The Role of Joint Ventures in the Economy of China

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What is a Joint Venture (JV)?

A Joint Venture is a business arrangement in which two or more parties agree to pool their resources and agree to develop a specific task. This task can be a new project or any other business activity. In a joint venture (JV), each of the participants is responsible for profits, losses and costs associated with it. However, the venture is its own entity, separate and apart from the participants' other business interests. Although JVs represent a great way to pool capital and expertise and reduce the exposure of risk to all involved, they do present some unique challenges as well. For instance, if party A comes up with an idea that allows the JV to flourish, what cut of the profits does party A get? Does the party simply receive a cut based on the original investment pool or is there recognition of the party's contribution above and beyond the initial stake? For this and other reasons, it is estimated that nearly half of all JVs last less than four years and end in animosity.

The venture can be for one specific project only - when the JV is referred to more correctly as a consortium (as the building of the Channel Tunnel) - or a continuing business relationship. The consortium JV (also known as a cooperative agreement) is formed where one party seeks technological expertise or technical service arrangements, franchise and brand use agreements, management contracts, rental agreements, for one-time contracts. The JV is dissolved when that goal is reached.

A joint venture takes place when two parties come together to take on one project. In a joint venture, both parties are equally invested in the project in terms of money, time, and effort to build on the original concept. While joint ventures are generally small projects, major corporations also use this method in order to diversify. A joint venture can ensure the success of smaller projects for those that are just starting in the business world or for established corporations. Since the cost of starting new projects is generally high, a joint venture allows both parties to share the burden of the project, as well as the resulting

A JV can be brought about in the following major ways:

- Foreign investor buying an interest in a local company
- Local firm acquiring an interest in an existing foreign firm
- Both the foreign and local entrepreneurs jointly forming a new enterprise
- Together with public capital and/or bank debt

Joint Ventures in China

It is interesting to study the joint-venture laws of China because they are a recent development and because a unique law exists. According to a report of the United Nations Conference on Trade and Development 2003, China was the recipient of US$53.5 billion in direct foreign investment, making it the world's largest recipient of direct foreign investment for the first time, to exceed the USA. Until recently, no guidelines existed on how foreign investment was to be handled due to the restrictive nature of China toward foreign investors.
Following the death of Mao Zedong in 1976, initiatives in foreign trade began to be applied, and law applicable to foreign direct investment was made clear in 1979, while the first Sino-foreign equity venture took place in 2001. Companies with foreign partners can carry out manufacturing and sales operations in China and can sell through their own sales network. Foreign-Sino companies have export rights which are not available to wholly Chinese companies, as China desires to import foreign technology by encouraging JVs and the latest technologies.

Under Chinese law, foreign enterprises are divided into several basic categories. Of these, five will be described or mentioned here: three relate to industry and services and two as vehicles for foreign investment. Those 5 categories of Chinese foreign enterprises are:

Sino-Foreign Co-operative Joint Ventures (CJVs),
Sino-Foreign Equity Joint Ventures (EJVs),
Wholly Foreign-Owned Enterprises (WFOE), (although they do not strictly belong to Joint Ventures)
Foreign investment companies limited by shares (FICLBS),
Investment Companies through Foreign Investors (ICFI).

Co-operative Joint Ventures (CJVs) are permitted under the Sino-Foreign Co-operative Joint Ventures. Co-operative enterprises are also called Contractual Operative Enterprises. The CJVs may have a limited structure or unlimited – therefore, there are two versions. The limited-liability version is similar to the EJVs in status of permissions - the foreign investor provides the majority of funds and technology and the Chinese party provides land, buildings, equipment, etc. However, there are no minimum limits on the foreign partner which allows him to be a minority shareholder. The other format of the CJV is similar to a partnership where the parties jointly incur unlimited liability for the debts of the enterprise with no separate legal person being created. In both the cases, the status of the formed enterprise is that of a legal Chinese person which can hire labor directly as, for example, a Chinese national contactor. The minimum of the capital is registered at various levels of investment.

