Using a Joint Venture Entry Mode to Penetrate the Chinese Construction Industry: The Case of Atkins Construction Consultancy

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This paper investigates the reasons why foreign firms are increasingly becoming Wholly Foreign Ownership Enterprises (WFOEs) in China, particularly in the construction sector. Specifically the objectives are to (a) investigate the choice of entry mode used by British construction firms to penetrate the Chinese construction industry before and after the deregulation of the foreign share of companies in 2003; and (b) investigate Atkins expansion approach to enter the Chinese construction industry. Qualitative analysis of available evidence reveals that Atkins first used its international experience and Joint Venture (JV) entry mode to locate in Hong Kong. After gaining the status of a WFOE it quickly expanded its business activities across the major cities in China.

INTRODUCTION

Since 1979, the Chinese government has vigorously pursued trade and liberalization policies in order to invigorate the economy and promote investment opportunities. Foreign firms have been encouraged to invest in the country. However, in recent times, there has been an increased uncertainty in the market due to the constant swings in the Chinese government policies on trade and liberalization of foreign investment. In addition to the complex and lengthy policies which are in place, State-Owned Enterprises (SOEs), which adopted the conventional ownership-structure from the communist economy, have dominated the Chinese economy and have been able to limit competition. Even though the Chinese economy has become an open economy in the last thirty years due to the trade and liberalization policies, the shadow of SOEs is still seen in the construction, mining, energy and transportation sectors (Hayter, & Han, 1998; Zhang, 2001; Yin, & Choi, 2005).

The openness of the Chinese economy has made it a business-friendly environment and has also promoted a significant number of inward foreign investments in the form of Joint Ventures (JVs), particularly in the manufacturing, mining, automobile and technological industries. The preference for JVs by foreign investors is rooted in the government's restrictions on the corporate ownership of foreign-invested firms (Roots, 1994; Pan & Tse, 2000; UNCTAD, 2007: 42). Since 2006, a growing wave of foreign investment in WFOEs has begun to emerge in the Chinese economy as a result of China joining the World Trade Organization (WTO) (UNCTAD, 2006). One of the key requirements of WTO's membership is to eliminate trade barriers between member-states and this has compelled the Chinese government to loosen restrictions on foreign ownership of Chinese subsidiaries in many sectors including the construction and transportation sectors.

The main purpose of this paper is to investigate the reasons why foreign firms are becoming Wholly Foreign Ownership Enterprises (WFOEs) in China, particularly in the construction sector. Specifically, the research objectives are to (a) investigate the choice of entry mode used by British construction firms to penetrate the Chinese construction industry before and after the deregulation of the foreign share of companies in 2003; (b) critically assess the determinants behind the decision to enter the Chinese construction industry; and (c) investigate Atkins' expansion approach to enter the Chinese construction industry. The data on which this study was based were collected mainly from secondary resources both in China and online. In view of its exploratory nature, it was decided that a case study will be most suitable to help in the analysis of this study. This paper will first review the recent literature on foreign direct

investment followed by the background of the construction industry in China. In the next section, this study will discuss the case study and the findings of this paper followed by conclusion and recommendations.

THE REVIEW OF RECENT LITERATURE

The recent review of the literature is based upon a combination of two theories applied to discuss Atkins's international company's rapid expansion in the Chinese market. The two theoretical models used for this study are the internalisation theory and the famous Dunning model. Proponents of the internalisation theory such as Johanson & Wiedesheim-Paul (1975) and Johanson & Vahlne (1977) among others believe that the internationalization process enables firms to move their business activities across national frontiers. Kim (2003) states that the gradual internationalization process assumes that a firm's specific location choice is made where the society, politics, economy and culture are similar to the firm's domestic markets. Gradually the firm's business activities expand to where there is greater difference in these aspects. In addition, during the internalization process, Johanson, Wieldesheim-Paul and Vahlne (1975) argue that companies are in favour of foreign direct investment requiring a lower level of resource commitment, such as exports, JVs in the early penetration. Along with the time given to companies to develop the experience to overcome problems facing its international market's expansion, companies will eventually adopt foreign direct investment and involve higher level of resource commitment in their foreign markets. Dunning (1980, 1988) however, argues in his famous eclectic paradigm that external and internal factors of locations are the key determinants of foreign direct investment, even when companies have possessed international experiences.

