulative total as of the end of June 2003.
Source: *Fortuna China Monthly*.

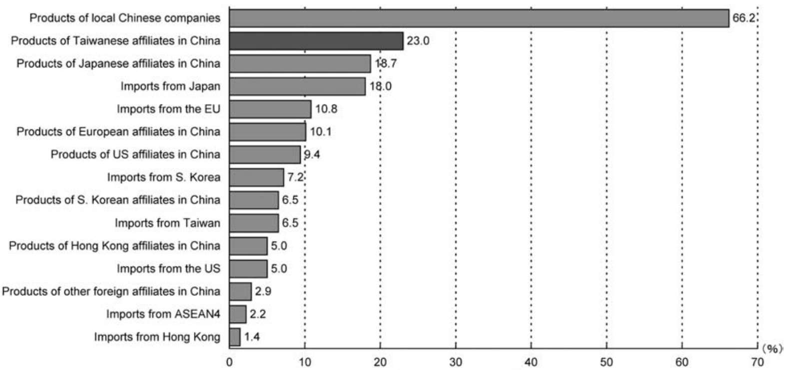
As yet, there are no investment protection agreements across the Taiwan Strait, given the ongoing political tensions regarding the unification and independence of Taiwan. Moreover, the Taiwanese authorities are unable to establish local agencies empowered to protect Taiwanese corporations in China. Thus, up until July 2002, the Taiwanese authorities required Taiwanese corporations – as a general rule – to channel their investments in China via third countries and regions. In a bid to protect their interests, Taiwanese corporations have opted thus far to invest in China through third countries and regions such as the British Virgin Islands, Hong Kong and Singapore. Given the foregoing situation, the Ministry of Commerce statistics do not provide a full account of investments in China by Taiwanese corporations through third countries and regions.

To supplement the statistical omissions, we have resorted to data and source material provided by Taiwanese corporate associations and Chinese government agencies such as the Taiwan Affairs Office. According to the publication *Fortuna China Monthly* which compiles the foregoing information, China–bound investment (on an actually–used basis) by Taiwanese corporations totaled $77.4 billion as of the end of June 2003. This is second only to Hong Kong ($215.4 billion) and surpasses by far the amount of investment by the US ($42.2 billion) and Japan ($39.1 billion). The sheer amount of investment in China by Taiwanese corporations is staggering even when taking into consideration cases where Japanese and US corporations invest in China via third countries and regions such as Hong Kong.

b. The large percentage of Taiwanese corporations in China's industrial production and exports

The percentage of Hong Kong, Taiwanese and Macanese corporations in China's value–added industrial production is 11.1% as of 2003. Since the industrial sector constitutes a larger proportion of the economy in Taiwan in comparison to Hong Kong and Macao, which in turn affects the composition of China–bound investments, we are inclined to believe that the percentage of Taiwanese corporations in China's value–added industrial production is slightly below 10%. The presence of Taiwanese corporations is in fact strongly felt among Japanese corporate affiliates in China (**Chart 6**).

Chart 6: Results of questionnaire survey on major competitors for Japanese affiliates in China



Notes: The questionnaire surveys provide multiple responses toward Japanese affiliates in the municipality of Shanghai and neighboring cities (effective responses: 183 companies). The respondents are limited to those companies whose products do not have a dominant market share in the Chinese market (effective responses: 139 companies). Time period of survey: June 2002.
Source: Japan External Trade Organization, Economic Information Department, [2002b], p. 23.

Taiwanese corporations pose a formidable presence in the China's information technology (IT) appliance manufacturers. Taiwanese manufacturers of IT appliances have shifted their production sites to China, raising the percentage of production in China from 22.8% in 1997 to 63.3% in 2003, surpassing the percentage of output in Taiwan (20.9%). In 2003, the amount of production in China by Taiwanese IT appliance makers reached \$36 billion. In the same year, the amount of IT appliances manufactured in China totaled \$49.1 billion, meaning that 79.1% of this sum was manufactured by Taiwanese IT appliance makers (Note 10). While China ranks second place in the world following the US in terms of the production of IT appliances, it would not be an exaggeration to say that Taiwanese corporations are providing the driving force.