Sino-Foreign Equity Joint Ventures (EJVs) The EJV Law is between a Chinese partner and a foreign company. Prior to China's entry into WTO – and thus the WFOEs – EJVs predominated. In the EJV mode, the partners share profits, losses and risk in equal proportion to their respective contributions to the venture's registered capital. These escalate upwardly in the same proportion as the increase in registered capital. The minimum equity is prescribed for investment (truncated), where the foreign equity and debt levels are:

- less than US$3 million, equity must constitute 70% of the investment;
- between US$3 million and US$10 million, minimum equity must be US$2.1 million and at least 50% of the investment;
- between US$10 million and US$30 million, minimum equity must be US$5 million and at least 40% of the investment;
- more than US$30 million, minimum equity must be US$12 million and at least 1/3 of the investment.

There are also intermediary levels. The foreign investment in the total project must be at least 25%. No minimum investment is set for the Chinese partner.
**Wholly Foreign Owned Enterprises (WFOEs)**

There is basic law of the PRC concerning enterprises with sole foreign investment controls, WFOEs. China's entry into the World Trade Organization (WTO) around 2001 has had profound effects on foreign investment. Not being a JV, they are considered here only in comparison or contrast.

To implement WTO commitments, China publishes from time to time updated versions of its 'Catalogs Investments' (affecting ventures) prohibited, restricted.

The WFOE is a Chinese legal person and has to obey all Chinese laws. As such, it is allowed to enter into contracts with appropriate government authorities to acquire land use rights, rent buildings, and receive utility services. In this it is more similar to a CJV than an EJV.

WFOEs are expected by PRC to use the most modern technologies and to export at least 50% of their production, with all of the investment is to be wholly provided by the foreign investor and the enterprise is within his total control.

WFOEs are typically limited liability enterprises (like with EJVs) but the liability of the Directors, Managers, Advisers, and Suppliers depends on the rules which govern the Departments or Ministries which control product liability, worker safety or environmental protection.

An advantage the WFOE enjoys over its alternates is enhanced protection of its know-how but a principal disadvantage is absence of an interested and influential Chinese party.

As of the 3rd Quarter 2004 WFOEs had replaced EJVs and CJVs as follows:

**Foreign Investment Companies Limited By Shares (FICLBS)**

These enterprises are formed under the Sino-Foreign Investment Act. The capital is composed of value of stock in exchange for the value of the property given to the enterprise. The liability of the shareholders, including debt, is equal to the amount of shares purchased by each partner. The registered capital of the company the share of the paid-in capital. The minimum amount of the registered capital of the company should be RMB 30 million. These companies can be listed on the only two PRC Stock Exchanges – the Shanghai and Shenzhen Stock Exchanges. Shares of two types are permitted on these Exchanges – Types “A” and Type “B” shares. Type A are only to be used by Chinese nationals and can be traded only in RMB.
Type “B” shares are denominated in Renminbi but can be traded in foreign exchange and by Chinese nationals having foreign exchange. Further, State enterprises which have been approved for corporatization can trade in Hong Kong in “H” share and in NYSE exchanges. “A” shares are issued to and traded by Chinese nationals. They are issued and traded in Renminbi. “B” shares are denominated in Renminbi but are traded in foreign currency. From March 2001, in addition to foreign investors, Chinese nationals with foreign currency can also trade “B” shares.

**Investment Companies by Foreign Investors (ICFI)**

Investment Companies are those established in China by sole foreign-funded business or jointly with Chinese partners who engage in direct investment. It has to be incorporated as a company with limited liability. The total amount of the investor's assets during the year preceding the application to do business in China has to be no less than US $ 400 million within the territory of China. The paid-in capital contribution has to exceed $ 10 million. Furthermore, more than 3 project proposals of the investor's intended investment projects must have been approved. The shares subscribed and held by foreign Investment Companies by Foreign Investors (ICFI) should be 25%. The investment firm can be established as an EJV.