Dunning (1980 & 1988) asserts that three dimensions are significantly critical in the selection of entry modes, which are what the firms initially own or acquire from the home country (ownership advantage); the benefits of firm-specific location provides (location advantage); and the core competences the firm possesses in integrating the advantages of foreign countries (internalization advantage). Although these dimensions of Dunning's work have been testified and refined by a huge amount of empirical research (Agarwal & Ramaswami, 1992; Erramilli & Rao, 1993; Kwon & Konopa, 1993; Kim & Hwang, 1992). Dunning (1988, 2000, 2001) restated that the flexibilities of sub-factors in each dimension should be kept to accommodate the different features given in investing countries and industries. It is strongly argued that the higher the ownership advantage firms originally possessed or obtained from home countries, the more likely they are able to increase profits from FDI.

In the case of Atkins engineering consultancy, giving its many years of international experience in other markets, it actually began its operation a JV but later on penetrated the Chinese construction industry by gaining the status a WFOE. Compared to Chinese construction firms, Atkins possess competitive advantages with regards to capital, advanced skills and modern knowledge, higher levels of management, experience in international and large scale projects, and superior performance and qualities. However, with constraints of limited understanding about the construction industry in China, to form a strategic collaboration with local partners is more advantageous than setting up a WFOE for its early expansion stages in China. By doing so, investment risks can be minimized as well as ensuring that complying with the various restrictions that the Chinese government requires for the foreign party investment (Cheah & Chew, 2005; Chen, 1998; Luo, 2001; Peng & Jiang, 2003; Shen. et al, 2001).

Regarding the location factor, Dunning and Wymbs (2001) point out that it is important to illustrate features of each industry when applying the eclectic paradigm. Instead of integrating the industrial factor into three fundamental determinants in Dunning's model, it is separated as a sole factor in the conceptual models. The completion of construction projects is combination of teamwork consisting of many individual construction firms offering various professions. Therefore, the better the harmonization between firms, the higher the efficiency can be, and the sooner the projects can be completed. The British firms may have expected to face communication problems and different working and management styles

when they begin their operations in China. In addition, the literature demonstrates that the limitation of government policies on the foreign equity is the principal reason behind the growing popularity of JVs across all industries in China (Chadee & Qiu, 2001; Chadee, Qiu, & Rose, 2003; Pan 1996). After China had gained the membership of WTO, due to the deregulation of foreign equity in JVs, the establishment of WFOEs was expected to increase in the construction industry. Furthermore, Dunning also stated that the internalization advantage refers to the capability of firms to integrate its endowments and resources provided in foreign markets into its ownership advantage in order to increase its foreign market revenue (Dunning, 1980, 1981, 1988, 1993: 81-83, 2000, 2001).

BACKGROUND INFORMATION OF THE CONSTRUCTION INDUSTRY IN CHINA

After Prime Minister Deng Xiaoping enacted a reform program to boost the internal economic growth during the 1980s, the construction industry began to change from its old ways and low esteem and became a recognized sector in the Chinese economy (Peng & Jiang, 2003; Lu & Fox, 2001). Construction firms in China are generally classified on the basis of the ownership structure, including state-owned enterprises (SOEs), urban and rural collectives owned enterprises (URCs), rural construction teams (RCTs) and foreign enterprises (Lu & Fox, 2001; Cheah & Chew, 2005; Peng & Jiang, 2003). As result of the economic reform program, and government private sector initiatives, the Chinese construction sector gained the opportunity to open the industry to private investment projects. However, the number of private participants was relatively small in the initial stages in comparison with the SOEs (Peng & Jiang, 2003). Although the openness of the Chinese economy has accelerated the liberalization of the construction industry, most construction activities were still dominated by SOEs (Peng, Jiang & Hongbin, 2004). Foreign firms can only undertake construction projects financed by international organizations, such as the World Bank, Asian Development Bank and foreign governments, or those which are wholly financed by foreign companies. To participate in projects that are subsidized by Chinese government or domestic banks will require foreign firms to form JVs or corporations with domestic firms (Shen & Lin, 2001; Luo, 2001; The Survey of Foreign Direct Investment in the Chinese Construction Industry, 2005).

Accepting WTO membership in 2001, a deregulation process on the ownership structure of foreign firms in the construction industry was implemented. By doing so, domestic construction firms were fiercely challenged by foreign contractors with strong financial and technological backgrounds. In addition, foreign construction firms have increased the adoption of JVs to penetrate the market (Chen, 1998; Cheah & Chew, 2005). Currently, the increase in JVs and subcontracting projects taking place in the industry has resulted in a gradual decline of the presence of SOEs in construction activities (Peng & Jiang, 2003). In 2003, a new policy was put in place to force a change in the foreign share in Sino-foreign JVs and to permit the set up of foreign firms in the industry (The Survey of Foreign Direct Investment in the Chinese Construction Industry, 2003).