Taiwanese corporations in China also make up a large proportion of China's total exports. In a list of the top 200 foreign exporters in the year 2003 released by China's Ministry of Commerce, there were 28 Taiwanese companies including the top three positions held by (1) Hong Fu Jin Precision Industry (Shen–zhen) Co., Ltd., (2) Tech Front (Shanghai) Computer and (3) Magnificent Brightness

(Suzhou) Ltd.. The total amount of exports by the 28 companies reached $32.61 billion, accounting for 7.4% of China's total exports.

As the foregoing shows, Taiwanese corporations are actively involved in manufacturing activities in China, making them significant targets for Japanese corporations. This makes JCT Investment all the more effective in targeting Taiwanese corporations in China. In fact, results of questionnaire surveys reveal many cases where Japanese corporations tapping the Chinese market in the form of JCT Investment sell IT–related parts and automobile parts not only to Japanese corporations in China but also to Taiwanese corporations in China.

(5) Advantages in cultivating China's domestic market

Amid the growing magnetism of the Chinese market backed by the country's ongoing strong economic growth, more and more Japanese companies are utilizing the Taiwanese employees of its Taiwanese subsidiaries and the human resources of its Taiwanese business partners in cultivating the Chinese market. It is beyond doubt that their high skills in communication with the Chinese are compelling firms to resort to such strategies.

Moreover, a considerable number of Japanese corporations are choosing joint venture partners from among Taiwanese corporations that possess distribution networks in China and have a proven record in the cultivation of China's domestic market. In comparison to the independent development of distribution routes, this provides a far more cost and time efficient method and a quicker path to permeate the Chinese market. Typical examples are "Japan–Taiwan joint venture investments in China" in the food and beverage sector.

The Tingsin Group and the Uni–President Group – both of which are frequent joint venture partners with Japanese firms – spread rapidly into various businesses centering around the foodstuff business, building a nationwide distribution network in China subsequent to their entry of the Chinese market around 1990. As of the end of 2003, Tingyi – the Tingsin Group's core company – had a distribution network of 344 business establishments, 77 warehouses, 4,860 wholesale bases and 49,311 direct retailers in China (Note 11). The Uni–President Group also has investments in more than 50 Chinese affiliates, covering a wide range of businesses including food, retail and restaurants. The Group also possesses a far–reaching distribution network by establishing 37 branch offices, 95 business establishments and 163 sales support offices in China and deploying a sales promotion unit of 6,557 members.

Japanese corporations are utilizing the distribution networks built in China by Taiwanese corporations in sectors other than food and beverages. For example, there are cases where Taiwanese trading companies undertaking China–bound exports of products manufactured by Japanese makers are entering into joint ventures in China with the Japanese maker manufacturing those products. The primary motive for Japanese companies is to use the distribution networks which the Taiwanese trading companies possess in China.

(6) The diversification of Chinese information sources using information networks of Taiwanese corporations

As shown by the results of the questionnaire survey in **Chart 4**, many of the Japanese corporations possessing Chinese affiliates are faced with problems such as the opacity, inequality and irrationality of laws and policy management. To avoid or resolve these problems, it is necessary to secure local routes and sources for the prompt and accurate collection of information.

There are Japanese corporations engaging in JCT Investment, that are diversifying their information sources by actively gathering information through networks of local Taiwanese companies. For example, in the case of investment in the form of "Japan–Taiwan joint ventures", information is gathered through the Taiwanese joint venture partner. In the case of investment utilizing Taiwanese subsidiaries, information is collected through Taiwanese corporate associations and networks among Taiwanese employees.

