CANADIAN FIRMS IN CHINA: HOME AND HOST COUNTRY FACTORS

by

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M.A., York University, 2002

A THESIS SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF

DOCTOR OF PHILOSOPHY

in

The Faculty of Graduate Studies

(Geography)

THE UNIVERSITY OF BRITISH COLUMBIA
(Vancouver)

December 2008

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Abstract

This thesis examines Canadian FDI (foreign direct investment) in China from 1978 to 2006 in the context of globalization and with a focus on the challenges faced by Canadian firms when doing business in China. Building on John Dunning’s ‘eclectic model’ of FDI and Kobrin’s ‘bargaining’ approach, this study explores the relative importance of home country (Canadian) and host country (Chinese) factors in explaining outcomes for Canadian firms in China in the mining, manufacturing and service sectors.

Using interview data collected from Canadian high-level management personnel working in these sectors during 2005 the study argues that it has been largely the host country factors that have been at work in causing difficulties for Canadian companies in China. These include issues such as Chinese government regulations and institutions, cultural differences between Canada and China, as well as market and business environment impediments in China. On the other hand, home country factors, particularly the small size of Canadian firms in China, have also played an important part in affecting the operations of Canadian firms there.

The empirical analysis of the mining, manufacturing and service sectors revealed that Canadian firms in China are not a homogenous group and their experience and challenges can only be understood in the context of the particular sector that they are engaged in. In particular, Canadian firms in the mining sector have been more subject to pressures from the Chinese state, while firms in the manufacturing sector have been subject more to factors surrounding the Chinese market and business environment. Firms in the service sector have fallen in between, and have been subject to both factors such as state regulation and local market and business conditions. The survey analysis of some Canadian successful firms in China also suggests that the fate of Canadian firms does not hinge solely on cultural dynamics associated with either
home or host country or regulatory issues, but also on the very real efforts that individual companies make to understand local conditions, and to become accustomed and to prosper in China.
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<th>Abbreviation</th>
<th>Description</th>
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</thead>
<tbody>
<tr>
<td>APFC</td>
<td>Asia Pacific Foundation of Canada</td>
</tr>
<tr>
<td>IPT</td>
<td>Investment protection treaty</td>
</tr>
<tr>
<td>CDIA</td>
<td>Canadian direct investment abroad</td>
</tr>
<tr>
<td>CIDA</td>
<td>Canadian International Development Agency</td>
</tr>
<tr>
<td>CIE</td>
<td>Canadian-invested enterprise</td>
</tr>
<tr>
<td>CJV</td>
<td>Contractual joint venture</td>
</tr>
<tr>
<td>FDI</td>
<td>Foreign direct investment</td>
</tr>
<tr>
<td>FIE</td>
<td>Foreign-invested enterprise</td>
</tr>
<tr>
<td>EDC</td>
<td>Export development Canada</td>
</tr>
<tr>
<td>EJV</td>
<td>Equity joint venture</td>
</tr>
<tr>
<td>ETDZ</td>
<td>Economic and technological development zones</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
<tr>
<td>IPR</td>
<td>Intellectual property right</td>
</tr>
<tr>
<td>JE</td>
<td>Joint exploration</td>
</tr>
<tr>
<td>M&amp;A</td>
<td>Mergers and acquisitions</td>
</tr>
<tr>
<td>MOFCOM</td>
<td>Ministry of Commerce</td>
</tr>
<tr>
<td>NAFTA</td>
<td>North American Free Trade Agreement</td>
</tr>
<tr>
<td>NIE</td>
<td>Newly Industrialized Economies</td>
</tr>
<tr>
<td>OECD</td>
<td>Organization for Economic cooperation and Development</td>
</tr>
<tr>
<td>SEZ</td>
<td>Special economic zone</td>
</tr>
<tr>
<td>SIP</td>
<td>Suzhou Industrial Park</td>
</tr>
<tr>
<td>SME</td>
<td>Small and medium-sized enterprise</td>
</tr>
<tr>
<td>TNC</td>
<td>Transnational corporation</td>
</tr>
<tr>
<td>TRIM</td>
<td>Trade-related investment measures</td>
</tr>
<tr>
<td>UNCTAD</td>
<td>United Nations Conference on Trade and Development</td>
</tr>
<tr>
<td>WFOE</td>
<td>Wholly foreign owned enterprise</td>
</tr>
<tr>
<td>WTO</td>
<td>World Trade Organization</td>
</tr>
</tbody>
</table>
Acknowledgements

I offer my enduring gratitude to the faculty, staff and my fellow students at the Geography Department of UBC, who have inspired me to continue my work in this field. I owe particular thanks to my supervisor Dr. David Edgington, for his support throughout the process of pursuing this degree. Without his insightful guidance and persistent encouragement, I would not be able to go this far for my research.

I express my gratitude to Dr. Trevor Barnes, Dr. Jim Glassman, and Dr. Grahame Johnson for serving on my supervisory committee and offering inspiring discussion and helpful advice for this project. Special thanks are given to Professor Johnson for his invaluable academic advice, wholehearted encouragement, as well as the delicious Cantonese food. I also want to express my appreciation to the friendship with, and support from, my friends at UBC, including Min-Jung, Sin Yih, Zhang Feng and his family, Zhou Yuan, Bai Lian, and Mary Luk. I would like to thank my work colleagues in Beijing, especially Zhu Shaobao, Zhou Shiyi, Gong Zegang, and Zheng Lianrong, who have been very supportive to my research and dissertation writing.

My last thanks go to my husband Joe, my son Jason, my in-laws and my parents, who have offered their support each in their own particular ways. Special thanks are owed to Joe, who has supported me as a husband, a friend, and a research assistant.

I acknowledge the support from all my interviewees and respondents, whose participation and frank discussions made this project possible. However, the opinions, analysis, and conclusions expressed in this dissertation are solely mine; any mistakes or errors remain my own responsibility.
Dedication

To my parents
PART I

1 Introduction

1.1 Research Background

Economic globalization has been a hallmark of our time, and foreign direct investment (FDI) is an important dimension of this process. Global FDI inflows increased nearly 600 per cent between 1990 and 2000, rising from $201.6 billion USD to $1409.6 billion (Sabuhoro and Sydor, 2007). FDI has grown much faster than either trade or income after the mid-1980s. Whereas worldwide nominal GDP increased at a rate of 7.2 per cent per year between 1985 and 1997 and worldwide imports at 9.2 per cent, worldwide nominal inflows of FDI increased at 17.6 per cent (UNCTAD 1999). Global FDI inflows have continued to grow faster than global GDP, with annual growth rate of 18.8 per cent from 2002 to 2006, compared to only 3.2 per cent annual growth rate of world real GDP during the same period (Sabuhoro and Sydor, 2007). This trend suggests that the primary mechanism of world economic integration has shifted from trade to FDI (Dicken, 2003: 52). Not all international business activities are associated with FDI and alternative forms include trade and technology licensing. Nonetheless, patterns of FDI flows and stocks have been a focal issue in economic geography in the past 20 years or so (Edginton, 1990; MacPherson, 1996; MacPherson and McConnell, 1992; Meyer, 2001; Meyer and Green, 1996a, 1996b; Green and McNaughton, 1995; Burgess, 2000; Shatz and Venables, 2000; Dicken, 2000, 2003). A common characteristic of these geographic studies of FDI is an examination of firm-specific and place-specific determinants of FDI with a sensitivity of different geographical scales (national and/or regional).

Apart from geographical studies of FDI, the business studies literature has also produced a
number of theoretical studies and detailed case studies of how transnational firms have fared in overseas ‘host’ countries (Dunning, 1977; Rugman, 1980; Meyer, 2001). In recent years China has emerged as the most popular destination for FDI. However, by all accounts, the policy environment for foreign direct investors in China is different from many other host countries to FDI, and much empirical evidence suggests that some investors are becoming discouraged by a more ‘difficult’ market and business environment while other investors have been deterred by it (Rosen, 1999; Dahles and Wels, eds., 2002). The specific contribution of this study to the literature is to hold one home country (Canada) constant and to look at how different firms in different sectors have fared in the large Chinese economy.

With a population of 1.3 billion people and a more and more open policy towards international trade and investment since 1978, China’s attractiveness as a location of low-wage labor supply and enormous consumer market for foreign business and investors is unquestionable. Its attractiveness increased even more after China entered the World Trade Organization (WTO) in 2001. In fact, after being the largest FDI recipient among all developing countries for nine consecutive years since 1993, China ranked the first in the world in terms of FDI inflow in 2002. By the end of April 2003, 436,394 foreign-invested enterprises had been established in China, utilizing foreign investment of over US$460 billion. Investors have come from over 180 countries and regions. Over 400 transnational corporations (TNCs) out of the world’s top 500 have made investment to establish their operations in China (OECD, 2003: 9). Examples include General Motors, Walmart, the ING Group and so on. For many business firms, the question of investing in China is not “why should we go to China”, but “who can afford not to go to China?” Still, many firms have ‘rushed’ in to China in the past 20 years only to come to grief, e.g. Beijing Jeep (Mann, 1997) and Guangzhou Peugeot (Harwit, 1994). It is not surprising if we find similar patterns for Canadian firms.

Canadian direct investment abroad (CDIA) has grown rapidly in the past decades, and has
exceeded the growth of the FDI into Canada since the mid-1970s (Rugman, 1987; Burgess, 2000). In 2004, CDIA reached $CAD57 billion, of which 72 per cent went to the United States (Cameron, 2005). Canada is a major G8 country and was the 9th largest economy in the world in terms of total GDP in 2003 (after the U.S., Japan, Germany, the UK, France, Italy, China, and Spain) (ibid: 13). Canada is also a major FDI source country, with CDIA ranked 9th in total FDI outflows in the world in 2003. However, compared with other G8 countries Canada is statistically only a small player in China, now the most dynamic economy in the world.

The relationship between Canada and China in terms of trade and investment is often called a “one-percent relationship”: Canadian goods and services account for only 1 per cent of China's annual imports; about 1.6 per cent of Canadian exports go to China; and Canadian direct investment in China adds up to slightly less than 1 per cent of total foreign investment in China (Gee, 2005). Only 0.2 per cent of global Canadian Direct Investment Abroad (CDIA) went to China in 2001 (Statistics Canada, CANSIM Table 376-0051, 2002-3-27). By the end of 2002, Canada was ranked 14th among all foreign investors in China. The rank dropped to 15th in 2006, behind the USA, Japan, Germany, France, Netherlands, the UK, some other Asian countries such as Hong Kong, Taiwan, Korea, and Singapore, and Pacific islands such as British Virgin Islands and the Cayman Islands. The total realized FDI from Canada to China between 1979 and 2006 was SUS 5.4 billion, accounting for only 0.77 per cent of the total capital directly invested in the mainland during the same period (Ministry of Commerce of China, 2007). On the one hand, total FDI from Canada accounted for an annual average of 5 per cent of global outward FDI from 2001 to 2004 (Ministry of Commerce, various years). Canada FDI has apparently underperformed in China. Therefore, there is a perception by Canada’s leaders – e.g. Minister of Foreign Affairs and Trade, David Emerson – that Canadian firms should be doing more in China (Emerson, 2008).

However, if we compare Canadian FDI stock with its total GDP, it is found that Canada’s
performance was actually not so poor when compared with other G7 countries (see Table 1.1). Thus, although Canada ranked 6th in terms of percentage of total FDI stock in China by 2004 among G7 countries, Canada’s performance of FDI stock expressed as a ratio to its GDP (ranked 3rd), behind only the USA and Japan.

**Table 1.1 FDI Stock in China by 2004 as % of GDP for G7 Countries (billion US$)**

<table>
<thead>
<tr>
<th>Country</th>
<th>Realized FDI stock in China</th>
<th>% of total FDI stock in China</th>
<th>GDP in 2004</th>
<th>% of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S.</td>
<td>48</td>
<td>8.54% (1)</td>
<td>11668</td>
<td>0.40% (4)</td>
</tr>
<tr>
<td>Japan</td>
<td>46.8</td>
<td>8.33% (2)</td>
<td>4623</td>
<td>1.01% (1)</td>
</tr>
<tr>
<td>Germany</td>
<td>9.9</td>
<td>1.76% (4)</td>
<td>2714</td>
<td>0.36% (5)</td>
</tr>
<tr>
<td>U.K.</td>
<td>12.2</td>
<td>2.18% (3)</td>
<td>2141</td>
<td>0.57% (2)</td>
</tr>
<tr>
<td>France</td>
<td>6.8</td>
<td>1.21% (5)</td>
<td>2003</td>
<td>0.34% (6)</td>
</tr>
<tr>
<td>Italy</td>
<td>2.8</td>
<td>0.50% (7)</td>
<td>1672</td>
<td>0.17% (7)</td>
</tr>
<tr>
<td>Canada</td>
<td>4.5</td>
<td>0.81% (6)</td>
<td>980</td>
<td>0.46% (3)</td>
</tr>
</tbody>
</table>

Note: 1. Data in this column were obtained from Ministry of Commerce official website [http://www.fdi.gov.cn/pub/FDI/wzti/lntjsj/wstzsj/2004yearzgwzj/t20060423_27900.htm](http://www.fdi.gov.cn/pub/FDI/wzti/lntjsj/wstzsj/2004yearzgwzj/t20060423_27900.htm)  
2. Number in parenthesis in this table represents rank among the G7 countries.

As a result, the low overall levels of Canadian FDI in China are just an important starting point to, and an important context and research background for, the current study of Canadian firms in China. It reflects the often-heard complaint by Canadian politicians that there are few Canadian firms doing business in China. However, this dissertation is not a study of ‘why Canadian firms do not invest in China’. On the contrary, it clearly looks at those firms that have made sufficient commitment to the Chinese market to open a business there. The focus of this study is to examine the difficulties of Canadian firms in China from both home and host country perspectives. It explores major characteristics of Canadian home country and their impact on Canadian firms overseas. It also discusses the role of Chinese regulations over FDI as well as the challenges of the Chinese market and business environment to Canadian firms in China.

In sum, the thesis examines the influences on FDI flows of two different types of countries: a developed country but with ‘semi-peripheral’ characteristics (Innis, 1956; Wallerstein, 1989) of Canada (home country) and the developing country of China (host country). What has been
the influence of ‘home’ country and ‘host’ country factors in shaping the patterns of CDIA in China, as well as the experiences of Canadian firms in China?

1.2 Research Objectives

Interest in Canadian firms in China has been triggered by the apparent lack of successful Canadian business in this country as measured by FDI statistics. However, the specific focus is to look at the operation of the few Canadian firms that have opened subsidiaries there. How can we understand their operations? What has brought them to China? What are the challenges they face there? In this thesis two macro-level frameworks derived from the literature on FDI will be ‘tested’ by micro-level interviews with 18 Canadian CEOs in China.

The specific research questions posed in the thesis are informed by a ‘home country – host country’ framework and also a ‘bargaining approach’ to understanding FDI outcomes. The theoretical literature indicates that TNCs expand abroad based upon a complex interaction between ‘firm-specific’ advantages (e.g. access to resources, technology or internalization brands) and host country-specific advantages (Rugman, 1980; Dunning, 1977). It will be shown that at a macro-level, the history of Canadian economic development has shaped the firm-specific advantages of its TNCs overseas. In the case of China, there have been interesting developments over the past 25 years or so as China has opened its economy to international investors, and thus has had important implications for Canadian investment there.

Other theories of transnational corporation (TNC) activity emphasize the importance of bargaining between TNCs and host countries, and implicitly assume that the TNCs have the upper hand, because of their size and superior bargaining power, and ability to learn about the host country's culture and business (Kobrin, 1987; Anderson and Cavanagh, 2000). A study comparing the size of TNCs (measured in terms of sales revenues) to the size of national states (measured in terms of GNP) found that around 50 per cent of the world’s one hundred largest
“economic units” are TNCs and the other 50 per cent are states (Anderson and Cavanagh, 2000). The size of TNCs to some extent indicates the strong power in bargaining with national states. Related to their large size and globally integrated operations, TNCs are able to manipulate the terms of their intra-corporate transactions by engaging in transfer pricing\(^1\) to reduce the taxes they pay in their host countries.

The superior bargaining power of TNCs derives from their ability to stimulate competitive bidding for their mobile investments among interested national states, which often allows TNCs to play off one state against another to gain the highest return for their investment (Dicken, 2003). In addition to the capital brought into the host countries, TNCs can also offer other attractions to potential host countries, including the transfer of technology, increased exports, additional employment, access to global markets, and an upgraded industrial structure. Other advantage of TNCs over their host countries may come from their ability to learn about local culture and business through their global experiences of transnational operation. While the relationship between TNCs and host countries is immensely complex, it is generally argued that host country governments are subject to a greater variety of constraints than are TNCs, and thus possess less bargaining power (Kobrin, 1987).

However, these assumptions break down in the case of Canada and China, even though Canada is a developed country and China is a developing country. Canada is a G8 country and an important trading nation. Canada has an industrial structure dominated largely by the US and other foreign TNCs (Wesson, 2001). Two key aspects of the uniqueness of the Canadian corporate sector are the high degree of concentration of foreign ownership of Canadian

\(^1\) Transfer pricing refers to the setting of transfer prices for products (goods and services) moving between semi-autonomous divisions (cost or profit centers) within large organizations. The practice is most often associated with TNCs, which respond to variable corporate tax regimes, tariff and other barriers to trade and exchange rates by setting prices for internal transactions between establishments located in different national locations in ways which minimize costs or maximize gains. For example, firms may charge high prices for semi-finished products moving for further processing to plants located in countries with high rates of tax in such a way as to reduce the tax take on profits generated by the work of such plants (Johnston et al., eds., 2000: 849)
businesses and the high degree of concentration of wealth and corporate power within Canada (ibid.). In other words, a significant part of the Canadian economy is controlled by foreign firms, e.g. General Motors and Toyota, and many Canadian-controlled corporations are controlled by a relatively small group of individuals and firms. There are often a relatively small number of corporations in any particular industry in Canada. Consequently, within each activity in Canada, a small number of oligopolistic firms compete within particular product markets, while most indigenous firms are “niche” producers and tend to be small. In addition, the major 'foreign' market for Canada is the USA, an adjoining English speaking country. Canada’s dependence on the US through trade has traditionally been high and has increased since the inception of free trade with the US, although the trade product quality has appeared to move from low-valued added to high-value added (Andresen, 2008). By 2001, more than half of Canadian outward investment stock was located in the United States (Statistics Canada, 2005: CANSIM Table 376-0051). The convenience of being able to access to such a close-by wealthy market is often argued to result in a generally lower level of knowledge and experience of other parts of the world, such as Asia. The APFC (Asia Pacific Foundation of Canada) notes that “most of today’s business leaders and policymakers rose to prominence at a time when Canada’s prosperity depended heavily on the benefits of the 1989 free-trade deal with the US” (APFC, 2003: 8). Compared with American or British TNCs, Canadian-owned firms have had a much later involvement in the international economy; thus CDIA did not really expand significantly until the mid-1970s, much later than firms in the US or UK (Rugman, 1987).

China on the other hand is a developing country but one that has a ‘strong state', and presents a united face to overseas companies (Huang, 2003). In spite of recent ‘opening up' programs, it still maintains complicated and restrictive barriers to foreign business operations inside the country (ibid). For some sectors, such as automobile and on-shore oil exploration, the Chinese government has retained complete control over FDI entry and has adopted a policy of
limited access for foreign firms in order to give competitive advantages to local Chinese firms (Liu and Dicken, 2006; Regulations of People’s Republic of China on Sino-foreign Cooperation in the Exploitation of Onshore Petroleum Resources, 2001). Having the world’s largest and fastest-growing market, as well as a large low-wage, high-quality labor pool, China can command a unique bargaining position, which enables it to play off one TNC against another. It will be argued in this study that Canadian firms are often intimidated by the business culture in China, which is very different from Anglo-American norms and values, and thus poses particular challenges for Canadian firms with limited experience of transnational operations.

The small levels of Canadian direct investment and low numbers of Canadian businesses in China are intriguing and reflect in part on Canada’s poor overall commercial engagement with Asia (Safarian and Dobson, 1995). However, to answer conclusively the question of why there are so few Canadian firms doing business in China would require an extremely broad study, including surveys of headquarters in Canada and comparative research in major investor countries that have established substantial operations in China - such as the USA, Japan and nations in the European Community. Nevertheless, this thesis contributes to this larger research goal by focusing on the specific Canadian firms that have taken steps to conduct business in China from 1978 to 2005, and by examining their activities and the challenges they face. This approach reflects the ‘comparative advantage’ of the researcher – someone who was born and brought up in China, and who is familiar with Chinese commercial and regulatory conditions (rather than those in the West) through previous work as an urban and regional planner in a major metropolitan region (Beijing).

Bearing in mind the importance of a ‘home country – host country’ approach to analyzing FDI, in both the business literature and geographical literature on direct foreign investments (e.g. Dicken, 2003; Dunning, 1977) I chose first to examine the array of existing Canadian firms in China – and their operations – by establishing the relative strength of ‘home country’ (Canadian)
factors and ‘host country’ (Chinese) factors. Specially, how have these shaped overseas business operations from Canada in China in different business sectors? Existing models that incorporate home country and host country factors have tended to be general in nature, and have not discriminated by looking at specific industries (e.g. mining, manufacturing or services). A series of research questions was thus raised at the outset of this research. First, on balance are Canadian or Chinese factors at work in causing difficulties for Canadian companies already in China? For example, are the difficulties encountered by Canadian companies in China related to Canadian factors, such as the small-scale size of Canadian firms going overseas and their lack of international experience, or are they related to Chinese factors such as the complexity of FDI regulations and the challenging Chinese business environment? Second, what are the distinctive ‘home country’ attributes of Canadian companies, and what are the distinctive ‘host country’ attributes of the Chinese economy and FDI regulatory framework that shape the flows of CDIA in China, specifically for the natural resource, manufacturing and service sectors? Third, how do these ‘home country’ and ‘host country’ features interact in the Chinese market and how do they affect the performance of Canadian firms in China? The second framework for analyzing FDI, which is reviewed in the literature, is a ‘bargaining approach’ (Kobrin, 1987). In the case of Canadian firms in China, if government regulations are anticipated to be a major factor influencing the behavior of Canadian firms in China, then how is the complex state control over FDI manifested in the case of Canadian firms operating in China? What are the social, cultural, political and historical forces behind the making of FDI regulations in China and how do they affect Canadian firms? Consequently the fourth research question is what are the impacts of the Chinese state (mainly regulations) and market and business conditions (including suppliers, customers and the workforce) on three specific sectors - mining, manufacturing, and services?

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2 The reason of selecting these three sectors for examination of Canadian firms in China will be discussed in Section 1.3.1 of this chapter.
To what extent does the impact of Chinese market and business conditions and regulatory regimes on these three sectors differ from each other?

The overall objective of this research therefore is to obtain deeper understanding of, and reasonable answers to, the above four questions by means of analytical frameworks drawn from the literature, statistical analysis, and also in-depth interviews. Following on from an exploration of these two macro-level frameworks (‘home country – host country’ and ‘bargaining approaches’ to FDI) I examine a range of statistics that throw light on these frameworks by analyzing changes in Canadian overseas investment and inward investment in China. Finally, I show how useful they are by means of in-depth interviews with 18 Canadian CEOs in China.

I argue that an industry-specific analysis allows a sharper understanding of overseas investment outcomes, and as shown later in the thesis the empirical results indicate that a different array of ‘home country’ and ‘host country’ factors (e.g. Canadian firm advantages, as well as Chinese regulations and local business environments) varied widely according to the specific sector examined. In the case of the mining sector, major difficulties for Canadian firms in China were mainly generated from the regulatory restrictions on mineral exploration and exploitation activities in general and the involvement of foreign investment in particular. For Canadian manufacturing firms, challenges from the local market and production management issues, including relations with customers, local suppliers, and local staff, were found to be important. Finally, for the service sector, Canadian firms have been mainly challenged both by government regulations and market /local business environment. These results were found by an analysis of Canadian ‘home factors’ such as industrial and organization structures of Canada. Conversely, I examined various Chinese ‘host factors’ from sources such as such as host state, host culture, as well as host market and business environment. The application and usefulness of the two frameworks mention above varied in different sectors and in each particular firm interviewed.
1.3 Research Methodology

1.3.1 Rationale of Sector Selection

The methodology in this thesis focuses on Canadian firms who already operate in China (the thesis does not cover Canadian firms that only export or license technology to China, see Grunau, 2006) as of 2005, and examines three important sectors – mining, manufacturing and services. It is argued that FDI in each sector is regulated quite differently from each other in China and this shapes the opportunities and constraints experienced by different firms. Apart from the more typical FDI in the Chinese manufacturing sector, the selection of mining and services sectors is made because these are two sectors where Canada has many advantages in the global economy (Britton, 1996). For example, the annual Top 1000 profit ranking companies compiled by *the Globe and Mail* in 2008 is ‘top-heavy’ with financial and energy firms, such as banks and oil companies (Milner, 2008). Canada’s financial players and resource companies together accounted for two-thirds of the $104.7 billion in earnings piled up by the country’s 1,000 largest publicly listed corporations in 2007 (ibid.) Although manufacturing may not be Canada’s overall economic strength, and it is one that is apparently losing ground to imports from developing countries due to the high cost of labor, it is the sector that has attracted most Canadian firms to China among all sectors so far (Ministry of Commerce, China, 2005). This can be attributed partly to the Chinese ‘open policy’ in the 1980s and early 1990s that encouraged FDI in manufacturing. The reason lies in China’s pursuit of industrialization since the late 1970s through participating in the global production chain with its low labor wages and other cheap production costs (e.g. land, utility, and production materials) as well as a rapidly expanding market for consumer and industrial products. Regulations on raw material operators (e.g. mining) and the service sector, however, are still move severe.
1.3.2 Qualitative Methods and Reflections

Qualitative methods have come to play an important role in contemporary geographical research. A number of prominent economic geographers have recently encouraged methodological reflexivity and diversity in economic geography studies and called for a distinctive critical relational geography (Tickell, et al., 2007).

To better capture the real experience of Canadian companies in China and to effectively expose the underlying power relations between Canadian TNCs in China and various social actors (e.g. government agencies, partners, suppliers, and workers) surrounding them, I employed a qualitative method, mainly face-to-face interviews, in this research. A firm-level survey involved an open-ended interview of 18 general managers, CEOs or owners of firms chosen from various lists of Canadian companies in China. This survey was conducted in China between January and August, 2005. A sample company questionnaire is presented in Appendix 1, and a list of all companies (in code) interviewed is given in Appendix 2. The questions asked to each company were adjusted according to the type of industry, and in every interview the discussion remained flexible and open-ended in order to gain a more viable and rich feedback. As shown in the Appendix 2, the number of Canadian firms that I interviewed in 2005 was relatively small compared with the total population of Canadian firms in China in each of the three sectors (total estimated numbers of firms in 2005 were 21 in the mining sector, 2,083 in the manufacturing sector, and 254 in the service sector – based upon the MOFCOM data). This may skew the findings in terms of the difficulties and challenges Canadian firms encountered during their operations in China. Nevertheless, the face-to-face interviews and on-site visits have helped me understand the actual experience of these Canadian firms, which could not be obtained by conducting a large-scale questionnaire survey. The limitations of this study caused by the ‘under-representativeness’ of the Canadian companies interviewed will be discussed in
the final chapter of this thesis.

It turned out to be a very difficult process tracking down my interviewees, mainly high-level management personnel of Canadian companies based in China, who often had tight work schedules and who needed to travel widely. To make contact with these ‘high ranking’ people, the prime way I took was to attend business activities organized by the Canada China Business Council (CCBC), the largest organization for Canadian business people in Mainland China. As a student member of CCBC (the cheapest membership), I was entitled to participate various business events and meetings, where I made acquaintance with some company CEOs who became interested in my research and agreed to share their experience with me. In the end, I was able to interview CEOs, chief representatives or plant managers of 18 Canadian firms in China, plus other informants working in NGOs, such as CCBC. I presented myself as a Canadian graduate student doing research on Canadian firms and I was treated as an insider by my Canadian respondents. On the other hand, raised and educated in China, I often positioned myself as an outsider to my Canadian respondents and an insider when trying to understand and interpret the interview information. These dual positionalities (both insider and outsider) will undoubtedly influence my way of doing interviews and delivering the knowledge I gained from the fieldwork (Glassman, 2007).

Before I conducted interviews with Canadian business leaders in China, I was fully informed by the existing, albeit modest, literature on the perils and pitfalls of conducting interviews with corporate elites (Brenner et al, eds, 1985; Fielding, 1993; Herod, 1993; McDowell, 1992; Patton, 1990; Schoenberger, 1991; 1992; 1994). During the interviews, I found myself often in a disadvantageous position versus my business elite respondents – “always powerful and usually knowledgeable, often on their guard, sometimes keen to demonstrate their relative power and knowledge and your relative powerlessness and ignorance” (McDowell, 1998: 2137). They were also alert when I asked something they deemed sensitive or
secretive, such as their bargaining process with local government, business strategy in market competition, and business statistics. On the other hand, being a female researcher – who is often perceived as “less threatening, more intriguing, or presumed to be a better audience for the recounting of exploits” (Schoenberger, 1992; Cochrane, 1998), I might have an easier time gaining access to my potential interviewees and getting more feedback (I often observed that my respondents became relaxed after the conversation started) than a male researcher might.

As informed by a growing literature on corporate surveys of business elites (Cochrane, 1998; McDowell, 1998; Parry, 1998; Shurmer-Smith, 1998; Woods, 1998), one should be aware of the danger of believing elites to report truthfully on what happened. As Cochrane (1998) warns us, “it is important to retain a form of committed skepticism, so that one does not simply believe the stories the elites tell about themselves—but nevertheless, those stories need to be taken seriously in their own right, as well as providing evidence about the ways in which power is constructed” (Cochrane, 1998: 2130). I also met challenges that arose due to shifts between “field sites, places of ‘analysis’, and spaces of engagement” (Tickell, et al., 2007). In conveying the knowledge obtained from firm interviews, I encountered difficulties in organizing the scattered information about particular firms and interviewees into a systematic and theoretically sound argument. During this process, I had to abandon some intriguing points raised by my respondents just because these points could not fit into any of my structured line of arguments, or because these points were not so relevant to the main purpose of the research.

1.3.3 Quantitative Methods

The data collected from interviews were supplemented by analysis of various firms’ annual reports and official government investment records both in Canada and China. I also collected and analyzed official statistical data on FDI in China since 1979, especially those classified by source countries. These data were obtained from Chinese official publications, such as the
‘Almanac of China’s Foreign Economic Relations and Trade’ and the ‘China Foreign Economic Statistical Yearbook’ (both are annual publications by China’s Statistical Bureau), as well as from international agencies such as the World Bank, the United Nations and the International Monetary Fund. I obtained a list of Canadian firms and their affiliates in 2005 from Canadian agencies both in China and Canada, such as the Canada China Business Council, the Asia Pacific Foundation of Canada (APFC), and the China Division of the Department of Foreign Affairs and International Trade of Canada, as well as from Chinese official agencies in charge of FDI, such as the Foreign Investment Administration of Ministry of Commerce (MOFCOM). Using various data sets I analyzed the general patterns (including spatial and sectoral patterns) and historical trends of Canadian investment in China since 1979, and this provided a useful background for further detailed analysis of Canadian firms in China.

There is no single authoritative statistical source showing the numbers of Canadian firms in any one year, or even by a sector. Thus, I have had to draw from many different sources in order to grasp the characteristics of Canadian firms in China. Statistics from different sources often use quite different definition of overseas business. For instance, the dataset obtained from Asia Pacific Foundation of Canada presents Canadian companies that have made direct investment in China. In other words, these were ‘mother companies’ of Canadian-invested companies in China. One company from this list may have established more than one subsidiary in China. That is why the number of Canadian firms in this dataset is much smaller than that in the dataset obtained from the Ministry of Commerce (MOFCOM, 2005) by the author during the fieldwork. The latter dataset contains the number of Canadian-invested companies established in China during 1984 and 1996. Again, Canadian firms in China listed in Canada China Business Council (CCBC) member directory (CCBC, 2006) were only those companies that were members of CCBC. There were other Canadian companies in China that did not choose to join CCBC. However, as the manager of CCBC told me, the member companies of CCBC represent the
majority of Canadian companies in China (my own interview with manager of CCBC Beijing Chapter on Feb. 23, 2005).

One should be careful about the reliability of Chinese statistics. There has been extensive discussion on the accuracy of Chinese statistics. For example, OECD (2003) states that MOFCOM (ministry of commerce of the People’s Republic of China) FDI statistics are not based on the internationally recognized standards that are generally applied by OECD countries. Also UNCTAD World Investment Report (UNCTAD, 2005) found that there are huge discrepancies between FDI flows as reported by China (the host country) and by a number of investing (home) countries. Therefore, in this thesis, I put the collection of Canadian statistics (e.g. those from Statistics Canada, Asia Pacific Foundation of Canada, and the Canada China Business Council) as my priority. In the areas where no Canadian statistics are available, such as the list of Canadian firms in China before the mid-1990s, Chinese official data were used, but with a focus on the growing trends and relative composition of the data (e.g. industrial and geographical composition) rather than on the actual amount of the FDI values.

1.3.4 Definition of Canadian Companies

It is necessary here to discuss the definition of a Canadian company in China. Canadian firms have been involved in China’s economy in various extents. Some have established one or more subsidiaries or branches in China, while others have only established representative offices in one or more cities. In the Chinese definition of foreign companies, Canadian-invested enterprises (hereafter CIEs) are those local firms having an investment by enterprises or other economic organizations registered in Canada, or by individual Canadian citizens, with at least 25% of the Chinese firm’s equity. All Chinese official data on Canadian FDI follow this definition. The ‘mother’ companies of these CIEs can therefore be indigenous Canadian firms headquartered in Canada, or in some cases, firms registered in Canada but headquartered in
other countries, such as the United States. In the latter cases, these firms are in effect Canadian subsidiaries of US companies, and so are not truly independent Canadian companies. Consequently, I did not include this latter type of CIE in my field research of specific companies. On the other hand, there are some enterprises in China containing investment by companies owned and run by Canadian companies or citizens but which are registered in countries or regions other than Canada. For example, some Canadian companies may use their Hong Kong-based subsidiaries to invest in China (this is a common practice for both Canadian and other Western country companies), either through joint-venturing with Chinese companies or by building wholly-owned factories in Hong Kong. In this case, the newly formed company is identified as a Hong Kong-invested company in Chinese official records. Some of these firms, as well as some Canadian companies that have only established representative offices in China, have been included in my fieldwork and interviewed because I believed these firms have Canadian characteristics, and also because they regard themselves as Canadian firms and represent Canadian interests.

There are many scholarly works that have studied foreign firms having difficulties in the Chinese market in particular industries (for example, Tao and O’Brien, 2003; Chen, 2001; Ambler and Witzel, 2000; Chan, 1996; Abramson and Ai, 1994). The unique contribution of this study to the existing literature is that it is a systematic research on Canadian direct investment in China, in which I held the ‘home country’, i.e. Canada, constant – and then looked comprehensively at various factors, especially those from the host country China, influencing Canadian companies in the mining, manufacturing and services sectors. Apart from theoretical issues of FDI patterns and the difficulties of international business in non western countries, there are also policy dimensions of this research, as noted earlier. The Canadian federal government is concerned that so few Canadian firms are succeeding in China (see the speech of Minister David Emerson in Canadian Embassy in China, 2008, as mentioned earlier). My study
will lead to certain policy recommendations on how the Canadian government can support Canadian firms in the Chinese market, dealt with in the final chapter of the thesis.

1.4 Dissertation Outline

This dissertation is organized in four parts and nine chapters. Part I contains two chapters. The present Chapter 1 comprises the introduction to the whole dissertation, discussing the research background, the scope and objectives of the research, and a discussion of research methodology and procedure. Chapter 2 reviews theories of FDI and multinational bargaining, focusing on the importance of home country factors and host country factors, the role of semi-peripheral countries and developing countries, and the importance of nation states as regulators and cultural containers. At the end of the chapter, an analytical framework to understand the situation of Canadian firms in China is developed and presented.

Part II (Chapter 3, 4, and 5) analyzes patterns of foreign direct investment in China since 1979, Canadian direct investment abroad (CDIA), and Canadian firms in China, using statistical data, research findings from relevant literature, and government reports. The results are presented in a way that expands the analytical framework of the thesis that I introduced in Chapter 2. Chapter 3 discusses some major components of China’s FDI regulatory framework and the detailed patterns of global FDI in China with a focus on its development phases, major types, major investors, sectoral composition, and spatial distribution. Chapter 4 investigates Canadian industrial and organizational structure and patterns of CDIA, including its historical development and trends, and more importantly, its geographical distribution and locational determinants. Chapter 5 examines the economic relations between Canada and China, as well as the general pattern and trends of Canadian direct investment in China, based on statistical data and the list of Canadian firms operating in China. Analyzing data in an aggregate fashion, these three chapters provide a research backcloth for further detailed study of Canadian firms in China.
from a micro-perspective.

Part III (Chapter 6, 7, and 8) of the thesis reports the major findings of the qualitative research of this project and the results of the company interviews. From these I identify the major impediments faced, and solutions taken, by Canadian firms in China in the sectors of mining (Chapter 6), manufacturing (Chapter 7), and services (Chapter 8). The findings weigh up the various ‘Canadian home country factors’ and ‘Chinese host country factors’ that influence FDI outcomes, and shed insights on the complexity of host country factors and bargaining with foreign firms in China, and on the general puzzle of “why so few Canadian firms invest in China?”

Part IV comprises the conclusion chapter (Chapter 9) and examines the relative balance of home and host country factors at work, and summarizes the differences between the three industrial sectors chosen for analysis. This is followed by a brief discussion of the theoretical and policy implications of the findings, as well as the limitation of the research and a possible further research agenda.
2 Theories of FDI and Multinational Bargaining

Canadian business with China can take many forms, including exporting from Canada, technology licensing and foreign direct investment (FDI). FDI is only one of many forms of business interaction between two countries. Several strategic considerations could motivate FDI activities, such as increased competitive intensity at the original location, cost-cutting requirements which prompt the search for new low-cost production locations, or pressure to enter new markets in response to similar moves by rivals. Measures undertaken by various governments in liberalizing investment regimes also profoundly affect FDI decisions. Therefore, FDI should be examined both at the firm level and at a country level (Sethi, et al., 2003). In the first section of this chapter, previous studies of FDI as well as determinants of FDI in China will be reviewed to explain why Canadian firms are attracted to FDI and to ‘internalizing’ business in China as suggested by Dunning's eclectic theory (Dunning, 1977).

This chapter places Canadian firms in China in the broader context of the globalizing world in which firms and nation states interact. Since the thrust of this thesis is to find out the home and host country factors that shape Canadian FDI into China and which cause difficulties for Canadian companies in China (and considering the pattern of Canadian investment there), theories on multinational bargaining process that are important in the business studies and geographical literature are explored through the discussion of home country and host country effects on TNCs, as well as bargaining relationships between TNCs and host countries. Based on the literature review, an analytical framework for this thesis is laid out at the final part of this chapter.
2.1 Theories of FDI

The theory of capital movements was the earliest explanation for FDI, which was viewed as a part of portfolio investments (Iversen, 1935; Aliber, 1971). Hymer’s (1960) groundbreaking contribution was the first explanation of FDI in the industrial organization tradition. Hymer saw FDI as a means of transferring knowledge and other firm assets, both tangible and tacit, in order to organize production abroad. In a similar way, Vernon (1966) used the product life cycle concept to theorize that firms set up production facilities abroad for products that had already been standardized and matured in the home markets. Following these two seminal pieces, numerous studies have been done to explain FDI and TNC activities from different theoretical bases, e.g. seeing FDI as a way of exploiting ownership advantages (Caves, 1971; Dunning, 1958), as risk diversification (Rugman, 1979), as organizational assets and knowledge transfer (Kogut, 1983). Further, Buckley and Casson (1976) and Hennart (1982) explained the logic for internalizing transactions within the MNE, while Knickerbocker (1973) argued that TNCs exhibit a bandwagon effect when they follow their rivals into new markets as a strategic response to oligopolistic rivalry.