The Ministry of Housing and Urban-Rural Development of the People's Republic of China (MOHURD) is the central administration body in charge of the supervision and regulations of the construction firms and its activities. Its administrative authority was maintained as the same as the former administration body, i.e. Ministry of Construction, except for the supervision of city transportation system and city development. In addition, the central level of jurisdiction is bestowed upon MOHURD to oversee the coordination between lower-level administrative bodies, to direct the construction development of the country and to guard the standards of constructions activities across the country (Lu & Fox, 2001, figure1-1). MOHURD takes the responsibilities to supervise the market development and the process of construction projects across the country, to set up safety and quality standards of constructions, propose long term plans and directions for the national construction activities, to ensure the implementation of regulations in different levels of administrative bodies, to draw up new regulations, to amend existing regulations and to monitor the coordination with provincial and local governments and associated institutions. The administration structure is divided into fifteen divisions and each of them is responsible

for one specific administrative area in order to support the function of MOHURD. The chart below describes the Administrative Hierarchy of the Construction industry in China.

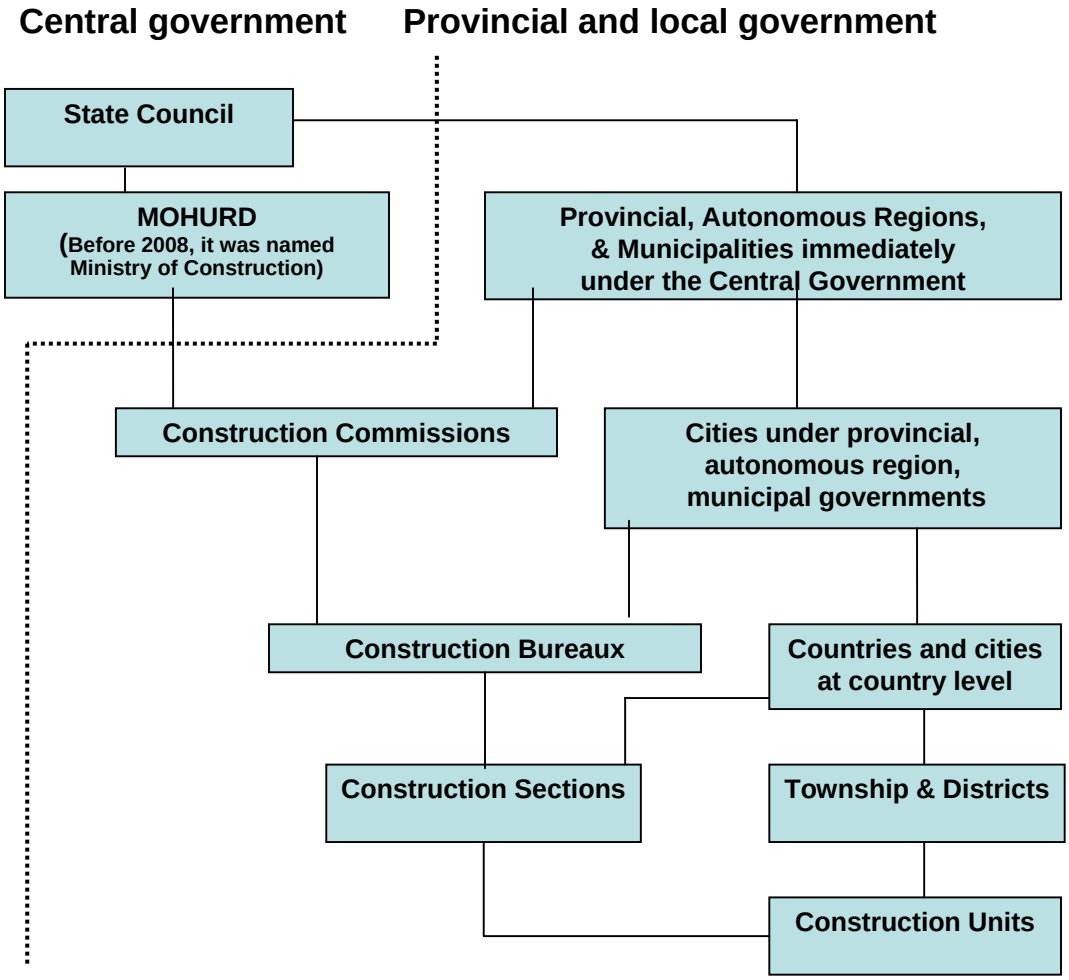

Figure 1-1: Administrative Hierarchy of the Construction industry in China
Source: Lu & Fox, 2001