Taiwanese corporations have established as many as 78 Taiwanese corporate associations in 23 of the 31 provinces, municipalities and autonomous regions of China. Many of these corporate associations maintain close relations with local government authorities. Furthermore, Taiwanese corporations in many cases take a far more outgoing stance in tackling new business opportunities in comparison to Japanese corporations. Thus, given the widespread notion that Taiwanese corporate associations have access to up–to–date information, there are Chinese sub–subsidiaries (wholly–owned subsidiaries of Taiwanese subsidiaries) established through wholly–owned Taiwanese subsidiaries of Japanese corporations that place great emphasis upon information obtained by joining Taiwanese corporate associations in China (Note 13).

(7) The utilization of Taiwanese industrial clusters in China

In the case of "Japan–Taiwan joint venture investment in China", many Japanese corporations actively utilize industrial clusters of Taiwanese corporations in China.

Taiwanese corporations are developing industrial clusters in sectors such as IT–related appliances, plastic products, metal products, shoes, umbrellas and furniture in the Southern China region and the Yangtze River delta area. Industrial clusters of Taiwanese corporations are characterized by the formation of networks composed of companies specializing in certain areas or products such as modules or parts thus enabling a division of labor in manufacturing. Furthermore, the high level of flexibility in the division of labor makes it possible to manufacture inexpensive products in a speedy manner matching market trends by changing the combination of companies.

Examples of the utilization of Taiwanese industrial clusters through JCT Investment are as follows. Firstly, there are corporations that opt for "Japan–Taiwan joint venture investment in China" in a bid to utilize the routes developed by Taiwanese corporations to procure parts in China (Note 14). Secondly, there are cases where Japanese companies enter into joint venture partnerships with major Taiwanese corporations, thereby incorporating itself into the industrial clusters of those Taiwanese corporations in China in order to: (1) reduce uncertainties regarding incoming orders, (2) avoid excessive capital investment through the consignment of orders to Taiwanese colleagues during busy seasons, and (3) receive support by Taiwanese business partners in terms of plant and factory management (Note 15).

(8) The advantages of "investment in China utilizing Japanese resources" from the perspective of Taiwanese corporations

The primary reason for Taiwanese corporations to opt for "investment in China utilizing Japanese resources" lies in the high technological level and branding power of Japanese corporations. Despite their expansion into China for cost–cutting purposes, many Taiwanese corporations have failed to differentiate themselves from others and are finding themselves embroiled in price wars and facing lower–than–expected profit levels. Therefore, many Taiwanese corporations invest in China through Japan–Taiwan joint ventures in a bid to differentiate themselves from other companies by taking advantage of the technological and branding powers of Japanese corporations or to gain technological and quality control techniques and methods.

Secondly, Taiwanese corporations also expect to take advantage of distribution networks and export channels of Japanese corporations in China, much in the same way that Japanese corporations engaging in JCT Investment look forward to the expansion of sales.

The third advantage is the bargaining power of Japanese corporations – particularly large corporations – toward China's central and local governments. While questionnaire surveys reveal that the Taiwanese party is, in most cases, in charge of daily relations with local governments, the Japanese party may in fact assume the central role in negotiations in areas of stringent government regulations on industrial policy and in cases requiring licenses and approvals by the central government (Note 16).

Furthermore, in view of the political tensions between China and

Taiwan, there are some who contend that the Taiwanese party enjoys the benefit of avoiding political risks when expanding into China by forming joint ventures with Japanese corporations (Note 17). These merits, however, were never stressed in the course of surveys and research (Note 18). Even if such expectations did indeed exist, they did not comprise the main motive for joint ventures with Japanese corporations.

4. The demerits of JCT Investment

(1) The costs necessary to bridge differences in views on managerial strategy among investing parties

While we have discussed the merits of JCT Investment and the "competitive edge of managerial resources" of Taiwanese corporations and Japanese subsidiaries in Taiwan, it is also true that there are demerits to JCT Investment.

The first major demerit is the costs necessary to bridge the differences in views on managerial strategy among the investing parties in comparison to investment on an independent basis by the Japanese parent company.