Above all, John Dunning’s eclectic paradigm (Dunning, 1977), which analyzes why and where TNCs would invest abroad, has been the dominant conceptual model for studies of foreign direct investment in the past two or three decades (Rugman and Verbeke, 2004). According to this Eclectic Paradigm, a firm is unlikely to engage in FDI unless three conditions are satisfied: firm-specific advantages (FSAs), internalization, and country-specific advantages. The FSAs, also called ownership advantages, are largely in the form of intangible assets (such as knowledge, technology and brand names) and are exclusive to the firm possessing them. The advantages must be of sufficient value to offset the risk of locating in an unfamiliar business environment. Besides possessing the FSA, a firm also has to have the desire and ability to
internalize the advantages by establishing a foreign subsidiary rather than leasing or selling its ownership advantages. This notion implies that it is more beneficial for the enterprise using internalization instead of other forms of advantage utilization (such as licensing, franchising, technical service agreements or subcontracts), which are usually more desirable when the product has reached its mature stage (completely standardized) or the firm does not have any concerns about the dissipation of its FSA to likely competitors. The last component, country-specific advantages, refers to the locational advantages of the FDI host country. Factors that may impact on a host country’s advantages in attracting FDI include market size, natural and created resource endowment, production cost, societal and financial infrastructure (e.g. credit, legal and educational facilities), transportation and communication infrastructure, economies of centralization for R&D and marketing, artificial barriers (e.g. import controls and exchange rate differentials), investment climate (e.g. political stability and investment incentives), and cultural differences and similarities (Meyer, 2001).

Based on Dunning’s framework, many studies have been conducted to investigate the determinants of FDI in China and explain why firms choose to invest in China (Wang and Swain, 1995; Wei, 1995, 2000; Liu et al., 1997; Dees, 1998; Zhang, 2000; Hong and Chen, 2001, and Wei and Liu, 2001). The empirical results from these studies indicate that market size, low labor costs and relatively large volumes of exports, the exchange rate, geographical distance, adult literacy, patent registration, linguistic ties, borrowing costs and imports, corruption and the regulatory burden, as well as country risk and cultural difference all have played important roles in foreign firms’ FDI decision in China. Canadian firms are attracted to FDI and ‘internalizing’ business in China mainly due to the ownership-advantages of Canadian firms and some specific country-specific advantages of China, such as growing market size, as well as low labor cost and production cost. Also, by internalizing business and establishing operations overseas, these Canadian firms could yield better return and better protection of their technology than by taking
the form of trade or technology licensing.

Instead of examining the reasons why Canadian firms invest in China, this study focuses on the real experiences and challenges of these firms doing business in China, based on the notion that Canadian firms act as intermediates on which the characteristics of Canada and China interact with each other. So the following sections are attributed to the discussion of TNCs, home country, and host country relations in the context of globalization.

2.2 Nation States and TNCs in a Globalizing World

Globalization has been a fashionable concept in the social sciences and public affairs since the 1970s and 1980s, although many scholars believe that the current phenomenon of globalization is far from unique and unprecedented. For instance, the world economy was highly integrated in the half century prior to World War I (1870-1914) through trade, investment flows, monetary systems, and labor migration (Hirst and Thompson, 1999; Dicken, 2003). In the period of after First World Ware until the 1970s, however, many scholars believe that these two rounds of globalization – historic and contemporary – are qualitatively or fundamentally different (Dicken, 2003; Bhagwati, 2004). For example, Dicken (2003) argues that international economic integration before 1914 was essentially ‘shallow’ integration, manifested largely through arm’s length trade in goods and services, while today’s world is more ‘deeply integrated’, organized primarily within the production networks of TNCs (Dicken, 2003: 11-12).

The enhanced mobility of economic activities spearheaded by TNCs has given rise to neo-liberal ideologies, which have celebrated the advent of a ‘borderless world’, the end of geography, the demise of national boundaries, and the homogenization of consumer tastes and cultures (Ohmae, 1995). This pro-free-market rhetoric has gained huge currency among business gurus, international economists and politicians, with the successful recovery of economy in the US and Britain by the Reagan and Thatcher governments in the 1980s. For example, Reich
(1991) found in the early 1990s that big firms were becoming more global in their operations and largely detached from their countries of origins as well as with respect to choice of production and trading sites. Therefore, he argued that a home base mattered less over time. However, this neo-classical notion of globalization, which often champions free-flowing investment, footloose industries and placeless TNCs, often exaggerates the bargaining power of TNCs with their host nation states. Geographers and other more place-conscious social scientists argue the continuing relevance of geography and local distinctiveness (as constituted by the spatiality of local people, cultures and social practices) in the general dynamics of globalization (Cox, 1997).

In fact, capital is not as free-flowing as we might imagine; instead, it is often geographically embedded in distinct national social or institutional structures (Yeung, 1998). For instance, Rugman and Verbeke (2004) suggest that despite ‘globalization’, most TNCs operate in a regional/triad basis rather than globally – Japanese firms invest most in Asia, European firms in the EU, and US/Canadian firms in the Americas. They also refer to the so-called ‘Scandanavian' school of Johansson and Vahlne (1977), which argues that firms build up their foreign operations slowly and incrementally rather than going ‘all-out’ for a global approach to business. Home-country characteristics of TNCs are argued to be essential to their advantageous position in global competition (Porter, 1990; Dicken, 2003). In his famous ‘diamond’ model of global competitiveness, Porter (1990) argued that a large and growing home market allowed some firms to enjoy economies of scale that translated into an advantage of global competition. Thus TNCs are not ‘placeless’ at all. They are not only influenced by their nationality, but also affected by the “traded and untraded interdependencies” in their host countries (Dicken, 2003; Storper, 1997). In fact, the pervasiveness and significance of geographical clustering of economic activities have recently been recognized by some leading economists and business studies scholars, notably Paul Krugman (1991, 1995) and Michael Porter (1990), and by the

Besides, TNCs are not totally free to shift assets and operations in and out of host countries. Instead they are typically regulated by national and local government policies. In East Asian countries TNCs are often constrained by powerful developmental states who have developed ‘mercantilist’ trade policies to protect local industry and to boost economic development. The balance of power often favors host countries instead of TNCs as suggested by the neo-liberal theory. Indeed, the theory of the capitalist developmental state as expounded by Johnson (1982), Henderson and Appelbaum (1992), Castells (1992), Woo-Cummings (1999), Yeung (2000), and Evans (1995) has been drawn from the experience of rapid economic expansion in the East Asian countries, and focuses on the strong role of states in leading the economic transformation. It suggests that the role of state policy has been decisive in both regulating and directing domestic economy, and also in influencing the inward and outward flows of capital, traded products, and technologies.

More recently, the statist theory of the state has increasingly faced criticism for its lopsided emphasis of the role of nation states while ignoring or greatly downplaying the importance of global forces. The intermediate argument acknowledges both the virtues and failures of global free markets and nation states, and seeks to find a more realistic and balanced way of addressing the issue of globalization and governance, for example through creating new form of governance that combine both market and state factors, as well as other actors in society (Agnew and Corbridge, 1995; Herod et al., 1998), or strengthening the mutual embeddedness of both state and the economy in which the market is located (Yeung, 2000). Another important critique of the developmental state thesis is Chibber (2003)’s book Locked in Place, which emphasizes the basis of developmental states in both specific social forces and world regional contexts.
Although China is still officially a socialist country with one single ruling communist party in power, its economic development has been undergoing a capitalist development path since the implementation of the nation’s reform policy in the late 1970s. Open-market mechanisms have taken an increasingly important role in most aspects of domestic Chinese economy, especially since the early 1990s. However, the power of the market is far from totally free from state intervention. On the contrary, the visible hands of government at all levels can be seen virtually throughout the economy and society. There is a debate on whether or not China is following an East Asian development state model (Xia, 2000; Wong, 2003; Baek, 2005). Most scholars agree that the Chinese state has held strong a hand over foreign investment, including market entry by foreign firms, technology transfer, trade, and daily operations. This study will contribute to this debate, through the lens of Canadian-invested enterprises in China, to reveal how the Chinese state and the China market have influenced the daily operation of foreign business.

2.3 TNCs and Home Countries

Many studies on the relationship between TNCs and nation states have been focused on the potential impact of TNCs and their cross-border investment activities on the home and host countries in aspects such as capital and finance, employment, technology, trade and linkages, and industrial structure. However, for the present study, the literature that focuses on the converse – the impact of host country regulations on TNCs — is more relevant. In this study, it is argued that ‘home-country effects’ are an important factor in explaining the nature of Canadian firm operations in China. TNCs inevitably encounter various challenges in their host countries when the home countries characteristics they carry with them interact with the place-specific characteristics of the host countries in which they operate. This section deals with the home-country effects on TNCs, while the next section deals with host-country effects.

The current trend towards globalization often implies that TNCs are gradually losing their
national character and are converging in their fundamental strategies and operations. Many argue however that the cognitive, cultural, social, political, and economic characteristics of the national home base still play a dominant role in the formation and activities of TNCs (Dicken, 2003; Pauly and Reich, 1997; Dicken et al, 1994; Doremus et al., 1998; Zukin and DiMaggio, 1990; Dunning, 1979). For example, Dunning has explicitly linked some ‘ownership-specific’ advantages of firms with the ‘location-specific’ characteristics of national states that were likely to generate and sustain them (Dunning, 1979: 280, Table 6). Table 6 in Dunning (1979) outlines some of the possible links that exist between the ownership-specific advantages of firms and the location-specific characteristics of the firm’s home country. It is these linkages that help to explain the different characteristics of TNCs from different source nations (Dicken, 2003: 227).

For example, the abundant natural resources and the expertise in exploiting such resources in Canada generate ownership advantages of Canadian companies in mining industries. These companies possess skills, expertise and technology relevant to identifying the location and value of particular resources and their exploitation and access to capital and markets – often accumulated over many years in domestic and foreign markets, and the ability to ‘internalize’ these skills in a large firm structure. Conversely, a relatively small market and high wage economy in part explains why Canada may not be viewed as a nation with international competitiveness in goods production.

Other scholars have made more empirically-focused studies of national business characteristics. For instance, Chandler (1990) discussed the fundamental differences of industrial enterprises from Britain, Germany, and the United States in the period of before the 1940s. As noted earlier, Johanson and Vahlne (1977) argues that firms build up their foreign operations slowly and incrementally rather than going ‘all-out’ for a global approach at the first

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3 Dunning’s ‘electric model’ also emphasizes ‘I’ for internalization factors, which refers to the desire and ability of a firm to internalize its advantages by establishing a foreign subsidiary rather than leasing or selling its ownership advantages.
instance; in other words starting with low risk and low commitments by focusing first on ‘near-by’ locations to home and certainly within their own ‘home’ triad region (e.g. NAFTA, EU, or the Asia-Pacific region). Only then do they venture further afield. The overseas investment activities of Canadian companies have typically followed Johansson and Vahlne (1977)’s ‘incremental model’, first investing in ‘near-by’ US market within its ‘home’ triad, then in the UK, and later venturing in new growing markets such as China (as demonstrated in Chapter 4).

More recent empirical studies on leading TNCs from Germany, the United States, and Japan, also revealed that the institutional and ideological legacies of distinctive national histories continue in today’s increasingly borderless world market to shape the core operations of multinational firms based in these three countries (Pauly and Reich, 1997; Doremus et al., 1998). Based on the comparative results of Pauly and Reich (1997)’s work, Dicken (2003) summarized differences between US, German and Japanese TNCs from three aspects: corporate governance and corporate financing, research and development, and direct investment and intra-firm trade (Dicken, 2003: 228, Table 7.4). Generally speaking, Canadian TNCs are more like American TNCs, mainly because of the close geographical and economical connections between these two countries. However, Canadian TNCs also have their own features, which are shaped by the unique national institutions and the distinctive ideological traditions of Canada. The empirical comparison of the American, German and Japanese firms provides some hints of how to identify the distinctive characteristics of Canadian firms, which will be dealt with in Chapter Four.

Despite the literature reviewed above, one should be cautious about over-emphasizing a firm’s nationality and its influence on corporate behavior. Thus on the one hand, emphasizing the dominant effects of home countries on TNCs should not lead to a claim that all TNCs from a particular nation are identical; a firm’s own specific corporate history will also predispose it to behave strategically in particular ways (Dicken, 2003: 234). On the other hand, the nationality of any TNC is not necessarily given by the location of the corporate headquarters or the
addresses of principal shareholders. More fundamentally a TNC is often shaped “by historical experience and the institutional and ideological legacies of that experience, both of which constitute the essential structures of states” (Pauly and Reich, 1997: 4; Doremus et al., 1998).

2.4 TNCs and Host Countries

Although the specific conditions of the home country environments exert an extremely powerful influence on TNCs’ behavior, the impact of the host country environments in which they operate may also be influential. Table 2.1 shows the links between host country features and location-specific advantages in attracting or deterring FDI flows.

Table 2.1 Links between Selected Location Specific Factors and Country Specific Characteristics likely to Affect them

<table>
<thead>
<tr>
<th>Location Specific Factors</th>
<th>Country Characteristics Affecting such Factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Market factors</td>
<td>Size of market and growth potential; ability to maintain market share and to promote trade between the subsidiary and parent company (an, thereby to realize transfer pricing advantages)</td>
</tr>
<tr>
<td>2. Cost factors</td>
<td>Factors influencing the cost of production, such as labor, energy and supporting facilities</td>
</tr>
<tr>
<td>3. Natural resource endowment</td>
<td>Endowed with abundant natural resource</td>
</tr>
<tr>
<td>4. Infrastructure factors</td>
<td>Societal and financial infrastructure, such as credit, legal and educational facilities; transportation and communication infrastructure</td>
</tr>
<tr>
<td>5. Innovation agglomeration</td>
<td>Economies of centralization for R&amp;D and marketing</td>
</tr>
<tr>
<td>6. Artificial barriers</td>
<td>Tariff barriers and import controls on the trade of goods and services and exchange rate differentials</td>
</tr>
<tr>
<td>7. Investment climate</td>
<td>Political stability, general attitudes toward FDI (which includes corporate tax rates and regulations) and industrial incentives and disincentives</td>
</tr>
<tr>
<td>8. Distance factors</td>
<td>Geographical distance, which increases transport costs; psychic distance where cultures, customs, language and so on are different</td>
</tr>
</tbody>
</table>

Source: the author compiled from Dunning (1979, 1993); Meyer (2001)

Dicken (2003) discussed four roles of nation states in a globalizing economy: as containers of distinctive cultures, practices and institutions, as regulators of trade, foreign investment and industry, as competitors, and as collaborators. The former two roles (container and regulator) have more impact on incoming TNCs, and thus are more relevant to the present study.

Regarding the impact of host country culture, there is a consensus in economic sociology
and economic geography that all economic activities are embedded in broader cultural structures and practices, or distinctive ‘ways of doing things’, of which the nation-state is one of the primary containers (Dicken, 2003: 126). Thus, when TNCs invest in a foreign country, their economic activity is inevitably intertwined with local cultural structures and practices, which impact on TNCs’ strategic behavior in both local and global activities. For example, during its operation in the China market, KFC (Kentucky Fried Chicken chain restaurants) constantly transformed the company’s menu in China and the way of making chickens, in order to better serve the taste of Chinese customers, and the localization strategy successfully won a bigger market share for the company than McDonald in the China market (Yang and Song, 2004).

The trend towards global markets and global competition has led to a widespread belief that consumer behavior is universal and that business conditions around the world are converging. However, various scholars and analysts have shown that culture affects business behavior and performance (Hicks and Redding, 1983; Brislin, 1993; Peterson, 1993; Weinshall, 1993). While there have been very few studies on changing values in mainland China, Chinese business appears to be influenced by two dominant traditional cultural contexts: a homogenous concept of social organization (e.g. a group orientation and deference paid to hierarchical status), and the pervasiveness of Confucian values. These traditions and cultural traits are significantly different from Western Judeo-Christian values and many scholars argue that this justifies a distinctly Asian culture (Pye, 1983).

When trying to classify host countries and home countries, some scholars have attempted to classify national cultures. This is an important way of indicating whether ‘home’ and ‘host’ cultures are ‘close’ or ‘far apart’, and how this is likely to influence overseas business. While all societies are unique, it is equally apparent that some societies are more alike than others in terms of cultural characteristics, or political-economic systems. For example, based on the five distinct cultural dimensions, namely Power Distance Index (PDI), Individualism (IDV), Masculinity
(MAS), Uncertainty Avoidance Index (UAI), and Long-Term Orientation (LTO), Hofstede (2001) characterized a number of countries into different clusters. Based on the comparison of cultural characteristics between Canada and China on Geert Hofstede™ Cultural Dimensions website\(^4\), it is found that Canada and China are far from each other in terms of cultural characteristics, especially in the dimensions of individualism (IDV) and long term orientation (LTO). Canada has Individualism (IDV) as the highest ranking (80) Hofstede Dimension, which is indicative of a society with a more individualistic attitude and relatively loose bonds with others. As a comparison, the Chinese rank lower than any other Asian country in the individualism (IDV) ranking, at 20 compared to an average of 24. This may be attributed, in part, to the high level of emphasis on a collectivist society by the Communist rule, as compared to one of Individualism. Canadian's lowest ranking dimension is Long Term Orientation at 23, which is indicative of a society’s belief in meeting its obligations and tends to reflect an appreciation for cultural traditions. By contrast, China has the highest-ranking factor of Long-term Orientation at 118, which indicates a society's time perspective and an attitude of persevering; that is, overcoming obstacles with time, if not with will and strength.

However, Hofstede’s cultural generalization and broad cultural stereotypes are contentious. For instance, Chang (2007) warns us that culture is not fixed; and that the relationship between culture and the economy is dynamic and they both influence each other. Many cultural changes come from changes in the underlying institutions and government policies. Thus one should be careful when we group countries into different cultural clusters based on their current cultures, practices, and institutions. Similarly, Ronald Inglehart argues that economic, technological, and sociopolitical changes have been changing the cultures of advanced industrial societies during the past several decades, even though economic development, cultural change, and political

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change go together in coherent and, to some extent, predictable patterns (Inglehart, 1977; 1997).

Aside from the cultural differences, Canada and China are also far from each other in ways of organizing the economies, particularly in their differing conception of the role of government in regulating the economy. Even within the apparently universal ideology of capitalism, societies have developed into three major distinctive varieties, namely neo-liberal market capitalism – exemplified by the United States and, to a lesser extent, the United Kingdom; social-market capitalism – exemplified by Germany, Scandinavia and many other European countries; and developmental capitalism – exemplified by Japan, South Korea, Taiwan, Singapore and most other East Asian countries (Dicken, 2003: 128). Canada, with its close geographical and cultural relationship with the U.S., demonstrates more characteristics of the neo-liberal market capitalism. Although China has not officially claimed to join the ‘capitalist camp’, its economic development in the last quarter of century has demonstrated some features of developmental capitalism (Xia, 2000).

The second role of nation states identified by Dicken as having higher relevance to incoming FDI and TNCs is their ability to set regulations regarding trade, foreign investment and industry. Governments involve in the workings of the economy at three different levels. At the macroeconomic level, the state usually pursues fiscal policies and monetary policies (e.g. taxes and interest rates) to control domestic demand or to manage the money supply, which "have extremely important implications for the distribution and redistribution of economic activity” (Dicken, 2003: 130). Incoming foreign investment operates as part of the national economy and thus is inevitably influenced by basic macroeconomic policies.

At a more tangible and material level, governments are the providers of more tangible services and infrastructures of national economies, such as physical infrastructure including roads, railways, airports, seaports, telecommunications systems, and also human infrastructure such as an educated labor force. Without this important infrastructure, private enterprises,
whether domestic or transnational, can not operate (ibid.).

Laws and regulations, at the middle level, are also important, together with policies concerned with trade, foreign investment and industry aimed at controlling and stimulating economic activity and investment (ibid.). For the purpose of the present study, only those policies concerning inward foreign direct investment are reviewed here. As showed in Table 2.2, the inward investment policies of host countries fall into four broad categories respectively, relating to the entry of foreign firms, to the operations of foreign firms, to government attitudes towards corporate profits and the transfer of capital, and to government stimulation of inward investment. In the present study, China as a host country for Canadian companies has played a role of ‘regulator’ for inward investment, and its regulations and policies towards incoming FDI have affected the entry and operation of Canadian firms in China, as will be shown in the empirical chapters (Chapter 6, 7, 8) of this thesis.
### Table 2.2 Nation States as Regulators of Inward Foreign Direct Investment

<table>
<thead>
<tr>
<th>At the macroeconomic level:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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<tr>
<td>Fiscal policies: to raise or lower taxes and public expenditure</td>
</tr>
<tr>
<td>Monetary policies: to raise or lower interest rates</td>
</tr>
</tbody>
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<table>
<thead>
<tr>
<th>Inward Investment Policies:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Relating to the entry of foreign firms:</td>
</tr>
<tr>
<td>Government screening of investment proposals</td>
</tr>
<tr>
<td>Exclusion of foreign firms from certain sectors or restriction on the extent of foreign involvement</td>
</tr>
<tr>
<td>Restriction on the degree of foreign ownership of domestic enterprises</td>
</tr>
<tr>
<td>Insistence on involvement of local personnel in managerial positions</td>
</tr>
<tr>
<td>Compliance with national codes of business conduct (including information disclosure)</td>
</tr>
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</table>

<table>
<thead>
<tr>
<th>Relating to the operations of foreign firms:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insistence on a certain level of local content in the firm’s activities</td>
</tr>
<tr>
<td>Insistence on a minimum level of exports</td>
</tr>
<tr>
<td>Requirements relating to the transfer of technology</td>
</tr>
<tr>
<td>Locational restrictions on foreign investment</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Relating to corporate profits and the transfer of capital:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Restrictions on the remittance of profits and/or capital abroad</td>
</tr>
<tr>
<td>Level and methods of taxing profits of foreign firms</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Relating to government stimulation of inward investment:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct encouragement of foreign investment: competitive bidding via overseas promotional agencies and investment incentives</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>At a more tangible and material level:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Physical infrastructure: roads, railways, airports, seaports, telecommunications systems</td>
</tr>
<tr>
<td>Human infrastructure: an educated labor force, laws and regulations</td>
</tr>
</tbody>
</table>

Source: Based on Dicken (2003): 129-131, 135-137, and part of Figure 5.6 on Page 136

### 2.5 Bargaining Relationship between TNCs and Host Countries

The literature on TNCs operations examined earlier emphasized the role of home country and host country features. This section focuses on another body of literature which has explored how TNCs actively bargain their way into host countries, while host countries regulate the nature of their operations there. Although host countries (as shown in last section) can be influential on the entry and daily operation of TNCs within their territories, TNCs are by no
means weak players in this game, and can bargain with host countries in terms of their entry and local operation. As shown in Dicken (2003: 280, Table 9.2), TNCs’ operations with different modes of entry, different functions and different attributes will affect the host economy in different ways. The major areas of potential impact of a TNC include capital and finance, technology, trade and linkages, industrial structure and employment. Overdependence of a host country on FDI may result in potential loss of sovereignty and autonomy, external dependence on foreign technology or capital, and truncation of individual plants or of the economy as a whole or of key sectors (e.g. the auto industry in Canada). Dicken’s (2003) discussion on potential TNC impacts implicitly indicates that TNCs often have more leverage than their host economies in bargaining, especially when they invest in a developing country, which is in more needs of foreign capital, advanced technology, export performance, and local employment, and where it may be in competition with other developing countries in bidding for internationally mobile investment.

Similarly, Figure 2.1 also suggests that, in general, host countries are subject to a greater variety of constraints than are TNCs, “a reflection of the latter’s greater potential flexibility to switch its operations between alternative locations” (Dicken, 2003: 309). However, TNCs also operate within certain constraints that will restrict the extent to which their power resources, shown in Figure 2.1, can be exercised. For example, if a company particularly needs access to a given location, and if the host country specifies regulations over the TNC’s location options, then a TNC may have to make concessions in order to break into the host country market it targets. Also, if a TNC engages in a highly competitive industry, such as TV set manufacturing in China, it is more likely to face greater constraints on exercising its ‘resource-based power’ (see Figure 2.1), such as brand recognition and technological advances. As Kobrin interprets the bargaining relationship between TNCs and host countries,

“In the case of MNC-HC [host country] bargaining, actual power is a function of: 1)
resources controlled by one party and demanded by the other; 2) constraints that prevent potential power from being implemented; and 3) the ability of either party to limit the behavior of the other directly (economic or political coercion)…. Power arising from the relative demand for resources (emphasis original) flows from differences in capabilities, including the availability of substitutes. It is a function of firm-specific assets or ownership advantages and imperfect markets that allow the firm to contain the advantages; host country capabilities that allow it to substitute for the firm’s resources; and host country resources that are demanded by the firm, and the firm’s ability to substitute for those resources.” (Kobrin, 1987: 617)

**Figure 2.1 Determinants of Relative Bargaining Power between TNCs and Host Countries**

**Transnational Corporation (TNC)**

**Constraints**
1. Degree of competition and concentration in the industry
2. Extent to which host-country government is important customer or distributor

**Power resources**
- Technological complexity, intensity, and rate of change
- Managerial complexity
- Capital
- Access to markets or export potential
- Advertising intensity and product differentiation
- Employment

**Host Country (HC)**

**Constraints**
1. Degree of global integration in the industry
2. Degree of competition among countries for the investment
3. Balance of payments difficulties or debt problems
4. Dependence of the economy on foreign direct investment
5. Political instability or uncertainty

**Power resources**
- Access to domestic market
- Control of natural resources
- Availability of inexpensive and productive labor
- Government incentives
- Government is a financier or supplier of materials

**Change over time in relative bargaining strength**

*Source: Based on material in Kobrin, 1987.*
In general, the relative bargaining power between TNCs and host countries depends on the relative scarcity and the degree of substitution of the resource being sought (whether by a TNC or a host country). Take the case of China as an example. The prospect of access to the world’s largest and fastest-growing market led many foreign firms to try to enter this market. However, the size and potential growth of its domestic market enables the Chinese government to bargain and play off one TNC against another, instead of the opposite situation suggested in most TNC-HC (host country) bargaining literature. Similarly, my study will show that many Canadian firms had very little bargaining leverage as they tended to be small scale, while the Chinese state – at least in theory – spoke with a unified voice and had a long history of controlling entry of foreign business into the country.

In the case of China, some studies have shown that there are constant negotiations between overseas investors and local governments. For FDI made by foreign investors with Chinese origin, e.g. those from Hong Kong, Taiwan, and Macao, personal contacts are often resorted to and social networks are built to achieve preferential treatment from local officials (Leung, 1993; Eng and Lin, 1996; Wang, 2001). For example, in his study on Hong Kong’s production subcontracting activities in the Zhujiang Delta, Leung (1993) found that preexisting kinship and business ties, which insured exchange reliability and facilitated further cooperation between firms, played an important part in shaping the distribution pattern of Hong Kong’s subcontracting activities in the Delta. The factor of personal contacts and social networks affecting FDI is usually detected among overseas Chinese who choose to invest in China. Since some of my interviewees in this study are overseas Chinese (they are actually Canadian managers with Chinese origin and sent by headquarters to China), the question of ‘influence of personal contacts’ was also raised during my interviews, which will be discussed later in the empirical chapters of this thesis.

It should be noted however that the whole bargaining process is dynamic and that the
relative bargaining strength between host countries and TNCs changes over time, as the bottom section of Figure 2.1 suggests. The currently accepted paradigm of TNC–HC bargaining relations in international political economy is the so-called ‘obsolescing bargain’, which was drawn mostly from examples in the natural resources industries (Kobrin, 1987). In these extractive industries, TNCs possess considerable advantages relative to poor and often isolated developing host countries. However, “Once invested, fixed capital becomes ‘sunk’, a hostage and a source of host country bargaining strength” and the balance of bargaining power is expected to shift from the TNC to the host country (ibid: 611). While there is considerable agreement that this obsolescing bargaining model applies to the natural resource-based industries, it is far less certain, as Kobrin found out in his study on the manufacturing industries, that this model applies in other sectors (such as manufacturing) in which technology change is frequent and/or where global integration of operations is common. “If an industry is inherently transnational, or if industry economics require global integration, the bargaining power of any single host country will be constrained” (Kobrin, 1987: 635).

A second issue is that while the bargaining approach is conceptually useful, it is very difficult to acquire good empirical data on ‘bargain making’. Both companies and local officials tend not to want to disclose the nature of any bargain made. Most small firms cannot bargain effectively and have to meet whatever regulations are posed on them by the host country. Consequently, my own survey of Canadian companies focuses on ‘day-to-day’ operations and this reveals the very real challenges in working within existing regulations once Canadian firms have set up an establishment in China, and/or working in an unfamiliar market or business environment.
2.6 Analytical Framework

Informed by the literature reviewed above, I now set out an analytical framework for this research (see Figure 2.2). With the overall background of so few Canadian firms investing in China, the focus is placed on examining the relative explanatory power of the home and host country factors depicted in Figure 2.2, as revealed by statistical and secondary data covered in Part II (chapters 3, 4 and 5) and in the interview material covered in Part III (chapters 6, 7 and 8).
Figure 2.2 Analytical Framework

CANADA

Home Country

Industry Structure

Different sectors

Organization Structure

Different Sizes

Firms

Suppliers

Customers

Partners

Market info

Macro economy

FDI Laws and regulations

Institutions

Physical infrastructure

Culture

Labor force

Host Market / Business Environment

Host State

Cultural and value dissonance

Government - government relations

Host Country

CHINA
Figure 2.2 is suggested by the work of John Dunning reviewed in Chapter 2. I argue that the array of influencing factors on Canadian business firms in China should be found not only in the host country of China, but also in Canada as the home country and nurturing base of these TNCs. As reviewed above, the industry structure and organization structure of Canada undoubtedly will make a profound influence on Canadian companies, which then carry these home country characteristics, and who then encounter Chinese host country characteristics (see the top of Figure 2.2). In China, informed by Dicken’s findings of states as cultural containers and FDI regulators, I identify six dimensions where Canadian firms might encounter difficulties while doing business in China. These comprise Chinese culture, the macro-economy, FDI policies, laws and regulations, Chinese institutions, the labor force and the physical infrastructure (see the right-hand side of Figure 2.2). Since China’s domestic market is increasingly open and fast growing – and many TNCs enter China with the aim of obtaining a large market share – the host market, along with the host state, will undoubtedly exert a large influence on Canadian TNCs activity in China. The possible actors of the host market include suppliers, customers, partners, and the flow of market information (the left-hand side of Figure 2.2). The Chinese market is closely related to, and shaped by, the Chinese state institution and structure. In fact, the total ten dimensions that are likely to influence Canadian firms, shown in Figure 2.2 of the host country factors, are all interrelated and interdependent.

Figure 2.2 also suggests that home country factors and the structure of the industry (the top of Figure 2.2) in which Canadian TNCs engage will affect TNCs’ bargaining power. So does the size of TNCs, which will positively affect the power resources of TNCs, such as technological and managerial resources, the amount of capital invested and employment created, export potential, brand name loyalty and so on. Thus Canadian firms in China in different industries and with different sizes will be studied and compared in later chapters of the thesis. Chapters 3, 4 and 5 will shed more light on the analytical framework shown in Figure 2.2.
Note that Figure 2.2 does not distinguish between different types of FDI – e.g. in resources, in manufacturing or in services. As the ‘home country’ and ‘host country’ factors are likely to be highly context specific according to the type of overseas business operation, consequently, Chapters 6, 7 and 8 will explore the relative importance of the various factors identified in the boxes of Figure 2.2 for the mining, manufacturing, and services sectors, respectively. The utility of this framework, as revealed by the company interviews, will be discussed in Chapter 9.

2.7 Summary

This chapter has reviewed the theories of FDI in the context of globalization. Specifically, the relationship between TNCs and nation states, including their home countries and host countries, has been explored based on Dunning’s eclectic model as well as other scholars’ work. It is argued that both home and host countries have impacts on overseas investment activities of TNCs, and the bargaining relationship between TNCs and their host countries is a dynamic one, manifesting the interaction between the characteristics of home countries (carried by TNCs when they do business in other countries) and those of host countries (where TNCs make a direct investment). The analytical framework developed from the literature review (set out in Figure 2.2) will act as a ‘road map’ for the rest of the dissertation. Chapter 3, immediately after the current chapter, discusses host country factors and thus ‘unpacks’ the ‘boxes’ dealing with Chinese host country factors in the lower part of Figure 2.2.
PART II

3 Host Country Factors and Patterns of Global FDI in China

Part II (Chapter 3, 4, and 5) of the thesis deals with patterns of foreign direct investment in China since 1978, Canadian direct investment abroad (CDIA), and Canadian firms in China, using statistical data, research findings from relevant literature, and government reports. The results are presented in a way that expands the analytical framework of the thesis that I introduced in Chapter 2. In particular, the objective of this chapter is to expand the home country – host country framework of Figure 2.2 in Chapter 2 by looking at the Chinese regulatory system as well as its market and business environment, and also changes in China since 1978. To place Canadian investment in China in context, a summary of global FDI in China is also given up to 2005 in this chapter.

Despite the debate over whether China has followed the East Asian developmental state model for the past twenty-five years (Xia, 2000; Wong, 2003; Baek, 2005), very few would deny the fact that the Chinese state has upheld a strong hand over global FDI flowing into the country, particularly in the form of a set of domestic laws, regulations and policies as well as active commitment to many international agreements governing foreign investment (Tao and O’Brien, 2003; Ambler and Witzel, 2000; Fu, 2000; Wei and Liu, 2001). However, many studies, including results from my own fieldwork, found that the Chinese state has been rather weak in terms of implementation and enforcement of relevant laws. For instance, laws relating to FDI and foreign enterprises were often abused or misinterpreted at the local level, leading to an ambiguity of rules. So, it is first necessary to understand the complex nature of the regulatory environment for incoming FDI in China in order to explore further the challenges of Canadian
companies doing business in China.

This chapter offers an overview of the major components of China’s FDI regulatory framework in the first part. The second section discusses other host country factors such as macro economic policy and changes since 1978, labor force issues, physical issues, situation of Chinese suppliers, customers and partners, and the availability of market information. The third section of the chapter describes the general patterns of global FDI in China, including its major development phases, investment vehicles, investors, industrial composition, and geographical distribution. At the end of this chapter, I will expand and include more detail on the ‘boxes’ of host state and host market and business environment introduced in the lower part of Figure 2.2 (page 40).

3.1 Overview of Regulatory Framework of FDI in China

3.1.1 Market Transformation and Role of State since 1978

With the death of Mao in 1976 and after a short period of transition under Hua Guofeng, a new pragmatic leadership under Deng Xiaoping launched economic reforms in late 1978, bringing in a series of new development strategies. In rural areas, rural reforms de-collectivized the rural communes and introduced the rural responsibility system. Farmers could decide their own economic activities, although they had to fulfill the contracted quotas of grain production required by the government. Urban enterprise reforms went slower than the agricultural reforms. Launched in late 1984, urban reforms allowed market forces to adjust the distribution of commodities and materials and encouraged the development of urban services. In the 1990s, China launched further economic reforms and advocated development of a socialist market economy. Meanwhile, the new leadership under Deng confronted Mao’s self-reliance policy by opening up its domestic economy to the outside world. A series of laws and regulations were
introduced to encourage inflows of foreign direct investment. Cities in southern and eastern coastal regions were in tandem opened up as special economic zones (SEZs) or open cities endowed with incentive policies to FDI (Fei and Smith, 1994).

The role of state has changed dramatically during the reform era, and it is not without debate among scholars. However, there is a consensus that the importance and autonomy of local state has been greatly increased since the reform began (Lin, 1997, 1999; Wei, 2000; Wei and Ma, 1996). Economic and administrative decentralization to local governments and enterprises is regarded as an important theme of reforms (Wei, 2000: 24). The central government was no longer the only driving force in the development process, as it did during the Mao era. Local governments and foreign investors became the new mechanisms of the development strategies in the post-Mao period. Thus, some scholars have deemed the Chinese system a ‘fragmented authoritarianism’, which has created space for autonomy, loopholes for bargaining, and hopes for democratization (Lieberthal, 1995). Most of the local state offices, tasks, and responsibilities in the reform era were primarily regulatory in nature, especially in the realm of land use management, city planning, and private trade (Getihu) (Shue, 1995). Thus, unlike the developments under Mao’s era when central government was responsible for all aspects of national economy, the transitional economy during the reform era has been driven by forces of central state, local state, and global forces (Lin, 1997), or in Wei’s (2000) words, by triple processes of decentralization, marketization, and globalization.

There was a long discussion of government regulation and its effects on production and accumulation among geographers during the 1990s. The regulation theory discussed at that time has examined the ‘rules of the game’ (e.g. ‘regulation systems’ and ‘mode of social regulation’ as well as ‘regime of accumulation’) for making money in the transition for post-war ‘fordism’ to post-1960s ‘flexible accumulation’ production and economic systems in western countries (Tickell and Peck, 1992). There were also regulationists who applied the regulation theory to the
analysis of global capital accumulation and development at the global scale (e.g. Lipietz, 1988). However, the regulation theory originated from western developed countries seems not as applicable to the Chinese case. As noted earlier in Chapter 2, China – similar to other Asian countries – has followed a more ‘developmental state’ model, in which the state has played a crucial role in guiding and pushing domestic economic development. Not surprisingly, the Chinese regulations are very different from existing western regulatory systems (including those in Canada). For instance, in Canada there is some control of business practices but not so much as in the Chinese situation. The state (national and local governments) in China likes to control foreign investment (with an eye on its own long-term development goals) and foreign firms need explicit permission to engage in businesses. In some cases the permissions detail the specific type of business that foreign companies can engage in. Moreover, China is famous for having overlapping lines of authority and competing ministries and commissions, which means that round after round of approvals must often be sought before a decision is made. On the other hand, Chinese firms and government ministries appear to be masters of drawing out negotiations until the terms of the investment begin to favor their interests. To some degree these negotiation practices and business attitudes and customs are influenced by pre-revolution (i.e. pre-1949) cultural and social traits and the pervasive Confucian ethos – respect for authoritarian rules and commands both by government and management (Kelley and Shenkar, 1999).

3.1.2 FDI Laws, Regulations and Institution

Since late 1978, when the Chinese government started to implement its reform and opening-up policies, a FDI regime allowing overseas companies to operate in China has been introduced, and over 200 laws and law-like regulations that seek to encourage as well as regulate FDI have been issued by the Chinese government (Fu, 2000; Chen, 1997).

The laws relating directly to FDI take the form of separate legislative enactments for each
form of foreign-invested enterprise (FIE), together with some laws which apply to all FIEs. At
the outset it should be noted that there are three main types of FIEs, namely equity joint ventures
(EJV)\(^5\), wholly foreign-owned enterprises (WFOE)\(^6\), and contractual (also called co-operative)
joint ventures (CJV)\(^7\). Accordingly, three national FDI laws -- The Law of the PRC on
Chinese-Foreign Equity Joint Ventures, The Law of the PRC on Wholly Foreign-Owned
Enterprises, and The Law of the PRC on Chinese-Foreign Contractual Joint Ventures -- were
adopted in 1979, 1986, and 1988 respectively. These laws states general principles while the
Implementing Regulations, adopted some years later, provide more detailed guidance on rules
and procedures for enterprise operation. These three laws were all amended in late 2000 or early
2001 in an effort of the Chinese government to join the World Trade Organization (WTO). More
details of each law can be found in the official website of the Ministry of Commerce of China
(MOFCOM) and OECD (2003: 59-63). One advantage for such multiform legislation is that
foreign investors can be certain of the rules governing the particular form of investment in
China that they have chosen. Nevertheless, this three-fold legislative division often produces
unnecessary complexity and compartmentalization that makes it difficult to co-ordinate the

\(^5\) EJV are limited liability companies in which, in general not less than 25 per cent of the investment is
contributed by the foreign partner. The net profit of an EJV is distributed between the parties to the venture in
proportion to their respective shares in the registered capital. Equity can include cash, buildings, equipment,
materials, intellectual property rights, and land-use rights but cannot include labor. Share holdings in a joint
venture are usually non-negotiable and cannot be transferred without approval from the Chinese government.
Investors are restricted from withdrawing registered capital during the live of the joint venture contract.
(Paglee, 2000a; OECD, 2003: 59-61).