The Current Market Environment

The Chinese government specifically classify the construction activities into two major categories which are building projects and civil engineering projects. Building projects normally refer to the constructions of housing, commercial buildings and building for other purposes. Civil engineering projects are connected to the construction of public infrastructure, such as transportation, power supply stations, railways and bridges (Peng & Jiang, 2003). Although a rapid progress of market liberalization is expected in China, some restrictions are still placed upon foreign investment in the construction industry. In fact, under the concern of potential impact on employment and the reform of SOEs, to undertake investment in the construction industry with a form of WFOE was only permitted before China's entry to WTO (Cheah & Chew, 2005). Due to advantages of large scale production and employment opportunities in China, SOEs often tend to have a dominant share and undertake construction activities with a higher level of capital. However, the oversized organizational structure and old-fashioned management style have enabled SOEs to keep up with new technology and to face intense market competition placed by URCs and RCTs. When the Chinese government tried to strengthen SOEs' competence by implementing the reform program, URCs and RCTs quickly took over SOEs market share with higher flexibility of its operation and services. Unlike SOEs, URCs and RCTs possess greater mobility which enables them to be

more accurate in conducting market-oriented tasks. In addition, working with a smaller size firms has given URCs and RCTs higher flexibility in the management of the work force and organization. However, with little financial base towards investment ventures compared to what SOEs used to enjoy, URCs and RCTs usually produce a poorer output quality and are only able to provide a narrow area of professions and a less satisfactory managerial performance (Chen, 1998; Peng & Jiang, 2003).

With strong foreign competition in the market, Chinese construction firms are found to lack the capability to perform R&D projects in comparison with firms from the UK, the US and other countries. Also, the domestic Chinese firms do not usually set up a research and development department in the organization. They tend to form the coordination of their activities with several firms to link design, supervision and engineering services in the supply chain. Since 1990s, 11,330 supervisory-based construction firms have now been set up and they have gained a strong position with the increasing demand in the market. The provincial and municipal governments also provide the support by establishing design institutions under their administrative structure. In addition, more engineering consulting firms are required with the growing number of international projects (Peng & Jiang, 2003). Although the bidding system always follow the conventional approach to decide the distribution of construction projects in the history of the industry, the Chinese government has not yet facilitated formal procedures and regulations along with the industrial development in the country. An arrangement of under-the–table negotiations with the government's agencies is often used by bidders who are interested in bidding for government projects. Without a sound legal framework of this process, the winner often goes to firms which have a good relationship with the government. Additionally, the roles of the bidders are not precisely classified by the services that they offer, such as design, supervision or engineering services. As a consequence, the winner may not possess all the attributes and the service expertise required to undertake the project. As a result, these bidders may subcontract the project to other firms in order to accomplish the task. Therefore, the current bidding system urgently requires a transparent bidding process and standardized documentations to identify the roles of the contractors, owners and engineers in the process. However, the expectation of a fairer and more competitive bidding procedure will rely on the proposal of a "Bidding Law" (Chen, 1998; Peng & Jiang, 2003).

Foreign Investment in the Construction Industry

Before 2001, the total contractual foreign funds invested in the construction industry amounted to US21.514 billion around 3% of the total foreign funds invested in China. The annual investment of foreign-funded projects in 2001 was only US$807 millions around 2% of total foreign direct investment in China. Since the introduction of the trade and liberalization policies, 622 firms from Hong Kong, Macao and Taiwan have been registered with the Ministry of Constructions. Also since 2001, 274 foreign firms used foreign direct investment as a means to enter the Chinese construction industry. The total number of projects undertaken by foreign firms was 256. In 2003, the number of foreign direct investment projects increased to 20.36% compared to its 2001 figure of around 2% (The Survey of Foreign Direct Investment in the Chinese Construction Industry, 2001-2004). In 2005, 287 foreign construction firms were registered with the Ministry of Housing and Urban-Rural development of the People's Republic of China. The share of foreign investors in the construction industry compared to domestic ones is relatively small. The data shows that in 2005 JVs were still the most common foreign investment method used to enter the construction industry (The Survey of Foreign Direct Investment in the Chinese Construction Industry, 2005 & 2006). Since 2005, more than 1000 foreign firms have registered in the form of Sino-foreign JVs in the industry. It is interesting to note that the investment made by Hong Kong based firms is almost two-thirds of total foreign investment among all Sino-foreign JVs in the construction industry followed by US and Japanese firms. However, the investment made by European firms is considerably insignificant in proportion to the investment made by US and Japanese firms. Most of the construction investment ventures are located in the eastern region. The share of foreign investment is about 15.94% compared to the share of east and other regions which is estimated to be 84.06% on the basis of total value of foreign investment. 22% of total foreign capital injected in the construction industry is invested

in Guangdong followed by Jiangsu, Shandong, Jiangxi, Hunan, Shanghai, Zhejiang, Beijing, Anhui and Liaoning (The Survey of Foreign Direct Investment in the Chinese Construction Industry, 2007).