Note that this is not a problem unique to JCT Investment. It is also prevalent in other countries of Asia. The more local investors there are, the more complicated it becomes to adjust views in comparison to investment on an independent basis. As a matter of course, there would also arise the necessity to bridge differences in view between the Japanese parent company and its overseas subsidiaries. In fact, a questionnaire survey conducted by the Overseas Research Department of JETRO in 2002 toward Japanese manufacturers in 11 countries and regions in Asia, the respondents cited the following problems in connection with business reconstruction: (1) difficulties in bridging differences of views with the parent company in Japan, (2) the ambiguity of policies regarding the division of labor among group companies, and (3) difficulties in bridging differences in views with joint venture partners (**Chart 7**).

In questionnaire surveys conducted toward corporations engaged in JCT Investment, the respondents also cited as a demerit the necessity to coordinate views among joint venture partners, the parent company in Japan, Taiwanese subsidiaries and other group affiliates in Asia. More specifically, the respondents said that the costs for the adjustment of views arise in the following circumstances.

Chart 7: Difficulties related to business reconstruction

(Cases, %)

Companies operating overseas		Total	Effective responses	Difficulty in coordination of views with Japanese parent company	Ambiguous division of labor with other group companies	Difficulty in coordination of views with joint venture partner	Incomplete legal system for business realignment	Others	Unknown
Total number		1,519	1,120	516	262	266	83	241	399
		100.0	100.0	46.1	23.4	23.8	7.4	21.5	26.3
Countries & regions	ASEAN (total)	907	667	303	176	132	49	155	240
		100.0	100.0	45.4	26.4	19.8	7.3	23.2	26.5
	S. Korea	33	27	9	5	7	–	11	6
		100.0	100.0	33.3	18.5	25.9	–	40.7	18.2
	Taiwan	**108**	**81**	**37**	**24**	**22**	**–**	**16**	**27**
		100.0	**100.0**	**45.7**	**29.6**	**27.2**	**–**	**19.8**	**25.0**
	China	**384**	**290**	**143**	**46**	**84**	**29**	**50**	**94**
		100.0	**100.0**	**49.3**	**15.9**	**29.0**	**10.0**	**17.2**	**24.5**
	Hong Kong	34	21	9	8	4	2	2	13
		100.0	100.0	42.9	38.1	19.0	9.5	9.5	38.2
	India	53	34	15	3	17	3	7	19
		100.0	100.0	44.1	8.8	50.0	8.8	20.6	35.8

Note: Date of survey: November 2002. Survey subjects: Japanese manufacturing enterprises in the 11 countries and regions of Asia. ASEAN includes Thailand, Malaysia, Singapore, Indonesia, the Philippines and Vietnam.
Source: Japan External Trade Organization, Overseas Research Department, [2003], p. 42.

a. The emergence of competitive relationships with other affiliates in China

An oft–cited case is the emergence of a competitive relationship between the Chinese affiliate established by JCT Investment and parent company in Japan or other group affiliates in China established by the Taiwanese partner, which in turn sparks a conflict of views.

Amid the maturation of both the Japanese and Taiwanese economies, there has been a sharp increase of cases where the Japanese parent company, the Taiwanese partner and Japanese affiliates in Taiwan establish a number of Chinese affiliates in view of the importance of the Chinese market for new business developments.

In the event there arises a competitive relationship among the affiliates in China, the possible alternatives would be as follows: (1) the consolidation of affiliates, (2) the demarcation of "turfs" among affiliates, and (3) the enhancement of competitiveness of affiliates through the toleration of competition among affiliates. Conflicts of opinion arise in deciding which alternative should be chosen. Although it is difficult to conclude with any certainty on which alternative is the best option because of the multitude of factors involved such as product characteristics (for example, the lead time, transportation costs, the economies of scale), differences in major purchasers (whether they are Taiwanese or Japanese corporations, etc.), the existence and competitiveness of competitors and the performance of affiliates, one fact for certain is that the rise of competition in the Chinese market is raising the necessity to adjust differences in strategy and making it more likely to trigger a conflict of views.