\(^6\) A WFOE is a limited liability company or other form of organization, if approved, established in China by
foreign investors exclusively with their own capital. The term “WFOE” explicitly excludes branches of
foreign companies in China. Wholly foreign owned enterprises enjoy exclusive management control of their
business activities and have autonomy in their operation and management with less interference from the

\(^7\) A CJV is a much looser arrangement than an EJV; it may or may not have legal person status and profit may
be distributed in the ways stipulated in the contract in stead of in proportion to shares in the registered capital.
Under the CJV structure, a foreign investor does not need to set up a new corporation in China. The foreign
investor and the Chinese partner participate in the joint venture by doing business using the Chinese business
license under a cooperative, contractual arrangement. The CV structure is flexible in that it allows the
percentage of ownership among the partners in a CV to change. The purpose of this flexibility is to allow the
foreign investor to make a faster return on their investment while at the same time ensuring the Chinese
partner that they maintain long term control over the CJV (Paglee, 2000c; OECD, 2003: 61-62).
activities of enterprises governed by different laws (OECD, 2003; Davies, 2003). For instance, the merging of enterprises in different forms is made excessively complex.

Apart from laws directly addressing FDI issues, the government has also enacted other laws or law-like regulations that are of direct interest to foreign investors, including a general company law, and specific laws dealing with intellectual property rights (IPR) protection. There are other laws specifically governing contracts, taxation, foreign exchange, labor management, and other matters of FIEs, such as the Economic Contract Law of the PRC of 1981, the Foreign Economic Contract Law of the PRC of 1985, the Income Tax Law of the PRC Concerning Joint Ventures with Chinese and Foreign Investment of 1980, the Foreign Enterprises Income Tax Law of the PRC of 1981, the Income Tax Law of the PRC for Foreign Investment Enterprises and Foreign Enterprises of 1991, and the Labor Law of 1994. A number of other laws regulating FDI, such as a competition law and/or an anti-monopoly law and a law governing mergers and acquisitions (M&A), were reportedly on the drawing board and are to be promulgated soon by the Chinese state to ensure the development of a genuinely competitive business environment for both domestic and foreign-invested enterprises at post-WTO period (OECD, 2003: 58-59).

Supplementing these basic laws are a large number of law-like provisions issued by some FDI-related functioning organs of the central government, mainly the State Council, the State Development and Reform Commission (the former Planning Commission), and the Ministry of Commerce (the former Ministry of Foreign Trade and Economic Co-operation). All of these government regulations relating to FDI are publicly available on the website of the Ministry of Commerce.

It should be noted that there are also numerous sub-national regulations. These comprise provincial and local rules issued by provincial/county People’s Congresses and governments at all levels to govern FIEs, usually providing more incentives than the central government to foreign investors in an effort to win fierce bidding wars for new FDI among different localities.
(Shirk, 1994). The importance of the national-local discrepancy toward FDI will be discussed later.

Table 3.1 summarizes Chinese laws relating to FDI since 1979 as discussed above and the general features of their evolution.

**Table 3.1 General Features of the Evolution of FDI Laws and Regulations**

<table>
<thead>
<tr>
<th>Phase</th>
<th>Period</th>
<th>General Features</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. The Cautious Phase</td>
<td>1979-1985</td>
<td>Passing of the Equity Joint Venture Law (EJV Law) in 1979; establishment of SEZs (special economic zones)</td>
</tr>
<tr>
<td>3. The Proliferating Phase</td>
<td>1990-2001</td>
<td>Amendments of the EJV Law and the WFOE Law; proliferation of laws and regulations on FDI as an effort to join the WTO;</td>
</tr>
<tr>
<td>4. The Refining Phase</td>
<td>2002-2008</td>
<td>The trade-related investment measures (TRIMs) in FDI laws were abolished; relaxation on services sector; unified corporate tax system for domestic and FIEs in 2008; relaxation on M&amp;A issues.</td>
</tr>
</tbody>
</table>


### 3.1.3 The Evolution of FDI Laws and Regulations

The evolution of FDI laws and regulations in China represents an increasingly open and accommodating attitude on the part of the Chinese government toward foreign companies. The process has also been a gradual reduction of geographical and sectoral restrictions of FDI by various government stipulations. The trajectory can be roughly divided into the following four phases (the cautious phase, the liberalizing phase, the proliferating phase, and the refining phase; also see Table 3.1 above). The evolution of some specific laws and regulations on FDI in the mining, manufacturing, and services sectors will be discussed in Chapter 6, 7, and 8.

With regard to the implementation of FDI-related laws and regulations in China, it is worth noting that gradualism and geographic particularism (e.g. SEZs and open-port cities) have been the most important features. The gradualism of the development strategy is often compared with
the “big bang” or “shock therapy” policy adopted by former socialist countries in Eastern Europe and leading to the collapse of these countries’ economy. The compatibility of political dictatorship and market economy in China’s economic reform is beyond common wisdom and has amazed many scholars (e.g. all the authors in the book edited by Walder, 1996). There were profound political and institutional considerations behind the strategies formulated in the early stage of the reform and open era in the 1980s. On one hand, a gradual and regional implementation of the open-door policy has reduced the opposition from some conservative skeptics in the Communist Party (especially those having a strong cultural and ideological objection). On the other hand, it allowed Deng Xiaoping and his allies to exploit the political advantages of the geographical particularism approach, which enabled the central leaderships to win political support from their provincial subordinates and eventually to reorient officials, especially those in inland areas, to the world economy, while maintaining national unity (Shirk, 1994: 43-44).

Following this strategy, the open-door policies, including policies towards FDI, were implemented gradually and regionally; essentially from only four Special Economic Zones (SEZs) at the beginning of the 1980s to the whole nation after 1992. The chronicle of the unfolding of regional policies for FDI is summarized in the following Table 3.2.
<table>
<thead>
<tr>
<th>Time</th>
<th>Open Region for FDI</th>
<th>Special Policies in these Regions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>Four SEZs (Shenzhen, Zhuhai, Shantou, and Xiamen)</td>
<td>Concessionary tax policies; exemption from export duties and import duties for equipment, instruments, and apparatus for producing export products; the easing of entry and exit formalities</td>
</tr>
<tr>
<td>May 1984</td>
<td>14 coastal cities (Dalian, Tianjin, Qinhuangdao, Yantai, Qingdao, Nantong, Lianyungang, Ningbo, Shanghai, Wenzhou, Fuzhou, Guangzhou, Beihai, Zhanjiang)</td>
<td>Similar as above, but with less generous tax incentives than those in SEZs; the same terms as SEZs for the “Economic and Technological Development Zones” (ETDZs) established in the open cities;</td>
</tr>
<tr>
<td>May 1985</td>
<td>Three “development triangles” (the Yangzi River Delta Region, the Pearl River Delta Region, and the Minnan Delta Region)</td>
<td>They enjoy most of the FDI preferential policies utilized in the 14 open cities</td>
</tr>
<tr>
<td>1988</td>
<td>Liaodong and Shandong peninsulas</td>
<td>The same policy incentives as the 14 coastal open cities</td>
</tr>
<tr>
<td>Early 1988</td>
<td>The “coastal development strategy” (the entire coastal areas, involving over 200 million population, 11 provinces)</td>
<td>Open policies; Zhao Ziyang’s “two heads outside, large in and large out”, encouraging labor-intensive industries in the coastal areas</td>
</tr>
<tr>
<td>April 1988</td>
<td>Hainan Island as the fifth, and the largest SEZ</td>
<td>Same policies as the other four SEZs</td>
</tr>
<tr>
<td>June 1990</td>
<td>Shanghai Pudong New Economic and Technological Development Areas</td>
<td>Same concepts as the SEZs and the ETDZs</td>
</tr>
<tr>
<td>1992</td>
<td>Nationwide implementation of FDI promotion (52 cities including all inland provincial capitals and along Yangzi River; over 15 border cities and counties)</td>
<td>Designated cities and counties were granted the same open policies as the coastal areas; the application of preferential policies shifted from regional priorities to national and local industrial policies.</td>
</tr>
</tbody>
</table>

Source: Summarized from Chen (1997a: 5-13).

### 3.1.4 Challenging Features and Limitations of FDI Regulations

As evidenced above, the highly formal regulatory framework of FDI in China may appear advantageous to foreign companies. The publication of rules for incoming business investment at first glance allows foreign firms a degree of certainty. But in reality, the framework has serious limitations, especially in the aspects of implementation and enforcement of law, and these present challenges for overseas companies. This is due to historical and cultural reasons, but more importantly the limitations originate from the single-party controlled, yet highly fragmented, political system of China.

First, there is the influence of traditions and cultures. China has experienced thousands of
years of imperial society, which was characterized by the instrumentality of law, secularism, lack of autonomy, direct rule of leaders, the dominance of criminal law, inequality, secrecy, and a preference of informal mechanisms to law in social control (Wang, 2001: 50-51). Although China introduced new legal codes resembling the Western legal system in the 1980s, it has only produced a nascent framework of a modern legal system, the ideal of rule of law remains far beyond the horizon. Compared with hundreds of years of law building history in Western countries, China still has a long way to go to build a modern society ruled without intervention of ‘will of powerful individuals’ but rather the rule of law (ibid).

Second, the one-Party political system is the ultimate source of the instrumental nature of law. The Chinese government has been ambivalent toward the idea of rule of law. While it has recognized the virtue of the rule of law, and that China needs laws to develop the country’s economy and engage in international economic system, the present Chinese leadership under the one-Party system, whose foremost mandate is to maintain its monopolistic power, sees law as an instrument of the state to serve the interest of the Communist Party, and no other opposition parties (in real sense) would be allowed to exist to challenge the authority of the Communist Party. The rule of law is secondary to this ultimate priority, and the law in China does not have either an autonomous status or internal logic. One result is that as the government and Party policies change frequently, the law also changes accordingly. Compared to Party policies and the will of powerful individuals, the role of law takes an inferior position. As one of my Canadian company respondents concluded, “All the problems relating to government corruption and legal procedures will eventually point to one single reason: the one-Party system” (Manufacturing Company No.4).

Third, a fragmented political system in China has weakened the organizational capacity to uphold an effective legal system. Thus, while the Chinese political system is dominated by one single powerful Communist Party, it is also characterized by overall fragmentation, mainly due
to the vastness of the Chinese territory and economic landscape (Lieberthal, 1995; Wang, 2001). For instance, the vertical division along the lines of functional systems (*tiaotiao*, or different ministries) and the horizontal division along the lines of geographical locations (*kuaikuai*, or different provinces and provincial-level units) cut across each other, creating many pockets of power that often do not co-operate with one another (Wang, 2001: 51-52). To make things worse, since the beginning of reforms in the late 1970s, the power of the central government has been decentralized in significant ways. While there are many debates over whether the Chinese central government lost or strengthened its control over local governments during the reform era, many agree that in the areas of FDI the central government has lost many of its traditional controls over the provincial and local governments. One result is that laws are made, interpreted, and enforced by many governmental organs that have different interests and so they are poorly coordinated overall. The handling of legal cases thus cannot avoid frequent intervention by powerful officials and organizations. This problem is worsened by the poor quantity and quality of the legal workers in China. Moreover, Chinese universities have produced more and more legal graduates, yet there is an overall shortage. In particular, the Chinese government has strived to better train its lawyers by signing an agreement with the Canadian government to send its lawyers for training in Canada, as many critiques point out, the number of competent lawyers is far from sufficient. More importantly, enhanced professionalism of legal workers is not able to change the fundamental flaws of the court system in China, such as its dependence on Party policies.

In summary, the first part of the chapter has reviewed the regulatory framework of FDI in China, including relevant laws and regulations, its evolution process and important features, and its limitations in implementation and enforcement. Clearly, China presents a wide array of regulations over incoming foreign investment. As shown in Figure 3.11 (see page 78), the major features are (a) gradual easing of regulations; (b) weak enforcement of law; and (c) fragmented
administration system. More details of the governing features of FDI laws and regulations on different industrial sectors, as well as the problems relating to these regulations, are revealed in the three sectoral case studies in the next part of the dissertation (Chapters 6, 7 and 8).

### 3.2 General Features of Other ‘Host Country’ Factors

Besides FDI regulations and institutions discussed above, other ‘host country’ factors outlined in Figure 2.2 (page 40) include macro economic policy and changes since 1978, labor force issues, physical issues, situation of Chinese suppliers, customers and partners, and the availability of market information. The general features of the above factors are discussed in this section.

#### 3.2.1 Macro Economic Policy and the Expanding Chinese Market

Since reform and opening up, macroeconomic policy mix has gradually become the Chinese government's most important instrument to ensure non-inflationary, stable economic growth. During the 1980s and up to the first half of the 1990s, the role of the government budget in macroeconomic management was very limited, because of the dramatic fall in the proportion of GDP which comprised government budget, and because of other institutional constraints. For example, implementation of the enterprise contract responsibility system in the 1980s virtually deprived the government of any flexibility to use expenditure and taxes to influence macroeconomic activities. Consequently, monetary policy assumed a dominant role in macroeconomic management in China during this period. However, since the middle of 1998, due to the impotence of monetary policy, fiscal policy has replaced monetary policy as a more active instrument in China's macroeconomic management, aimed at getting rid of deflation (Yu, 2001).

Since 1978 when reforms began, China's economic growth has been spectacular. Over the
past twenty odd years, China registered an average annual growth rate in GDP of about 9.4 percent. This has led to a rapid increase in the size of the Chinese market, and has proved to be an attractive factor for overseas FDI. For instance, in 2007, China’s GDP (nominal) as estimated by International Monetary Fund (IMF) reached US$3.28 trillion, ranked 4th in the world lagging behind the US (US$13.8 trillion), Japan (US$4.38 trillion) and Germany (US$3.32 trillion).

However, China's economic growth has not been smooth. Since 1978, the economy has experienced six episodes of macroeconomic instability (see Figure 3.1 and Table 3.3) and the macro economic policy and its changes in China since 1978 have been closely related to the macroeconomic cycles during the period.

**Figure 3.1** Annul GDP Growth Rate of China (1978-2007) (%)

![GDP Growth Rate Chart]

Source: China Statistical Bureau

<table>
<thead>
<tr>
<th>Cycle</th>
<th>Period</th>
<th>Peak year</th>
<th>Bottom year</th>
<th>Type of policy</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1978-1981</td>
<td>1978 (11.7%)</td>
<td>1981 (4.4%)</td>
<td>Austerity</td>
</tr>
<tr>
<td>2</td>
<td>1982-1986</td>
<td>1984 (14.5%)</td>
<td>1986 (8.5%)</td>
<td>Austerity</td>
</tr>
<tr>
<td>3</td>
<td>1987-1990</td>
<td>1988 (11.3%)</td>
<td>1990 (3.9%)</td>
<td>Austerity</td>
</tr>
<tr>
<td>4</td>
<td>1991-1996</td>
<td>1992 (13.6%)</td>
<td>1991 (8.6%)</td>
<td>Austerity</td>
</tr>
<tr>
<td>5</td>
<td>1997-2001</td>
<td>1997 (8.8%)</td>
<td>1999 (7.1%)</td>
<td>Expansionary</td>
</tr>
<tr>
<td>6</td>
<td>2002-2007</td>
<td>2007 (11.4%)</td>
<td>2002 (8%)</td>
<td>Austerity</td>
</tr>
</tbody>
</table>

Except for the fifth cycle, each of these episodes was cyclical in nature and was characterized by excessive credit expansion, a sharp rise in inflation, and deterioration in the balance of payments, followed by a tightening of financial policies and administrative controls, and a reduction in macroeconomic imbalances (Liu, 2005; Wang, 2008). The fifth cycle was exceptional due to the worsening of world economy mostly triggered by the Asian Financial Crisis in 1997. Owing to concerns that the GDP growth rate in 1998 might fall below 8 percent, and to the fact that monetary policy was becoming increasingly impotent in dealing with the deflation and lack of effective market demand, the government turned to expansionary fiscal policy (‘proactive fiscal policy’) in the middle of 1998 (Yu, 2001). The sixth macroeconomic austerity policy was called ‘precautionary’ to differentiate from the other four austerity policies taken previously. The policy was taken during the economic growing phase instead of reaching the over-heating point. The cycle ended quite abruptly in 2008 due to the economic crisis of the year.

3.2.2 Labor Force Issues

Apart from a rapidly growing domestic market, a cheap and ample supply of labor has also attracted FDI to China. Related to the thrust of this dissertation, which is focused on Canadian-invested firms in China, the labor force issues discussed here cover three aspects: labor supply and labor wages (mainly rural-urban migrants), labor quality (affected by education), and work values in China.

3.2.2.1 Labor Supply and Labor Wages

With the implementation of China reform and open policy as well as transition from the agricultural society to modern industrial one, rural-urban migration have positively enhanced industrialization and urbanization in China. The number of rural-urban migrant worker increased from 30 million in the mid and late 1980s to about 180 million in 2005, and the scale
keeps rising (CGAN, 2006). Migrant laborers mostly come from China’s underdeveloped western and central provinces such as Sichuan, Anhui, He’nan, Gansu, and mainly migrate to urban areas, south-eastern coastal locations and metropolises like Beijing, Shanghai, as well as nearby townships, surrounding counties, small cities and provincial capitals (Zhan, 2005). These rural-urban migrants significantly contribute to prosperity of urban area, the development of the countryside, and also to China’s modernization. However, they are also a marginal and vulnerable group in the city due to drawbacks of a set of polices connected with household registration system (HRS), such as policies and regulations on migration, employment, social security and so on (Roberts, 2002; Dong and Bowles, 2002).

A new development in the labor arena since around 2003 has involved a growing shortage of unskilled labor in Chinese cities and towns (Chan, 2005). Media reports on labor shortages in the coasted cities have offered a variety of explanations, such as poor working conditions, low wages, decreases in wages, wages in arrears, various forms of abuses, improving economic conditions in the rural sector due to recent higher prices for agricultural produce and lower agricultural taxes, and so on (ibid.). There are also reports on the looming shortage of unskilled labor supply in China due to the one-child policy and the aging population in cities (French, 2006).

This situation is an apparent paradox as China has by far the world’s largest manufacturing workforce, at more than 100 million, and is known widely to have low labor costs (Banister, 2005a). According to Judith Banister, who finished a report on China’s manufacturing employment and earnings commissioned by the U.S. Bureau of Labor Statistics in 2005, China’s manufacturing employees averaged about US$0.57\(^8\) compensation per hour worked in 2002, about 3 percent of the average hourly compensation of manufacturing production workers in the

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\(^8\) Labor compensation estimates are converted into U.S. dollars at the official exchange rate for 2002 (Janister, 2005b).
United States and of many developed countries of the world (Banister, 2005b). China’s regional competitors in the newly industrialized economies of Asia had, on average, labor costs more than 10 times those for China’s manufacturing workers; and Mexico and Brazil had labor costs about 4 times those for China’s manufacturing employees (ibid.). However, due to high level of growth (e.g. over 8% GDP growth rate since year 2000, the recent labor shortage has driven up wages in China by about 10% a year (Business Week, 2006) and has started to affect China's manufacturing competitiveness. As Banister notes:

“Labor compensation in China’s manufacturing sector is higher than it was a decade or two ago. This means that some other developing countries are now able to compete with China purely on the basis of earnings per manufacturing worker...Of course, China remains highly competitive globally because of its relatively low labor costs and many other favorable factors, but rising labor compensation in China has begun to erode the country’s manufacturing price advantage” (Banister, 2005b).

3.2.2.2 Labor Quality

Since the founding of the People’s Republic of China in 1949, an important governmental effort has been to eliminate illiteracy and popularize compulsory education. In 2004, illiteracy among the young and middle-aged population decreased to less than 5 percent, and the nine-year compulsory education basically has been established in the areas where 90 percent of the country’s population live (Zhonghua Net, 2004). International cooperation and exchanges in education have increased year by year. Since 1979, some 582,000 Chinese students have studied in 103 countries and regions, among whom 160,000 have returned after finishing their studies (ibid.).

However, a McKinsey survey showed that although there were over 8.5 million university graduates with over 7-year working experience, most of them were severely lack of necessary working skills (You, 2005). Take the education of engineers as an example. There were about 1.6 million engineers in China, more than any other country in the world. However, as the McKinsey survey found, only 10 percent of them met the management requirements of
multinational corporations in China, because they were trained in an education system which focused more on theory instead of practical skills (ibid.).

On the other hand, there is a wide divide between rural and urban areas in terms of education attainment. As Knight and Li (1996) revealed, other than age, the most important factor influencing a person’s education attainment was whether he/she lived in a rural or an urban area. The reasons were to be found in the separate administrative and funding arrangements for rural and urban education and also in terms of opportunity costs and perceived economic returns. Migrant laborers are largely uneducated beyond high school and most have not participated in training programs for non-agricultural employment (NBS & MOLSS, 2001). Most of them are employed in industries that do not need university education and/or special skills, such as construction and sanitation (Zhan, 2005).

3.2.2.3 Work Values in China

Work-related values refer to the goals or rewards people seek through their work, and they are expressions of more general human values in the context of the work setting (Schwartz, 1999: 41). Work values are believed to be greatly impacted by cultural values (Jaw et al., 2007) and cultural exposure experience (Ju, 1993). It is widely accepted that Chinese culture is very different from that of the west. For example, Jaw et al. (2007) reveals that cultural values (Confucian dynamism, individualism, masculinity, and power distance) play a major role in differentiating work values (self-enhancement, contribution to society, stability and rewards, openness to change, and power and status), especially the role of Confucian dynamism in Chinese context. Chinese workers are more reticent with their opinions and tend not to speak out against authority. Many of them are willing to work overtime. Ju (1993) have reported that Chinese employees who have been under Western cultural influence are more aggressive and ambitious than those who have not.
3.2.3 Physical Infrastructure

Infrastructure is an important public good, whose construction and operation will affect the normal running and increase of the national economy. Since modernization in 1978, infrastructure is mainly supported by the government in China. China has invested intensively in public infrastructure during the last 30 years. According to a report released by the National Bureau of Statistics (NBS), from 1989 to 2001, the Chinese government spent 6.3 trillion yuan (about 761 billion US dollars) on 1,553 infrastructure projects, covering sectors including farming, forestation, animal husbandry, fisheries, energy, raw materials, transportation, postal and telecom services and other public services (People's Daily, 2002). By the end of 2001, China boasted over 70 thousand kilometers of railway, 1.7 million kilometers of roads, 1.48 trillion kilowatt hours of national electrical capacity, 230 million cubic meters of daily water volume, 28,000 kilometers of oil and gas pipeline, and 300 million of telephone and mobile phone users (ibid.). Other public service facilities like coal gas equipment, sewage plants and city buses also expanded quickly during the period of 1989 and 2001.

However, despite the great improvement in infrastructure during the past two decades, the supply of certain basic infrastructure, such as electricity and water, sometimes cannot meet the tremendous demand generated by the rapid economic development, especially in the eastern coastal provinces. For instance, China started to face power shortages in 2002, which became more severe in 2003 and 2004, due to the ‘strict administrative control’ over the electricity supply market (Liu, 2003). In the spring of 2008, brownouts (darkness resulting from the extinction of lights) were reported in at least 13 provinces, and at its peak nationwide demand outstripped supply by nearly 70 gigawatts, or the equivalent of most of Britain's generating capacity (Bai and Hua, 2008).
3.2.4 Chinese Market / Business Environment

The Chinese market offers great business opportunities for overseas companies due to its rapid economic growth and huge market. However, it presents many challenges, ranging from inadequate market data, problem of an appropriate entry strategy, lack of access to local sales channels, difficulty in finding the right partners, and cultural differences, and so on.

First and foremost, China has a different culture from the US and Europe. For instance, Chinese consumers have a very strong national pride and they like to be associated with their nationality and country. Hence, Chinese consumers are very supportive of local ‘made in China’ products. Hence, foreign investors sometimes have a hard time trying to market their own branded products to the Chinese consumers because their products often seem too unfamiliar and foreign (Ambler and Witzel, 2000). Rosen (1999) suggests that the fastest and most efficient way for foreign investors to market their products in China would be to partner with a local company, who would be able to communicate to the locals and who would have a better understanding of the Chinese culture. Since local firms would be more familiar with the necessary administrative procedures, and some might even have a good relationship with the higher authorities, having a Chinese partner would also help foreign companies minimize any delays of paperwork with the government. However, joint-venture partnerships bring their own challenges. For instance, foreign companies may have problems looking for suitable Chinese partners as they do not have the necessary network in China (Rosen, 1999). Furthermore, if foreign investors do not understand the Chinese business culture, conflicts with local partners often arise when different decision making tools are used compared to the Chinese (ibid.).

Consumer demand and market segments in China are continually evolving as they spread across a broader geographic area and consumer spending power increases significantly. Hence a number of diverse issues confronting foreign companies in China include: how to cover various
geographic and customer segments; how to manage the end-customer relationship; how to structure the distributor and sales force; how to streamline processes and boost productivity; and how to manage the shift into broader market segments beyond the “high end” (Michael, 2007). Michael (2007) argues that foreign companies in China must constantly reassess their sales and distribution models to keep up with a rapidly changing market.

China’s markets are difficult to research and understand because of a rare combination of five factors, including the sheer size of the country, its rate of market change, the availability of its secondary information that is often old, questionable, or inaccurate, the fragmented and diverse markets in China, and the unreceptivity of Chinese individuals and businesses towards direct research inquiries (Oliver and Coulter, 2004). To overcome the difficulties of obtaining market information, some firms have set up representative offices to function as “learning centers” (Rosen, 1999). Other firms work with overseas Chinese, or rely entirely on joint-venture partners, local authorities, or patrons for an analysis of the China market (ibid.). Oliver and Coulter (2004) note that to obtain accurate China market analysis, foreign companies should undertake more systemic research in China than in more orderly and established markets and use appropriate market research techniques.

3.3 General Patterns of Global FDI in China

This section will discuss some key features of global FDI in China, including its development trajectory since the late 1970s up to 2005, the situation of the major types of FDI, major investors, sectoral composition, and its spatial distribution. It should be noted that Chinese statistics collects two types of FDI data: contractual (or committed) FDI and FDI actually utilized. The former type of data show the amount of FDI possibly used in the future. This type of data is not normally collected or used in OECD countries. To be consistent with international standards, all FDI statistics quoted in this section are those for actually utilized
investment.

3.3.1 The Developmental Trajectory of FDI Inflows in China

Since China implemented its reform and open-door policy in 1979, FDI inflows into the country have shown a generally growing trend, despite a short period of setback after the Asian Financial Crisis in 1997 (see Figure 3.2). More specifically, the developmental trajectory can be divided into the following five distinctive phases, which are closely related to the evolution of FDI regulations discussed above in Section 3.1.

Figure 3.2 Realized FDI Inflow into China, 1979-2005 (current prices)

Sources: Data for 1979-1996 are from Chen (1997a: 3). Data for 1997-2005 are from the official website of the Division of Foreign Investment Management of the Ministry of Commerce: http://www.fdi.gov.cn/

3.2.1.1 The experimental period, 1979-1983

An important experiment during this early period (1979-1983) was the establishment of the four Special Economic Zones (SEZs), namely Shenzhen, Zhuhai and Shantou in Guangdong Province, and Xiamen in Fujian Province. FDI inflows in China were highly concentrated in these two provinces. For example, more than 70 percent of total FDI in China in 1983 was located in either Guangdong or Fujian province (Chen, 1997a: 2). During this initial period, both
the Chinese government and foreign investors were very cautious about introducing or making investments in China. Therefore, China’s performance in attracting FDI inflows was not very impressive. The accumulative realized FDI in this phase amounted only to US$1755 million, averaging US$351 million annually (ibid; also see Figure 3.3).

**Figure 3.3 Realized FDI Inflow into China, 1979-1983 (current prices)**

3.2.1.2 The gradual development period, 1984-1991

During this period, the Chinese government made much effort to promote FDI inflows, including opening more and more areas and regions to foreign invested enterprises (see Table 3.1), and introducing a series of laws and regulations to encourage FDI inflows. Therefore, although the infamous Tian’anmen event of 1989 slowed down the pace of FDI inflows, the absolute amount of inward FDI continued to increase, with average annual value of US$2693 million in the year up to 1991, much greater than the previous phase (Chen, 1997a) (see Figure 3.4).
3.2.1.3 The rapid growth period, 1992-1997

The most remarkable change during this period was Deng Xiaoping’s tour of southern China in 1993 and a series of speeches, emphasizing the further openness of China to the outside world, which boosted the confidence of foreign investors. Since then, further ‘open policies’ have been implemented nationwide instead of concentrating exclusively in the coastal areas. As a result, the inflows of realized FDI in China in 1992 reached US$11 billion, doubling the figure of 1991. The annual average incoming FDI amount during 1992-1997 reached US$32.8 billion, a great leap from the US$2.7 billion in the previous period up to 1991. Instead, since 1993, China has become the second largest FDI recipient in the world (behind the USA) and the single largest host country among developing countries (Chen, 1997a) (see Figure 3.5).
3.2.1.4 The adjustment period, 1998-2001

This period witnessed a slight setback in annual FDI in 1999, and a slow growth since then. The adjustment was caused mainly by the Asian Financial Crisis of 1997, which had a great negative impact on China’s economic development and FDI absorption. Foreign investors stopped or slowed down their investing pace generally in Asian countries since 1997-8, including China. Since China was not affected by the crisis directly, we still can see a slight increase of FDI inflows in 1998. However, in 1999, FDI inflows in China dropped to US$ 40.4 billion, declining 11% from US$45.6 billion in 1998, the first negative growth rate since 1979 (see Figure 3.5). The Chinese government adjusted its open policies, responding to the post-crisis difficulties, and tried to resume the confidence of foreign investors. As a result, FDI inflows began to increase in 2000 and 2001, although the absolute amount did not match the peak achieved in 1998 (Figure 3.6).
3.2.1.5 New booming period, 2002-2005

China’s entry into the WTO at the end of 2001 brought a new flux of global FDI into the country. For the first time in 2002, China’s actual utilization of FDI topped the world, reaching an amount of US $52.7 billion, up by 12.5% compared with 2001. The year of 2003 saw only slight growth due to the SARS outbreak in some parts of the country. Then in 2004, with the recovery of the global economy, China’s FDI absorption resumed a fast pace, with actual realized FDI inflow of US $60.6 billion, up by 13.3% from the previous year. However, the year of 2005 experienced the second negative growth rate of FDI absorption since 1979 (the first was in 1999), with FDI inflow of US$60.3 billion, down slightly from US$60.6 billion in 2004 (see Figure 3.7). Some people warned that China had lost its attraction to global FDI in the face of fierce competition from its neighbors, such as India and Vietnam. However, many commentators remained positive in China’s attractiveness to foreign investors (Yan, 2005).
3.3.2 Major Types of FDI

Besides the three major types of FDI in China, namely equity joint ventures (EJV), contractual joint venture (CJV), wholly foreign-owned enterprises (WFOE), as discussed in Section 3.1.1, there are also other two types of FDI, share-holding Inc. (Share-holding)\(^9\), and Joint Exploration (JE)\(^{10}\), which were introduced in the 1990s.

EJV had been the most popular form since the mid-1980s, constituting about half of total utilized FDI in China in 1996 (Wei and Liu, 2001; also see Table 3.4). However, its popularity has been declining since the mid-1990s, dropping to 29% of total FDI in 2003 (see Table 3.4). The same can be said about the attractiveness of CJV form, which has declined gradually in the

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\(^9\) A foreign-invested holding company is a limited liability company, either wholly-foreign-owned or an equity joint venture, established by foreign investors for the purpose of engaging in direct investment. This form of FDI was introduced in the late 1990s and has set higher threshold for entry. For example, the foreign investor must contribute at least US$10 million in actually paid in capital, if the investor’s total assets exceed US$400 million and has actually paid-in investment in China of at least US$10 million; otherwise, the investors should have already set up 10 enterprises in China and the actually paid-in capital must be no less than US$30 million before applying to set up a holding company (OECD, 2003: 63-64).

\(^{10}\) Joint exploration is a form of FDI in which a foreign company and a Chinese entity sign contracts for projects involving joint exploration for both inland and offshore oil and gas, or other mineral resources (OECD, 2003: 64).
past two decades. Instead, the form of WFOE has been used by more and more foreign investors since the beginning of 1990s, along with the relaxation of China’s restriction on WFOE set-up, and the increasing confidence of foreign investors in China’s commitment to its openness to the outside world (Sun, 1998). In 2003, about 62% of FDI took the form of WFOE. Many foreign companies preferred to establish a company under its absolute control and without intervention from other shareholders, especially those from China. So understandably, when China relaxed its restrictions on WFOE establishment in terms of industry or location, more and more foreign investors chose this form of FDI. The remaining two forms of FDI have been used quite sparsely, either due to the higher entry-threshold or limited applicable industries. In sum, Table 3.4 shows that among the five major types of foreign investment vehicle, WFOE has been utilized more and more by foreign investors, while the popularity of EJV and CJV has been declined gradually over time since the 1990s.

### Table 3.4 Utilization of FDI by Form (%)

<table>
<thead>
<tr>
<th>Year</th>
<th>EJV</th>
<th>CJV</th>
<th>WFOE</th>
<th>Share-holding</th>
<th>JE</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>50</td>
<td>19</td>
<td>30</td>
<td>0</td>
<td>0.6</td>
<td>100</td>
</tr>
<tr>
<td>1997</td>
<td>43</td>
<td>20</td>
<td>36</td>
<td>0.6</td>
<td>0.7</td>
<td>100</td>
</tr>
<tr>
<td>1998</td>
<td>40</td>
<td>21</td>
<td>36</td>
<td>1.6</td>
<td>0.4</td>
<td>100</td>
</tr>
<tr>
<td>1999</td>
<td>39</td>
<td>20</td>
<td>39</td>
<td>0.7</td>
<td>1</td>
<td>100</td>
</tr>
<tr>
<td>2000</td>
<td>35</td>
<td>16</td>
<td>47</td>
<td>0.3</td>
<td>0.9</td>
<td>100</td>
</tr>
<tr>
<td>2001</td>
<td>34</td>
<td>13</td>
<td>51</td>
<td>1.1</td>
<td>1</td>
<td>100</td>
</tr>
<tr>
<td>2002</td>
<td>28</td>
<td>9.6</td>
<td>60</td>
<td>1.3</td>
<td>0.5</td>
<td>100</td>
</tr>
<tr>
<td>2003</td>
<td>29</td>
<td>7.2</td>
<td>62</td>
<td>0.6</td>
<td>0</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: China Foreign Economic Statistical Yearbook 2000 and 2004

### 3.3.3 Major Investors by Home Country

By the end of 2004, China had approved 508,941 foreign-invested enterprises, among which about 220 thousand had stopped operating (MOFCOM, 2006). The accumulated contractual FDI and FDI actually utilized reached US$ 1096.6 billion and US$562.1 billion.
respectively during the period of 1979 to 2004. Hong Kong has always been the largest investor in China since 1979. It alone contributed about 60% of cumulative FDI inflows in China during 1983-1995 (Sun, 1998: 24). By the end of 2006, Hong Kong’s share of the total FDI stock in China dropped to 40% with actual amount of US$279.76 billion, still ranking first among all foreign investors. Other top ten investing countries/regions ranking from the highest in 2006 included Japan, Virgin Islands, the United States, Taiwan, Republic of Korea (R.O.K.), Singapore, the United Kingdom, Germany, and Cayman Islands (see Table 3.5).

**Table 3.5 Top 15 Home Country Investors in China by end of 2006 (US$ billion)**

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country/region</th>
<th>Realized FDI Value</th>
<th>Share %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Hong Kong 11</td>
<td>279.76</td>
<td>39.74</td>
</tr>
<tr>
<td>2</td>
<td>Japan</td>
<td>57.97</td>
<td>8.24</td>
</tr>
<tr>
<td>3</td>
<td>Virgin Islands</td>
<td>57.16</td>
<td>8.12</td>
</tr>
<tr>
<td>4</td>
<td>U.S.A.</td>
<td>53.96</td>
<td>7.66</td>
</tr>
<tr>
<td>5</td>
<td>Taiwan</td>
<td>43.89</td>
<td>6.24</td>
</tr>
<tr>
<td>6</td>
<td>R.O.K.</td>
<td>35.00</td>
<td>4.97</td>
</tr>
<tr>
<td>7</td>
<td>Singapore</td>
<td>30.00</td>
<td>4.26</td>
</tr>
<tr>
<td>8</td>
<td>U.K.</td>
<td>13.92</td>
<td>1.98</td>
</tr>
<tr>
<td>9</td>
<td>Germany</td>
<td>13.42</td>
<td>1.91</td>
</tr>
<tr>
<td>10</td>
<td>Cayman Islands</td>
<td>10.76</td>
<td>1.53</td>
</tr>
<tr>
<td>11</td>
<td>France</td>
<td>7.80</td>
<td>1.11</td>
</tr>
<tr>
<td>12</td>
<td>The Netherlands</td>
<td>7.76</td>
<td>1.10</td>
</tr>
<tr>
<td>13</td>
<td>Samoa</td>
<td>7.51</td>
<td>1.07</td>
</tr>
<tr>
<td>14</td>
<td>Macao</td>
<td>6.94</td>
<td>0.99</td>
</tr>
<tr>
<td>15</td>
<td>Canada</td>
<td>5.41</td>
<td>0.77</td>
</tr>
<tr>
<td></td>
<td>Others</td>
<td>72.71</td>
<td>10.33</td>
</tr>
</tbody>
</table>

Source: MOFCOM (2007)

Canada was ranked 15th, with a total realized FDI stock of US$5.41 billion, accounting for 0.77% of the total FDI stock in China by the end of 2006. However, when I compared total

11 Hong Kong here is seen as a source of FDI to the China Mainland, according to the practice of Chinese Statistical Bureau.
FDI stock in China of each G7 country by 2004 against their total GDP in 2004, it is found that Canada’s performance of FDI into China appeared more robust (ranked 3rd among the G7 countries) when considering its relatively small economy (see Table 1.1 in Chapter 1).

One unique feature of FDI in China has been the great contribution of the overseas Chinese business people. For instance, the influx of capital from Taiwan and South Korea had grown dramatically since the late 1980s and early 1990s due to the beneficial change of political relationship between China and these two countries, as well as rising labor costs in South Korea and Taiwan and also the appreciation of their domestic currencies. Besides Hong Kong, Taiwan and Macao, some FDI from other Asian, European, Australian, and North American countries including Canada has been made by people with Chinese origins (Wei and Liu, 2001: 22). This issue will be examined in the chapters dealing with case studies of Canadian companies in China in Part III. It is also worth noting that the so-called ‘round-trip’ phenomenon, which refers to Chinese domestic capital being invested through Hong Kong or the Virgin Islands, and then back to the Chinese mainland in order to take advantage of certain tax privileges available to FIEs, may overestimate the total FDI inflows into China (Dees, 1998; Coughlin and Segev, 2000).