**Examples of Joint Ventures in China**

**Renault-Dongfeng auto joint venture**

China has approved a joint venture worth some 7.76 billion yuan ($1.27bn; £778m) between its second-largest car maker, Dongfeng Motor Group, and French car manufacturer, Renault. The new venture plans to build 150,000 vehicles and engines a year. China is the largest car market in the world and Renault is one of the few big car makers that does not yet have a facility there. The 50-50 joint venture will be called Dongfeng Renault Automotive Co Ltd. Dongfeng is state-owned and has existing partnerships with Honda and Nissan, amongst others. Renault's joint venture with the Chinese giant will see it enter a crowded marketplace filled with competitive local brands. While car sales in Western countries have been waning, Chinese sales have been growing. Official figures showed vehicle sales rising by 4.3% in 2012 to 19.3m. Under Chinese trade laws, foreign carmakers looking to launch manufacturing operations in China must have a local partner. Approval was granted for the new venture between Renault and Dongfeng by China’s National Development and Reform Commission. *(December 2013, BBC Business News)*
Tesco and China Resources Enterprise

Tesco has been to tap into China's fast growing consumer market

Tesco has finalised a deal with the state-run China Resources Enterprise (CRE) to create the largest food retailer in China. The joint venture will combine Tesco's 131 outlets in the country with CRE's almost 3,000 stores, called Vanguard. CRE will own 80% of the new chain and Tesco will have a 20% stake. "The partnership creates a strong platform in one of the world's largest markets," Tesco chief executive Philip Clarke said in a statement. "We can now combine our strengths to build a profitable multichannel business, offering our customers in China the best of modern retail."

Asian growth
According to figures from research group IGD, China is the world's biggest market for food and groceries with an annual value of more than one trillion dollars. And the market is forecast to grow by 50% over the next three years. Tesco, the biggest supermarket chain in the UK, has been keen to tap into this potential, and has been operating in the country since 2004. The firm has also been eyeing the Indian market - which is forecast to witness rapid growth in the coming years. Earlier this year, it announced a joint venture with Trent Limited, part of India's Tata Group, which operates the Star Bazaar retail business in India. Tesco said it would invest around £85m in the joint venture. Once the venture has been finalised it will operate 12 stores retailing a range of products including groceries and home care products.(May 2014, BBC Business News)

Kellogg Company And Wilmar International Limited
Kellogg Company and Wilmar International Limited announced a 50:50 joint venture between Kellogg and Wilmar for the manufacture, sale and distribution of cereal, wholesome snacks and savoury snacks in China. Wilmar's wholly-owned subsidiary in China, Yihai Kerry Investments Co., Ltd, will participate in the joint venture. Wilmar will contribute infrastructure, supply chain scale, an extensive sales and distribution network in China, as well as local China market expertise to the joint venture. Kellogg will contribute a portfolio of globally recognized brands and products, along with deep cereal and snacks category expertise. The Joint Venture will use the Kellogg's and Pringles brands. Together, Kellogg and Wilmar will leverage this complementary expertise to maximize marketing and manufacturing synergies. China is expected to become the largest food and beverage market globally within the next five years, driven both by the growth of a middle class consumer base in large cities and an increased desire for a wide range of packaged and branded foods. Cereal consumption is currently being driven by rapid growth in milk consumption, along with consumers' desire for healthy and convenient breakfast foods. Snack foods also represent a very large growth opportunity. "China's snack-food market alone is expected to reach an estimated $12 billion by year-end, up 44 percent from 2008," said John Bryant, Kellogg Company's president and chief executive officer. "To capture this growth, we will leverage the key strengths Kellogg and Wilmar bring to the partnership—the globally recognized Kellogg’s® and Pringles® brands and deep category knowledge; scale and local market experience; and our mutual commitment to consumer-focused innovation." This joint venture positions our China business for growth and fundamentally changes our game in China. Our organizations have developed a strong working relationship and trust. I am pleased to be working together with Kuok Khoon Hong and his talented team, and have every confidence that our partnership will be a long-term success," concluded Bryant. Wilmar's Chairman and Chief Executive Officer, Kuok Khoon Hong, added, "This joint venture with Kellogg will complement our existing Consumer Product business and leverage on our extensive distribution network and support infrastructure in China. With our joint strength and shared vision, I am confident that we will be able to develop a leading cereal and snacks business together." The joint venture company will be headquartered in Shanghai, China. Launch of the joint venture is subject to customary conditions, including regulatory approvals by the Chinese government and anti-trust approvals. (Kellogg's website September 2012)