b. Conflicts regarding customer relations

As reiterated above, JCT Investment has the merits of taking advantage of both Japanese and Taiwanese corporations in China, maximizing scale economics and the diversification of risks. However, conflicts may arise regarding which client – either that of the Japanese or Taiwanese party – should be accorded preferential treatment. Such conflicts tend to arise in busy seasons when output falls short of accepted orders (Note 19). Even in normal times, there may be conflicts between the Japanese and Taiwanese parties regarding the allocation of human resources to clients because of the limited number of employees (Note 20). These problems tend to arise in cases where the Japanese party and the Taiwanese party have supplied merchandise to companies in different corporate groups (*keiretsu*).

c. Completion of the learning process

When a joint venture party has absorbed all the technology and know–how from its joint venture partner, it may start to feel that the burden of coordinating differing views outweighs the merits of the business tie–up. It may then suggest a dissolution of the joint venture to the counter–party. This is, so to speak, "the completion of the learning process" though JCT Investment.

d. Others

In other cases, changes in managers of the Taiwanese and Japanese parties and employees dispatched to Taiwanese subsidiaries may make it difficult to coordinate views (Note 21). In contrast to the large number of Taiwanese corporations being sole proprietorships – meaning that large investments are frequently decided in top–down fashion – large investment decisions at Japanese corporations are made in bottom–up style and thus require considerably time for feasibility studies. The different speed of decision–making processes and attitude toward feasibility studies may trigger a conflict of views (Note 22).

(2) Conflict of views between the Japanese parent company and the Taiwanese subsidiary over leadership controls of Chinese affiliates

In the event a Japanese corporation invests in China through a Taiwanese subsidiary in which it has a majority stake, and the same Taiwanese subsidiary has a large controlling share of the Chinese affiliate, the Japanese parent company may exercise a relatively high level of control toward the Chinese affiliate. In this respect, the costs necessary to bridge differences in views are smaller than in Japan–Taiwan joint ventures.

Note, however, that clashes of opinion frequently occur regarding the degree of control over the Chinese affiliate by the Taiwanese subsidiary. The delegation of management controls over the Chinese affiliate to the Taiwanese subsidiary may accelerate the decision–making processes and raise employee morale among Taiwanese employees. Precisely for these reasons, there are cases where the investment ratio of the Taiwanese subsidiary is raised above the Japanese parent company, thus affording the Taiwanese subsidiary a higher level of control over the Chinese affiliate (Note 23).

Meanwhile, from the perspective of the Japanese parent company, the foregoing may serve as obstacles to the coordination of strategies with Chinese affiliates and other Asian affiliates within the same corporate group. On the other hand, from the standpoint of Taiwanese subsidiaries, the reduction of the Japanese party's stake in investment may make it more difficult to obtain support because of a lower level of interest on the part of the Japanese party (Note 24). Nevertheless, the reinforcement of unified controls by the Japanese parent company may drag down the decision–making process or serve to dampen the morale among Taiwanese employees.

The question of whether to localize management or pursue unified controls by the parent company is a longstanding issue that defies a simplified solution. Even so, it is an unavoidable and challenging issue requiring careful consideration when investing in the form of JCT Investment.

(3) Efforts to minimize the costs for coordination of different views

As one way to minimize the costs for coordination of views, an overwhelming majority of Japanese corporations investing in the form of JCT Investment choose their business partner from among Taiwanese corporations with which they have built relations of mutual trust through longstanding business relations and tie–ups. More specifically, they are choosing business partners from among (1) technological licensees, (2) consignees of manufacturing operations, (3) partners in establishment of joint venture companies in Taiwan, (4) distribution agents of its products in Taiwan and

Taiwan–China trading companies dealing with its products, and (5) companies owned by Taiwanese proprietors closely acquainted with chief executives of Japanese corporations. By doing so, both parties are striving to minimize the costs necessary for the coordination of opinions.

While it is relatively rare to have third parties act as mediators, there are cases where (1) major Japanese trading companies, or (2) major Japanese manufacturers, act as mediators. There have been cases – while extremely rare – of chief executives of Japanese corporations seeking out and proposing joint ventures with Taiwanese corporations succeeding in business endeavors in China and vice versa of Taiwanese corporations seeking out and proposing joint ventures with Japanese corporations with high technological skills.