**3.3.4 Sectoral Composition**

Chinese official data show that FDI in China has been highly concentrated in the secondary sector, which includes industries such as mining and quarrying, manufacturing, electric power, gas and water production and supply, and construction. For example, in 2003 the secondary sector absorbed FDI of 39.2 billion US dollars, accounting for 73 per cent of the total FDI inflows into China in that year. Within the secondary sector, manufacturing has been a growing industry in terms of FDI since the adoption of the open-door policy, taking up US$36.9 billion FDI or 69 per cent of total FDI flowing into China in 2003 (MOFCOM, 2004). Other industries
included in the secondary sector are mining, production and provision of electricity, water and gas, and construction, which in total accounted for less than 4 per cent of total FDI inflows in China in 2003 (ibid.). The manufacturing industries of telecommunication equipments, computers and other electronic equipments, specialized and generalized equipments, and transportation equipments, have had the most appeal to foreign investors. The primary sector, which includes industries of farming, forestry, animal husbandry, and fishery, attracted only 3.1% of total FDI in 1993 (Coughlin and Segev, 2000), and this share dropped to just 1.9% in 2003. The tertiary sector, which includes all of the remaining industries including banking and finance, gained some ground from the primary sector over the study period, though it remained far behind the secondary sector in terms of FDI absorption. In 2003, about 13.3 billion US dollars of FDI was targeted to the tertiary sector, accounting for about 25% of the total FDI inflows (MOFCOM, 2004).

The high concentration of FDI in the secondary sector is a typical phenomenon of industrializing countries such as China. It is closely related to China’s industrial policy, which has encouraged investment projects with advanced technologies and in infrastructure construction, while restricting investment in many service sectors such as banking, insurance, education, and medical services. With China’s entry into the WTO and the accompanying promise of opening many service sectors to FDI, as well as the maturing of China’s economy and the increasing disposal income of its citizens, a continuing increase of the share of service sector is expected in the long run, although the industrial sector, especially certain high technology-extensive industries, will also likely remain strong in the near future.
3.3.5 Spatial Distribution of FDI in China

Since the reform and opening up of the country, all the Eastern, Central, and Western regions of China\(^{12}\) (see Figure 3.8) have made remarkable progress in economic development and FDI absorption.

**Figure 3.8 The Three Regions of China**

![Map of China showing regions](image)

However, the development pattern in China has been a highly uneven one with the Eastern, Central, and Western region taking up respectively 86%, 9%, and 5% of total FDI stock in China by the end of 2004. The top five provinces in attracting FDI in the year of 2004 were Guangdong, Jiangsu, Shandong, Shanghai, and Zhejiang, all located in the Eastern region (see Figure 3.9). They alone took up 39.7 billion US dollars of FDI, or 65% of total FDI inflows of the year. The Central region attracted US$6.7 billion, or 11% of total FDI inflows in 2004.

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\(^{12}\) According to China Statistics, the Eastern region include 11 provinces or municipalities: Beijing, Tianjin, Hebei, Liaoning, Shanghai, Zhejiang, Jiangsu, Fujian, Shandong, Guangdong, and Hainan. The Central region includes 8 provinces: Shanxi, Jilin, Heilongjiang, Anhui, Jiangxi, Henan, Hubei, and Hunan, and the Western region includes 12 provinces, municipalities or autonomous regions: Chongqing, Sichuan, Inner Mongolia, Guizhou, Yunnan, Guangxi, Tibet, Shaanxi, Gansu, Qinghai, Ningxia, and Xinjiang.
Jiangxi province was the star in the region utilizing FDI of US$2 billion. The five provinces or autonomous regions that attracted the least FDI in 2004 were Guizhou, Xinjiang, Gansu, Qinghai, and Tibet, all located in the Western region. Sichuan ranked Number one in the Western region in attracting FDI, amounting to 0.37 billion US dollars.

**Figure 3.9 Geographical Distribution of FDI Flows into China in 2004**

![Image of a map showing the geographical distribution of FDI flows into China in 2004.](image)

**Legend**

Utilized FDI Value
- 0 - 90
- 91 - 290
- 291 - 790
- 791 - 2,580
- 2,581 - 10,012

US$ millions


This uneven spatial pattern of China’s FDI distribution did not occur immediately. Figure 3.10 reveals the different growth paths of the three regions in terms of FDI attraction. For the provinces in the Eastern region, FDI inflow had grown steadily since 1979 and experienced a sudden leap from 1992 to 1995. For other provinces, the growth of inward FDI was much less, especially for those in the Western region. As a result, the gap between the Eastern region and
the Central and Western regions in terms of magnitude of annual FDI inflows was actually enlarged after 1992.

**Figure 3.10 FDI Inflows into China by regions 1983-1997 (1980 constant US$ prices)**

Source: Coughlin and Segev (2000: 8-9).

There are two main reasons, essentially constitutional and economic factors, for this uneven distribution of FDI in different regions of China (Chen, 1997b; Fu, 2000; Sun, 1998). First, as mentioned previously, until 1992, only the Eastern coastal areas enjoyed the special policies granted by the national government and aimed at attracting FDI. The time lag of the open policy implementation in interior areas has made it very difficult for them to catch up to their Eastern counterparts. Second, the coastal region, traditionally a relatively affluent area, has tremendous advantages over the inland regions in terms of economic conditions, such as higher GDP level, a larger pool of skilled workforce, more advanced infrastructure, and overall a better investment environment (Chen, 1997b; Fu, 2000). With the special endowment of open policies since the 1980s, the coastal area has become a much more developed region in China, and has been able to provide better infrastructure system, more skilled workers, and other facilities attractive to foreign investors. Apparently, foreign investors, including those from Canada, were more
attracted to large coastal cities rather than the west, except for mineral and agricultural
investments. The spatial distribution of Canadian FDI in China, which will be shown in more
detail later in Chapter 5, was much consistent with the national pattern.

From the mid-1990s, the government has encouraged FDI flows into the Central and
Western regions as part of its policy of attempting to spread the benefits of economic
development to China’s vast interior. The “Go West” policy, which contains series of incentives
to direct FDI more positively, was commenced officially in 1999. A Catalogue of Advantageous
Sectors for Foreign Investment in the Central and Western Regions was also published soon
after. Projects included in this catalogue enjoy the same treatment as those in the catalogue of
encouraged projects. A major emphasis of policies designed to attract FDI to the Western region
is on the construction of basic infrastructure facilities such as agriculture, water conservancy,
ecology, transport, energy, municipal administration, environmental protection, minerals,
tourism, and resource development. However, since the adoption of the “Go West” policy in
1999, there had been little evidence of a major diversion of FDI from the Eastern region to the
Western and Central regions (OECD, 2003: 84). It is perhaps unrealistic to expect such a shift to
happen until the difference in infrastructure endowment (e.g. roads, rail ways and airports) has
been greatly evened out, a process that will likely take decades. Foreign investors therefore
remain skeptical about the attractions of hinterland provinces, which, compared with the cities
in the Eastern region, have smaller populations, far lower incomes, and more scarce skilled
labor (ibid). It is suggested that to redirect investment westward, the Chinese government may
prefer to put the main emphasis on improvements in the business environment (e.g.
infrastructure construction) and in the institutional development, particularly to raise the
standard of investment promotion and investment approval in these regions to that prevailing in
the open coastal zones (ibid.: 85).
3.4 Summary

This chapter has focused on host country factors of China and the general patterns of FDI in China, including its regulatory framework and key features such as development trajectories, major investment types, major home country investors, sectoral composition, and geographical distribution. The discussion of the regulatory environment for FDI in China reveals a both strong and weak state of China. On one hand, China has made great progress in building a relatively complete and consistent regulatory framework to govern the global FDI into the country. On the other hand, the central government and the courts are rather weak in terms of law enforcement, mainly due to the one-Party controlled, yet highly fragmented, political system of China. Discussion of other factors of China as a host country reveals that Canadian firms in China may encounter various challenges both from the cultural differences and the local Chinese market and business environment. A host culture has influenced its host state structure and market/business environment, which in turn have important impact on the shaping and evolvement of the host culture. Figure 3.11 expands the ‘Chinese boxes’ in Figure 2.4 using the material in the first and second part of this chapter.

Such regulatory and business environment for business operation is very different from that in Western developed countries such as Canada, which are generally ruled by legal systems with very little direct intervention by bureaucrats or political organizations. The Chinese regulatory system has likely impacted on Canadian firms in the following ways.
First, there has been very little Canadian FDI in China until the 1990s due to China’s initial caution about the introduction of FDI and the slow gradual opening of China’s regulation on foreign investment in the 1980s. Second, the heavy concentration of Canadian FDI in the coastal area of China can be attributed to the earlier opening of the area to FDI than the inland regions, as well as its advantageous economic conditions, such as higher GDP level, a larger pool of skilled labor, and more advanced infrastructure. Third, according to the restrictive and ambiguous nature of Chinese regulatory environment for FDI, large Canadian firms might be able to cope with the regulatory state and lack of transparency, while smaller firms unless they had government help would possibly flounder in this type of situation. Fourth, the preferential
policy in attracting FDI into the manufacturing sector, as well as the regulatory restriction over
the mining and services sector resulted in a more rapid growth of Canadian FDI in China’s
manufacturing sector, and with a much slower growth in the more regulated sectors of mining,
and services such as banking.

These features will be examined in more detail in Chapter 5 (Canadian FDI in China), as
well as tested in the three empirical chapters of Part III, with a focus on mining, manufacturing
and services sectors respectively. But before we turn to Chapter 5, the characteristics of
Canadian economic structure and Canadian TNCs, as well as patterns of Canadian direct
investment aboard will be examined in the next chapter (Chapter 4).
4 Canadian Direct Investment Abroad and Canadian TNCs

The previous chapter focused on the various factors identified as ‘host country effects’ and factors identified in Figure 2.2. It provided the necessary background to understand broad-scale trends affecting FDI in the host-country, specifically the patterns of global FDI in China as well as the regulatory framework concerning incoming FDI in this country. Now it is time to look at the ‘home-country effect’, or more specifically, the patterns of Canadian direct investment abroad and the major characteristics of Canadian TNCs.

Historically, Canada has relied heavily on inward foreign capital for its economic development, attracting FDI from all over the world, especially from the United States, the United Kingdom, and other developed countries. Indeed, in terms of inflows of FDI, Canada has been among the largest in the G7 countries (Burgess, 2000: 109). However, since the mid-1970s, the flows of outward FDI from Canada have exceeded those of inward FDI. In the last 20 years or so, Canada has reversed its reputation from a net capital importer to a net capital exporter (Rugman, 1987; Burgess, 2000). Accordingly since 1980, more and more research interest has been directed to Canadian direct investment abroad (CDIA), from different perspectives (Rugman, 1987; Meyer and Green, 1996a, 1996b; MacPherson and McConnell, 1992; Rao et al., 1994).

This chapter consists of two parts. The first part identifies the major characteristics of Canadian TNCs, which are mainly influenced by the organizational and industrial structure of Canada. In other words, this part discusses the home-country-effect on Canadian firms investing overseas. The second part reveals some key patterns of CDIA, including its development in the past three decades, its industrial composition and its spatial distribution.
4.1 Characteristics of Canadian TNCs

As reviewed in Chapter 2, a country’s cognitive, cultural, social, political, and economic characteristics play a dominant role in the formation of the unique characteristics of its domestic firms. Yet, compared with firms from the USA, Germany and Japan, whose characteristics have been widely compared and discussed (see Pauly and Reich, 1997; and Dicken, 2003), Canadian firms are not so outstanding and distinctive in terms of corporate governance or corporate financing. Nevertheless, Canada’s colonial history, its ambivalent and dependent relationship with the US, and its geography, politics, and society, have together shaped the unique industrial and organizational structure of the country. In turn, these factors have shaped the characteristics of Canadian TNCs operating domestically and internationally. In this section, first I will discuss the general Canadian economy. Then the sectoral composition of Canadian economy will be explored, followed by the examination of the uniqueness of the corporate sector as well as its possible causes and consequences to Canadian economy. Based on the above discussion, the characteristics of Canadian firms, both foreign and domestic owned, will be examined.

4.1.1 General Discussion of Canada’s Economy

Canada is a country that is well endowed with various natural resources. The history of the economic growth and development of Canada can be explained by Harold Innis’s staple theory based on Canada’s specific geographical and historical circumstance (Barnes et al. 2001). Staples are defined as a set of minimally processed primary resources such as lumber, pulp and paper, fish, fur, and minerals, and a staples theory is a theory of economic growth (or lack thereof) that is based on the export of these goods to a principal economy (Innis, 1956). Recent studies on Canadian economy have investigated a variety of different staple sectors such as forestry (Hayter and Barnes, 1990; Wallace, 1996; Parker, 1997; Hayter, 2000; Barnes et al.
2001), mining, fishing (Clapp, 1998), and most recently coal (Gunton 2003), particular in British Columbia.

The Canadian economy has moved into manufacturing and service sectors of the economy, particularly since the Second World War when great increases took place in the share of Canadians employed in goods producing and service industries (Wesson, 2001). A more significant trend in the later post-war period has been the growth in service employment. Even in 1960, the majority of Canadian workers were employed in services; and in 2000 the ratio of service to manufacturing employment was about twice the ratio in 1960 (ibid). Currently, Canada’s goods-producing industries account for 33 per cent of national economy, yet the Canadian services sector is much larger, employing three out of four Canadians and generating two-thirds of the gross domestic product (GDP) (Statistics Canada, 2005). Thus the Canadian economy is also dubbed as a “post-industrial’ economy (Wesson, 2001).

However, Canadian tertiary industries as a group are not internationally competitive or successful exporters, except for those in metropolitan regions such as Vancouver, where the exports of producer services to the Asia Pacific have been expanding since the 1970s (Davis and Hutton, 1994). As a whole the service sector has been a source of trade deficits (Britton, 1996). The strongest growth since 1945 has occurred in private-sector services, such as trade, finance, and transportation-communications, which operate almost exclusively in domestic markets (ibid). On the other hand, primary commodities and primary manufactures dominate Canada’s exports. Indeed, Canada’s largest export sector is within a manufacturing sector, e.g. automobiles and parts (Holmes, 2000). This feature has led scholars such as Britton (1996) to call Canada a ‘pre-industrial economy’ or a ‘new staple economy’, in which raw materials were replaced by goods processed in various degrees (ranging from primarily or intermediately to highly processed goods). Why would Canada be described as a “pre-industrial” and “post-industrial” economy at the same time? Answers to this paradox may be found in the
uniqueness of the Canadian corporate sector that will be discussed in next section.

Since the 1970s, the main international economic thrust in Canada has been NAFTA (North America Free Trade Agreement), although Canada is a founding member of APEC (Asia-Pacific Economic Cooperation). While some claim that the lowering of tariffs between the USA and Canada were not that important, the introduction of the US-Canada FTA (Free Trade Agreement) in 1989 coincided with a dramatic strengthening of trade and Canadian firms doing business across the border (see the work of economic geographer John Britton (Britton, ed. 1996; and also Alan MacPherson (MacPherson, 1996; MacPherson and McConnell, 1992)). Conversely, since NAFTA Canada has received a declining share of the USA outward FDI, and in some cases US companies have closed plants in Canada and have instead exported from the United States to Canada (UNCTAD, 1996). Indeed, one striking feature of direct investment flows between the US, Canada and Mexico since NAFTA is that between 1994 and 1997 Canadian investment in the USA grew at a faster rate than US investment in Canada (Holmes, 2000).

Despite the current ‘resources boom’ that is helping Canada’s economy, another issue is long-term productivity, technology and added-value in Canadian firms. A recent pessimistic analysis of this has been conducted by business scholars Michael Porter and Roger Martin, who argued that Canada is lagging in the global competitiveness race. Porter and Martin (2001) found that although Canada has enjoyed a spectacular macroeconomic turnaround since 1991, much of that growth was due to the depreciation of the Canadian dollar instead of the improvement in productivity growth or technological upgrading. These two scholars warned that to build global competitiveness, Canada – both government and industry - must shift from their ‘comfort zones’ and engage in relentless innovation and upgrading of productivity (Porter and Martin, 2001).
4.1.2 Distinctiveness of the Canadian Corporate Sector

Wesson (2001) summarized three key aspects of Canadian corporate sector’s uniqueness. The first is related to ownership and control. Significant numbers of Canadian corporations are controlled by foreign companies (e.g. GM Canada). Furthermore, many Canadian-controlled corporations are dominated by a relatively small group of individuals and firms. The second is related to the competitive environment faced by Canadian corporations. Canada often has a relatively small number of corporations in any particular industry. The third unique aspect relates to the activities performed by Canadian corporations, which are involved in the extraction and processing of natural resources to a far greater extent than is typical of a nation of Canada’s level of wealth.

The first two unique aspects of Canadian corporate sector have both historical and institutional causes. For instance, Canada began as a colony of Great Britain and was initially seen as a source of raw materials, as well as a market for its finished products. After the American Revolution, thousands of United Empire Loyalists came to the East part of Canada from the U.S. These Loyalists were mainly middle-class merchants and small businessmen, who tended to be politically conservative, but who felt that the state should intervene to protect small businesses from competitive pressures. This ambivalent attitude towards competition proved to be a very persistent idea in Canadian politics and economics (Wesson, 2001: 70).

In addition to this historical factor, two other reasons have been proposed to explain why Canada lacks a strong competition policy (Wesson, 2001: 78-79). First, it is often argued that as the Canadian economy is relatively small, it cannot support more than one or two companies in many scale-intensive industries without a great loss of efficiency. Second, because the Canadian economy is relatively open and is highly integrated with that of the USA, many analysts argue that Canadian industries face competition from abroad and consequently domestic concentration
is not so important.

According to Wesson (2001), the institutional cause of a Canadian corporate sector with a high degree of foreign ownership and an ambivalent attitude towards competition is mostly related to the National Policy introduced by Sir John A. Macdonald’s Conservative government in 1878. The Policy had two simple components – high tariffs on manufactured goods and an open market for foreign investment. The tariff was seen as a means of protecting infant manufacturing industries in Central Canada (Ontario and Quebec) from their larger and more fully developed U.S. competitors. Under such circumstances, foreign competition was reduced by the tariff, and domestic competition was often naturally limited by economies of scale and other economic factors. Therefore, Canadian firms in many industries (e.g. food production, banking, and retail) were protected from competition to a large extent and were immensely profitable. Once established, many Canadian firms were able to grow to dominate their market using mostly internally generated funds. As a result, there is a concentration of ownership and market power among Canadian firms. Canadian business abounds with concentrated industries, such as beer with the major firms comprising Molson and Labatt, Canadian banks (the big five), and department stores (The Bay and Eaton’s, which was purchased by USA-based Sears Canada in 1999). This phenomenon is also related to the concentration of wealth in Canada. For example, Diane Francis in her 1986 book Who owns Canada, estimated that 32 families and five conglomerates owned about one-third of Canada’s non-financial assets in the 1980s (Francis, 1986).

The other central element of Macdonald’s National Policy, a wide open-investment policy, led to more and more foreign firms to invest in Canadian subsidiaries, either through acquisition or new investment in order to produce goods in Canada for the Canadian market. These branch plants typically produced a broad product range at an inefficient small scale for Canadian consumption (Britton and Gilmour, 1978). Because they were foreign owned, they had
few incentives to improve their efficiency and compete internationally, since they would only be
competing with their parents. In addition to encouraging a high level of foreign investment in
Canadian manufacturing industries, the National Policy allowed foreign natural resources firms
continued open access to Canada’s raw material resources. These foreign firms (usually
American) invested in Canada to extract raw materials such as oil, gas, and metals, and then
export them back to the US for processing. In sum, a high level of foreign ownership in
Canadian manufacturing and natural resources industries formed a typical branch-plant
economy of Canada, in which foreign affiliates were “truncated” and tended to rely to a large
degree on their parents, or other foreign firms, for important activities and inputs such as
manufacturing, research and development, marketing and strategic planning.

Overall, due to Canada’s rich endowment of natural resources, a 19th century decision to
protect the Canadian economy with high tariff barriers, and the presence of a dominant neighbor
to the south, Canadian institutions have been more inclined to replicate practices and strategies
elsewhere rather than innovate to be uniquely positioned in global terms (Porter and Monitor

4.1.3 Characteristics of Canadian Industry and Canadian Firms

A key feature of the Canadian economy is that a small number of oligopolistic firms
compete within particular product markets, while most firms are “niche” producers. While this
pattern is common throughout the industrial world, Canada’s large indigenous firms are of
modest scale by world standards, and many of its biggest industrial producers, such as General
Motors and Imperial Oil, are subsidiaries or branches of foreign firms (Britton, 1996:10).

After comparing Canadian and Western European industrial structures based on value
added and employment, Britton and Gilmour (1978:52-55) concluded that manufacturing in
Canada is underdeveloped except in primary resources processing such as wood
products/furniture, pulp and paper products and non-ferrous metals, and transport equipment. An overall lack of high-technology specialization is another distinct and general pattern. Certain secondary manufacturing industries, such as textiles, knitting mills, apparel, furniture, and printing industries, have low levels of foreign ownership, use standard technology, and have establishment sizes one-third or two-thirds of the US level. This latter feature suggests that many Canadian companies are unable to attain scale economies in non-production activity, in part due to inadequate industry rationalization. In all other secondary manufacturing industries (generally high-technology activities) foreign ownership is relatively high and their performance in Canada is low, due to the suboptimal establishment sizes, as well as replacement of engineers and scientists by supervisory staff in these foreign affiliates. Another feature of the Canadian manufacturing sector is its overall productivity gap with the USA – about 20 per cent (Britton and Gilmour, 1978:52). A brighter side of the Canadian economy is that Canadian banks are among the best managed and the most advanced in the world (BankIntroduction.com, 2005).

Another favorable aspect is the mining industry, making Canada one of the world's leading exporters of minerals and mineral products. The export of mineral products has made a significant contribution to Canada's international trade, accounting for 14.4% of Canada's total domestic exports in 2006 (Natural Resources Canada, or NRCan). Yet Canada’s rich endowment of natural resources has been eroded in value (except for the present mineral and energy boom, 2003-2008). The downward price pressure on natural resources due to the low cost competition from developing countries during the 1980s has eroded the competitive advantages of Canadian resource industry (Porter and Monitor Company, 1991). To retain global competitiveness, Canada’s resource-based industries have to increase share of processed goods in their exports, and thus much more technological upgrading is needed. Beyond this, resource firms must increasingly export technological and managerial expertise rather than simply export the commodities themselves, and this will manifest itself in more aggressive outward foreign

In general, there are three types of private corporations in Canada: Canadian subsidiaries of foreign TNCs, large domestic conglomerates, and indigenous small and medium sized enterprises (SMEs)\textsuperscript{13}. The last type of corporations, the indigenous SMEs, comprises over 98 per cent of Canadian corporate organizations. Operating in such a unique corporate environment as discussed earlier, these Canadian corporations together possess following interrelated characteristics.

4.1.3.1 Low Research and Development Expenditure

First, they tend to display a lower R&D spending and less indigenous innovation than international competitors. Compared to its global competitors, Canadian private firms rank last in company-funded R&D; indeed only a tiny fraction undertakes any R&D at all (McMillan and Baluta, 2001: 340). Several studies have also suggested that Canadian TNC's advantages are less concentrated in R&D intensity, unlike those of major home countries such as the USA, Japan and those in the EU, and more likely to include marketing, organization, engineering, and other skills (Rugman, 1987; McFetridge, 1994). This can be attributed to the less competitive business environment in Canada and the high level of foreign ownership among Canadian firms. Little competition makes firms lack of incentives to spend on R&D and improve technology edge. The “truncated” Canadian subsidiaries of foreign TNCs tend to use mature technology transferred directly from their parents. Evidence suggests that after the US-Canada Auto Pact in 1965 and after NAFTA (North American Free Trade Agreement) in 1994, US TNCs operating in Canada have ‘hollowed out’ their Canadian subsidiaries by repatriating key decision-making functions to their US headquarter locations (Arthurs, 1999).

\textsuperscript{13} There is no standard definition of small and medium-sized enterprises (SMEs). Many industrialized countries define a manufacturing enterprise employing fewer than 500 people, or a service company with less than 50 employees, as a SME (Rao and Ahmad, 1996; Fujita, 1993). Some studies on SMEs have used annual sales revenue to categorize these firms. For example, in one study conducted by Industry Canada, firms with annual sales of less than US$100 million were defined as SMEs (Rao and Ahmad, 1996). My paper adopted the former definition.
4.1.3.2 Poor Industrial Productivity

A second feature of Canadian companies is overall poor industrial productivity. Orthodox economists attributed this feature to the tariff protection of Canadian industry, and the lack of competitiveness. However, Britton and Gilmour (1978) argue that the cause of the trade and productivity problems Canada has faced in the post-1945 period are complex and not solely related to tariffs, which only protected low-tech industries leaving the medium- or high-technology industries out of domestic control. Other reasons can be attributed to foreign plants that are supplied only with relatively mature technology from within the corporation (ibid). Ironically, when foreign and domestic plants are compared, US-controlled plants have a better productivity performance. The explanation for this apparent abnormally may lie in the larger average size of foreign-controlled plants (ibid). In a number of cases, Canadian industries suffer from small plant size and minimally efficient scale is not achieved (ibid).

4.1.3.3 Low Levels of Entrepreneurialism

A third factor impacting on Canadian firm productivity concerns their overall conservative strategic thinking and lack of risk-taking spirit. Many firms content to compete in Canada, with little orientation toward global competition (Porter and Monitor Company, 1991). Those firms that did compete internationally tended to focus on the U.S. and pursue strategies that depended on natural resource advantages or lower labor costs than other G-7 competitors instead of sophisticated products and processes (ibid.). This characteristic may be related to the less competitive business environment formed in the Canadian domestic market. Whatever the real reasons, the conservative behavior of many Canadian firms, especially when compared with those from the USA, is a widely perceived feature of Canadian businesspeople and Canadian enterprises, as I found out during my interviews with Canadian managers and other business circle informants in China. Canadian business has also long been accustomed to lean heavily on government support (Drummond, 1966). A recent report by EDC (Export Development Canada)
revealed that over 70 per cent of Canadian companies in Brazil rely on EDC for information on local market condition and for advice on exporting or investing in the country.

In summary, a characteristic of the Canadian economy is its openness to foreign investment and trade especially from the USA (Barnes et al, 2000), which makes Canada a typical “branch plant economy” largely controlled by foreign firms. It is thus not surprising that Canadian TNCs do not display a very distinctive characteristic on global stage, as most of them are actually Canadian subsidiaries of American firms.

4.2 Key Patterns of CDIA

4.2.1 Growth of CDIA and its Relationship with Inward FDI

Canadian direct investment abroad (CDIA) is defined by Rugman (1987) as investment made by Canadian investors to acquire a lasting interest in a concern operating abroad with a view to have an effective voice in the management of that concern. Based on the IMF and OECD’s definition of direct investment, Canadian standard investing practice has generally adopted the threshold of 10 per cent equity ownership in a foreign firm as the establishment of direct foreign investment. So far, Canadian financial control authorities have only considered long-term capital as direct investment: that is, long-term debt (bonds, debentures, loans, advances) and equity (common and preferred shares and retained earnings).

As noted earlier, Canada itself has historically been a significant FDI magnet among developed countries. Its reliance on FDI has helped finance a faster rate of economic development than would otherwise be the cause. On the other hand, outward FDI from Canada since World War Two was insignificant until around 1975, when it started to accelerate, and CDIA reached the peak levels in 2002 (Figure 4.1). The amount of CDIA dropped to CAD$403 billion in 2003 from CAD$433 billion in 2002, but then rose back up to CAD$445 billion in
2004. The decline of CDIA in the year of 2003 may be contributed to the overall cooling of
global investment due to the ‘9/11 tragedy’ in the U.S. in 2001, and the burst of the US

**Figure 4.1 Growth of CDIA since 1945**

Since 1975, Canada’s position as a net importer of direct investment has been reversed.
Figure 4.2 compares the annual flows of CDIA and inward FDI between 1960 and 1985. The
figure reveals that since 1975, both annual flows of CDIA and inward FDI have changed
dramatically. The US and other foreign firms divested more assets in Canada than they had
acquired, in 1976, during 1981-82, and again in 1985. On the other hand, the net repatriation of
foreign capital from Canada has been confined to these four years (Rugman, 1987: 4). This shift
in capital flows, as Rugman (1987) argues, might be attributed partly to foreign firms’ declining
interest in Canada during the 1980s, and the decision to shift capital to other strategic countries
such as the NIEs (Newly Industrialized Economies) in Asia.
Figure 4.2  Canadian Inward and Outward FDI Flows, 1960-85

Source: based on Rugman (1987:3, Table 1).

It should be noted that the flow value of FDI and CDIA does not include retained earnings, or reinvested capital by TNCs in the host country. This absence could make great difference to the growth pattern discussed above. With retained earnings included, there is a net gain of inward FDI in Canada between 1975 and 1980 (Rugman, 1987: 67, Table A-7), in contrast with an overall reversal trend since 1975, as identified in Figure 4.2. Based on this addition of retained earnings before the mid-1980s, MacPherson (1996) concluded that despite the rise of CDIA, Canada continued to be a net capital importer rather than a net exporter. However, this notion was subsequently overthrown by Burgess (2000) who used more recent data between 1987 and 1997, and found out that Canada was indeed a net exporter of foreign investment, even when retained earnings were included.

Since the mid-1980s onward, CDIA has gained great momentum and witnessed phenomenal growth during the last two decades. Specifically, accumulated CDIA levels doubled between 1986 and 1992 (Globerman, 1994: 2), and tripled in the period between 1992 and 2001, reaching 389.4 billions at the end of 2001 (Statistics Canada, CANSIM Table 376-0051). On the other hand, foreign firms have continued to invest in Canada, but on a smaller scale than before. As a
result, the stock of Canadian-owned assets abroad outstripped FDI in Canada in 1997 (Figure 4.3). The rapid growth of CDIA stock relative to the inward FDI stock in the last two decades has been attributed to numerous factors, such as a greater outward-orientation of Canadian TNCs, a greater need for foreign capital in the U.S. which is the dominant destination for Canadian investments, an improved profitability picture in the U.S. and the U.K., and a relatively faster growth rate of non-residential capital stock in these two countries (Rao et al., 1994: 76).

**Figure 4.3** Stock Values of Inward FDI and CDIA, 1980-2002

![Graph showing the growth of CDIA and FDI](image)


### 4.2.2 Industrial Composition of CDIA

One general feature of the industrial composition of CDIA is the continuous decline of primary industries and the increasing importance of financial services industry. Over the last three decades, the combined share of CDIA stock in mining, petroleum and gas, and utilities declined from 36.5 percent in 1960 to 15.7 percent in 1991; conversely, the share of financial services increased from a mere 1.3 percent in 1960 to 30.2 percent in 1991 (Rao et al., 1994: 68)
and even 34.5 percent in 2004 (Statistics Canada, 2005). The share of manufacturing has also declined, but at a much smaller scale, from 55.9 percent in 1960 to 43.8 percent in 1991 (Rao et al., 1994: 68), and to 24.1 percent in 2004 (Statistics Canada, 2005). Figure 4.4 shows the industrial composition of CDIA stock in 2004. More than three-quarters of CDIA in the manufacturing sector is concentrated in resourced-based processing industries, mainly primary metals, wood and paper products, and beverages. However, the share of technology-intensive industries (mainly chemicals and chemical products, and electrical and non-electrical machinery) has increased substantially over the last 30 years (Rao et al., 1994: 68). The ‘all other industries’ in Figure 4.4 includes mainly service industries other than finance, insurance, wholesale and retail trade. The trends in the industrial composition of CDIA can be said to be similar to those occurring more widely in the industrial distribution of FDI in Canada and the rest of the world.

**Figure 4.4 Canadian Direct Investment Abroad Stock by Industry, 2004**

![Pie chart showing the industrial composition of CDIA stock in 2004.](image)

Source: Statistics Canada (Canada's International Investment Position, 1926 - 2004), May 2005

### 4.2.3 Geographic Distribution of CDIA

The USA has been the largest host country for CDIA, despite the fact that its share has declined significantly, from a peak of 68.5 percent in 1980 to 58.0 percent in 1992, and to 43.6
percent in 2004. Until 2001, the U.S. still held more than half of CDIA stock (Figure 4.5). The U.K. is the second largest host country to CDIA, accounting for 10 percent of total CDIA stock in 2001. Its share reached 14 percent in 1990, but experienced a setback in the 1990s. More than 60 percent of the decline in the U.S. share of CDIA stock had been captured by the U.K. over the second half of the 1980s (Rao, et al., 1994: 67). By contrast, Canadian investment in Pacific Asia, the fastest growing region in the world, appears to be lagging behind; its share was only 7 percent of total in 2001. Other resource countries, e.g. Australia, have stronger links with Asia-Pacific than Canada (Edginton, 2004). For instance, just prior to the financial crisis in 1997, Australia sent nearly 60% of its exports and 10% of its FDI to the Asia Pacific region (ibid).

**Figure 4.5 Geographical Distribution of CDIA Stock in 2001**

However, the growth of CDIA in Pacific Asia has been remarkable, albeit from a very small scale. For instance, Canadian investment flowing into Asia has grown 11 times between 1980 and 1999, compared with 9 times for Europe and just 6.5 times for the U.S (Statistics Canada). Also, the share of global CDIA into Japan and Singapore increased from only 1 percent in 1982 to 3.8 percent in 1991 (Rao et al., 1994: 67).

As shown in Figure 4.6, Canadian TNCs display a North American ‘continental investment pattern’, with the majority of CDIA remaining in North America in the last 20 years, although its
share continued to drop during the period. On the contrary, the share of Europe has kept on increasing during this period. Indeed, virtually all of the Western Europe is a vital target region for Canadian firms, especially the U.K., France, the Netherlands, West Germany and Switzerland. By comparison, Asia, Oceania and South America, collectively dubbed as ‘second tier’ in relative importance to Canadian direct investment (Meyer and Green, 1996b), do not show any apparent growth trend, and possess a very small share of total CDIA. But even so, certain countries stand out. The most notable in this regard are Japan, Singapore, Australia, Brazil and Hong Kong (Meyer and Green, 1996b).

Figure 4.6 Stock Value of CDIA by Investment Region

![Graph showing stock value of CDIA by investment region.]


Another interesting phenomenon worth noting is that in the top 10 countries for CDIA in 2004, there are some unexpected countries, if only economic or strategic motives considered. These countries are Barbados, Ireland, Bermuda, and Netherlands, occupying respectively the third to 6th position in 2004 CDIA ranking (Table 4.1). The reason why they attracted so much CDIA is that they are ‘tax havens’, whose relatively loose tax regulations allow TNCs to enjoy a ‘double dip’ into government-decreed interest deductions in both home and host countries. For example, for a Canadian-based TNC investing in the U.S., it is technically feasible to use a triangle financial maneuver through a tax-haven country to claim interest deductions on debt.
capital raised in Canada to finance its investment in the U.S. (Rugman, 1987: 21). Details are offered in Brean (1984) (see also Rugman, 1987). The fast growth of CDIA in Barbados and other tax heavens countries in the last decade indicates that this kind of financial manipulation may be an increasingly important determinant for CDIA location decision. However, as Rugman (1987) warns, such manipulation has rarely turned a losing venture into a profitable one. Consequently, tax heavens may play only a supplementary role to the underlying economic and managerial reasons for CDIA location. Other countries listed in the top ten countries for CDIA in 2004, besides the U.S. and the U.K., include France, Hungary, Japan, and Australia. China was ranked 14th in attracting direct investment from Canada.

Table 4.1 Canadian Direct Investment Abroad by Geographic Distribution, 2004

<table>
<thead>
<tr>
<th>Location</th>
<th>$Cdn Millions</th>
<th>% Share</th>
</tr>
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<tbody>
<tr>
<td>U.S.A.</td>
<td>193,855</td>
<td>43.56</td>
</tr>
<tr>
<td>U.K.</td>
<td>43,991</td>
<td>9.88</td>
</tr>
<tr>
<td>Barbados</td>
<td>30,595</td>
<td>6.87</td>
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<td>Ireland</td>
<td>20,564</td>
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<td>Bermuda</td>
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<td>2.64</td>
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<tr>
<td>Netherlands</td>
<td>10,896</td>
<td>2.45</td>
</tr>
<tr>
<td>France</td>
<td>10,441</td>
<td>2.35</td>
</tr>
<tr>
<td>Hungary</td>
<td>10,049</td>
<td>2.26</td>
</tr>
<tr>
<td>Japan</td>
<td>9,576</td>
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</tr>
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<td>Australia</td>
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</tr>
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<td>Germany</td>
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<td>1.96</td>
</tr>
<tr>
<td>Brazil</td>
<td>6,402</td>
<td>1.44</td>
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<tr>
<td>Italy</td>
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<td>0.31</td>
</tr>
<tr>
<td>China</td>
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<td>0.15</td>
</tr>
<tr>
<td>India</td>
<td>251</td>
<td>0.06</td>
</tr>
<tr>
<td>Russia</td>
<td>188</td>
<td>0.04</td>
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<td>Other</td>
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</tbody>
</table>

Source: Statistics Canada (Canada's International Investment Position, 1926 - 2004), May 2005
Note: the amount is the CDIA stock value

This section has identified three broad trends in CDIA: a much faster growth in CDIA than in Canadian inward FDI; a decline in the U.S. share of CDIA and increase in Western Europe; and the increasing importance of financial sector in the industrial composition. A
special emphasis has been given to the overall spatial distribution patterns of CDIA.

4.3 Summary

As revealed in the first part of this chapter, Canada is both a ‘post-industrial’ and ‘pre-industrial’ economy, due to the fact that the service sector plays a dominant role in Canadian economy in terms of GDP and employment while Canada’s exports are dominated by primary commodities and primary manufactures. Canada presents a typical branch-plant economy, in which there is a high level of foreign ownership in Canadian manufacturing and natural resources industries. This poses great impact on Canadian companies, which display a lower R&D spending and less indigenous innovation than international competitors, and overall poor industrial productivity. The Canadian economy comprises a small number of oligopolistic firms competing within particular product markets, and a majority of small and medium-sized Canadian indigenous firms, which are mostly “niche” producers. The findings of characteristics of Canadian industry and Canadian firms - as explored in this chapter - are summarized Figure 4.7, which expands the research framework of this thesis with a focus on the upper part (home country) of Figure 2.2. Whether or not the framework of Figure 4.7 is useful in interpreting the challenges faced by these Canadian firms in China will be discussed in Chapter 9.
While we might be skeptical of overt cultural explanations for overseas business strategy and outcomes, there is considerable literature that points to certain structural features of the Canadian economic system that presents obstacles to Canadian firms conducting business in other countries, such as the overall lack of research and development conducted in Canada, the dominance of foreign MNCs in the Canadian economy, and the small-scale or medium-scale nature of many companies. A study of Canadian small and medium-scale enterprises in Asia suggests that relative to large firms, their disadvantages are significant in four areas: availability of capital at a reasonable cost, market intelligence, international experience, and managerial depth and dynamism (Rao and Ahmad, 1996). Frost (1999) also gives an interesting case study
of Canada's largest MNC in China - Nortel Networks – and a case study that illustrating the need for ‘persistent adaptability’ in order to survive in emerging markets.

The second section identified three broad trends in CDIA: a much faster growth in CDIA than in Canadian inward FDI; a decline in the U.S. share of CDIA and increase in Western Europe; and the increasing importance of financial sector in the industrial composition. A special emphasis has been given to the overall spatial distribution patterns of CDIA, which reveals that China is not a preferred destination for Canadian companies. Indeed, most Canadian businesses appear to be unprepared to deal with the rise of China as an economic power, according to a study of manufacturers and exporters jointly conducted by Asia Pacific Foundation of Canada (APFC) and Canadian Manufacturers & Exporters (CME) (APFC and CME, 2006). The survey of 986 companies found that just over one third of the companies surveyed were already doing business with China, the majority of them with less than three years' experience. The unpopularity of China for CDIA is perhaps related to obstacles such as the geographical distance and cultural difference between Canada and China, lack of information about the China market, the ambiguity of Chinese regulations on FDI, and adverse operating conditions in China. My survey of Canadian firms in Part III of the thesis will focus on the two latter issues, which causes many difficulties for Canadian companies in China.
5 Canadian FDI and Canadian TNCs in China

Having looked at global FDI in China and Canadian direct investment abroad, the current chapter connects these two themes together and examines patterns of Canadian FDI in China. Chapter 3 and Chapter 4 show that China is a major FDI recipient and Canada is a major FDI source country in the world. However, Canadian FDI in China represents only a small fraction of total FDI inflows in China as well as of total FDI outflows from Canada. By the end of 2006, Canada was ranked 15th among foreign investors in China, behind the USA, Japan, Germany, France, Netherlands, the UK, some other Asian countries such as Hong Kong, Taiwan, Korea, and Singapore, and Pacific islands such as British Virgin Islands and the Cayman Islands (Ministry of Commerce of China, 2007).