ATKINS Engineering Consultancy in China

Atkins is the largest multidiscipline consultancies in the UK construction industry and it is also ranked as one of the top five largest firms in the construction industry worldwide. The UK based construction company started its operation in 1938 and now has expanded its business across national frontiers - to Europe, USA, the Middle East, India and Asia Pacific. Atkins has also successfully expanded its business to China by transferring its international experience to the newly formed branches in the cities of China. Atkins began its Chinese JV operation in 1973 with its branch company set up in Hong Kong. It started to expand the business across major cities in China in 1994, including Shanghai, Chengdu, Wuhan, Beijing, Shenzhen and Tianjin. Atkins has now been registered in China as a WFOE with several branches handling regional construction projects in the major cities. As result of its outstanding services and the competence to undertake large scale projects, it has been successful in wining the government's urban development projects (Atkins PLCs website, retrieved on 9th March.2009).

Atkins main operational activities include professional services in construction design of foreign investment and engineering consultancies in the public infrastructure and urban planning projects, giving the companies 30% turnover in 2007. The Chinese government's 11th five year plan is to spend RMB140 billion to build 42 city airports during 2006-2010, and Atkins is in a favourable position to win most of the government projects (Atkins Annual Financial Report, 2008). During its 15 years experience in China, Atkins has firmed up its position in China as a master planner in the services of urban development and architect design of public infrastructure. Its notable archives include the success of Thames Town outside of Shanghai and the winning design for the TEDA towers in the city port of Tianjin in 2006. Moreover, Atkins has earned the prestige of joining many projects with local and foreign firms, and the governments'. Currently, one of the ongoing projects that Atkins coordinates with foreign partners is associated with Hilton international Company to design and plan Hilton International Square in Chengdu. Hilton International Company invested RMB2 billion and estimates that the project will completed in 2010-2012. In addition to the coordination with multinational businesses, Atkins also often wins over design competitions in the large urban development projects in major cities. The current construction projects which have been undertaken by Atkins are the architectural design for Yinchuan airport terminal building and Central park located in Taiyuan. During 2001-2002, Atkins annual revenue accruing from China's investments showed a positive upward trend increasing from £35.5 million in 2001 to £36 million in 2002. It decreased by 14.4 percentage points from £36 million in 2002 to £30.8 million in 2003. It revived in 2004 increasing by approximately 9.4 percentage points from £30.8 million to £34 in 2004. In 2005, Atkins annual revenue fell sharply to £27.6 million from its previous year's figure. However, in 2006 it began to increase and at the end of 2006 the annual revenue stood at £31.6 million. During 2007-2008, Atkins annual revenue from its Chinese operations increased by approximately 14% from £34 million in 2007 to £38.7 million in 2008. The positive rise in Atkins annual revenue during 2007-2008 demonstrates the company's determination not only to win the Chinese government's major projects but also to increase its annual revenue from its Chinese investment ventures (Atkins Global Annual Report 2001-2008).

CONCLUSION

This study investigated the reasons why foreign firms are gaining the status of wholly foreign ownership enterprises in the Chinese construction industry. Qualitative available evidence indicates that the Chinese government has put certain measures in place that encourage foreign companies to gain the status of wholly foreign ownership. In addition, the government is giving incentives to top global construction consultancies to join the development of large scale infrastructure. Also, the present Chinese government is anxiously removing the obstacles that militate against the attraction of foreign direct investment. The study clearly shows that most foreign firms used JVs to penetrate the Chinese construction industry

before and after deregulation of the foreign share of companies in 2003. In the case of Atkins engineering consultancy, the evidence reveals that the company first used its international experience and JV strategic entry mode to locate in Hong Kong. After gaining the trust of the government and the status of WFOE it spread its business activities across the major cities in China.

The research has limited focus since it concentrates only on the construction industry. Therefore the findings may not necessary apply to other industries in China or other countries in the region. The study would have benefited from cross-sectoral research to ascertain whether similar entry strategies are employed in these sectors. This study proposes that future research should examine the strategies employed by other sectors of the Chinese economy to attract significant FDI inflows.

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