Given the rise of conflicts of interest with other Chinese and Asian affiliates, some corporations are providing safeguards by holding frequent affiliate managers' meetings in a bid to coordinate and bridge differences in opinion (Note 25). Other measures to harmonize opinions is the installation of the managing director in charge of China, Taiwan and Hong Kong in the position of *zong jing li*, a position equivalent to corporate president of the affiliates in these regions, so that all information is channeled to the aforementioned managing director (Note 26).

5. The future prospects ~ the effectiveness of JCT Investment as a viable business model ~

(1) Prospects of a "decline" or "sustainable development"?

As shown above, there has been a surge of JCT Investment since the period around 2000. The question then is whether JCT Investment will continue to function as a viable business model.

Broadly speaking, there are two viewpoints regarding this matter.

a. “Decline”

One school of thought forecasts a “decline”, on the grounds of two main predictions as follows. The first prediction is that it will become easier for Japanese corporations to embark upon investments in China on its own along with the transformation of the Chinese economy into a market economy and the improvement of the investment environment, thus gradually eroding the necessity for joint ventures with and investments via Taiwanese corporations and diminishing the merits of JCT Investment. The second prognosis is that Japanese corporations will build up their own know–how and human resources necessary for the development of business in China along with the expansion of its investments in China, thus making it unnecessary to seek the assistance of Taiwanese employees and corporations.

b. “Sustainable development”

The other predicts a “sustainable development”, based upon the view that the merits of “Taiwan–based China investment will continue to live on since: (1) China’s investment environment will indeed improve, but at a slower–than–expected pace, (2) small and medium–sized companies will continue to face a shortage of know–how and human resources regarding business in China, and (3) the odds are high that Taiwanese corporations will continue to thrive in China. Given the reason cited in (3) above, contenders maintain that the merits of JCT Investment will survive since it will facilitate sales toward Taiwanese corporations in China and provide access to Taiwanese corporations’ distribution networks in China.

(2) JCT Investment will survive – at least for the time being

In view of the circumstances and events to date, the odds are high that JCT Investment will continue to thrive for the time being.

For example, a questionnaire survey conducted jointly in 2003 by the Industrial Investment Center, Ministry of Economic Affairs of

Taiwan and the Nomura Research Institute revealed that 79 Japanese companies in Taiwan are considering possible tie–ups with Taiwanese companies in the course of business development in China (rate of response: 30.4%, time point of survey: April 2003) (Note 27). Even though “tie–ups with Taiwanese companies” do not all fall into the category of JCT Investment, a fair percentage would have the potential to develop into JCT Investment.

Japanese companies are not necessarily optimistic about the improvement of the investment environment in China. In a questionnaire survey of Japanese corporations in China, asking whether China’s membership to the WTO would lead to the improvement of the Chinese government’s laws and measures, 67.5% said that they “look forward to an improvement but are doubtful regarding actual implementation”, 4.6% responded that they “do not have any expectations”. Together, they surpass the percentage of responses that they “look forward to improvement and feel confident of its positive effect” (27.8%) (Note 28).

Furthermore, the cultural factors in the background to the problems in personnel and labor management may not be underestimated. The merits of JCT Investment should remain in terms of the assistance of Taiwanese employees of Taiwanese subsidiaries and Taiwanese partners in the mitigation and solution of these problems. Although large corporations will most likely acquire human resources and know–how through its business endeavors in China, JCT Investment will remain an attractive method of investment for small and medium–sized companies that find it difficult to acquire such human resources and know–how.

Furthermore, the merits of JCT Investment in terms of facilitating sales toward Taiwanese corporations in China and the utilization of Taiwanese corporations’ distribution networks and industrial clusters in China, should remain attractive not only for small and medium–sized firms but also for large corporations in view of the prospects of the expansion of Taiwanese corporations’ investment in China. Judging from the foregoing, JCT Investment should remain a significant business model worthy of consideration for investment in China.