This chapter first discusses the economic relations between Canada and China, including trade and investment. Results will be summarized in Figure 5.10 at the end of this chapter, which is drawn to expand the analytical framework in Figure 2.2. Then a detailed discussion of Canadian FDI in China will be presented based on official data both from Canada and China, including its historical trajectory, industrial composition, and geographical distribution.

5.1 Economic Relations between Canada and China

5.1.1 Bilateral Relations and Government Trade Support

In the early stages of China’s post-1978 economic reforms, when the total Canada-China trade volume between Canada and China was still very low, the Canadian business community in China was already compelled by the immediate need for an institutional partnership between the private sector and government to promote Canadian business in the emerging Chinese market. For instance, Maurice Strong, a founding co-chairman and architect of the Canada China Business Council (originally called the Canada China Trade Council from 1978 until
December 23, 1993) put it, “Business and government have to work together, especially when you’re opening a market that is dominated by government. You need a government dimension to supporting the private entry of private capital and initiative into China.” (comments made in 1978, cited in Young, 2003)

Compared with other western developed countries, Canada had built exceptionally strong relationships with China, dating back from Canadian doctor Norman Bethune’s assistance to Mao Zedong’s Communist Party fight against the Japanese military invaders in 1938. In the post-1949 era, Canada was one of the first Western countries to recognize the People's Republic of China in October 1970. Even prior to this period, Canada was also the only major western country that did not invade China in 1900, when China was under military attack of European and American imperialist armies. The bilateral relations between these two countries have become stronger throughout the latter half of the 20th century (see some key milestones in Chinese-Canadian relations summarized by the CBC in 2006 and shown in the Appendix 3). Major events in the relationship include Pierre Trudeau as the first Canadian prime minister to pay an official visit to PRC in 1973, and two Team Canada Missions led by Prime Minister Jean Chrétien to China in 1994 and 2001.

Perhaps the climax of bilateral relations took place in 2005 when President Hu Jintao visited Canada on a state visit and met with Prime Minister Paul Martin. The two governments at that time announced the bilateral relationship was being officially elevated from a ‘cooperative partnership’ to a ‘strategic partnership’. A committee - known as the Canada-China Strategic Working Group - was created and intended to be a regular meeting of deputy ministers to build on the ‘strategic partnership’, dealing with a range of crucial bilateral issues, including trade, investment, energy, and climate change. The actions on the Canadian side have been more active. For instance, in the year of 2005 alone (until October 2005), federal ministers visited
China 16 times, some of them going more than once. However, there appeared to be little result from this government activity and support. “Never has Canada tried so hard to drum up trade with an overseas partner with so little to show for it”, wrote Marcus Gee for The Globe and Mail in a report on China (Gee, 2005).

Measures taken by the Canadian government in 2005 to build stronger economic relations with China include: (1) the announcement of the Pacific Gateway strategy in 2005, which is a $590-million plan to upgrade port and other transport facilities in British Columbia to facilitate trade with Asia; (2) a tripling of the number of scheduled weekly flights between Canada and China; (3) bilateral work on an agreement on foreign-investment rules; (4) an increase in the number of trade offices in China (ibid.).

Canada, like the rest of the world, has been determined to obtain a large share of China's market. However, this has posed a major challenge to Canadian politicians as there is a need to balance trade policy against concerns about China’s poor human rights record. Trade, investment and human rights have been indisputably important elements of the bilateral relationship in the past ten or so years. Promoting Canadian values - such as democracy and civil society - in China sometimes contradicted Canadian pursuit of trade policy interests, leading to the limbo of the bilateral relationship. For instance, a major setback happened in 1989 when the bloody suppression of the Tiananmen Square student protests took place. In response, Ottawa halted official exchanges with China and limited development assistance, focusing instead on programs that were specifically for humanitarian relief (APFC, 2004).

Another major setback occurred in the regime of the most recent federal government, particularly owing to Prime Minister Harper’s ongoing criticism of Beijing’s human rights record. According to Jonathan Manthorpe of the Vancouver Sun, the foreign policy of the current Government of Canada has emphasized freedom, democracy, human rights and the rule of law,
or the so-called ‘cool politics, warm economics’. Officials in the Harper government have argued that China’s unhappiness with Canada in response to this policy will have no serious effect on trade and economic relations. They have noted that exports to China have increased substantially since Mr. Harper took office in January 2006, despite the friction (Manthorpe, 2007). Take merchandise trade as an example. Canada’s merchandise exports to China increased from CAD$7.1 billion in 2005 to CAD$7.7 billion in 2006, while the imports volume growing from CAD$29.5 billion in 2005 to CAD$34.5 billion in 2006 (Sabuhoro and Sydor, 2007:32 Table 4-2).

However, the Canadian business community in China has been worried that the current government’s approach to China has been adversely received by the Chinese government. APFC co-CEO Paul Evans has stated, “the economic relationship goes hand in hand with the political relationship” (Evans, 2007). In his Presentation to the Subcommittee on International Human Rights of the Standing Committee on Foreign Affairs and International Development in early 2007, he warned that “however important the state of human rights in China is to Canadians, this is just one of several big issues in our bilateral agenda with China”, and “it is essential to establish a positive political relationship at the most senior levels before we turn to any of these issues, whether they be human rights, commerce and trade, human exchanges or management of a host of global problems” (ibid). Similarly, the Beijing office of Canada China Business Council (CCBC) has also suggested “a comprehensive and balanced framework that allows us to advance both our values and our interests without sacrificing either” (The Quarterly Review of CCBC, 2007).

Nonetheless, despite these recent concerns over Canadian position on human rights in China, generally speaking, the bilateral relationship between Canada and China has been maintained quite well. With growing global influence, China has become an increasingly active participant
in the global economic and political system. It is now the second largest trading partner of Canada, the United States and Mexico (Evans, 2007). And it now exports more to the United States than does Canada and is likely to become America’s and also Japan’s principal trading partner within five years (ibid). So a mutually respectful relationship considering values and interests of both sides would be beneficial for both Canada and China.

5.1.2 Trade Relations and the Composition of Trade

As noted above, Canada resumed its diplomatic relations with China in 1971, one of the few western countries that first recognized the People’s Republic of China. However, economic relations between Canada and China can be dated back to the late 19th century when Canadian banks built branches in port cities such as Shanghai and Guangzhou (Wang, ed., 2001: 62). The Canadian Wheat Board initiated trade relations between the People’s Republic of China and Canada by exporting wheat to China in the early 1960s, which at the time was afflicted with draught at home and an embargo from abroad.

Generally speaking, the bilateral trade between Canada and China began to increase in the 1990s, and in the past decade imports from China to Canada increased more dramatically (see Figure 5.1). China is now Canada’s second largest trading partner, behind the United States (China Daily, 2007). Since 1990, Canada's imports from China have risen at an annual average rate of 22.8% while export growth averaged 12.5% (Roy, 2005). In 2005, China was the fourth largest export market and second largest source of imports to Canada. The bilateral trade reached $36.6 billion14 in 2005, with imports from China comprising 80% (ibid). However, the proportion of Canada’s trade with China accounted for only 4.5% of total Canadian trade, as 71% was with the US. In 2004 Canada was China’s 18th trade partner, behind Saudi Arabia, Brazil and the Philippines (China Customs, 2005).

14 All currencies used in this chapter are Canadian dollars, unless stated otherwise.
Figure 5.1  China Trade with Canada 1995-2004, in billions of Canadian dollars using China data\textsuperscript{15}

Since 1990, Canada’s exports to China have risen by an annual average of 12.5%, while imports averaged 22.8% up to 2004. While Canada imports rose rapidly in 2004, its exports to China grew even faster, with annual growth rate over 50% during the year of 2003 and 2004 (from International Trade Canada 2005, based on Chinese official data). Canada and Australia were the only major OECD nations to post above-average growth, reflecting their large resource content (Roy, 2005).

The recent trend in the composition of Canada’s exports to China continues the trend that began early in the 1990s (Figure 5.2). At that time, wheat was the major export to China. Now shipments are more diversified, especially for industrial goods, some natural resources and machinery and equipment. Organic chemicals and metals and minerals led industrial goods, contributing nearly a third of all Canadian goods exported to China in 2004. Organic chemicals, almost all ethylene glycol, saw remarkable growth in shipments to China. China uses ethylene glycol (produced almost entirely in Alberta) primarily to produce polyester for textiles and

\textsuperscript{15} Canada’s measure of imports from China is much bigger than China’s measure of exports to Canada, because Canada includes Chinese goods that pass through a third country such as the United States or Hong Kong. China does not count those sales as exports to Canada.
clothing. The implication is that Canada has played an important role supplying basic raw materials to China’s burgeoning textile and clothing exports (mostly to the US and EU) than it lost in domestic clothing and textile output to these imports.

**Figure 5.2 Canada's Top 10 Exports to China, 1995-2004, billions of dollars**

![Bar chart showing Canada's top 10 exports to China from 1995 to 2004.](chart.png)

Source: Statistics Canada (2005)

China is quickly establishing itself as a voracious consumer of energy, raw materials and, increasingly, finished goods. It is also becoming the hub of global manufacturing, and an unbeatable competitor when it comes to low-cost production. Canada's energy sector has therefore reaped the benefits of Chinese demand for oil, gas and other commodities. Canada’s exports such as ethylene glycol, used to make antifreeze, have increased dramatically, rising four-fold by over $0.5 million from 2004 to 2005 approaching $1.4 billion (Roy, 2005). Canada’s traditional manufacturing exports, on the other hand, have failed to adapt to changes in the Chinese market. For instance, sales of telephone equipment, once an icon of Canadian exports, have plummeted in the Chinese market in the past decade (ibid).
The composition of Canada’s imports from China, which represented 7.7 percent of total imports in 2005, has shifted markedly over time. Machinery and equipment surpassed consumer goods, such as clothing, for the first time early in 2004. Imports of consumer goods such as toys, games, and sporting goods have played a shrinking role in Canadian-Sino trade since the early 1990s (see Figure 5.3). Consumer goods such as toys, clothing and footwear recorded the smallest increase in 2004 of all the other groups of imports. The share of consumer goods in imports from China fell from 65% in 1993 to 40% in 2004 (Roy, 2004). Thus, clothing’s share of all imports from China fell from a third in 1993 to less than 15% in 2004, despite the abolition of quotas in four stages over this period. China’s share of Canada’s toy imports leveled off at just over a half. Conversely, photographic equipment has risen in importance, while furniture imports from China jumped nearly one-third last year alone (Roy, 2005).

**Figure 5.3  Canada’s Top 10 Imports from China, 1995-2004, billions of dollars**

<table>
<thead>
<tr>
<th>Product</th>
<th>1995</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Computers and mechanical appliances</td>
<td>0.5</td>
<td>1.5</td>
</tr>
<tr>
<td>Electrical or electronic machinery</td>
<td>1.0</td>
<td>2.5</td>
</tr>
<tr>
<td>Toys, games, sporting goods</td>
<td>0.1</td>
<td>1.0</td>
</tr>
<tr>
<td>Furniture, lamps, etc.</td>
<td>1.5</td>
<td>2.0</td>
</tr>
<tr>
<td>Woven clothing</td>
<td>0.5</td>
<td>1.5</td>
</tr>
<tr>
<td>Tootware</td>
<td>0.5</td>
<td>1.0</td>
</tr>
<tr>
<td>Crocheted or knitted clothing</td>
<td>0.5</td>
<td>1.0</td>
</tr>
<tr>
<td>Iron and steel</td>
<td>0.5</td>
<td>1.0</td>
</tr>
<tr>
<td>Plastic</td>
<td>0.5</td>
<td>1.0</td>
</tr>
<tr>
<td>Optical, medical, photographic equipment</td>
<td>0.5</td>
<td>1.0</td>
</tr>
</tbody>
</table>

Source: Statistics Canada; the Globe and Mail, October 29, 2005 Page W1
The breakdown of Canada’s imports from China closely resembles China’s exports to the rest of the world. Machinery and equipment (including transportation equipment) contributed close to half of China’s export growth between 1990 and 2000, followed by even stronger gains so far this decade. Apparently, China’s exports to Canada have shifted more to the upper-end of the value-added chain, which also reflects the global trend in FDI in China. Thus, in the 1980s, most foreign direct investment in China within manufacturing was concentrated in labor intensive industries such as clothing and textiles, which at that time dominated China’s exports. In the 1990s, however, foreign investment shifted to investment goods such as machinery, transportation equipment, electronics and communication (see Chapter 3).

Canada’s relationship with China is rather unique as Canada has been one of a few countries in a position to take advantage of export opportunities arising from China’s development, mainly because of its resources as well as its expertise in transportation and communication infrastructure. Imports have risen rapidly too, with machinery and equipment and more recently auto parts displacing consumer goods as the source of this growth (Figure 5.3).

The patterns of trade are likely to shape patterns of foreign direct investment from Canada to China. They tend to suggest that Canada’s resource sector firms and import sector enterprises might have a strong presence in China. However, direct investment in either direction remains minimal, with Canadian enterprises more active in China than Chinese companies in Canada. The investments that Canadian firms have made in China have been led by Canada’s traditional areas of expertise in resources and services (Roy, 2005). The next section discusses broad-scale patterns of Canadian direct investment and Canadian TNCs in China.

Besides trade, international education, student flows and immigration from China to Canada also affect investments from Canada into China in the services sector. Most international students in Canada come from Asia, and especially China. China is today the largest source country of international students for Canada, followed by South Korea, the US, Japan and
France (Holroyd, 2006). According to Citizenship and Immigration Canada (CIC) data, foreign student stock\textsuperscript{16} from China has increased over 10 fold in the past decade or so, from 3,017 in 1998 to 36,747 in 2004 (Holroyd, 2006: 3). The great majority of these foreign students return after graduation to their country of origin. Returning students bring with them knowledge of the language, culture and social customs of their host country Canada, and this knowledge as well as their personal networks of fellow students and friends has the capacity to make them ideal ambassadors for economic and commercial relations between Canada and China. Some other students chose instead to become an immigrant and permanent citizen in Canada. These immigrants converted from international students, together with the influx of Chinese immigrants since the late 1990s, formed an important force in shaping the Canadian direct investment in China in the services sector (Stevenson, 2005). There is evidence that some of these immigrants invest in the development of technology sectors in China taking advantage of its low labor costs and their technological expertise to set up outsourcing companies back home (ibid). More evidence and examples will be illustrated in Chapter 8.

5.2 Canadian FDI and Canadian TNCs in China

Statistics Canada’s records indicate that Canadian FDI in China began in 1971, one year after the two countries established diplomatic relations (Ma, 1995). However, the scale of investment was very small during the early period. It was not until 1979 when China opened its economy to the world Canadian investors started to consider investing in this country. This section examines the development of Canadian FDI in China since the early 1980s, as well as its industrial composition and geographical distribution.

\textsuperscript{16} Foreign student stock refers to the total number of international students in a country at a particular time.
5.2.1 Development Phases

Overall, the development of Canadian FDI in China since the early 1970s can be divided into four phases (see Figure 5.4\textsuperscript{17} and Figure 5.5): a slow growth phase from 1971 to 1992, a rapid FDI increasing phase from 1993 to 1998, an adjusting phase from 1999 to 2001, and a rapid growing phase again since 2002. This trajectory is closely related to economic development and policy transformation both in China and Canada, as well as to the changing economic and political landscapes in Asia and beyond.

Figure 5.4 Realized Canadian FDI Flows in China (1983-1990)

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{fdi_flows.png}
\caption{Realized Canadian FDI Flows in China (1983-1990)}
\end{figure}

Source: State Statistics Bureau of China (1992)

\textsuperscript{17} Official data from Canada on FDI in China before the year of 1990 are not available due to confidentiality. Since the Canadian FDI amount before 1990 is very small, Figure 5.4 is based on Chinese official data. Despite different definitions and procedures of reporting, the Chinese data display the overall trend of Canadian investment in China.
The first phase comprised a steady but slow growth phase from 1971 up until 1992, particularly after 1979 when China undertook reforms and initiated an open-door policy. Still, by the end of 1982, total investment stood at only less than C$1 million (Ma, 1995). In 1983, Canadian businesses began to increase their investment in China. However, as shown in Figure 5.4, the Canadian investment in the 1980s remained very small, with only 22 million US dollars invested in the peak year of 1989 (State Statistics Bureau of China, 2004). Overall, in the early 1980s both the Chinese government and Canadian investors were very cautious about introducing or making investments in China as China had just opened its door to the world after a thirty-year ‘close’ period. Moreover, the Chinese market was ‘far-from-home’ and unfamiliar for Canadian business community.

The Chinese government has made many reform efforts in the second half of the 1980s to promote FDI inflows, including opening more and more areas and regions empowered with special economic policies to foreign invested enterprises, as well as introducing a series of laws and regulations to encourage FDI inflows. However, Canadian investors, distinctive due to their
conservative business style and cautious overseas investment, gradually increased their investment in China, but at a very slow and unsteady pace. Furthermore, when Canadian FDI in China started to gain momentum in 1989, the bilateral relationship suffered a major setback — the bloody suppression of the Tiananmen Square student protests in June 1989. In response to this event, Ottawa halted official exchanges with China and limited development assistance, focusing on programs that were specifically for humanitarian relief (APFC, 2004). This ban on exchanges remained in place for three years until former international trade minister Michael Wilson visited China in 1992, which led to renewed Canadian business interest in China.

The second phase, from 1993 to 1998, saw a remarkable rise of Canadian investment in China, especially in the year of 1993 (see Figure 5.5), when Canadian FDI in China reached C$225 millions, more than five times the 1992 figure. Since then, Canadian investors have increased their investment in China steadily, with an average annual growth rate of 15.5 percent during the period between 1993 and 1998 (Statistics Canada, 2006). Following Minister Wilson’s visit to China, Zhu Rongji, then vice-premier of China, visited Canada, consigning the period of strained relations in the early 1990s to the past. But more importantly, former Chinese leader Deng Xiaoping toured Southern China in 1992 and made a series of speeches that emphasized the further openness of China to the outside world and boosted the confidence of foreign investors. As a result, the open-door policies towards international trade and business were implemented nationwide instead of concentrating exclusively on a few coastal areas (Wei and Liu, 2001). China consequently witnessed a flood of inward foreign investment, including from Canada. Indeed, China became the second largest FDI recipient in the world and the single largest host country among developing countries ever at the ‘tipping point’ of 1993. The first
Team Canada Mission\textsuperscript{18} to China took place in 1994, and was judged by the participants as both a commercial and political success (APFC, 2004). Canadian direct investment in China grew to CAD$366 millions in 1995 from CAD$257 millions in the previous year, with a annual growth rate of 42\% (ibid) (see Figure 5.5).

If the second phase of development lifted Canadian investment to a plateau of a value range between CAD$200 and 400 million, the third phase climbed to a new height of over 500 million Canadian dollars following 1998. The year of 1999 saw a phenomenal leap of Canadian FDI flowing into China with a value of CAD$711 millions, almost doubling the amount in the previous year (Figure 5.5). This record high investment is somewhat mysterious as the investment dropped to less than CAD$600 millions in the following year (2000), and it was never able to reach such as peak again until 2002. One possible explanation is related to the Asian Financial Crisis in 1997 and the Canadian Internet boom in the late 1990s (APFC, 2004). When its neighboring countries were caught up in the financial crisis, China, with its closed financial system protecting the economy from the global “hot money” by overseas investors, emerged as the “new engine of growth in Asia”, and “assumed the de facto mantle of economic leader of the region” (APFC, 2004: 25). At the same time, the Canadian economy was booming due to North American the high-tech and Internet bubble, which peaked in 1999 before it ‘bust’ at the turn of the new century. The “9.11” tragedy in the United States further dampened the ability of Canadian overseas investment (ibid).

Since 2002, Canadian direct investment in China entered another rapid growing phase, with a yearly value of over one billion Canadian dollars in 2004 and 2005 (Figure 5.5). The Asian

\textsuperscript{18} Team Canada Missions are a unique partnership in Canada's international business development efforts to increase trade and investment, as well as create jobs and growth in Canada. They are led by the Prime Minister with the participation of provincial premiers and territorial government leaders, and the Minister of International Trade.
Pacific Foundation of Canada (APFC) in its Asia Pacific Review 2004 provided two possible reasons for this round of Canadian FDI surge in China. According to the APFC, the first was a change in strategy of Canadian companies, which began switching to production closer to their Asian markets, in order to “more effectively serve growing Asian markets and existing clients in those countries, rather than to seek cheaper offshore production bases for goods destined for sale in Canada” (APFC, 2004: 27). The second, and related, factor has been a steady growth in the sale of Canadian services such as banking and business consultancy in China and other Asian countries.

5.2.2 Industrial Composition of Canadian Investment in China

According to a database compiled by Asia Pacific Foundation of Canada\(^\text{19}\), there were 332 Canadian firms that had made a direct investment in China (including Hong Kong) by September 2005. These firms are grouped into five broad industry categories and their composition is shown in Figure 5.6. Here, ‘high-tech industry’ refers to telecommunication, biotechnology, engineering, information technology, the Internet, and aerospace. ‘Business services industry’ refers to all other services industries with relatively low-tech application, such as finance, accounting, education, legal services and so on. In total, about 58 percent of Canadian firms investing in China provided services (high-tech 29% and business services 29%) as their main business activities in 2005. The rest, 42 percent of the firms, were in the goods producing sector, including manufacturing, agriculture and forestry, mining, and oil and gas. It should be noted that these firms, especially the larger firms, often operated in two or more business sectors at the same time, producing both goods and services (e.g. Nortel and Canadian Tier). The Canadian firms in this database were classified based on their main business activities

\(^{19}\) This dataset was drawn from Asian Pacific Foundation of Canada (APFC) and comprised information on Canadian companies investing in China by September 2005. Companies on this list are those registered in Canada that have made an investment in China, including Hong Kong. The companies listed were actually the ‘mother companies’ of Canadian-invested companies in China.
in China.

**Figure 5.6 Industrial Composition of Canadian Firms with Investment in China (including Hong Kong) (2005)**

Source: Asia Pacific Foundation of Canada, 2005

In Canada, while goods-producing industries accounted for about 33% of the national economy overall – measured by GDP, the Canadian services sector has been a larger employer of the workforce, employing three out of four Canadians and generating two-thirds of Canadian gross domestic product (Statistics Canada, 2006). The industry composition of Canadian firms in China is therefore somewhat in line with the profile of the Canadian domestic economy, and at the broad-scale level illustrates the principle of Dunning’s ‘ownership advantages’ in explaining Canadian investment in China. Canadian overseas investment advantage relating to China appears to lie in advanced technology, sophisticated services, and natural resources.

According to Figure 5.6, it seems that Canadian companies have made disproportionately larger investments in the manufacturing sector (19%) when compared to its domestic presence (16% of total GDP in 2006). One reason for this is closely related to China’s FDI policy since
1978, which has encouraged foreign companies to set up green field production plants in the mainland. By contrast, the Chinese government has firmly controlled the market entry of the service sector, e.g. banking and telecommunications. If we look at the Chinese government’s database\(^{20}\) of Canadian-invested enterprises in China (excluding Hong Kong) from 1984 to 1996 (see Table 5.1), it appears that there were a total of 1,270 Canadian-funded enterprises in China before 1996, and 72% of these enterprises fell in the secondary sector, which includes mining, oil and gas extraction, manufacturing, construction, production and supply of electricity, gas, and water. Only 24% of these enterprises were engaged in the service sector, such as banking, tourism, real estate and so on. With China’s entry into the WTO (World Trade Organization) in 2001, we should expect more Canadian-invested firms engaging in the service sector because the Chinese government has relaxed its control over the services sector as a condition to gain entry into the WTO (Mattoo, 2003).

| Sector Composition of Canadian-Invested Projects in China (excluding Hong Kong) (1984-1996) |
|---------------------------------|-----------------|-----|
| First sector                   | 44              | 3.5%|
| Second Sector                  | 916             | 72.3%|
| Third Sector                   | 307             | 24.2%|
| Total                          | 1267            | 100%|

Source: MOFCOM (2005)

### 5.2.3 Geographical Distribution of Canadian Investment in China

According to the Ministry of Commerce of China, by 2005 Canadian firms had invested in 2,031 projects with a total investment of US$4,735 million in all provinces, autonomous regions, and provincial-level municipalities (provinces hereafter) in Mainland China except Tibet.

\(^{20}\) The data set was obtained from the Ministry of Commerce of China during my research fieldwork. It includes all projects in mainland China invested by Canadian companies or citizens before the year of 1996. Data after 2000 are not available from the Ministry, as since 2000 local authorities had not been required to report foreign-invested projects with investment less than 30 million US dollars to the central government.
The spatial distribution of Canadian FDI in China has been highly concentrated in the coastal provinces (see Figure 5.7). For example, the top five provinces that hosted Canadian-invested projects in 2005 were Shanghai, Shandong, Beijing, Liaoning, and Jiangsu, all in the east part of China.

**Figure 5.7 Geographical Distribution of Canadian-invested Companies in China (1984-1996)**

To better illustrate this uneven distribution, I divided the whole country into three regions according to the Chinese official system: the east region includes 12 provinces - Beijing, Tianjin,

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21 On the website of “Invest in China”, operated by Investment Promotion Agency of MOFCOM, there is a function called ‘Company Search’, where one can inquire about the registration and operation of foreign-invested enterprises, including their location, registration capital value, source nation/area, and industry. It should be noted that “such query data is that of the foreign-invested enterprises that have joined in the online joint annual examination of foreign-invested enterprises in 2005”.
Hebei, Liaoning, Shanghai, Zhejiang, Fujian, Shandong, Guangdong, Guangxi, and Hainan; the
central region includes 10 provinces - Shanxi, Jilin, Heilongjiang, Anhui, Jiangxi, Henan, Hubei,
Hunan, Chongqing, and Sichuan; the west region includes 9 provinces - are Inner Mongolia,
Guizhou, Yunnan, Tibet, Shanxi, Gansu, Qinghai, Ningxia, and Xinjiang (Chen, 1997b: 7). As
shown in Figure 5.8 and Figure 5.9, the uneven pattern of Canadian FDI is rather astounding,
with the East region hosting about 82% of the total Canadian-invested projects, and 76% of total
Canadian FDI stock. Only 4% of the projects and 6% of the investment capital went to the West
region (Figure 5.8).

**Figure 5.8 Shares of Canadian-Invested Projects by Region (2005)**

![Pie chart showing distribution of Canadian invested projects by region]


**Figure 5.9 Shares of Canadian Direct Investment by Region (2005)**

![Pie chart showing distribution of Canadian direct investment by region]

Despite this skewed geographic distribution, Canadian FDI in China has been highly consistent with the total FDI in China in terms of geographical distribution (Coughlin and Segev, 2000). Two main explanations, basically constitutional and economic, have been proposed by scholars to explain this phenomenon (Chen, 1997; Sun, 1998; Fu, 2000, to name a few). First, the eastern coastal areas enjoyed exclusive special policies attracting FDI until 1992 when China decided to spread investment throughout the whole country. However, the time lag of policy implementation directed towards the interior areas has made it very difficult for these regions to catch up with their eastern counterparts (Chen, 1997b). Second, the coastal region has advantages over the inland regions in terms of economic conditions and investment environment, as discussed in Chapter 3. The coastal region has traditionally been a relatively affluent area compared with the inland. With the special endowment of open policies, it became a much more developed region in China, which equipped this region to provide better infrastructure system, more skilled workers, and other facilities attractive to foreign investors, including those from Canada (Sun, 1998; Fu, 2000).

However, an analysis of the investment amount in the MOFCOM data indicates an interesting pattern. The top five provinces that hosted the average largest projects funded by Canadian business in 1996 were in Guizhou, Anhui, Xinjiang, Qinghai, and Hainan, many of which are located in central or western areas of China. Among them, three provinces, Guizhou, Xinjiang and Qinghai, are located in the Western region of China, and Anhui in the Central region. This atypical pattern may be explained by the heavy investment in the mining industry by Canadian companies. Indeed, there were about 45 Canadian mining companies that maintain projects in Western and Central region of China (APFC, 2005). Canada is one of the prominent investors (the other one is Australia) in China’s mining industry (especially gold mining), which started to relax restriction on foreign participation in recent years.
5.3 Summary

Canadian governments at all levels have made great efforts in ‘drumming up’ Canadian trade with China since 1970, when Ottawa extended diplomatic recognition to the People's Republic of China. With a positive image in China, a solid track record as an exporter and a motivated government that has been making efforts to promote Canadian business in China for years, it might be considered that Canada should be leading in the race to profit from China's economic boom. Trade between Canada and China has expanded in line with diplomatic efforts. Thus, imports have risen rapidly, with machinery and equipment and more recently auto parts displacing consumer goods as the source of this growth. Canadian exports, despite its smaller share in the bilateral trade, have also risen in recent years. Canada has been able to take advantage of export opportunities arising from China’s development, mainly because of its resources as well as its expertise in transportation and communication infrastructure. The trade patterns examined in this chapter tend to suggest that Canada’s resource sector firms and import sector enterprises might have a strong presence in China. However, overall FDI in China has been weak. After decades of diplomacy, lobbying, and negotiation, Canadian direct investment in China added up to slightly less than 1 per cent of total foreign investment in China in 2004 (Gee, 2005). By comparison, Canadian outward FDI has accounted for about 5 per cent of total global FDI annually from 2001 to 2004 (Ministry of Commerce of China, various yeas).

The APFC data set of Canadian companies that have made direct investment in China (including Hong Kong) shows that in total, about 58 percent of Canadian firms investing in China provided services (high-tech 20% and business services 29%) as their main business activities in 2005. The rest, 42 percent of the firms, were in the goods producing sector, including manufacturing (19%), agriculture and forestry (6%), mining, and oil and gas (17%). This pattern indicates that Canadian strength lies in advanced technology, sophisticated services,
and natural resources. Overall, the industry composition of Canadian firms in China suggests a strong link between trade and investment patterns, as well as reflecting Dunning’s ‘ownership advantages’ theory of FDI (Dunning, 1977).

The link between Canada and China in terms of bilateral relationships, trade and investment discussed in this chapter is an important part of Figure 2.2 raised in Chapter 2. Figure 5.10 is an expansion of the ‘boxes’ related to the relations between Canada and China.

In summary, Canadian companies have gradually increased their presence in the China market for the past two decades. However, it should be noted that Canadian direct investment in China has continued to be very insignificant in terms of both its share of total FDI inflows in China, and its share of total Canadian direct investment abroad (CDIA). The paucity of Canadian investments in China is puzzling, considering the strength of the trade connection between these two countries. This thesis now turns to examining difficulties and challenges Canadian companies face when doing business in China, and this is the focus of the chapters in Part III.
Figure 5.10 Relations between Canada and China

- China’s 18th trade partner;
- China’s 15th foreign investors in 2006;
- Accounted for 0.77% of total FDI in China from 1979-2006.

Canada

China

Strong government – government relations

Weak trade and FDI outcomes

Cultural and value dissonance

Human rights issue

Democracy and civil society

Different business cultures

Contribution of Dr. Bethune in the 1930s

Frequent bilateral visits after 1978

Strategic partnership in 2005

- Canada’s second largest trading partner;
- Canada’s fourth largest export market and second largest source of imports;
- Attracted 0.2% of global CDIA in 2001.
PART III

6 Canadian Investment in the Mining Sector

Part III of the thesis covers case studies of Canadian firms in China in the sectors of mining (Chapter 6), manufacturing (Chapter 7), and services (Chapter 8). This chapter deals with major impediments faced, and solutions taken, by Canadian firms in the mining sector.

As discussed previously, overall Canadian direct investment in China, compared with other developed countries, has been modest and ranked 15\textsuperscript{th} in terms of total incoming FDI in 2006. However, Canadian investment in the China’s mining sector has recorded continuous growth since the early 1990s. Canadian mining firms, together with those from Australia, have been the most important strategic investors in the mining industry of China. Although the overall level of FDI in the mining sector in China is relatively low, Canadian companies have played a major role in China. For example, Canadian companies represented 21 of 39 international firms that had exploration budgets for China in 2004, according to a report prepared by the Canadian Intergovernmental Working Group on the Mineral Industry (IGWG, 2004).

Moreover, Canada and China have built a deep working and investment relationship in the mining sector. Thus, during the past few years, Canadian officials, including Ministers and Premiers, have been invited to participate and address the China Mining Congress and Exhibition (CHINA MINING) hosted in Beijing annually by the Ministry of Land and Resources of China (Liu, Y.K., 2005). CHINA MINING is also an important strategic partner of the Prospectors and Developers Association of Canada (PDAC) convention (ibid.). The significance of Canadian FDI in China’s mining sector and the mineral resources development to both countries justifies a particular research focus on Canadian direct investment in China’s
mining industry.

This chapter consists of five sections and focuses on the ‘home’ and ‘host’ country factors which have been important in explaining Canadian mining activity in China. Overall, I conclude that Chinese regulations have played a dominant role in shaping Canadian business outcomes in this sector. The first section reveals some facts about China’s mining sector. The second section explores the profile and geographical distribution of Canadian mining companies in China. The third section discusses the regulatory difficulties for foreign companies in China’s mining industry, despite the recent progress made by the Chinese government in improving the investment environment in the sector. The forth section reports on the daily operations and difficulties for Canadian mining firms in China, based on my own fieldwork and personal interviews in 2005. The last section is a case study examining the success story of a Canadian mining firm that has successfully established and flourished in China after overcoming numerous legal and management hurdles. This success story sheds further light on Canadian home country advantages.

6.1 Some Features of China’s Mining Sector

China’s mining sector consists of six major sectors, namely the mining of coal, drilling for oil and natural gas, black metallic minerals, colored metallic minerals, non-metallic minerals, and other mining industries (National Industry Classification Standard of China, GB/T4754-2002). At present, over 92% of the country’s primary energy, 80% of the industrial raw and processed materials and more than 70% of the agricultural means of production come from mineral resources (the Ministry of Land and Resources, China). With China increasing its development pace, the demand for various mineral resources has increased dramatically, and thus laid even greater importance to the mining industry of the country.

Even though domestic production of key minerals has increased sharply in recent years,
China runs a substantial and growing deficit in minerals trade. In 2005, China imported 127 million tons of oil, 275 million tons of iron ore, 4.6 million tons of manganese ore, 4.1 million tons of fine copper ore, and 9.1 million tons of potash fertilizer. Chinese geologists estimate that demand for minerals over the next 30 years may exceed production by as much as a factor of five (APFC Bulletin, 2003).

The pace of mineral exploration, production, and consumption growth in China has become faster in the past decade. From 2001 to 2005, the total capital investment in China’s mining industry has nearly tripled, rising to 320.4 billion yuan (RMB) from 114.5 billion yuan in 2001 (see Figure 6.1).

**Figure 6.1 Fixed Capital Investment in the Mining Industry (2001 – 2005)**

![Graph showing fixed capital investment in the mining industry from 2001 to 2005.](image)


Accordingly, the total output of the industry during the same period has more than doubled, with 530 billion yuan in 2001 to 1481 billion yuan in 2005 (see Figure 6.2). Already, China is one of the world's largest producers and consumers of coal and gold, and the second largest consumer of non-ferrous metals such as copper and aluminum. As the world's largest buyer of copper, the second largest international buyer of iron ore, and the third largest buyer of alumina,
China's presence in global markets is widely felt.

**Figure 6.2 Total Output of the Mining Industry (2001 – 2005)**

The expansion of the minerals industry in China has been achieved without significant FDI, and the mining sector has lagged behind other sectors in economic reforms and openness to overseas investment. The state-owned mining enterprises form the pillar of mineral resources exploitation in China. These companies provide all crude oil, natural gas and 36% of the output of other mineral in China (The State Council of China, 2006). Accordingly, the overall level of FDI in the mining sector in China is relatively low. In 2005, the mining industry had just 252 foreign-funded projects and utilized FDI of only US$354 million. This accounted for only 0.6% of the total foreign-funded projects and utilized FDI in the country in that year (Ministry of Commerce, China, 2005). Also, China only attracted about 2% of global exploration expenditure in the same year (ibid.).

Mineral resources are deemed strategic resources in China. Chinese mines have, until
recently, been managed under a planned economy where production targets and the number of jobs created for local workers were the measures of success (CIMG, 2000). The sector is one of the last to move into a competitive market driven environment (ibid.). Considering Canada’s comparative expertise in mining at a global level (shown in Chapter 3), and China’s demand for investment and technology in this sector, then it is no surprise that Canadian mining companies have been able to lever their way into China to meet part of its domestic demand since the early 1990s. In 2005, Canadian-based companies held the dominant share of the mineral exploration market in both China and Mongolia. At the end of 2005, companies of all sizes listed on Canadian stock exchange held interests in 110 properties in China and in more than 90 in Mongolia. Conversely, forty-nine of the 88 companies of all sizes that planned to explore for minerals in China in 2005 were based in Canada (IGMG, 2006). This chapter now turns to the discussion of the profile of Canadian mining firms in China.

6.2 Canadian Mining Companies in China

The mining industry in Canada is rather unique and plays a dominant role both in global market and in domestic economy in terms of exports. This section first discusses the general features of the mining industry in Canada, followed by the profile of Canadian mining firms in China.

6.2.1 Mining Industry in Canada

Canada has rich natural resources and is one of the world's leading exporters of minerals and mineral products. The export of mineral products accounted for 14.4% of Canada's total domestic exports in 2006 (Natural Resources Canada, or NRCan). Canada also plays a dominant role in the global exploration industry both in terms of exploration activity and as a source of funds for this exploration activity, thanks to decades of accumulated experience and expertise in
geology, geophysics, geochemistry, engineering, mineral production, law, taxation, investment analysis, due diligence, and most importantly, the strong fund raising capability of the Toronto Stock Exchanges. In 2004, Canadian markets raised $11.4 billion in equity financing for exploration and development, representing 48% of total equity financing raised globally (PDAC, 2006).

Many Canadian companies have had long-standing experience with foreign mining projects, thanks to their domestic experience and expertise. At the end of 2005, companies of all sizes listed on Canadian stock exchanges held interests in a portfolio of almost 3,770 mineral properties located abroad, accounting for almost 48% of the total mineral property portfolio held by these firms (IGWG, 2007). Canadian mining companies have been most active in Latin America and the Caribbean. Since 1996, the number of mineral property interests held by Canadian companies in this region exceeded the number held in the United States (IGWG, 2007).

6.2.2 Canadian Mining Companies in China

Canadian companies have been among the leaders in exploring Chinese mining potential since the early 1990s (Ministry of Commerce, China; my personal interview, Beijing, June 21, 2005). Their main interest at that time was gold. However, China had asserted a highly restrictive policy towards foreign participation in gold exploration and mining. Nonetheless, in 1995 Canadian firms established two separate Sino-foreign mining joint ventures and obtained approvals from the Chinese government for gold exploration and mining projects – the first such approvals given to foreign firms. These two companies were terminated two years later (McKenzie and Leung, 2001). The number of the foreign exploration companies dropped from the highest 50 in 1997 to about 10 in 2001 (ibid.).

Interest was rekindled over the past few years since 2003 due to the unprecedented demand
for mineral commodities from China, and the more relaxed regulations on mining and the improved investment environment in China since the late 1990s (shown in Chapter 3). According to statistics from the Ministry of Land and Resources in China, foreign investment was made in 124 prospecting and mining projects in China in 2002, up 10 percent over the previous year. By the end of 2005, China had attracted a total of US dollars 7 billion to its mining industry (Ministry of Land and Resources of China, 2006).