Jaguar Land Rover Chinese joint venture

JLR, owned by India’s Tata, exports more than 80pc of all the vehicles it makes and has been held up as a poster child of British automotive success by ministers.
Britain’s luxury car maker Jaguar Land Rover has sealed a joint venture with Chinese company Chery Automobile, marking £1.1bn of investment in the world’s second largest economy. The investment from the joint venture will include a new manufacturing plant in Changshu, near Shanghai, which is expected to open in 2014. The two companies will also provide a new research and development and engine production facility. Models will be specifically tailored for the Chinese market. “The joint venture will blend together the heritage and experience of luxury premium vehicle manufacturer Jaguar Land Rover with the intricate knowledge and understanding of Chinese customers evident at Chery,” JLR said. The partnership will be known as Chery Jaguar Land Rover Automotive Company, and marks a formal commitment from JLR to China, which is already its third largest market behind the UK and the US. (Daily Telegraph online, November 2012)

syncreon Joint Venture Contract

Contract signing – Michael Neumann, CCO syncreon and Li Weidou, General Manager, China FAW Group Import & Export Corporation

syncreon Holding Inc. and China FAW Group Import & Export Corporation signed a joint venture agreement to form FAW Syncreon Logistics (Dalian) Co., Ltd. The signing ceremony, held in Changchun, Jilin Province on September 20th 2010, was attended by senior executives of each company including Mr. Jin Yi, Vice President, China FAW Group Corporation, Mr. Li Weidou, General Manager, China FAW Group Import & Export Corporation; and for syncreon Holdings Inc., Mr. Brian Enright, CEO and Michael Neumann, CCO. The new company will initially operate in and from the port city of Dalian, Liaoning Province providing parts logistics services to the automotive industry in North East China. Start of operations is scheduled for the 2nd quarter of 2011 with the launch of a new 40,000 m² (430,000 sqft) logistics centre in the Dalian Development Area. www.syncreon.com/

CNPC and Total in talks to transfer stake in joint venture
China National Petroleum Corp and French oil major Total are in talks to transfer a stake in a joint venture oil refinery in the northeast port city of Dalian. Wang Dongjin, president of CNPC’s listed unit PetroChina, met with a Total vice-president in Beijing and discussed “domestic and overseas upstream projects and a stake transfer in the Wepec refinery”, CNPC said on its website. Total holds one of the most diverse investments of the foreign oil majors in China, including a 22.4 per cent stake in the West Pacific Petrochemical Corp, or Wepec, refinery, set up in the 1990s to export gasoline. However, foreign oil majors have been frustrated by their limited role in China’s closed market. China has not opened most of its energy and fuel markets to foreign or even private competition, despite commitments when it joined the World Trade Organisation. In recent years the Wepec joint venture has been limited in its ability to profit by China’s growing demand for refined products, due to difficulties in obtaining a licence to sell domestically. Total confirmed that it was in talks with PetroChina to sell its stake, although declined to give any details on the timing or the reasons for the divestment. CNPC operates Wepec, which is also partially owned by state-owned Sinochem and local companies in Dalian. The sale, if completed, will come at a time when Chinese state-owned enterprises are being encouraged to sell minority stakes in key assets, to bring in outside capital without relinquishing control. CNPC has said it will sell off oil pipelines while its main rival Sinopec is seeking partners for its retail business, including gas stations and convenience stores. (www.ft.com/ July 2014)

Further reading

Strategies for Asia Pacific: How can foreign companies enter China successfully? Abella, Bellver, Brusselmans. www.slideshare.net/cedricbrusselmans/how-can-foreign-companies-enter-china-successfully-lu-rui-co


North East China: Untapped Marketing Opportunity: www.eabc.co.uk/NorthEast%20China.htm

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July 2014