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Notes:

1. Sato [1997] is an antecedent and comprehensive discourse on JCT Investment. The discourse provides an analysis of the merits of JCT Investment and the division of powers within multinational enterprises from the perspective of the superiority of the managerial resources of the overseas subsidiaries of multinational enterprises and the organizational structure of multinational enterprises. Matsushima [2003] sets forth a positive appraisal of JCT Investment as one model for investment in China by small and medium companies of Japan, taking the case of Kashima Electronics Inc. Matsushima maintains that, in addition to the development of an effective division of labor between the Japanese parent company and the Chinese affiliate, the utilization of a "complementary functional linkage" between Japanese and Taiwanese corporations in the Guangdong Province of China through the joint venture with Taiwanese corporations led to Kashima Electronics' business success in China. Ren–Jye, Liu [2001a] addresses Chinese investments by Japanese affiliates in Taiwan from the perspective of the expansion of Japanese affiliates in Taiwan.
2. Refer to Fujimoto [2003] for the architectural characteristics of design information.
3. Interview with Company A, a Japanese affiliate in Taiwan in September 2003.
4. Fujimoto [2003], pp. 103~104.
5. For example, the Tingsin Group has experienced joint ventures in China with Sanyo Foods Co., Ltd., Asahi Breweries, Ltd. and Itochu Corporation. The Uni–President Group has had joint ventures in China with Nisshin Oil (currently Nisshin Oillio Group), Kirin Brewery Co., Ltd., Itochu Corporation, Kikkoman Corporation, Mitsui & Co., Ltd./Dai–ichi Broiler and Kirin Beverage.
6. Toyo Keizai Inc [2004], pp. 1,580~1,583.
7. "Competitive edge of managerial resources" refers to superiority "centering around management (from an external point of view) and (more substantially), knowledge and experience, marketing methodology such as patents and know–how regarding management, covering more widely, the technological and professional expertise, market position (monopolistic control, if any) in distribution/raw material purchase/funding, trademarks (brands) and organization for credit, information collection and research & development" (Komiya [1967]).
8. JETRO, Economic Information Department [2002a] p. 75.
9. Ministry of Economy, Trade and Industry, Ministry of Health, Labor and Welfare, Ministry of Education, Culture, Sports, Science & Technology [2004] p. 17.
10. Directorate General of Budget Accounting and Statistics, Executive Yuan, Market Intelligence Center, Institute for Information Industry
11. Tingyi (Cayman Islands) Holding Corp., *2003 Annual Report*, April 20, 2004.
12. Internet website of Uni–President Group (www.uni–president.com.tw), June 16, 2004.
13. Interview with Company B, a Japanese affiliate in Taiwan in October 2003.

14. For example, the case example of Seikow Chemical Engineering & Machinery, Ltd. (*The Japan Industrial Journal*, September 5, 2003).
15. Matsushima [2003] etc.
16. Interview with Company B, a Japanese affiliate in Taiwan in October 2003.
17. *Global Views Monthly*, March 2004, p. 70.
18. Sato [1997] also reveals similar survey results (p. 225).
19. Interview with Company C, a Japanese affiliate in Taiwan in October 2003.
20. Interview with Company D, a Japanese affiliate in Taiwan in September 2003.
21. Interview with Company F, a Japanese affiliate in Taiwan in September 2003.
22. Interview with Company C, a Japanese affiliate in Taiwan in October 2003.
23. Interview with Company B, a Japanese affiliate in Taiwan in October 2003.
24. Interview with Company G, a Japanese affiliate in Taiwan in October 2003.
25. Interview with Company H, a Japanese affiliate in Taiwan in September 2003.
26. Interview with Company I, a Japanese affiliate in Taiwan in October 2003.
27. Industrial Investment Center, Ministry of Economic Affairs of Taiwan and the Nomura Research Institute [2003], p. 18.
28. Japan–China Investment Promotion Organization, Economic Information Department [2002], p.7.

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