Compared with many local Chinese companies, the Canadian firms have demonstrated a number of key ‘ownership advantages’ (in Dunning’s terms) in terms of their core competencies – such as mining exploration and engineering techniques and financing capabilities.

When I attempted to analyze patterns of Canadian mining companies in China, it proved very difficult to obtain a complete data set of either the Canadian mining companies themselves or the mining projects invested by Canadian companies in China. Dispersed data from different sources, such as the Chinese government websites, company reports, NGOs such as the Canada China Business Council (CCBC) and the China International Mining Group (CIMG), as well as professional organizations, were assembled to obtain an indicative profile of Canadian mining firms in China. The Asia Pacific Foundation of Canada has tracked and counted Canadian new ventures in Asia since 2003. Table 6.1 shows the new contracts struck by Canadian firms in China from 2003 to 2006. This table indicates that natural resources sector announced a large number of new deals after 2003, which also demonstrates that Canadian mining companies have been very active in making investment in China’s natural resources industry in the past few years. For example, the APFC data set records that forty-seven per cent of Canadian ventures (28 out of 59) established in China in 2006 were engaged in natural resources sector.
Table 6.1 New Canadian Ventures in China (Number of deals) (2003-2006)

<table>
<thead>
<tr>
<th>Industry</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aerospace</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Biotech</td>
<td></td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Construction</td>
<td></td>
<td>2</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Education</td>
<td>4</td>
<td>5</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>Finance</td>
<td>2</td>
<td></td>
<td>4</td>
<td>7</td>
</tr>
<tr>
<td>Healthcare</td>
<td></td>
<td></td>
<td>4</td>
<td></td>
</tr>
<tr>
<td>ICT</td>
<td>7</td>
<td>4</td>
<td>4</td>
<td>6</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>12</td>
<td>7</td>
<td>9</td>
<td>10</td>
</tr>
<tr>
<td><strong>Natural Resources</strong></td>
<td><strong>39</strong></td>
<td><strong>50</strong></td>
<td><strong>17</strong></td>
<td><strong>28</strong></td>
</tr>
<tr>
<td>Other</td>
<td>3</td>
<td>10</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>68</strong></td>
<td><strong>80</strong></td>
<td><strong>46</strong></td>
<td><strong>59</strong></td>
</tr>
</tbody>
</table>

Source: Asia Pacific Foundation of Canada, 2007.

Table 6.2 is a list of 21 sample companies and 38 mineral exploration or mining projects recorded by Canadian firms in China that I compiled from various sources. One outstanding feature of this array of investments is that among the total 38 projects, 27 or 71% of them were gold projects. As mentioned above, Canadian mining companies have been more interested in gold than other minerals.
Table 6.2  Sample List of Canadian Mining Companies in China, 2004

<table>
<thead>
<tr>
<th>Company Name</th>
<th>Project Name</th>
<th>Location</th>
<th>Mineral</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dynasty Gold Corp.</td>
<td>Red Valley</td>
<td>Qinghai</td>
<td>Gold</td>
</tr>
<tr>
<td></td>
<td>Hatu</td>
<td>Xinjiang</td>
<td>Gold</td>
</tr>
<tr>
<td></td>
<td>Wild Horse</td>
<td>Gansu</td>
<td>Gold</td>
</tr>
<tr>
<td>GHG Resources Ltd.</td>
<td>Shangzhai etc. (3)²²</td>
<td>Yunnan</td>
<td>Gold</td>
</tr>
<tr>
<td>TVI Pacific Inc.</td>
<td>Shuikoushan</td>
<td>Hunan</td>
<td>Gold</td>
</tr>
<tr>
<td>Golden China Resources Corp.</td>
<td>Nibao, Xiongwu,</td>
<td>Guizhou</td>
<td>Gold</td>
</tr>
<tr>
<td></td>
<td>Wangmo (3)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Beyinhar</td>
<td>Inner Mongolia</td>
<td>Gold</td>
</tr>
<tr>
<td>Eldorado Gold Corp.</td>
<td>Tanjianshan</td>
<td>Qinghai</td>
<td>Gold</td>
</tr>
<tr>
<td>Magnus Internat Resources</td>
<td>Huidong</td>
<td>Sichuan</td>
<td>Gold</td>
</tr>
<tr>
<td></td>
<td>Mangshi</td>
<td>Yunnan</td>
<td>Gold</td>
</tr>
<tr>
<td>Minco Gold Corp.</td>
<td>Changcheng</td>
<td>Guangdong</td>
<td>Gold</td>
</tr>
<tr>
<td></td>
<td>Gobi, BYC (2)</td>
<td>Inner Mongolia</td>
<td>Gold</td>
</tr>
<tr>
<td></td>
<td>White Silver Mountain</td>
<td>Gansu</td>
<td>Gold</td>
</tr>
<tr>
<td></td>
<td>etc. (3)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mundoro Mining Inc.</td>
<td>Maoling</td>
<td>Liaoning</td>
<td>Gold</td>
</tr>
<tr>
<td>Pacific Imperial Mines Inc.</td>
<td>Tangshan, Salachong (2)</td>
<td>Yunnan</td>
<td>Gold</td>
</tr>
<tr>
<td>Sparton Resources Inc.</td>
<td>Luxi</td>
<td>Yunnan</td>
<td>Gold</td>
</tr>
<tr>
<td>Goldrea Resources Corp.</td>
<td>Daye</td>
<td>Shandong</td>
<td>Gold</td>
</tr>
<tr>
<td>Jinshan Gold Mines Inc.</td>
<td>Chang Shan Hao 217</td>
<td>Inner Mongolia</td>
<td>Gold</td>
</tr>
<tr>
<td>China Diamond Corp.</td>
<td>701 Changma Mine</td>
<td>Shandong</td>
<td>Gold-diamonds</td>
</tr>
<tr>
<td>Continental Minerals Corp.</td>
<td>Xietongmen Project</td>
<td>Tibet</td>
<td>Gold-copper</td>
</tr>
<tr>
<td>Southwestern Resources Corp.</td>
<td>Boka</td>
<td>Yunnan</td>
<td>Gold-copper</td>
</tr>
<tr>
<td></td>
<td>Yiliang</td>
<td>Yunnan</td>
<td>Nickel-PGM</td>
</tr>
<tr>
<td>New Pacific Metals Corp.</td>
<td>Kang Dian</td>
<td>Sichuan</td>
<td>Nickel-Copp er-Platinum</td>
</tr>
<tr>
<td>Orsa Ventures Corp.</td>
<td>Yuan Mu</td>
<td>Yunnan</td>
<td>Nickel</td>
</tr>
<tr>
<td>Gobimin Inc.</td>
<td>Huangshan etc.(3)</td>
<td>Xinjiang</td>
<td>Nickel-Copp er</td>
</tr>
<tr>
<td>Red Dragon Resources Corp.</td>
<td>Weixi</td>
<td>Yunnan</td>
<td>Lead-zinc</td>
</tr>
<tr>
<td>Silver Dragon Resources Inc.</td>
<td>Aoabaotugonao</td>
<td>Inner Mongolia</td>
<td>Silver</td>
</tr>
<tr>
<td>International Barytex Resources</td>
<td>Dulong</td>
<td>Yunnan</td>
<td>Tin-zinc</td>
</tr>
</tbody>
</table>

Source: from various sources

The following map (Figure 6.3) shows the geographical location of the 38 projects in Table 6.2. The numbers in Figure 6.3 represent the number of projects invested by Canadian mining companies in a particular province. The Figure indicates that most of these projects are located in western provinces such as Yunnan (12), Gansu (4), and Xinjiang (4).

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²² The numbers in the brackets of this column represent the amount of projects a company has in different localities of the same province.
In the eastern coastal areas, only Liaoning, Shandong and Guangdong have attracted Canadian exploration and mining investment. This phenomenon is partly related to the relatively richer endowment of mineral resources in China’s western provinces, and partly related to the policy of the Grand Western Development Project advocated by the central government since the late 1990s, which offers tax incentives to companies investing in the poorer western region. Figure 6.3 also shows that Yunnan in the southwest of China had the most mining projects invested by Canadian firms in 2004. This is not only because Yunnan is well endowed with gold and other precious minerals, but also because Yunnan was the first province that was authorized by the Ministry of Land and Resources to issue exploration and mining licenses to foreign investors in 1999 (Ministry of Land Resources of China, 1999). Three of the Canadian mining
companies indicated in Table 6.2 were interviewed in 2005 to identify the experiences of investing in China’s mining sector.

### 6.3 Regulatory Framework on FDI in China’s Mining Sector

It is believed by many foreign mining and service companies that the Chinese rules and regulations in the mining industry erected many barriers to FDI in the production stage of mining, e.g. the need to form joint ventures with a Chinese firm (CIMG, 2006). Consequently, most foreign mining companies that have opted to enter China were junior mining companies involved in the risky business of exploration rather than full production of proven deposits. Many of the international major mining companies (e.g. Barrick) have offices in China but few are involved in operating large projects (from my own fieldwork).

#### 6.3.1 The Regulatory Framework Governing the Mining Sector in China

To explain this important part and to show the relative ‘bargaining’ power of the Chinese state in relation to mining TNCs, this subsection examines in some detail the host country laws and regulations, as well as institutions relating to mining. It then examines how these have affected the operations of Canadian mining firms in China.

The Mineral Resources Law of the PRC is the principal mining law of the State. The Law was adopted in 1986, with subsequent regulations being promulgated in 1993 and 1994 (China Development Gateway, 2005a). This initial law did not provide any special provision for foreign investment in mineral resources and consequently international firms were unable to secure permits to either explore or carry out mining operations in the 1980s and early 1990s.

In order to encourage foreign exploration and exploitation mineral projects, as well as to meet its economic expansion needs, since the late 1990s, the Chinese government has made great efforts to upgrade its inadequate legislative framework governing the mining industry. The
most significant measures taken include the amendment to the Mining Law of 1986 (effective on January 1, 1997), and the promulgation of the Exploration Registration Regulations, Mining Registration Regulations and Transfer Registration Regulations (all effective on January 12, 1998) (China Development Gateway, 2005a).

This legislative progress has had multiple dimensions (Zheng, 1998). First, the same treatment is now accorded foreign investment enterprises as domestic enterprises, particularly regarding exploration rights, mining rights and the transfer of those rights. Second, the transfer of exploration rights and mining rights has been permitted since the late 1990s. As indicated, the Mining Law of 1986 prohibited transfer, leasing or mortgaging/charging of rights to mineral resources in China, and it was regarded as one of the major barriers to the healthy growth of investment in China’s mining sector. Third, the amendment of the Mining Law stipulated that the holder of an exploration license had a ‘legal priority’ to obtain a mining license for any deposits it found. By contrast, the Law of 1986 only gave a “preferential right” to exploration permit holders, and the 1986 law was silent about the precise nature and extent of the vaguely expressed right. By promising clear and reliable assurances to develop the mineral deposits discovered, the new policy regime appears to have attracted far more investment into the country’s mining sector.

The second significant effort taken by the central government in the late 1990s was to set up an integrated management system for mineral resources by combining the unified central management with classified local government managements at all levels after the 1998 government restructuring. Before that, approvals or licenses had to be obtained from one or more of the Ministry of Foreign Trade and Economic Cooperation, the State Planning Commission, the Ministry of Geology and Mineral Resources, the Ministry of Metallurgical Industries, the Gold Bureau, the State Bureau of Building Materials, and the State Administration of Industry and Commerce, or their counterparts at the provincial or local levels
of government. During the late 1990 restructuring, the functions of mineral resources management belonging to the State Planning Commission and all other related departments were transferred to the Ministry of Land and Resources (China Development Gateway, 2005b).

Third, in December 2000, the State Council issued the “Certain Opinions Concerning Further Encouragement of Foreign Investment in Exploration of Mineral Resources other than Oil and Gas” (the Certain Opinions hereafter). The new rules represented considerable progress over the prior regulatory regime applicable to foreign mining companies. Most significantly, the Certain Opinions eliminated the need to set up a joint venture with a Chinese party or any other separate entity in exploration of mineral resources other than oil and gas. A foreign company may now conduct mineral exploration on its own by obtaining an exploration permit in its own name, or under a cooperative arrangement with a Chinese party, with the latter holding the permit (McKenzie and Leung, 2001).

Other progress after China’s joining the WTO in 2001 included adopting national treatment of foreign mining enterprises, widening the public usage of geological information, establishing a public mineral resources information system, and streamlining the approval procedures for foreign exploration and mining rights applications.

6.3.2 Continuing Regulatory Difficulties for Canadian Mining Companies

Although the Chinese government has made great efforts to upgrade its restrictive legislative framework governing the mining industry in recent years, in reality, there have continued to be many barriers that impede FDI into Chinese mining sector. The China International Mining Group (CIMG), through its members, has discussed some of these issues

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23 The China International Mining Group (CIMG) is a forum for international mining and service companies plus individuals with interests in creating business opportunities in China’s mining industry. With 90 members covering base and other metals as well as a number of mining service companies, it is regarded as the largest industry-working group in China today. The CIMG is administered by AustCham Beijing and is supported by the Australian Embassy in Beijing, British Chamber of Commerce in Beijing, Canadian Embassy in Beijing.
and has highlighted the difficulties encountered in relation to conducting exploration and mining in China (CIMG, 2006).

(1) The auction of mining rights and bidding by international firms is the most favored model by the Chinese government, but it is a process that is not favored by most international mining companies for obtaining exploration titles.

(2) The current legal regime does not guarantee security of title to foreign investors, particularly through the project approval process.

(3) There is no transparent process for conducting the valuation of exploration/mining assets.

(4) There is an insufficient definition of the ‘Qualified Explorer’s status’.

(5) There is irregular application of the law between national and provincial departments.

(6) Access to geological information practically remains very difficult.

(7) The vague project approval process is a major concern by foreign investors.

(8) The complicated tax and royalty regime has an adverse effect on mining investment in China from foreign mining companies.

(9) The current corporate structures are ill-suited to mining operations.

The above issues raised by members of CIMG identified some difficulties caused by China’s mining regulations to foreign mining companies, including those from Canada. As the CEO of a Canadian gold mining company noted,

“When we just entered the China market (in 1994), the Chinese government asserted a highly restrictive policy towards foreign participation in (gold) exploration and mining. We were only allowed to cooperate with a Chinese partner in designated marginal gold deposits (i.e., low grade and difficult to mine deposits)…… The joint venture approval procedure was also very tedious and involved many central and local government departments……the other big problem is that we had to sell all gold to the People’s Bank of China for renminbi (local Chinese currency) at prices other than the international price of gold. This adds significant foreign exchange and commercial risks for our operations in China.” (Mining Company No.2)
More detailed discussion of these issues can be found in the 2006 White Paper prepared by CIMG (CIMG, 2006). These regulatory impediments demonstrate the weak development of the regulatory framework governing FDI as well as the tight control of foreign investment in China’s mining sector. These issues are deemed by CIMG members as important factors dampening levels of FDI in China’s mining sector (ibid.).

6.4 Daily Operation Difficulties for Canadian Mining Firms in China

Apart from national regulations, this section further addresses the ‘host market’ and ‘host state’ issues for Canadian mining industry. It draws attention to the importance of Chinese partners and the labor force in explaining the importance of Chinese host country factors on Canadian mining operators in China. The profile of the three Canadian mining companies I interviewed in 2005 is presented in Table 6.3. Two companies entered the China market in the mid-1990s when China started to relax its regulations on foreign investment in the mining sector, and the third is a more recent entrant.

**Table 6.3  Profile of Canadian Mining Companies, Interviewed in 2005**

<table>
<thead>
<tr>
<th>Company</th>
<th>Sector</th>
<th>Location</th>
<th>Date of Entry</th>
<th>Chinese Origins of CEO (Y/N)</th>
</tr>
</thead>
<tbody>
<tr>
<td>No.1</td>
<td>Onshore oil and gas industry</td>
<td>Heilongjiang, Hebei, Sichuan, Chongqing</td>
<td>1994</td>
<td>Yes</td>
</tr>
<tr>
<td>No.2</td>
<td>Gold mining</td>
<td>Hebei, Sichuan, Xinjiang, Guansu, Inner Mongolia</td>
<td>1994</td>
<td>No</td>
</tr>
<tr>
<td>No.3</td>
<td>Gold and copper mining</td>
<td>Yunnan</td>
<td>2004</td>
<td>No</td>
</tr>
</tbody>
</table>

How have Canadian mining firms organized their day-to-day operations in the particular host country environment in the PRC? From interviews with these Canadian mining companies, it appears that even after Canadian investors decided to move to China and establish joint ventures, after overcoming all initial regulatory difficulties such as detected in Section 6.2, their operations may not go smoothly. Here are some examples of the difficulties they encountered in
their daily operations, based on my fieldwork.

6.4.1 Problems with Chinese Partners

The Canadian firms reported in interviews that although the newly revised law allowed WFOEs to obtain exploration and mining licenses, the common practice in the industry remained that foreign companies partnered with Chinese local SOEs - usually the corporate arm of the local government Land and Resources Department. For example, Southwestern Resources Corp., a Canadian gold mining company, entered a cooperative joint-venture with the Southwestern Geological Inspection Team No. 209 in 2002 to explore the Boka Gold Ores in Yunnan province. The Chinese partner, the Southwestern Geological Inspection Team No. 209, claimed its 40% share of this joint-venture with the exploration and exploitation rights of the gold mine, while the Southwestern Resources Corp. claimed 60% share with the US$3.1 million cash, which was also the registered capital of the joint venture (Qiu, 2008).

The over-riding problem with joint venture and relationship with Chinese partners revolved around opposing management objectives and business culture. Thus, contrary to their foreign partners who were usually profit-driven, the local Chinese SOEs appeared to care more about local political factors, such as keeping or increasing employment. As a result, the advanced technology brought into China by foreign firms is often abandoned, because it will often reduce jobs ‘on the field’. One general manager of a Canadian mining company stated, “So in China sometimes you have to think how to make things inefficient in order to work with your Chinese partner and get things done. It is totally opposite to western way of doing business” (Mining Company No.2).

As part of the cooperation package, foreign firms usually promise to train staff of the SOEs. In the case of Canadian mining firms, they often cooperated by sending trainees to Canada in order to take technical courses and attend professional seminars. However, as one mining firm
complained: “Chinese officials were often more interested in going to Nigara Falls and sightseeing rather than learning at formal courses. They do not need to obtain extra skills to be promoted back in China. Corruption is another big issue in this industry. Again, it is related to the monopoly status of their Chinese partners” (Mining Company No.3).

6.4.2 Difficulties in Managing Chinese Workers

The Canadian firms also reported many difficulties in managing their key Chinese staff, such as local mining engineers. Paradoxically, the lack of engineering talent does not appear to be an issue that hinders growth in the Chinese domestic mining industry. There appears to be an ample supply of qualified, skilled technicians in the local market. However, many engineers have apparently moved from the state sector to foreign owned enterprises, either because they are not satisfied with the state system employment or because they can obtain higher compensation in foreign firms. However, changing the mindset of a Chinese local labor force that has been trained in a SOE and the switch has been made to a profit-driven foreign firm has turned out to often be a very hard and slow process. For foreign mining firms who come from western market economic system and have to be responsible for their shareholders, making profit is not unexpectedly their ultimate goal. Canadian firms therefore usually negotiate very hard to obtain each possible barrel of oil or other minerals from China and elsewhere as soon as possible, as it is very costly to maintain the daily operation of any exploration or operational mining field. However, to the Canadian firms’ disappointment, their Chinese engineers often do not work as hard and efficiently as they initially expected. As the president of a Canadian oil company commented, “For the Chinese, if the oil is not out today, or tomorrow, no problem, because their children and their grandchildren can get it. We can not be here forever. We have to make money now. So our staff has to change their mindset. And I admit it is a very hard and slow process." (Mining Company No.1)
A common complaint of foreign firms is that Chinese workers lack of initiative and tend to avoid responsibility, and it is no exception in the mining sector. When a significant event occurred and impacted on business operations, as one of my informants noted (Mining Company No.3), “they (Chinese workers) just reported it and wait for instructions. Consequently, Chinese engineering employees require a great deal of supervision, and this is an extra impediment when running a mining business in China”. Some executives reported that the managerial work required to effectively supervise the Chinese workforce was four to five times more than in western countries (Mining Company No.1, and No.3).

6.4.3 Problems with Local Communities

Although foreign firms pay tax, royalties, and all other fees to local government in order to acquire land for exploration or mining, the local farmers whose land has been occupied by mining companies obtain little, if anything, from the mining investment. In many cases, local farmers and local communities have become infuriated with foreign firms, who, in their eyes, have used their land to make money. Consequently, the situation of poor relations with local communities often makes foreign mining firms’ life very difficult ‘on the ground’. Also, to smooth the relationship with local communities, foreign companies usually hire farmers from the nearest villages to do simple jobs, such as cooking and cleaning. Mining companies inevitably have to hire local villagers for their operations (e.g. for cooking and cleaning) and so must think all kinds of innovative ways to make sure that the local community benefit directly from their investments. For example, when one Canadian mining firm distributed a bonus to the local village-based companies that worked for them, then these local companies were required to bring a sheet with every worker’ signature showing they were indeed distributing the bonus, rather than pocketing these funds themselves (Mining Company No.1). By this way, the Canadian company could make sure that every laborer obtained a benefit, which of course could
increase their incentive to work more efficiently. Moreover, once the mining project is complete and when a new project site is chosen, the mining companies have to fire local village workers hired for cooking and cleaning and hire instead the farmers from a new location. This adds additional managerial burdens to the exploration and mining firms (interview with Mining Company No.3).

6.5 A Success Story

Given such difficulties of daily operation and the numerous barriers set by the mining regulations, have there been any success stories from Canadian mining companies? The answer is of course yes. Although there is no comprehensive data base of corporate entry and exit in this sector, many mining companies come and go in China - but some stay and succeed. The success story related here is a small and medium-sized oil and gas company based in Canada (Mining Company No.1). As shown above, this company had its share of challenges faced by many Canadian mining firms in China. The company entered the onshore oil and gas industry in China in 1994, and now it owns about ten oil and gas projects in several provinces and municipalities, including Heilongjiang, Hebei, Sichuan and Chongqing. The company claimed to be the only Canadian company operating in China’s onshore oil and gas industry. Some global oil and gas ‘giants’ invested here, but they departed from China in the late 1990s, including a well-known Canadian oil and gas firm, Husky (from my interview with Mining Company No.1). Why can this Canadian SME survive and profit in this industry?

“Because we are small enough” (interview with President of the Mining Company No.1). This comment seems to be related to the fact that small firms can be more flexible and efficient in management, which is particularly important in managing the exploration and mining activities on the mining fields, as discussed above. “Being small is very important in this
industry. There are so many problems in each level of operation. For a large company, local working firms may need to report to 6 or 7 people before it reaches the general manager in Canada. The whole process makes big companies crazy. It is just unfeasible for them to operate in such a circumstance. When something happens on the field, it can easily reach me and I can respond very quickly. This is our advantage” (ibid).

In their success, another decisive factor concerns Chinese mining investment regulations. Onshore oil blocks are demarcated by the government, and those opened to foreign investors are usually small and dispersed. It is therefore often uneconomic for large foreign firms to work on such small-scale oil blocks.

According to the Regulations of the People’s Republic of China on Sino-foreign Cooperation in the Exploitation of Onshore Petroleum Resources promulgated in 1993 and amended in 2001, any foreign investors who wish to participate in the onshore oil and gas exploration or exploitation have to cooperate with either the China National Petroleum Corporation (CNPC) or the China Petrochemical Corporation (Sinopec), the two national monopolies of the industry in China. Unlike the ‘offshore’ oil industry, which was opened to FDI in 1982, the ‘onshore’ oil industry in China did not accept any foreign investment until 1993 when China became a net oil importer and the Regulations mentioned above was promulgated. Indeed, the onshore oil industry has consequently been highly concentrated and monopolized. Even in 2005, besides the two giant SOEs (CNPC and Sinopec), other domestic investors, state-owned or private, were not allowed to enter the industry. The industry is only opened to those foreign investors that can bring in capital and technology the local Chinese industry severely lacks.

When the government decided to open the industry to FDI in the early 1990s, both CNPC and Sinopec kept the high grade and easy-mined oil blocks for themselves, and left those dispersed and less profitable oil blocks for foreign explorers. This practice has upset many large
oil multinationals that flocked into the market when China just relaxed the investment restrictions in the 1990s. Accordingly, in 2005 when I conducted my interviews, most of the foreign companies that were active in this industry provided technological services to local oil companies, instead of actually engaging in the oil mining industry. Mining Company No.1 was one of the few successors in this highly regulated industry.

This case study provides an interesting counter-example to the orthodox bargaining theory of transnational corporations, which often implicitly assumes the supremacy of large TNCs in penetrating foreign markets over the smaller ones due to various factors such as capital, technology, human resources, and international experience (Hymer, 1976). However, in such a highly controlled and monopolized industry as the on-shore oil industry in China, TNCs, especially those large ones, have experienced a hard time in surviving and making profits. The case study therefore indicates that large TNCs are not as powerful and freely in doing business around the world as conventional theory enlightens. For TNCs in certain industries, small means powerful in surviving and thriving in a foreign environment. In this particular case small-scale and determined Canadian company was able to sustain successful operations in a small on-shore oil-block for over a decade.

6.6 Summary

This chapter has focused on activities of Canadian companies in the mining sector of China. Canada has long held a dominant role in world’s natural resources industry both in terms of exploration activity and as a source of funds for this exploration activity. This is an important ‘home country’ advantage for Canada and so it is not surprising that Canadian companies have been among the leaders in exploring Chinese mining potential since the early 1990s. Conversely, natural resources in China are regarded as part of a national strategy and thus the mining industry has been highly regulated, especially when it comes to the issue of inviting FDI.
Despite the recent progress in relaxing the foreign investment regulations, foreign mining firms generally have encountered numerous difficulties both from the regulatory regimes and the daily operations in the field. It is not surprising that Canadian mining firms in the survey also complained of these regulations. Canadian companies have been geographically dispersed in China’s provinces according to the distribution of natural resources such as gold.

In sum, the mining sector is one of the most heavily regulated sectors in China. Investment and operations in this industry is far from free market condition. Thus, among the host country factors, as identified in the analytical framework of Figure 2.2, Chinese state, especially FDI laws, regulations and institutions, has posed great challenges to Canadian mining firms in China. The Chinese market factors, namely customers, suppliers, partners and market information, have had limited impact on the operation of these firms. On the other hand, the survey of Canadian firms found that smaller mining firms were more successful in China than the larger multinationals. An example was given of a small-scale successful Canadian mining company in the on-shore oil industry. Thus, the small-scale of Canadian mining firms in this particular case does not present challenges for their operation in China as suggested by Dunning’s ownership-advantage model.

To make a comparison with mining, in the next chapter I will look at the manufacturing sector. Here, the Chinese government has encouraged FDI since the implementation of the Reform and Opening-up policy in 1978, and thus can be regarded as the most liberal sector in terms of inviting foreign participation.
7 Canadian Investment in the Manufacturing Sector

As noted in Chapter 3, the original intent of the Chinese government when implementing its reform and opening-up policies in 1978 was to absorb the superior technologies and advanced management skills of western firms by attracting them into manufacturing industries. To meet this end, a series of preferential policies were issued following the beginning of the reform era in the early 1980s.

Although the manufacturing sector plays less of a role in the Canadian domestic economy, Canadian companies have made disproportionately larger investment in China’s manufacturing sector than their domestic Canadian presence might anticipate, especially before China’s entry into the WTO (see Chapter 5). A database obtained from the Ministry of Commerce of China showed that from 1984 to 1996, 66% of Canadian-invested enterprises in China were engaged in the manufacturing sector. By comparison, firms in manufacturing accounted for less than 30% of total enterprises in Canada (Wesson, 2001). This is an interesting phenomenon because as argued earlier in this thesis, Canadian manufacturing companies as a whole do not have any special relative advantages in either global or domestic markets, yet as a group they have made significant investments in China. In part this is because Canadian manufacturing firms, many of which are actually subsidiaries of American multinationals, own specific technological and marketing advantages over Chinese domestic companies (e.g. production technologies, environmental technologies, and familiarity with the US market). But perhaps more importantly, the relative importance of Canadian investment in manufacturing in China, rather than say in the service sector, can be attributed to the policy guidance and encouragement of the Chinese government.

This chapter illustrates the general theme of the thesis and the focuses on home country and host country factors by examining the experiences of Canadian manufacturing firms in China.
The organization of this chapter is as follows. Section 1 reports on the characteristics of the manufacturing sector in Canada, and compares this against the profile of Canadian manufacturing companies in China. Section 2 discusses the regulatory regime in China governing FDI in the manufacturing sector, and examines how various regulations and policies affect the behavior of foreign firms. Section 3 investigates the difficulties of daily operations of Canadian manufacturing firms in China. Section 4 provides a more in-depth success story of a Canadian small and medium-sized manufacturing enterprise in the suburb of Beijing, and illustrates the relative balance of home and host country factors in shaping investment outcomes.

7.1 Canadian Manufacturing Companies in China

This section first discusses the characteristics of the manufacturing sector in Canada, which sets a background of understanding Canadian firms in China. Then the profile of Canadian manufacturing firms is explored, including their date of establishment, firm size, industry type, and geographical distribution.

7.1.1 Characteristics of the Canadian Manufacturing Sector

As indicated in Chapter 4, Canada became industrialized during the turn of the 20th century. However, the manufacturing sector is no longer the backbone of the country’s economy today. In 2005, the goods-producing industries accounted for 33 per cent of national economy, while the services sector was much larger, employing three out of four Canadians and generating two-thirds of the gross domestic product (GDP) (Statistics Canada, 2005). Canada is also often described as having an ‘open’ economy, as it relies heavily on trade with foreign countries, especially the United States, and on capital flows to finance its industries. Indeed, more than half of all assets in the manufacturing sector in Canada are controlled by foreign multinationals, and this ratio has remained relatively stable over the last 25 years (Lileeva, 2006). The majority
of Canadian manufacturing output is produced by affiliates of United States multinationals, who
together accounted for over 80% of output produced by foreign-controlled firms in Canada.
Foreign-controlled producers have a significant presence in almost all of the manufacturing
industries. Indeed, all of the 22 manufacturing industries at the SIC 2-digit level of aggregation
have at least 10% of their output produced by foreign-controlled firms, and 8 industries have
over 50% of their output produced by foreign-controlled firms, e.g. the ‘transportation
equipment’ sector, (e.g. automobile assembly plants), ‘refined petroleum and coal products’,
‘chemical and chemical products’, and the ‘food’ sector (ibid.).

As discussed in Chapter 4, there are three broad-scale types of private corporations in
Canada: Canadian subsidiaries of foreign TNCs, large domestic conglomerates, and indigenous
small and medium sized enterprises (SMEs). Foreign ownership is relatively higher in
secondary manufacturing industries (generally high-technology activities such as auto industry
and equipment manufacturing industry) than in services and the primary manufacturing
industries geared to processing natural resources (Britton and Gilmour, 1978: 59).

The degree of foreign ownership in Canada is also correlated with research and
development activity, i.e. foreign controlled firms such as GM Canada tend to invest more in
R&D than local firms. Indeed, Baldwin and Hanel (2000) report that far from being passively
dependent on R&D from their parents, foreign-owned firms in Canada are more active in local
R&D than the population of Canadian-owned firms. They are also more often involved in R&D
collaboration projects, both abroad and in Canada, as they enjoy the advantage of accessing
technology from their parent and affiliated companies.

Large domestically-owned Canadian firms are often conglomerates that hold oligopolistic
status in the primary resources processing industries, such as wood products/furniture, pulp and
paper products and non-ferrous metals, and transport equipment, e.g. Canfor and Bombardier
(Britton and Gilmour, 1978:52-55). Moreover, Canadian-owned firms in these industries have
been purposely protected from competition by the government to a large extent and have been often immensely profitable. Once established, many Canadian firms have been able to grow to dominate their particular market using mostly internally generated funds. The remaining private corporations, smaller in size but the largest in terms of total numbers of firms, have been mostly ‘niche’ producers, usually with a single small-scale plant. These indigenous firms are usually operated locally and family-initiated and family–owned. If they ever venture abroad, then the adjacent states of the United States, such as the New York and Ohio State, are the most preferred locations for the overseas investments of these SMEs as noted earlier in the thesis (MacPherson and McConnell, 1992; O’Hagan and Anderson, 2000).

7.1.2 Profile of Canadian Manufacturing Companies in China

It proved very difficult to obtain a complete and updated database when trying to analyze the array of Canadian manufacturing companies established in China. The analysis of Canadian manufacturing companies in China is based mainly on two sets of data: the Asian Pacific Foundation of Canada (APFC) dataset and the dataset obtained from the Ministry of Commerce of China. These two datasets were used in Chapter 5. The former database includes a list of firms registered in Canada and having invested in China by 2005. The companies in this list were actually the “mother company” of Canadian-invested subsidiaries in China and one should be aware that these ‘mother companies’ usually invested in different projects (joint-ventures or WFOEs) in different geographical locations in China. Thus the number of Canadian firms in this data set would appear much less than those data sets that comprise Canadian-invested firms (specific firms established by Canadian ‘mother companies’). The latter dataset includes all projects in mainland China that had investments by Canadian companies or citizens from 1984 to 1996. This dataset, though not current, is still very relevant to my study of Canadian manufacturing companies in China. This is because the manufacturing sector was the sector that
was first opened to foreign investors, and the sector that was strongly encouraged by Chinese governments in order to attract FDI, especially during the 1980s and the first part of 1990s. In this dataset, there were a total of 1,270 Canadian-funded enterprises in China before 1996, and 840 or 66% of them were in manufacturing industries.

7.1.2.1 Date of Establishment

An analysis of Canadian manufacturing companies by date of establishment is shown in Table 7.1.

Table 7.1  Canadian Manufacturing Firms in China by Year of Establishment

<table>
<thead>
<tr>
<th>Year</th>
<th>Number</th>
<th>Registered Capital (US$ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1984</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>1985</td>
<td>1</td>
<td>6.5</td>
</tr>
<tr>
<td>1986</td>
<td>3</td>
<td>10.3</td>
</tr>
<tr>
<td>1987</td>
<td>1</td>
<td>1.7</td>
</tr>
<tr>
<td>1988</td>
<td>3</td>
<td>1.2</td>
</tr>
<tr>
<td>1989</td>
<td>4</td>
<td>8</td>
</tr>
<tr>
<td>1990</td>
<td>4</td>
<td>1.8</td>
</tr>
<tr>
<td>1991</td>
<td>8</td>
<td>18.6</td>
</tr>
<tr>
<td>1992</td>
<td>41</td>
<td>122</td>
</tr>
<tr>
<td>1993</td>
<td>69</td>
<td>159</td>
</tr>
<tr>
<td>1994</td>
<td>57</td>
<td>306</td>
</tr>
<tr>
<td>1995</td>
<td>71</td>
<td>122</td>
</tr>
<tr>
<td>1996</td>
<td>50</td>
<td>77</td>
</tr>
<tr>
<td>1997</td>
<td>63</td>
<td>115</td>
</tr>
<tr>
<td>1998</td>
<td>59</td>
<td>82</td>
</tr>
<tr>
<td>1999</td>
<td>73</td>
<td>106</td>
</tr>
<tr>
<td>2000</td>
<td>113</td>
<td>175</td>
</tr>
<tr>
<td>2001</td>
<td>182</td>
<td>272</td>
</tr>
<tr>
<td>2002</td>
<td>215</td>
<td>435</td>
</tr>
<tr>
<td>2003</td>
<td>324</td>
<td>851</td>
</tr>
<tr>
<td>2004</td>
<td>374</td>
<td>1049</td>
</tr>
<tr>
<td>2005</td>
<td>367</td>
<td>1185</td>
</tr>
<tr>
<td>Total</td>
<td>2083</td>
<td>5105.1</td>
</tr>
</tbody>
</table>

Source: Data were obtained from the Invest in China Website operated by Investment Promotion Agency of MOFCOM (2007)
Canadian manufacturing firms first started to enter into China in 1984 (see Table 7.1). However, the scale was very small until 1992, when the number of Canadian-invested manufacturing firms rose sharply to 41 from 8 in 1991. Since then, the years from 1992 to 1999 saw a steady growth of Canadian-invested manufacturing projects in China (see Figure 7.1). The year of 2000 witnessed a sharp jump of project numbers, reaching 113 in 2000 from 73 in 1999. Since 2000, both the number and registered capital amount of Canadian manufacturing firms established in China have accelerated, with an annual growth rate of about 45%.

**Figure 7.1 Canadian Manufacturing Companies in China: Number and Registered Capital 1984-2005**

![Graph showing the growth of Canadian manufacturing companies in China from 1984 to 2005.](image)

Source: Based on data in Table 7.1.

Indeed, the companies established from 2000 to 2005 accounted for 76% of the total number of Canadian manufacturing firms established in China since 1984. The same ratio during the same period for registered capital invested by Canadian manufacturing firms was 78%. This suggests that since the turn of this century, Canadian manufacturing companies have increased the pace of moving manufacturing facilities out of Canada and towards low-labor-cost locations, such as China, in order to maintain their market competitiveness in today’s global market. The sharp increase of Canadian manufacturing FDI in China after 2000 may also be related to China’s entry into the WTO in 2001 and the rapid expansion in the Chinese market.
during this period.

7.1.2.2 SMEs vs. Large Firms

I now turn to comment on the difference between large and small firms from Canada that have invested in China. According to the APFC data, as of September 2005, there were 332 Canadian firms that had made a direct investment in China, 68 or 20% of which were engaged in manufacturing industries.

While there is no standard definition of SMEs, many industrialized countries define these as a manufacturing enterprise employing fewer than 500 employees, or a service company with less than 50 employees (UNCTAD, 1993). Some studies have used annual sales or revenue to categorize firms. For example, in one study conducted by Industry Canada, firms with annual sales of less than US$100 million are defined as SMEs, while large firms with sales between US$10 and US$500 million, and very large firms with sales over US$500 million (Rao and Ahmad, 1996).

To identify the number of SMEs among these 332 companies, I used a criterion of annual revenue of $50 million, the revenue threshold used by The Blue Book of Canadian Business 2005 to list the largest companies operated in Canada. In this book, only those companies, both holding and operating firms, with annual revenue of $50 million or more are listed. By examining the Blue Book, I calculated that two thirds, or 223, of 332 Canadian firms that had made investment in China were actually SMEs. Similarly, among the 68 Canadian manufacturing companies investing in China, 43, or 63% of them were classified as SMEs. The MOC dataset also revealed that 77% of all Canadian-invested companies in China before the mid-1990s had employed less than 100 people. Only 20 companies, or 2% of the total 840 Canadian-invested manufacturing firms in China, had over 500 employees in China.

While the number of two thirds may not seem very impressive compared with the SMEs’
dominant position (over 98%) in all Canadian business enterprises, it is indeed very significant
given the fact that compared with their larger counterparts, SMEs tend to stay at home in
Canada serving the domestic market, or if they need to expand, they tend to invest first in
neighboring countries, mainly the USA. In illustrating this point, a database of Industry Canada
in 1996 shows that 56 percent of all Canadian firms conducting business in the Asia Pacific
region and other foreign markets are SMEs, while the same figure for U.S. firms is only 12
percent (Rao and Ahmad, 1996: 410). Clearly, these analyses point to SMEs as being a Canadian
characteristic in overseas investments. Some well-known large-scale Canadian companies
investing in China, such as Bombardier and Northern Telecom (not included in my set of
interviews), appear to be the exception to this phenomenon and they cannot represent the
majority of Canadian firms in China.

7.1.2.3 Industry Type

Another relevant finding from the MOC dataset is that over 70% of Canadian-funded
enterprises were involved in relatively mature and low-technology manufacturing industries,
such as food manufacturing, beverage and tobacco, textiles, clothing, leather, and chemical
manufacturing industries (see Table 7.2). These are industries in Canada that have relatively low
levels of foreign ownership, use standard technology, and have establishment sizes one-third or
two-thirds of the US level (Britton and Gilmour, 1978). Only about 200 enterprises out of 840
Canadian-invested manufacturing firms in China were engaged in relatively high-tech activities,
such as machinery, computer and electronic product, electrical equipment, appliances and
components, and transportation equipment manufacturing (Table 7.2). By contrast, these are
industries that usually have high foreign ownership in Canada, and so the decision to invest
abroad (including when and where) was often made by headquarters outside of Canada. This is
an important reason why so few Canadian firms in manufacturing have invested in China.
Table 7.2  Industry Types of Canadian Manufacturing Firms in China (1984-1996)

<table>
<thead>
<tr>
<th>NAICS code</th>
<th>Industry type24</th>
<th>Number of companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>311</td>
<td>Food manufacturing</td>
<td>76</td>
</tr>
<tr>
<td>312</td>
<td>Beverage and Tobacco Product Manufacturing</td>
<td>31</td>
</tr>
<tr>
<td>313</td>
<td>Textile Mills</td>
<td>28</td>
</tr>
<tr>
<td>314</td>
<td>Textile Product Mills</td>
<td>19</td>
</tr>
<tr>
<td>315</td>
<td>Clothing Manufacturing</td>
<td>95</td>
</tr>
<tr>
<td>316</td>
<td>Leather and Allied Product Manufacturing</td>
<td>24</td>
</tr>
<tr>
<td>321</td>
<td>Wood Product Manufacturing</td>
<td>25</td>
</tr>
<tr>
<td>322</td>
<td>Paper Manufacturing</td>
<td>16</td>
</tr>
<tr>
<td>323</td>
<td>Printing and Related Support Activities</td>
<td>11</td>
</tr>
<tr>
<td>324</td>
<td>Petroleum and Coal Products Manufacturing</td>
<td>6</td>
</tr>
<tr>
<td>325</td>
<td>Chemical Manufacturing</td>
<td>97</td>
</tr>
<tr>
<td>326</td>
<td>Plastics and Rubber Products Manufacturing</td>
<td>33</td>
</tr>
<tr>
<td>327</td>
<td>Non-Metallic Mineral Product Manufacturing</td>
<td>60</td>
</tr>
<tr>
<td>331</td>
<td>Primary Metal Manufacturing</td>
<td>22</td>
</tr>
<tr>
<td>332</td>
<td>Fabricated Metal Product Manufacturing</td>
<td>55</td>
</tr>
<tr>
<td>333</td>
<td>Machinery Manufacturing</td>
<td>65</td>
</tr>
<tr>
<td>334</td>
<td>Computer and Electronic Product Manufacturing</td>
<td>64</td>
</tr>
<tr>
<td>335</td>
<td>Electrical Equipment, Appliance and Component Manufacturing</td>
<td>39</td>
</tr>
<tr>
<td>336</td>
<td>Transportation Equipment Manufacturing</td>
<td>26</td>
</tr>
<tr>
<td>337</td>
<td>Furniture and Related Product Manufacturing</td>
<td>4</td>
</tr>
<tr>
<td>339</td>
<td>Miscellaneous Manufacturing</td>
<td>44</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>840</td>
</tr>
</tbody>
</table>

Source: MOFCOM (2005)

However, it should be noted that the MOC data were only as updated as 1996. While more recent data were not available, it could be expected that more and more Canadian manufacturing firms would engage in high-technology activities, considering the various reforms and legal and administrative progress of the Chinese government, as well as the confidence of foreign firms towards the Chinese market. Indeed, the APFC data base used in Chapter 5 indicated that 29%

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24 The industry type was classified according to the North American Industry Classification System (NAICS) 2002 – Canada.
of all firms were in high technology sectors compared with 19% in general manufacturing. Among the six Canadian manufacturing companies I interviewed in China, four were involved in high-tech industries, including information technology (Manufacturing Company No.6), bio-technology (Manufacturing Company No.3), telecommunications (Manufacturing Company No.4), and transportation (Manufacturing Company 5). The other two firms were engaged in resource processing (Manufacturing Company No.2) and food processing equipment manufacturing (Manufacturing Company No.1) respectively.

**7.1.2.4 Geographical Distribution**

As I mention above, Canadian firms, especially large ones, often tend to invest in more than one location of China. For example, Magna International Inc., a global supplier of technologically advanced automotive systems and components and complete modules, maintained six manufacturing facilities in China in 2005 (from the APFC data set). The APFC data show that Hong Kong is the most favored location reported for Canadian manufacturing companies; 23, or about one third of the total 68 Canadian firms investing in China chose Hong Kong as their destination (but no necessarily for the factory operation). For cautious investors, such as Canadian companies, Hong Kong\(^{25}\), with its highly open and advanced business operation system, is an ideal bridgehead and subsequent springboard to mainland China. Their factories may be located in the neighboring Pearl River Delta of Guangdong province (see Lin, 1997). Both the Canadian business community and the Canadian government are well aware of this geographic preference. The only Canadian Chamber of Commerce in China is located in Hong Kong.

Within the mainland, coastal provinces in the lower Yangtz River Delta region including

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\(^{25}\) Hong Kong here is regarded as part of host country of China. In fact, it is only in China’s FDI statistics that Hong Kong is regarded as a home country investor of FDI to China.
Jiangsu, Zhejiang, and Shanghai, have been the most popular location among Canadian manufacturing investors, attracting 34 of the total 68 Canadian companies. Other important destinations include Beijing and Guangdong, attracting respectively 14 and 11 Canadian manufacturing firms.

Similar patterns are shown in the MOC data, which reveals that the lower Yangtz River Delta hosted 40% of Canadian-funded factories, Beijing, Tianjin and Hebei 21%, and Guangdong 8% (see Figure 7.2). Indeed, the Yangtz River Delta (close to Shanghai), Beijing-Tianjin-Hebei economic belt, and the Pearl River Delta in Guangdong are the three most important manufacturing bases in modern China, especially since the implementation of the reform and open-up policy. The Pearl River Delta was the earliest test sites for FDI, and many FDI from Hong Kong, Taiwan and other Asian countries flooded into this region during the early stage of the reform era in the 1980s. Since the early 1990s, however, the Yangtz River Delta, and later the Beijing and surrounding area, caught up, and became the most important destinations for FDI, especially those large TNCs from Europe and North America, including Canada. As noted in Chapter 4, this pattern also suggests that physical infrastructure has played an important part in affecting the geographical distribution of Canadian manufacturing FDI in China (and related to the ‘infrastructure’ box shown in Figure 2.2, page 40).
Following on from the above analysis, my research fieldwork on Canadian manufacturing firms in China focused on Beijing, Shanghai and Jiangsu. Six Canadian-funded manufacturing plants were visited and asked questions relating to their operation (see Appendix 1). The CEOs reported a number of difficulties and challenges in their daily operations reported in later section. Before sharing the major findings, I would like to first discuss the regulatory framework on Chinese manufacturing sector in the next section. As with the mining sector discussed in Chapter 6, the regulations and policies relating to manufacturing FDI have had an important impact on the daily operation of Canadian companies.
7.2 Regulatory Framework for Manufacturing FDI in China

The chapter now turns to examine the influence of Chinese regulations on Canadian investors in the manufacturing sector. As mentioned previously, the manufacturing sector has attracted the majority of global FDI flowing into China since the implementation of the ‘Reform and Opening-up’ policy in the late 1970s. Its share among the total FDI stock in China has kept over 60 per cent. For example, by the end of 2005, the contracted FDI stock in the second sector, which is dominated by manufacturing, reached 883 billion US dollars, accounting for almost 70% of the total contracted FDI stock (Ministry of Commerce, 2006). According to Chinese official data, by the end of 2005, there were a total of 179,949 FIEs (foreign invested enterprises) in manufacturing with a total investment of 896 billion US dollars.

Total FDI into China also shows a high concentration pattern within the manufacturing sector. For example, in 2001, 81.26% of FDI industrial added value was concentrated in just 16 industries within the total manufacturing sector of over 40 industries, among which the electronic and communication equipment manufacturing industry created the most added value, accounting for nearly 20% (Wang, L.L., ed., 2004:111).

The past and future trend of manufacturing FDI in China has been shaped largely in part by the regulatory framework governing incoming FDI, which I found demonstrates the following features.

7.2.1 Gradual Relaxation of Regulations

The Open Door policy, which mainly focused on attracting FDI in manufacturing, has been implemented gradually and regionally, from only four Special Economic Zones (SEZs) at the beginning to the whole nation in 1992. The chronicle of the unfolding of the regional policies to FDI can be found in Table 3.1 in Chapter 3.
The economic benefits and privileges brought by the implementation of open policies to the local governments and officials in eastern coastal region greatly boosted the local enthusiasm to embrace the open policies, and motivated officials in other jurisdictions that were not blessed with special policies to spontaneously ask for the special policies, including those in inland regions who originally opposed the policies. However, under the pressure of an increasing east-west gap in economic development, since 1992 the application of preferential policies has shifted from specific regional priorities to broader national policies and also local industrial policies. Foreign investment has since then been allowed to take place in any part of China. However, the gap due to the ‘lost decade’ for the western regions of China did not disappear, even with the relaxation of the regional restrictions of FDI (Coughlin and Segev, 2000).

7.2.2 Expansion of Investment Vehicles since 2001

This sub-section comments on the particular Chinese host country factors in the box of Figure 2.4 as ‘Chinese partners’.

There are three major forms for FDI entry into China: an equity joint venture (EJV), a contractual joint venture (CJV), and a wholly foreign owned enterprise (WFOE) (which are also generally called foreign invested enterprises (FIEs)). China’s approach and management of FIEs have evolved from restrictions and controls to more liberalized and internationalized approach. The chronicle of the relaxation of FDI vehicles is summarized in Table 7.3.
Table 7.3  Chronicle of the Relaxation of FDI Vehicles in China

<table>
<thead>
<tr>
<th>Time</th>
<th>Law and Regulations</th>
<th>Effects</th>
</tr>
</thead>
<tbody>
<tr>
<td>1979</td>
<td>EJV Law</td>
<td>Rather general, and more like a series of political declarations of the legal status of FDI on Chinese territory</td>
</tr>
<tr>
<td>1980</td>
<td>Regulations on the four SEZs</td>
<td>WFOEs were only allowed within boundaries of SEZs</td>
</tr>
<tr>
<td>1983</td>
<td>Implementing Regulations of the EJV Law</td>
<td>A more detailed and workable regulations on the implementation of the EJV Law</td>
</tr>
<tr>
<td>1986</td>
<td>WFOE Law</td>
<td>Provides legal permission for the operation of WFOEs on a nationwide scale. Accelerating the introduction of new and high technologies through local production by foreign enterprises, as WFOE can more effectively protect their own technologies.</td>
</tr>
<tr>
<td>1988</td>
<td>CJV Law</td>
<td>the most flexible form of FDI: no minimum foreign contribution required; contribution and profit sharing are decided through negotiation and expressed on contracts, rather than in monetary value.; no provisions for the term of duration, and so on.</td>
</tr>
<tr>
<td>1990</td>
<td>Amendments to EJV Law; Implementing Rules for WFOE Law</td>
<td>The Amendments loosened the control on the management and structure of EJV by abolition of the stipulation that the chairman of the board of a JV should be appointed by Chinese investors, and by the provision of protection from nationalization.</td>
</tr>
</tbody>
</table>

Source: based on material in Chen (1997a).

Statistics of FIEs in China show that during the period of the 1980s and the early 1990s, most foreign firms chose joint ventures for their investments. Yet, the period since the mid-1990s witnessed an apparent trend towards ‘sole-foreign-ownership’ (WFOE), because by using this form of investment, foreign investors can take the total control of their enterprises. The year of 1998 was the first time that the contractual investment contributed by WFOEs (41.8%) exceeded that by JVs (33.2%). In 2004, the share of the contractual investment in the form of WFOE reached 76.4%, exceeding the total of that by EJVs and CJVs and becoming the most popular form of investment vehicle for foreign companies. Indeed, many manufacturing companies who entered China via joint-venturing with a Chinese company in the 1980s or early 1990s chose to buy out the Chinese shares and became a WFOE.
As with the Canadian mining sector companies, some of the Canadian manufacturing companies I visited encountered problems cooperating with their Chinese partners. One typical aspect of contradicting ways of doing business is that western manufacturers have generally been more market-driven with their technology and products, while in China engineers have been more technology-driven. Consequently, foreign companies have often preferred running business on their own without a Chinese partner in order to avoid the difficulties involved when arguing with their Chinese partners over market strategy and management style.

Since China entered the WTO in 2001, new forms of investment vehicles became popular – especially mergers and acquisitions (M&A). Indeed this is now the most popular form of global FDI, and has been available since 2004 for foreign firms who wished to invest in China, especially in China’s state-owned enterprises (SOEs) (OECD, 2005: 454). The enactment of the Interim Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors in 2003, and its subsequent amendments in 2006, enabled foreign firms to invest through acquiring shares or assets of domestic corporations, instead of green field investment. More and more firms, especially large TNCs, chose M&A arrangements to enter the China market. However, foreign M&A is still in its early stage in China despite its increasing popularity by foreign TNCs. The legal framework needs to be perfected and concerns about foreign monopolization of some industries in China have been raised.

It is important to note that some industries, which are not competitive enough when compared with foreign companies (e.g. the auto industry), or which are deemed strategic by the government (such as electricity), are only allowed the form of joint ventures with foreign shares at less than 50% (Mattoo, 2003).
7.2.3 A More Level Ground for Foreign and Domestic Firms

As the previous commentary illustrated, generally speaking, China has been more and more open to foreign investors in terms of both geography and levels of foreign ownership. However it is not the case in terms of preferential policy for FIEs as opposed to domestic Chinese firms in the 1980s. It is well known that the Chinese government offered various incentives to FDI, including tax reduction, import tax exemption, reduction of land use fees, and priorities in obtaining water, electricity and other infrastructure services for “export-oriented” and “technologically advanced” FIEs, and so on (Fu, 2000). However, starting in 2008, various ‘super-national treatments’ enjoyed exclusively by FIEs will disappear, and be replaced by a more level ‘national treatment’ measures. For example, corporate income tax rates for FIEs will increase from 15%, or even lower in certain cases, to 25%, while comparably the tax rate for domestic firms will decrease from 33% to 25%. Only authorized as ‘high-technology’ companies, no matter foreign or domestic, will be able to enjoy the lower tax rate of 15%. The reason behind this change in China’s FDI policy is that the type of industry and the technical content of a company’s products are now given a higher priority than the location of the proposed investment (i.e. whether it is or not in a special development zone) and the foreign ownership of a company.

In summary, foreign companies in China today face a more level playing ground vis-à-vis domestic firms. Nevertheless, one of my Canadian firm interviewees complained that China was not really a level playing field for foreign companies. According to this manager’s experience, Chinese domestic firms usually had two bookkeepers and could always avoid the inspection of government officials, while foreign companies had to obey all laws and regulations (interview

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26 The definition and supported sector of ‘high-technology’ companies can be found in The Administration Measures of Authorizing ‘High-Technology’ companies promulgated by the State Council on January 1, 2008. The regulation was posted on the official website of State Administration of Taxation (State Administration of Taxation, 2008).
with Manufacturing Company No.1). He also thought that the promised tax break (or tax exemption for the first two years following the year of making profits, and a half of this level for the following three years) was of little assistance because when the firm commenced to make a profit, the profit was in fact very little. After perhaps five years later when a firm could really make a profit in China, then this was the time the company had to pay the full level of taxes (which meant 15% — added by the author).

Although the new unified corporate income tax rate will not be implemented until 2008, there were some concerns from some Chinese scholars and local officials that the new regulations might defer FDI into China, and make China a less attractive destination for FDI compared to other low-labor-cost countries in Asia, such as Vietnam. However, some empirical evidence, including my own fieldwork with Canadian companies in China, showed that preferential policies by the government, such as tax reductions in the first years following the year of making profits, only played a minor role in attracting foreign manufacturing companies, whose main purpose of relocating their production facilities to China was to use the cheap labor cost and/or to reach the huge and growing consumer and industrial markets of China.

Generally speaking, regulatory frameworks for manufacturing FDI have improved since the beginning of the reform era in 1979. Foreign investors engaged in the manufacturing sector have gained more and more freedom in terms of their investment locations and degree of ownership. Although the ‘super-national treatment’ for foreign-invested firms in preferential corporate income tax rate will end soon, FIEs have a 5-year adjustment period before they actually need to pay the unified corporate tax rate of 25%. Given the relative cheap labor in China, despite its increasing trend and the fast-growing market, China is still a favorable place for Canadian and other foreign manufacturers, especially when compared with regulations facing Canadian mining firms as covered in Chapter 6.

Nonetheless, there still exist certain institutional barriers in China’s regulatory system
governing FDI, such as the lack of any legal transparency, excessive bureaucracy, conflicts between the central and local government, local protectionism, and the growing corruption (Wang, 2001). While these problems are faced by both large and small firms, these issues tend to be more challenging for SMEs, mainly because large firms usually obtain more attention (thus help) from local governments in China due to the large amount of capital and employment they bring to local jurisdictions, and also because large firms enjoy more financial and managerial advantages in collecting information. For example, during my fieldwork with Canadian manufacturing firms, interviewees in smaller business tended to complain more about excessive paperwork and government corruption, while larger companies were relatively satisfied with the overall situation, yet at the same time they showed empathy for their smaller counterparts. Barriers involving excessive regulations are encountered by foreign investors in many different sectors, not merely in manufacturing. However, foreign manufacturers in China face some unique difficulties in their daily operation, especially when interacting with different actors in the market, which will be illustrated in more detail in the next section.

7.3 Daily Operation Difficulties for Foreign Manufacturers in China

The thesis chapter now turns to examine many of the problems facing small-and-medium-sized Canadian firms in China and addresses various host market and host state boxes in Figure 2.2 (e.g. customers, suppliers, and labor force). These problems were mainly revealed from my personal interviews with the six Canadian manufacturing companies in China in 2005.

The profile of the six Canadian manufacturing companies I interviewed in 2005 is shown in Table 7.4. The size of these firms was relatively small, with only one company hiring over 250 employees. These companies were mainly located in large cities and the lower Yangtze River Delta, such as Beijing, Shenzhen, Shanghai, and Suzhou. Half of the companies interviewed
entered China around or before the mid-1990s, and another half after 2001. Among the six managers of Canadian manufacturing companies I interviewed during my fieldwork, three of them were with Chinese origin, educated in Canada and Mainland China or Hong Kong.

**Table 7.4  Profile of Canadian Manufacturing Companies, Interviewed in 2005**

<table>
<thead>
<tr>
<th>Company</th>
<th>Sector</th>
<th>Number of employee</th>
<th>Location</th>
<th>Date of Entry</th>
<th>Chinese Origins of CEO (Y/N)</th>
</tr>
</thead>
<tbody>
<tr>
<td>No.1</td>
<td>Food processing equipment</td>
<td>80</td>
<td>Hebei province</td>
<td>1994</td>
<td>No</td>
</tr>
<tr>
<td>No.2</td>
<td>Metal processing and manufacturing</td>
<td>3,200</td>
<td>Beijing, Jiangsu, Huizhou, Shenzhen, Zhongshan, Suzhou, Shanghai, Ningxia,</td>
<td>1986</td>
<td>Yes</td>
</tr>
<tr>
<td>No.3</td>
<td>Medical device manufacturing</td>
<td>80</td>
<td>Shanghai</td>
<td>2004</td>
<td>Yes</td>
</tr>
<tr>
<td>No.4</td>
<td>Telecommunication equipment</td>
<td>200</td>
<td>Suzhou</td>
<td>2002</td>
<td>No</td>
</tr>
<tr>
<td>No.5</td>
<td>Transportation equipment</td>
<td>105</td>
<td>Shanghai</td>
<td>1996</td>
<td>No</td>
</tr>
<tr>
<td>No.6</td>
<td>Equipment manufacturing</td>
<td>130</td>
<td>Suzhou</td>
<td>2003</td>
<td>Yes</td>
</tr>
</tbody>
</table>

As mentioned above, the regulatory framework for manufacturing FDI has been relatively liberal and favorable compared with those for mining sector and services sector (the latter sector will be discussed in the next chapter). Yet, my research fieldwork with Canadian manufacturing firms in China found that there were many difficulties in the daily operation of manufacturing firms from Canada. These difficulties were focused on the China’s market (such as interaction with local suppliers and customers), infrastructure, and local employees, rather than dealing with regulations and government agencies (see Table 7.5). I will now address each of these issues in turn.
Table 7.5  Interviewee Responses to Daily Operation Difficulties

<table>
<thead>
<tr>
<th>Difficulties</th>
<th>Responses (total = 6)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Problems related to customers</td>
<td>4</td>
</tr>
<tr>
<td>1.1 Not to honor contracts</td>
<td>4</td>
</tr>
<tr>
<td>1.2 Violation of IPR</td>
<td>3</td>
</tr>
<tr>
<td>2. Problems with suppliers</td>
<td>4</td>
</tr>
<tr>
<td>3. Problems of managing local employees</td>
<td>6</td>
</tr>
<tr>
<td>4. Insufficient infrastructure</td>
<td>3</td>
</tr>
</tbody>
</table>

Source: the author’s own interviews

7.3.1 Problems with Chinese Customers

Four Canadian manufacturing firms I interviewed were engaged in equipment manufacturing (see Table 7.4), which meant that their customers were other businesses - mostly Chinese companies or institutions - instead of individual Chinese consumers. Indeed, many Canadian manufacturing companies came to China because their main customers in North America or Europe had relocated to China. For instance, one Canadian manufacturing company I interviewed (Manufacturing Company No.4) came to China because their major customer, Nortel, moved their production facilities to China years ago. There were also some instances of other firms using China as a producing base to serve their global customers (e.g. Manufacturing Company No.5 and No.6). Along with China’s rapid economic development, many foreign companies turned to serve the local Chinese market, which includes both local Chinese firms and foreign firms operating in China. However, in general, Canadian companies were more comfortable dealing with their foreign firm customers in China compared to domestic Chinese firms, and many of problems reported in the interviews are related only to their Chinese customers.

There are two main problems related to local customers as reported by my interviewees. The first was that local domestic customers tended not to honor contracts (four out of six interviewees reported this). For example, a senior manager of a Canadian medium high-tech
company told me that they were reluctant to do business with Chinese customers.

“These Chinese partners do not honor their contracts. They put orders to ask us to produce something for them, but then they never come and take the commodity. So we end up with huge inventories. We have some products in our warehouse produced two years ago” (Manufacturing Company No.5).

Canadian SMEs usually do not want to go to local courts to settle business disputes because of the high costs of capital and time involved. Chinese courts are well known for their hostility to foreign investors. As a Canadian lawyer\(^\text{27}\) who has worked with several multinational corporations in China for over a decade reported, Chinese courts are bureaucratic and administrative organs as the law in China does not have any authority of its own. Recently, a Law Professor at Peking University also called for judicial independence as the top priority for Chinese leadership (Beijing Review, 2005). Not surprisingly, none of the Canadian companies I interviewed had ever been to court with their Chinese customers.

A common strategy for large Canadian companies in case of contract violation was to specify in their contracts a place outside of China (such as Hong Kong or Singapore, which have more accountable courts) as the arbitration site in the case of contract violation. This is a compromise solution, because even if foreign firms had an arbitration award in their favor, they still encountered the problem of how to enforce the award. In order to enforce the award, Canadian firms often have to appeal to the local Chinese courts, which are very biased in favoring the local Chinese party against foreign investors, as reported by my informants. However, small and medium Canadian companies tried to avoid as many Chinese customers as possible. If possible, they preferred choosing other foreign firms in China as their customers. For instance, one Canadian manufacturing firm reported: “Once we get enough foreign firms as

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\(^{27}\) The lawyer’s name is Clive Ansley. He made the argument in a public lecture on China and the West: Becoming Aware of the Challenges and Opportunities organized by China Research Association in Simon Fraser University in October 2005.
our customers, we will get out of business with these Chinese customers” (Manufacturing Company No.4).

One other problem related to customers was the violation of IPR (intellectual property right) rules (three out of six interviewees reported this). This issue was especially severe for high-technology companies. At the policy level, China had been as compliant on IPR issues as many other developing countries in Asia (Fu, 2000). But IPR enforcement in China either through judicial or administrative means remained problematic. The weak protection of IPR was one of the biggest concerns of Canadian manufacturing companies, especially those in the high-technology industries. The Operation Manager of a Canadian high-technology firm complained,

“In some cases, our Chinese customers ordered something and took several units ‘for testing’, but they never came back. They gave these units to our Chinese competitors who then copied them and sold them at a cheaper price, because they can save the research and development fee” (Manufacturing Company No.4).

Some Canadian high-technology firms have hesitated building manufacturing facilities in China due to this very reason. For instance, Andrew Benedek, CEO of Zenon Environmental, which sold its wastewater treatment equipment produced in Canada to China, once told the Canadian Business magazine (Wahl, 2004: 28).

“We were looking at China as a very dangerous market from our point of view. There were lots of potential competitors that would be happy to get a hold of one of our membranes and start to copy us. In my view sitting here [his Oakville boardroom], we had more to lose than to gain.”

7.3.2 Problems with Local Suppliers

The cheap cost of raw materials has been one of the factors that attracted foreign manufacturing firms relocating their production facilities into China. The local purchase of raw materials was a very common choice for the Canadian manufacturers I interviewed in China (e.g. Manufacturing Company No.1, 2, 4, and 5). Still, one large problem for Canadian
manufacturing firms I visited was the quality of materials supplied by local companies (see Table 7.5). In particular, the quality of production material from Chinese suppliers often did not meet the requirement of Canadian firms, or it was not consistent over a long time. In order to keep good quality of their products, one manufacturing company I visited let their material purchaser pick the material directly from the Chinese suppliers to ensure a high standard (Manufacturing Company No.1). Yet, by doing so, the purchaser had to bribe the warehouse keeper of their suppliers. Moreover, this Canadian factory in China checked every shipment of material they bought before using them for production. Such a procedure is of course a very time- and money-consuming practice, but for the company it was the only way to produce high-quality products. As one of my interviewees told me, it was very difficult for foreign firms to compete with local Chinese firms on price. The only way to win the market is to produce high-end good-quality products and either export these or sell them to high-end customers in China (Manufacturing Company No.4).

7.3.3 Problems with Managing Local Employees

A very real challenge for Canadian manufacturing firms in China was the shortage of experienced middle-level management personnel, together with the lack of flexibility, creativity and responsibility of Chinese workers, and also the difficulty in attracting and retaining labor in certain second-tier cities (i.e. outside the major centers of Beijing, Shanghai, and Guangdong) (see Table 7.5).

It is not surprising to learn of a shortage of experienced managers in China, as China has only been opened to the rest of the world for less than 30 years. Indeed, although there are many MBA courses available at Chinese local colleges or universities, even the teachers themselves often lack practical experience in business, especially operations in a global market, as one of my interviewees told me (Manufacturing Company No.6).
Regarding labor creativity and responsibility, one Canadian manager told me,

“My workers only do what they were told and never take initiative to solve problems, because they are afraid they would get blamed if they do something outside the instruction. This is just the blame culture of the Chinese” (Manufacturing Company No.4).

The owner of another Canadian manufacturing firm made similar comments,

“It is extremely difficult to have staff co-operate with each other. Responsibility is not easily accepted. It is always somebody else’s problem.” (Manufacturing Company No.1)

The lack of creativity of the Chinese staff on the job was also mentioned, and this may be attributed to the rigid education system in China, which is more theoretically oriented and based on ‘rote’ learning methods. The absence of responsibility and co-operative spirit may be related to ancient Confucian thought, which emphasizes being worldly wise and making oneself safe (mingzhe baoshen). While culture and local education system may provide part of explanation for the behavior of Chinese workers, we should also be aware that this might also be an enculturated phenomenon of early industrialization, as formerly rural, agrarian population try to adjust to the expectations of urban industrial employers, as informed by the literature on the difficulties of getting Western workers during the early industrialization period of West Europe and the US (e.g. Butlin, 1986; Kim, 2006). Thus the habits of Chinese workers, in this sense, might be less specifically ‘Chinese’ than varied ‘pre-industrial’ characteristics. This notion may explain the differences between Chinese workers and Canadian workers, with the latter in a more advanced industrialization stage and thus may be more professional and adjusted to their industrial work. It is therefore hardly surprising for us to read the following comments made by a Canadian factory owner in China:

“My workers don’t take pride in what they do. When a new machine is manufactured, I would look at it very proudly. But I didn’t see any pride in my workers’ eyes. They are indifferent, and just curious why I make such a fuss about something that I want. They just relate their work to their salary. In Canada, people usually try their best, and leave their boss to give them what they deserve. But here in China, people would do better if they are paid more. This is something I never understand even after I have spent over 12 years in China.” (Manufacturing Company No.1)
There also exist cultural differences and mistrust between foreign employers and their Chinese workers (Chen, 2001). Thus, Chinese workers who are employed by a foreigner may not link their work too much with themselves. In other words, they do not feel they are responsible for the success of the factory. This is very different from Chinese state-owned-enterprises, where workers feel they are indeed part of their factory community. Typically the SOE takes care of not only their income, but also their health care, pension, children, spouse, and even arranges funerals (Steinfeld, 2000).

For some Canadian SMEs located in second-tier cities such as Suzhou, labor attraction and labor retention were significant problems and posed great challenges. A Canadian general manager in the Suzhou Industrial Park told me that, 

“It is really difficult to find middle-level managers here in Suzhou. We have to hire people from Shanghai, who commute between these two cities on a daily basis. And we have to pay a high salary to attract them” (Manufacturing Company No.4)

7.3.4 Insufficient Infrastructure

Generally speaking, foreign manufacturers were quite satisfied with local infrastructure in Chinese cities such as Beijing, Shanghai, and Guangzhou, including transportation and telecommunications. One of the most severe infrastructure insufficiencies that China has encountered in recent years has been the energy shortage, especially electricity. This has also been one of the biggest challenges for some of Canadian manufacturers that I visited (see Table 7.5). The constant change of energy price was also a problem for these companies. As one chief representative of a Canadian manufacturing firm noted,

“The current biggest difficulty for us is the constant change of policy, which make prediction and assumption of investment very challenging. China’s policy is usually changed overnight without any consulting and public hearing. For example, energy price went up recently, which made our investment assumption very different from before. In comparison,
policies in western countries are more predictable, which is more beneficial for long-term investment.” (Manufacturing Company No.2)

Given all these complaints vented about China, why would these Canadian manufacturing firms decided to invest and stay in China? The main reasons, as found out from my fieldwork, were low production costs (especially low labor wages) and expected economic growth in China (which means a growing market). As of 2005 when the interviews were conducted, labor shortage and rising labor wages (as discussed in Chapter 3) were not an issue for my respondents, in part because it was still at the early stage of the labor shortage. But more importantly, it might be because these Canadian manufacturing firms, which were mostly engaged in equipment manufacturing, could offer more competitive wages and compensation packages than those export-oriented clothes or toy factories in Southern China.

7.4 A Success Story

To counterbalance these comments on problems identified in Canadian manufacturing companies in China, the chapter finishes with an in-depth analysis of one company that appeared to be successful, and analyzes the reasons for this success.

The success story I report here concerns a small-scale family-run equipment manufacturing company wholly-owned by a Canadian (who is a Caucasian). This type of family-owned enterprise represents over 90% of manufacturing companies in Canada. The mother company of the factory was founded in 1978 in Ontario, Canada by a Canadian entrepreneur called ‘Mike’. The company manufactured equipments for use in feed, grain, pet food, fish food, fertilizers, seed cleaning and industrial facilities. It fabricated its own line of material handling equipment and specialty systems using light and heavy gauge mild and stainless steel materials.

Mike entered the China market in 1989 as an installer of exported equipment from his Canadian operations. This experience, as Mike recalled, did not give him too much knowledge
or help in setting up his own company in China in 1994. The only experience that helped was that he realized the huge demand for his products in the China market. In 1994 Mike established a wholly-foreign-owned factory in a suburban development area 30 kilometers east of Beijing. The plant was a 20,000 sq.ft. (2,000 m2) plant manufacturing products identical to those produced by its mother Canadian facility, offering Canadian-style quality and service for projects in China and for export to Southeast Asia and beyond. After over 10 years operation in China, in 2005 Mike’s factory in China employed over 80 workers and staff, serving both Chinese and overseas markets. In fact, Mike’s factory was the only foreign company in the food and grain industry in China. All of his customers were international corporations operating in China, which had previously used to import machines from abroad. Mike himself in 2005 spent most of his time in China and left his Canadian company for his two sons to run.

Mike’s company in Canada grew from 40 staff to over 80 staff in 2005. Its major business turned from equipment manufacturing to providing services for factory installation. Since the China plant could produce cheaper machines, the Canadian company was able to install cheaper equipments for their customers in North America. Being able to access to cheaper and high-quality equipments from China made it more competitive in the Canadian market. This is an interesting example showing that overseas investment in China does not necessarily mean the loss of employment at home. Overseas investment in China often led to employment outsourcing, but in some cases it can benefit Canadian operations.

Mike invited me and his friend Grace, who introduced me to Mike, to visit his factory in the suburb of Beijing where he shared his experience in China with us. As an owner of a foreign SME in China, Mike had encountered numerous difficulties during his venture, and yet his success can be attributed to the following factors.
7.4.1 A Synthetic Way to Tackle the Cultural Difference.

The No.1 difficulty Mike encountered in China was, like other Canadians, the significant cultural differences that exist between North American and Chinese business conducts. Factors such as markets, suppliers, and workers are very different in China. Many firms complained of many regulations, too complex personal relationships with customers and suppliers as well as local officials, and too much paperwork. In sum, the ways of doing business in China were so different from Canada that Mike started to lose confidence in himself in 1995, and this was the worse stage of his venture in China.

“I did very well in Canada. I started my own business from zero and became very successful. I knew what I was doing. But when I first came to China, I tried to do things in a Canadian way, and was told that no, you can’t do this. It seemed that all my skills and experience in Canada are useless in China. I began to question my ability. I don’t know what I can do. But soon after, I sank down and told myself: well there is something I can’t change in China, but in other areas, I am going to do what I did in Canada. So I gained confidence again and started to figure out my own way of doing business in China. It was really hard.”

Mike’s experience was very common for many foreign new comers in China. Understanding and adapting to the cultural differences between China and the West while insisting on one’s own advantage (e.g. management skills and manufacturing skills) helped Mike survive the ‘strange’ China market and became successful.

7.4.2 A ‘Firm and Fair Strategy’ to Solve the Labor Problem

As discussed in the last section, Mike also encountered problems involving cultural differences associated with his workers’ attitudes towards the job, such as lack of responsibility and cooperation spirit, lack of pride in one’s work, and so on. Mike’s strategy to overcome the cultural and ethical difference in his workers was a “firm and fair strategy”.

“I am firm at what I require. I have to keep the profit margin in order to keep the factory. I have to keep the bottom line. But on the other hand, I am very fair to my workers. I give them a good salary. I pay their health insurance, pension and all other welfare. I treat them fairly and with respect.”
In fact, Mike was planning to sell his factory two years before the interview in 2003 and spend more time with his two grandchildren in Canada. But he was worried about his 80 staff’s future (65 of them were factory workers) if the factory were to close. The factory appears to be like a child to him. So he decided to keep it and let his new GM (general manager) take more duties over the day-to-day running of the factory.

7.4.3 Trust Local Staff to Deal with Local Business

It is easier for the local staff of a FIE to communicate with local government officials and local suppliers and customers, due to the local language and cultural understanding and local connections. Mike therefore let his Chinese staff deal with local government officials and banks. He became tired of dinners with local officials and reckoned that his Chinese staff could do much better than him. Mike also began to rely on his Chinese staff to check raw materials supplied by local Chinese companies. The giving of more trust to his Chinese staff enabled Mike to focus on product innovation and long-term management.

7.4.4 Keep Innovating and Perfecting Products

One secret of Mike’s success was that he kept innovating and perfecting his equipment. Before starting his own business in Canada, he worked for an equipment manufacturing company for several years, and he became very talented in equipment design and invention. He could design new machines according to his customers’ requirements, and later turned custom design into a standard product. At the time of the interview, his factory had dozens of categories of equipments to serve his customers. Besides that, his factory also had the ability to adapt to his customers' needs through designing specialty equipment, which was not generally available on the market in China at the time of the interview. This ongoing innovation was crucial to keep his company ahead of the competition and satisfy a fast developing market in China and the whole
world for equipment and machinery.

7.4.5 Personality, Personality, Personality

The utmost important source of Mike’s success in China was his strong personality as well as his design and manufacturing and management skills. His desire to meet challenges pushed him out of his comfortable home in Canada to make a subsidiary venture in China. He overcame all kinds of difficulties in China such as the failure of his first factory in China. His first adventure in China was to set up a JV in Harbin, the capital city of Heilongjiang province in Northeast China, which turned out to be a failure. Based on his Harbin experience, Mike remarked that “finding a right partner” and “getting help with knowledge of the Chinese market” were the major difficulties when he first entered the China market. He had to liquidate the JV soon after. After that, he shifted his operation to Beijing where he believed business would be more regulated, and decided to set up a wholly owned enterprise. He reported that it took him three years to adapt to the Chinese environment and five years before he could make a profit. Mike also admitted that by personality he was different from many of his Canadian fellows in China, who would prefer staying home and enjoying a quiet and peaceful life.

The lack of entrepreneurship, especially compared with US managers, was a common comment I heard from the Canadian business circle in China. One typical example concerns Mike’s two sons, who preferred staying in Canada and taking care of Mike’s businesses at home. Mike planned to leave the management of his Chinese factory to a Chinese GM (general manager) after he retired and returned to Canada - in one or two years after the interview. Mike was very optimistic about China and the future of his factory in China. After spending over a decade in China, Mike has seen China improve its legal and business environment. His factory also obtained more and more orders, and at the time of interview, he had to turn away some orders due to limited production capability. However, at this stage, Mike had no intension of
expanding his business in China due to his age. “If I were 10 years younger than now, my factory would be much more prosperous.” But as discussed at the time of the interview, he merely wanted to retire, and spend more time with his family back in Canada. The advice that Mike would like to give any Canadian entrepreneur who wanted to explore the China market was as follows:

“Come to China. There are plenty of opportunities here. Everything is possible in China. But also be prepared it is totally different from Canada. Don’t think you can make quick money here. You would fail otherwise.”

7.5 Summary

The manufacturing sector has attracted most Canadian direct investment in China, despite the fact that Canadian manufacturing companies do not have much relative advantage in either global or Canadian domestic market. This phenomenon can be largely attributed to the relative balance of home country and host country factors covered in Chapter 3, in particular the more relaxed regulatory framework on manufacturing FDI in China, compared to mining or services. It also demonstrates that ownership advantage is not the only factor that triggers FDI activity. The host country factors, such as the favorable policy, low labor cost and growing market, have played more important part in attracting Canadian manufacturing firms into China. As a result, most of the difficulties that Canadian manufacturing firms reported in the interviews arose not from regulatory restrictions or institutional barriers, as in the mining sector. Instead they are mainly generated from production management, including relations with customers, local suppliers, and local staff. So for the analytical framework of Figure 2.2, it is the Chinese market factors that have more explanatory power than the Chinese state, as well as the home country factors of Canada.

Manufacturing in Canada is generally foreign owned so it is not surprising that there is little investment from Canada into China per se other than SMEs in niche industries such as food
processing equipment manufacturing and injection molding equipment manufacturing). Based on my interviews, Canadian firms do not have any firm-related advantages related to branded products (e.g. IBM or Coca-Cola) and appear to have focused on supplying other businesses in China with niche products. These firms have faced many problems due to the characteristically small scale of production back in Canada which prevents them from investing into any strategic research on their Chinese markets and any research on how to overcome the challenges of such a very different business environment. The small scale of Canadian firms and the lack of risk-taking spirit of Canadian entrepreneurs, as identified in the analytical framework of Figure 2.2, have attributed to the low level of Canadian FDI in China, as well as the challenges faced by Canadian firms in China. However, the case study of 'Mike' shows these challenges can be overcome. This case study also pointed to the types of factors that Canadian companies need to emphasize in order to do well in the Chinese market.

After over two decades of industrialization, China is now moving towards an industrial upgrading stage. Along with this agenda, regulations on the service sector have been gradually relaxed, and more and more FDI has been allowed to enter the sector, especially since China’s entry into WTO in 2001. Canada itself has long been a ‘post-industrial’ country since the 1960s, and its service companies own some relative advantages in this sector, such as banking, education, and business consultancy. So how well have Canadian services companies done in China? Let’s find it out in the next chapter.
8 Canadian Investment in the Services Sector

According to the United Nations World Investment Report (UNCTAD, 2004: 7), the structure of world FDI has shifted towards services. In the early 1970s, this sector accounted for only one-quarter of the world FDI stock; in 1990 this share was less than one-half; and by 2002, it has risen to about 60% or an estimated $4 trillion. Over the same period, the share of the primary sector (e.g. agriculture and mining) in world FDI stock declined, from 9 per cent to 6 per cent, and that of manufacturing fell even more, from 42 per cent to 34 per cent. The statistics of FDI in China, however, present a very different profile. By 2005, the services sector accounted for only 29.36 per cent of total inward FDI stock, while the shares of the primary sector and manufacturing were 1.96 per cent and 68.69 per cent respectively (Ministry of Commerce, China, 2005). The recent structure of inward FDI in China has just reached the profile of world FDI structure record in the 1970s. In other words, for overseas investors, China is still predominantly favored as a manufacturing economy. Service sector FDI in China lags behind the world average by around 30 years. One major reason for this is that many service industries have, until recently, been relatively closed to foreign entry for various reasons. China is a typical example of a host country where tight controls exist over foreign investment in the services sectors (e.g. telecommunications and finance), despite the fact that China has been gradually deregulating its services FDI policies since the late 1990s and even more so since entering the WTO in 2001.

Nonetheless, if we look at the structure of Canadian FDI in China, the services sector (by which I refer to all other industries except for manufacturing and primary sector) accounted for 35 per cent of total investment amount of Canadian-invested companies in 2005, while the share of manufacturing FDI was 63 per cent (Ministry of Commerce, 2005). Therefore, the proportion
of the service sector FDI from Canada was much higher than the overall country’s average (29 per cent as indicated above) in China, which implies that Canadian companies have made more investment in services sector than most other countries.

I argue that this situation is much in line with the domestic economic structure of Canada, which has become a service-dominated economy since the 1960s (Wesson, 2001:63). Indeed, certain Canadian services companies have enjoyed a greater comparative advantage in China than their manufacturing counterparts, especially in the financial sector, as the Canadian banking system is very competitive in the world (Canadian Bankers Association, 2005). However, due to the highly-regulated nature of the service industries in China, as well as the very nature of service industries by which individual customer-relations are very important, Canadian services companies have been challenged both by Chinese institutional factors (regulation and government intervention) as well as cultural factors (for example, dealing with local customers). This chapter discusses the operations of Canadian services companies in China and compares this with the activities of Canadian mining and manufacturing firms described earlier.

The organization of this chapter is as follows. Section 8.1 discusses the characteristics of the services sector in Canada, and the profile of Canadian services companies in China. Section 8.2 explores the regulatory regime governing FDI in services sector in China, and how these regulations and policies affect foreign firms operating in the country. Section 8.3 presents certain difficulties involved in the daily operations of some Canadian services firms in China, based on my fieldwork conducted in 2005. Section 8.4 provides a success story of a Canadian services enterprise, and Section 8.5 offers an evaluation.

8.1 Canadian Services Companies in China

This section first discusses the characteristics of the service sector in Canada, following by the examination of the profile and patterns of Canadian services companies in China, with a
focus on industrial structure and investment location.

8.1.1 Characteristics of the Canadian Service Sector

Canada became industrialized about 100 years ago at the turn of the 20th century, and became ‘servicelized’ during the 1960s. Almost all service industries exhibited stronger than average growth since the 1960s. Industries such as business services, communications and wholesale have enjoyed strong growth in recent years (see Table 8.1). Today, the services sector generates about two-thirds of Canadian gross domestic product (GDP) (Statistics Canada, 2005). Producer services, such as transportation and storage, communications, wholesale trade, finance, insurance and real estate, and business services, play an increasingly larger role in the Canadian service economy (Industry Canada, 2001). Specifically, services account for about three quarters of total employment of Canada. In general, service producing industries are more labor intensive than their goods producing counterparts. More than two thirds of Canadian self-employed people work in the service sector.

Table 8.1 Real Gross Domestic Product, Annual Growth Rate

<table>
<thead>
<tr>
<th>Category</th>
<th>1960’s</th>
<th>1970’s</th>
<th>1980’s</th>
<th>1990’s</th>
<th>Share of Total GDP 1999</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transportation &amp; Storage</td>
<td>6.0%</td>
<td>4.3%</td>
<td>2.6%</td>
<td>3.2%</td>
<td>4.6%</td>
</tr>
<tr>
<td>Communications</td>
<td>8.3%</td>
<td>9.6%</td>
<td>5.5%</td>
<td>4.5%</td>
<td>3.6%</td>
</tr>
<tr>
<td>Wholesale</td>
<td>7.3%</td>
<td>4.3%</td>
<td>6.3%</td>
<td>5.4%</td>
<td>6.4%</td>
</tr>
<tr>
<td>Retail</td>
<td>5.4%</td>
<td>5.7%</td>
<td>3.2%</td>
<td>2.9%</td>
<td>6.4%</td>
</tr>
<tr>
<td>Finance, Insurance, Real Estate</td>
<td>3.3%</td>
<td>3.6%</td>
<td>2.4%</td>
<td>3.2%</td>
<td>16.1%</td>
</tr>
<tr>
<td>Business Services</td>
<td>8.2%</td>
<td>10.2%</td>
<td>6.5%</td>
<td>4.9%</td>
<td>6.0%</td>
</tr>
<tr>
<td>Accomodation, Food, Beverage</td>
<td>2.4%</td>
<td>4.7%</td>
<td>1.3%</td>
<td>1.1%</td>
<td>2.7%</td>
</tr>
<tr>
<td>Other Services</td>
<td>5.0%</td>
<td>3.7%</td>
<td>2.3%</td>
<td>0.7%</td>
<td>3.9%</td>
</tr>
<tr>
<td>MANUFACTURING</td>
<td>6.6%</td>
<td>4.3%</td>
<td>2.9%</td>
<td>3.4%</td>
<td>18.0%</td>
</tr>
<tr>
<td>TOTAL ECONOMY</td>
<td>5.6%</td>
<td>4.3%</td>
<td>2.9%</td>
<td>2.4%</td>
<td></td>
</tr>
</tbody>
</table>

Legend: Growth is 25%-50% higher than that of total economy

Growth is more than 50% higher than that of total economy

The service sector encompasses a wide and varied range of economic activity, including banking, janitorial services, education, entertainment, transportation, health, and much more. The size of Canadian service firms can range from a one-person company (e.g. in business consultancy sector) to a company hiring thousands of people (e.g. in banking or insurance sector). It was found that more than two-thirds of the self-employed worked in the service sector (Industry Canada, 2001). The incidence of self-employment was notably high in business services, with self-employment accounting for 32% of employment (compared to a 16.6% average) (ibid).

In the international sphere, services accounted for 13 per cent of total Canadian exports, which is less than the worldwide average of 19 per cent in 1999 (Industry Canada, 2001: 35). Nevertheless, Canada was the 12th largest exporter of services, accounting for 2.2 per cent of world services exports in 1997 (WTO annual report 1998). There appears to be considerable scope for further strong growth in Canadian services exports (Industry Canada, 2001). Architectural, engineering and other technical services, R&D services, as well as computer and information services have enjoyed international trade surpluses since the 1980s (ibid).

**8.1.2 Patterns of Canadian Services Companies in China**

As noted earlier in this thesis, Canadian direct investment abroad (CDIA) is dominated by services industries, especially in developing countries (Beaulieu et al., 2004). Overall, by far the largest share of CDIA was concentrated in finance and insurance, followed by energy and minerals, services, and machinery. For instance, during the period of 1999 and 2003, around fifty per cent of CDIA into industrial economies was in services, 24% in ‘other’ sectors and 19% in energy and minerals, with only 7% in manufacturing, including machinery and transportation equipment (see Figure 8.1). CDIA in developing countries was even more concentrated, with services making up 60 per cent of CDIA, energy and metallic minerals 27 per cent, while
machinery and transport equipment (representing most of manufacturing activities) accounted for only 2 per cent (see Figure 8.2).

**Figure 8.1 Canadian Direct Investment Abroad by Sector: Industrial Countries (1999-2003)**

![Pie chart showing sector distribution.](image)

**Figure 8.2 Canadian Direct Investment Abroad by Sector: Less Developed Countries (1999-2003)**

![Pie chart showing sector distribution.](image)

Source for both figures: Beaulieu et al. (2005: 116).

Why are services FDI from Canada so prominent? There are two different ways in which services can be traded: sales across the border, and sales by foreign affiliates. The latter way consists mostly of FDI in services, in which a service provider (e.g. a bank) sets up a branch in a
foreign country to serve customers in that country. There are two main driving forces for FDI in services (Copeland, 2003: 21). In the *market access view*, FDI arises so that service providers can have a facility close to customers. For example, Canadian banks have set up branches in China to serve the Chinese customers or Canadian customers operating in China, which enables the banks to grasp some market share of the Chinese financial market. In this view, if services are differentiated products, one would expect to see high levels of FDI between similar countries and that it would be complementary to intra-industry trade in that sector. In the *comparative advantage view*, firms set up branches in other countries to take advantage of differences in factor prices (capital, expertise, labor cost etc.) across countries. Thus, Canadian service companies chose to invest in China with an aim of access to the fast growing market, as well as taking advantages of their more advanced techniques and expertise in the Chinese services sector.

As noted earlier in the thesis, the most comprehensive list of Canadian services companies was the membership list of CCBC (Canada China Business Council). This showed 280 member companies of CCBC as of May 2005, of which over 85 per cent, or 254 companies, were engaged in services industries. The sub-industry structure of these services companies is presented in Figure 8.3. This indicates a total 254 Canadian companies in various services industries, in which business consulting services comprised the most (41), followed by information communication technologies (24), financial, investment, and insurance (22), and transportation services (21). Among the nine Canadian services companies I interviewed, three were engaged in business consulting services, four in finance, investment, and insurance, one in education, and one in distribution logistics.
As noted, Canadian financial service companies already enjoy a reputation for being among the best financial companies in the world in terms of safety, efficiency, and innovation capability (Department of Finance, Canada, 1999). The CCBC argues that China has gradually discovered the strengths of Canadian businesses. According to the survey of the Canadian financial services sector in China conducted by CCBC (CCBC, 2005), there were nineteen Canadian financial institutions in the Chinese mainland by the August 2005, including four of the top five Canadian banks – the Bank of Montreal (BMO), the Canadian Imperial Bank of Commerce (CIBC), Royal Bank of Canada (RBC), and Scotiabank. TD Canada Trust is the exception as it has chosen Taiwan as its target market rather than the PRC (CCBC, 2005). In the investment and fund management business, Canadian leaders in China include AGF Management Ltd., one of
Canada’s largest investment management companies; BMO Nesbitt Burns, a major Canadian brokerage firm and subsidiary of the BMO Financial Group; and CML Global Capital Ltd., an investment firm (see Table 8.2 and Table 8.3).

**Table 8.2  Canadian Banks in China -- Snapshot**

<table>
<thead>
<tr>
<th>Bank</th>
<th>Head-quarter in Canada</th>
<th>Office location &amp; Type</th>
<th>Year of establishment</th>
<th>RMB license</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Guangzhou-Branch</td>
<td>1993</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Shanghai-Rep. office</td>
<td>2001</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>Royal Bank of Canada</td>
<td>Toronto</td>
<td>Beijing-Rep.office</td>
<td>1981</td>
<td>No</td>
<td>Primary role-Liaison office</td>
</tr>
<tr>
<td>CIBC</td>
<td>Toronto</td>
<td>Beijing-Rep.office</td>
<td>1981</td>
<td>No.</td>
<td>Primary role-Liaison office</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Shanghai-Rep. office</td>
<td>2004</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Guangzhou-Branch</td>
<td>1998, 1995(Rep.office)</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Chongqing-Branch</td>
<td>1998</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Shanghai-Rep. office</td>
<td>2004</td>
<td>No</td>
<td></td>
</tr>
</tbody>
</table>

Source: CCBC (2005: 7)
### Table 8.3  Canadian Other Financial Companies in China --Snapshot

<table>
<thead>
<tr>
<th>Insurance</th>
<th>Head-quarter in Canada</th>
<th>Office location in China</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manulife</td>
<td>Toronto</td>
<td>Shanghai, Beijing, Ningbo, Foshan, Dongguan, Guangzhou and Hangzhou</td>
</tr>
<tr>
<td>Sunlife</td>
<td>Toronto</td>
<td>Tianjin, Beijing, and Guangzhou</td>
</tr>
<tr>
<td><strong>Other Financial Services</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>AGF Management Ltd.</td>
<td>Toronto</td>
<td>Beijing</td>
</tr>
<tr>
<td>Bevertec CST Inc.</td>
<td>Etobicoke</td>
<td>Beijing</td>
</tr>
<tr>
<td>BMO Nesbitt Burns</td>
<td>Toronto</td>
<td>Beijing, Guangzhou, and Shanghai</td>
</tr>
<tr>
<td>Brascan Corporation</td>
<td>Toronto</td>
<td>Beijing</td>
</tr>
<tr>
<td>Canadian Tire Corporation Ltd.</td>
<td>Toronto</td>
<td>Shanghai</td>
</tr>
<tr>
<td>CML Global Capital Ltd.</td>
<td>Calgary</td>
<td>Shanghai</td>
</tr>
<tr>
<td>Deloitte &amp; Touche</td>
<td>Toronto</td>
<td>Beijing, Dalian, Guangzhou, Nanjing, Shanghai, Shenzhen, Suzhou, and Tianjin</td>
</tr>
<tr>
<td>Ernst &amp; Young</td>
<td>Toronto</td>
<td>Beijing, Dalian, Guangzhou, Shanghai, Shenzhen, and Wuhan</td>
</tr>
<tr>
<td>KPMG LLP</td>
<td>Toronto</td>
<td>Beijing, Shanghai, Guangzhou, and Shenzhen</td>
</tr>
<tr>
<td>NBS Technologies Inc.</td>
<td>Toronto</td>
<td>Shanghai</td>
</tr>
<tr>
<td>Pricewaterhouse Coopers</td>
<td>Toronto</td>
<td>Beijing, Dalian, Guangzhou, Shanghai, Chongqing, Shenzhen, Suzhou, Tianjin, and Xi’an</td>
</tr>
<tr>
<td>Vendtek Systems Inc.</td>
<td>Port Coquitlam</td>
<td>Beijing</td>
</tr>
</tbody>
</table>

Source: CCBC (2005: 7)

Regarding investment locations, Beijing, Shanghai and Guangzhou were the prime cities for entry and operation. Other second-tier cities such as Tianjin and Dalian in the East and Chongqing and Xi’an in the western region, have also been chosen by some financial services firms. It should be noted that for some cases firms did not choose their investment location voluntarily. For example, the reason that Scotiabank set up a branch in Chongqing in western region is because it “has been selected by the China Banking Regulatory Commission (CBRC)
as the first foreign bank to open a branch in the city” (CCBC, 2005). Another example is a Canadian insurance company, who chose Tianjin as its entry city because “it was proposed by the China Insurance Regulatory Commission (CIRC) as the first foreign insurance joint-venture in the city”, given the situation that in 2002 Beijing was not allowed as a potential location under the China Insurance Entry regulations at that time, and Shanghai was too crowded with competition in the industry (Service Company No.6).

Chinese regulations over the service sector have played a vital part in the entry and operation of foreign companies in financial services as well as other business services industries. Thus, before exploring the major difficulties that the Canadian firms encountered in China, I examine the regulatory framework for the service sector and its evolution over time to explore the impact on Canadian firms in China.

8.2 Regulatory Framework on Service FDI in China

China’s services markets have historically been heavily regulated and foreign services providers’ access to the market has been significantly restricted. For example, China’s telecommunication sector was closed to FDI until November 2001, when the government relaxed the laws on restrictions of FDI in the sector (Wang, 2004:211). However, since 2001 China’s WTO GATS (General Agreement on Trade in Services) commitments, which became effective on December 11, 2001, represent the most radical reform program ever on services sector in the WTO history as well as Chinese liberalization history (Li, 2003). These commitments include the financial sector, distribution, telecommunications, professional services, and so on, through the elimination of many existing limitations on market access, at all levels of government (USTR, 2002). These sectors are traditionally regarded as a high return to investment margin field dominated by state-owned-enterprises (SOEs).
8.2.1 General Regulations on Service Sector

How much has China’s policy on service sector already changed, and how is it likely to change over the next few years? China’s schedules of WTO commitments provide a first source of information. China participated in the Uruguay Round services negotiations and submitted a schedule under GATS in April 1994. Although it is not clear how far this schedule reflected the actual openness Chinese services markets at that time, it provides some indication of the situation in 1994. As part of its accession negotiations, China submitted a schedule of commitments in October 2001. Relying on these two schedules, Mattoo (2003) constructed a table describing “the state of ‘policy’” at three points of time: 1994, 2001, the presumed date of accession, and 2008, the date by which all liberalization commitments will have been phased in (i.e. seven years after accession)” (Mattoo, 2003: 7). The table can be found in the Appendix 4.

The GATS (General Agreement on Trade in Services) defines trade in services as the supply of a service through any of four modes: mode one, cross-border supply, is analogous to trade in goods, and arises when a service crosses a national frontier, e.g. the purchase of software or insurance by a consumer from a supplier located abroad; mode two, consumption abroad, arises when the consumer travels to the territory of service supplier, e.g. to purchase tourism, education or health services; mode three, commercial presence involves foreign direct investment, e.g. when a foreign bank or telecommunications firm establishes a branch or subsidiary in the territory of a country; mode four, movement of individuals, occurs when independent service providers or employees of a multinational firm temporarily move to another country (Mattoo, 2003: 3). Among the four modes through which trade in services is conducted, only mode three, commercial presence, involves foreign direct investment. Consequently, the table in the Appendix 4 only presents the content relating to Mode 3 at three different points of time, namely 1994, 2001, and 2008. The table in the Appendix 4 shows China’s liberalization
commitments on different service sectors in the three points of time, namely 1994, 2001, and 2008. These service sectors include professional services, computer and related services, telecommunications, construction, distribution, educational and environmental services, financial services, tourism and travel related services, and transport services.

Mattoo (2003) argued that among the four modes of trade in services, it is with regards to commitments on commercial presence that TNCs encounter a range of restrictive measures, relating to following four aspects²⁸.

8.2.1.1 Regulations on form of establishment

A typical restriction before 2001 was the requirement imposed on a foreign company to form a joint venture (JV), either an equity joint venture (EJV) or contractual joint venture (CJV). Foreign ownership in EJVs was frequently restricted to specified levels, ranging from minority ownership (49% or less) – (e.g. for telecommunications, securities, and international transport), 50% – (e.g. for life insurance), and majority ownership – (e.g. for taxation companies, computer and related services, real estate, distribution services, educational services, and environmental services), to full foreign ownership. Majority foreign ownership was not allowed in retail chain stores which sold multiple products and different brands of products such as books, newspapers, pharmaceuticals and chemical fertilizers, and have more than 30 outlets. The industries with limitations on foreign ownership have been usually deemed by the Chinese governments as strategic (such as telecommunications) or closely related to the basic needs of general public (such as education, environment, and life insurance).

8.2.1.2 Regulations on geographic scope of activity

Prior to 2004, the business activities of foreign invested companies were allowed only in specified cities or in special economic zones. For example, upon China’s accession to the WTO,

²⁸ More detailed discussion on sector-by-sector typical restrictions can be found in Mattoo (2003: 6-9) and Yang (2007: 235-251).
retailing and a full range of subordinated services were only allowed to conduct business in five SEZs (special economic zones) and eight cities, or were subject to quotas (e.g. only 4 branches were allowed in Beijing and Shanghai). These geographical restrictions were finally eliminated by 2004. Most financial services, including insurance and banking, were also subject to geographic limitations when China became a member of WTO. For example, only four cities, Shanghai, Shenzhen, Tianjin and Dalian, were open to local currency (RMB) banking services; and only five cities were open for the insurance industry, Shanghai, Guangzhou, Dalian, Shenzhen, and Foshan.

8.2.1.3 Regulations on business scope

For foreign companies in certain industries, transactions were permitted only with a subset of consumers or restricted in some other way. One typical example was that foreign legal firms whose business scope were restricted, upon China’s accession to WTO, to home country legal affairs for Chinese and China-based clients, and to entrusting, on behalf of foreign clients, Chinese law firms to deal with Chinese legal affairs. These restrictions remain in force even after 2008. Another example concerns foreign firms in the construction and related engineering industries. These firms can only take projects financed by foreign investment and/or grants, or by loans from IFIs (International Financial Institution) or those which are technically difficult for Chinese enterprises. To make things worse, no clear standards are set to measure the technical difficulty. Also, foreign invested travel agencies are not allowed to conduct overseas travel business for Chinese citizens. They are not permitted to establish branches in China either. Foreign wholesale companies in China suffer from certain restrictions, e.g. salt and tobacco are excluded from the scope of commitments on commission agents and wholesalers.

8.2.1.4 Other regulatory requirements

Foreign firms may be required to have a certain minimum amount of assets and be established as a representative office for a certain period of time before commencing full
business operations (e.g. in the banking sector). For instance, foreign travel agencies with annual sales of over US$ 40 million are allowed to establish JV travel agencies with majority ownership. Travel agencies with annual sales of over US$ 500 million can establish a wholly foreign owned enterprise. Foreign travel agencies must have a registered capital of no less than 4 million RMB. Foreign banks and other financial institutions are allowed to establish enterprises with partial or full ownership or branches depending on their total capital assets in the year before application, e.g. over US$10 billion for wholly foreign ownership, over US$ 20 billion for branches, and over US$10 billion for JVs (Yang, 2007: 244).

Interestingly, most restrictions pertain to Chinese market access and there are relatively few limitations on national treatment. In fact, one of the striking aspects of China’s schedules of restrictions under the WTO is the willingness to commit across various modes and sectors to full national treatment for foreign providers (Mattoo, 2003). One possible explanation may be related to the ‘super-national treatment’ of foreign invested companies in China since the early 1980s. For example, foreign firms across sectors had enjoyed discounted corporate income tax rate and cheaper land prices in some localities since the implementation of the Reform and Open Policy in the late 1970s, as discussed in last chapter.

Besides the restrictions shown in China’s WTO commitments on services sector as discussed above, there are also other forms of restriction and obstacles to services FDI. One typical example concerns the banking sector, which was fully liberalized at the end of 2006. Along with lifting restrictions in line with WTO accession, new regulations have arised. According to the new regulations, the government will remove regional restrictions and other limits on foreign-funded banks, affording them the same treatment as Chinese banks, but only for foreign banks that meet a new set of requirements. The most significant requirement is to

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29 National treatment is defined under Article XVII in the traditional GATT manner, as treatment no less favorable than that accorded to like domestic services or service suppliers (Mattoo, 2003: 4).
encourage foreign banks to transform their branches into subsidiaries incorporated in China and consequently subject to Chinese banking supervision. This includes wholly foreign-funded banks and Sino-foreign joint-venture banks. There are also other requirements distinguishing between locally incorporated subsidiaries and other foreign banks, as well as demands for different amount of paid-in capital and operating capital for foreign banks with different corporate status. While China is far from opening its vault for foreign banks, even after keeping all its WTO commitments, the new laws mark a watershed from previous constraints on market access and current regulations are more in line with general administrative restrictions on business operations (APFC, 2006).

Other obstacles involving market access and national treatment of foreign services providers in China is the constant change of rules and regulations. The most recent example concerns the real estate industry. According to the “Foreign Investment Industry Guide” issued in 2004, foreign investors have been encouraged to develop ordinary housing projects for general households, but they were restricted to land development, luxury hotel, villa, top-grade office, and international convention center, and were allowed to do other business in the real estate industry. However, under the pressure of climbing housing prices starting from 2006, especially in the first-tier cities of Beijing, Shanghai, and Shenzhen, the National Development and Reform Commission (NDRC) and the Ministry of Commerce jointly issued the newly revised version of the Guide in 2007. According to the new Guide, ordinary housing projects are not in the ‘Encouraged’ category any more for foreign firms, and new content of real estate agent or broker business in the second-tier housing markets was added to the ‘Restricted’ category. So, for foreign firms in certain service industries, especially those concerning the welfare of general public, such as housing, they have to face many operational uncertainties and risks in the Chinese market.
8.2.2 Regulations on Certain Service Sectors

The last section discussed some general regulations on service sector in China and how these regulations have been diluted over time. I now turn to examine the regulations on foreign firms in some particular service sectors, especially during the period of before 2001. The relaxation of regulations after 2001 on different service sectors can be found in Appendix 4.

8.2.2.1 Regulations on FDI in the banking sector

Restrictions on the banking sector in the 1980s and 1990s mainly involved two aspects: geographical scope and business scope.

The openness of China’s banking sector to foreign investment started in the early 1980s (see Table 8.4). In 1982, foreign banks were allowed to set up branches in Shenzhen economic special zone, to conduct foreign currency business. In 1985, other four economic special zones, namely Zhuhai, Shantou, Xiamen, Hainan, were open to foreign banks for foreign currency business. In 1992, seven more cities, namely Dalian, Tianjin, Qingdao, Nanjing, Ningbo, Fuzhou, and Guangzhou, were open to foreign banks, and in 1995 the list was expanded to 24 cities in China. In 1997, there were total 142 branches set up by foreign banks, and 543 representative offices established by foreign banks in China. In July 1998, when the Chinese government removed the geographical restrictions on foreign banks, there were a total of 162 foreign bank branches in the whole country (He, 2004).
Table 8.4 Dilution of Geographical Restrictions on FDI in the Banking Sector for Foreign Currency Business

<table>
<thead>
<tr>
<th>Year</th>
<th>Geographical Openness</th>
</tr>
</thead>
<tbody>
<tr>
<td>1982</td>
<td>Shenzhen economic special zone (SEZ)</td>
</tr>
<tr>
<td>1985</td>
<td>Four other SEZs: Zhuhai, Shantou, Xiamen, Hainan</td>
</tr>
<tr>
<td>1992</td>
<td>Dalian, Tianjin, Qingdao, Nanjing, Ningbo, Fuzhou, and Guangzhou</td>
</tr>
<tr>
<td>1995</td>
<td>Total 24 cities were opened to foreign banks</td>
</tr>
<tr>
<td>1998</td>
<td>All geographical restrictions were removed</td>
</tr>
</tbody>
</table>

Source: He (2004)

Before 1996, the business scope of foreign banks in China was confined in foreign currency business. However, in December 1996, foreign banks, under the government approval, could set up branches that conducted RMB (renminbi, the Chinese currency) business in Pudong, Shanghai, and later in Shenzhen economic special zone in August 1998 (He, 2004: 142). Since China’s entrance into the WTO, the dilution of regulations on the banking sector in terms of geographical and business scope has been accelerated, and by 2006 the whole sector was fully liberalized (see Appendix 4). However, as discussed in the last section, upon the arrival of the full liberalization of the sector to foreign investment, new regulations with different forms of restrictions emerged.

8.2.2.2 Regulations on FDI in the insurance sector

The openness of China’s insurance sector to FDI has been much slower than the banking sector. In the 1980s, foreign insurance companies were only allowed to set up representative offices in China, without the right to conduct the actual insurance businesses. It was not until 1992 that American International Assurance Company, Limited (AIA), a wholly owned subsidiary of American International Group, Inc. (AIG), obtained the government approval to set up a branch in Shanghai. It was the first foreign organization to be granted an insurance
license in China after 1949. In July 1994, Tokio Marine & Fire Insurance Company was allowed to establish a branch in Shanghai. In 1995, China designated Gugangzhou, the capital city of Guangdong province, as another city other than Shanghai that was opened to foreign insurance organizations. It was not until 2001 that other cities were opened for foreign insurers. In November 1996, Manulife-Sinochem, the first life insurance joint venture, was established in Shanghai. After that, other foreign-funded life insurance companies followed suit, including China Pacific Insurance (Group) Co., Ltd and Allianz Dazhong Insurance Group. By the end of 2001, there were 19 Sino-foreign insurance joint ventures and 13 foreign insurance braches in China (Lin, 2004).

8.2.2.3 Regulations on FDI in the telecommunication sector

China’s telecommunication sector was completely close to foreign investors before 2001 (Wang, 2004). In November 2001, the Chinese government abolished two regulations promulgated in 1993 and 1995 that prohibited the market access of foreign investment in the telecommunication sector. In the following month, the State Council passed the Management Provision on Foreign Investment in Telecommunication Enterprises, which clarifies the issues of market access of foreign investors in China’s domestic telecommunication market (ibid.). Further dilution of regulations on FDI in the sector can be found in Appendix 4.

Overall, as documented above, Chinese regulations over the service sector have been focused mainly on restrictions on market access in terms of geographical location and business scope. The majority of the nine Canadian services companies I interviewed showed their understanding to these restrictions and did not perceive the regulations as a problem, except for the regulation on ownership, which will be illustrated in Section 8.3.1.3. The greater comfort with Chinese regulations by Canadian service firms – compared with those in mining and manufacturing sector - may in part be attributed to the late entry of these companies into the
Chinese market. Seven out of nine Canadian service companies I interviewed entered the China market in the late 1990s or after 2001, when the market restrictions were already relatively relaxed by the Chinese government. China’s GATS commitments represent the most radical services reform program negotiated in the WTO, and China has promised to eliminate, over the next few years after 2001, most restrictions on foreign entry and ownership, as well as most forms of discrimination against foreign firms (Mattoo, 2003). Thus, it is not surprising that the companies that were interviewed in 2005 did not express much complain about Chinese regulations over the service sector. Instead, most challenges facing these companies were concentrated in the uncertainty of policy, excessive paperwork and government corruption, investment location selection, as well as some issues related to the China market. These challenges will be discussed in the following section.

8.3 Operation Difficulties for Canadian Services Firms in China

The nine Canadian service companies I interviewed in 2005 were engaged in services covering logistics, investment, business consultancy, education, corporate training, banking, and insurance (see Table 8.5).
Table 8.5  Profile of Canadian Service Companies, Interviewed in 2005

<table>
<thead>
<tr>
<th>Company</th>
<th>Sector</th>
<th>Number of employees</th>
<th>Location</th>
<th>Date of Entry</th>
<th>Chinese Origins of CEO (Y/N)</th>
</tr>
</thead>
<tbody>
<tr>
<td>No.1</td>
<td>Logistics</td>
<td>35</td>
<td>Beijing, Shanghai</td>
<td>2004</td>
<td>No</td>
</tr>
<tr>
<td>No.2</td>
<td>Venture investment</td>
<td>7</td>
<td>Beijing</td>
<td>1993, 2004</td>
<td>Yes</td>
</tr>
<tr>
<td>No.3</td>
<td>Business consultancy</td>
<td>27</td>
<td>Beijing</td>
<td>1997</td>
<td>Yes</td>
</tr>
<tr>
<td>No.4</td>
<td>Education</td>
<td>14</td>
<td>Beijing, Taiyuan</td>
<td>2002</td>
<td>Yes</td>
</tr>
<tr>
<td>No.5</td>
<td>Corporate training and coaching</td>
<td>150</td>
<td>Over 10 cities such as Beijing, Shanghai, Shenzhen, Guangzhou etc.</td>
<td>1996</td>
<td>Yes</td>
</tr>
<tr>
<td>No.6</td>
<td>Insurance</td>
<td>260</td>
<td>Tianjin, Beijing</td>
<td>2002</td>
<td>No</td>
</tr>
<tr>
<td>No.7</td>
<td>Low-interest loan, investment</td>
<td>6</td>
<td>Beijing</td>
<td>1979</td>
<td>Yes</td>
</tr>
<tr>
<td>No.8</td>
<td>Banking</td>
<td>55</td>
<td>Beijing, Chongqing, Guangzhou, Xi’an</td>
<td>1982</td>
<td>Yes</td>
</tr>
<tr>
<td>No.9</td>
<td>Business consultancy</td>
<td>5</td>
<td>Shanghai</td>
<td>2003</td>
<td>No</td>
</tr>
</tbody>
</table>

The size of these firms was relatively small, with only one company hiring over 250 employees. These companies were mainly located in large cities, such as Beijing, Shanghai, Guangzhou, and Shenzhen. This is in part because there are more customers and thus more business opportunities in China’s large cities than in its smaller cities, and in part because China has opened certain service sectors only in large cities, e.g. banking and insurance. Except for two Canadian companies that entered the China market in the early stage of China’s reform and open era (namely in 1979 and 1982), other Canadian firms came to China in the late 1990s and the early 21st century, when China gradually relaxed its regulations over the service sector. Among the nine managers of Canadian services companies I interviewed during my fieldwork, six of these were with Chinese origin, educated in Canada and Mainland China or Hong Kong. As will be demonstrated, the cultural affinity of these Chinese origin CEOs has proved to be a

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30 The company established a representative office in Beijing as early as in 1993. At that time, The company invested in an oil company in China, and in 1995 it successfully divested and exited the China market. The representative office remained idle until in 2004, when the company was attracted by the booming economy of China.
distinctive firm-oriented advantage when dealing with clients in the service sector in China.

The difficulties caused by the regulatory framework governing services FDI include uncertainties and ambiguities of policy, local variations of regulations, government influence in choosing investment location, excessive paperwork and government corruption and so on. On the other hand, due to the very nature of the services sector, foreign services providers also face challenges from the market and individual customers, such as variations in customer tastes, intense competition both from local and foreign services providers, and unfamiliarity with the market.

8.3.1 Government Policy Issues

8.3.1.1 Uncertainty of policy

The policy uncertainties in the service sector include changes of regulations without public hearing or pre-warning in certain industries. For instance, in the logistics industry, one Canadian moving company, which is engaged in business of helping expatriates of TNCs and foreign embassies move from their home country to China, first planned to open a representative office in Beijing in 2004. But in the middle of these preparations, the regulations changed and the company had to set up a WFOE (wholly foreign owned enterprise) in order to operate its service in the local market effectively. As the General Manager of the company, a non Chinese-origin Canadian, reported:

“So I had to do it all over again. All I did for the first few months was just a waste….When I registered the company, I was asked to provide a Chinese name for the company, and the register office refused to provide any translation service to me. I explained to them that I don’t need a Chinese name as all of my customers would be foreigners anyway. I still couldn’t get through. It took one month for me to just sort out the name of the company…It just drove me crazy…” (Service Company No.1)

Decentralized economic power from the central to local governments also causes confusions and difficulties to Canadian companies. Since the implementation of the reform and
opening-up policy in the late 1970s, much of the central economic authority regarding control over foreign companies has been delegated to local governments (Shirk, 1994). This has resulted in different rules pertaining in different provinces. As one of my interviewees commented,

“It is nice to increase competition among (Chinese) provinces, but the central government has given too much power to the provincial governments, especially the policy-making power. They should not be decentralized down from the central level. Otherwise, each province has its own rules. It is just too much for a company to do business in different provinces. You have to handle the cultural as well as regulation differences everywhere you do business (within China).” (Service Company No.1)

Similar comments were also made by my informants in the corporate training industry (Service Company No.5). Apparently the fragmented business regulations throughout China result in difficulties for Canadian services companies who want to expand their business in different provinces of China (more discussion on this issue can be found in Chapter 3). There is no such thing as one unified national law or regulation governing the FDI in certain industries in China. This is the same as when it is often understood to be no such thing as one single Chinese market, as each locale has its unique market structure and customer taste. Differences in Chinese regional markets will be discussed in greater detail later in this section.

8.3.1.2 Excessive paperwork and government corruption

The excessive government regulations and all the paperwork were acceptable for some of my service company interviewees, particularly those who had working experience in other developing countries or had a deep understanding of Chinese history and culture (e.g. Service Companies No.1, 3, 4, 5, 7 and 8). Many companies reported that it would be a real shock for a Canadian company who first invested in China as it was much simpler and straightforward to set up a company in Canada. Other informants believed that excessive bureaucracy and paperwork in China was the cost that they had to pay to enter the market, especially as close relations with the central or provincial governments was deemed crucial for foreign services companies in
China (Service Companies No. 2, 3 and 5). For example, many Canadian companies in China have set up a government affairs department to specifically deal with government relations - such as the CEO of Service Company 3, which is a business development company focused on helping international corporations achieve success in the China market, told me.

As noted earlier in the thesis, the scale of most Canadian services companies, especially those in business and professional services industries, is usually small or medium-sized, except for Canadian banks and insurance companies. Consequently, excessive bureaucracy and fragmented regulations impact most on smaller firms who generally have insufficient resources to address the wide array of Chinese regulations and administrative procedures. The issue of government corruption also affects small companies more than large ones. For instance, all large Canadian companies I interviewed (e.g. over 500 employees) told me that they had no need to corrupt any government officials to arrange a business deal. Due to the large amount of capital and employment they brought to local jurisdiction, they were welcomed by local governments who always tried their best to please them. Yet, it was different for Canadian service sector SMEs, who sometimes had to pay money to bribe bureaucrats no matter how reluctant they were to do this. As a United Nations survey (UNCTAD, 1993) found out, transnational SMEs are ‘environment takers’ in their host countries. They often had to do something against their own business ethics in order to survive in foreign markets.

8.3.1.3 Dealing with Chinese partners
As mentioned earlier in the thesis, the problem of dealing with Chinese partners has been recognized among many foreign companies in China, who usually preferred running their business wholly on their own. Many Canadian services companies in China encountered this type of challenge either because they were mandated to seek a partner with a Chinese company by government regulation, (e.g. in the banking and life insurance sector), or because they needed
to learn more knowledge about the local market from their Chinese partners, or both. As one interviewee in the international education industry mentioned,

“Since I don't know the place and the people in XX city, I had to partner with a Chinese school to do this. I even let them do the promotion, as I am not stationed there. Yeah, sometimes I feel a bit helpless, because whether I can make a profit all depends on the promotion work of my Chinese partner. I can't control this part….And the working approach of my partner and me is so different…” (Service Company No.4)

For most foreign services companies, finding a reliable and effective local partner was one of the major challenges when exploring the market. Even if they were not subject to government regulations in terms of partnering, many service sector firms still faced the pressure from the market, since the best way to understand the market was often through partnering with an indigenous Chinese company.

8.3.1.4 Choosing a location

The fourth type of challenge originating from governments was the influence posed on foreign services companies to select particular investment locations. This was especially the case in some highly regulated industries, such as banking and life insurance. Responding to the question of “Why did you establish a branch in Chongqing” by CCBC staff, the spokesman of a Canadian bank commented:

“We are pleased to have been selected by the CBRC (China Banking Regulatory Commission) as the first foreign bank to open a branch in Chongqing, which is the biggest city in the world in terms of population and the center of the rapidly developing western region. This has allowed us to develop a very good relationship with the Chongqing government who has given very good support. We are ideally placed to provide banking services to the growing list of multinationals investing in the Western region…” (CCBC Quarterly Review Q205, Volume 8, Issue 2: 10)

While there is some truth about the answer, the reality reported to me in an interview was that the Chongqing branch, which was established in 1997 when Chongqing was just promoted to a provincial-level municipality such as Beijing and Shanghai, did not make any profit until
around 2005 when the economic development of the city started to take off (Service Company No.8). Apparently, choosing Chongqing as its second branch location for this Canadian branch was not an autonomous decision based on market return and profitability. Thus, the ‘invisible’ hand of government agencies (sometimes just a ‘suggestion’ made by a high-level official) can be seen in various decision making process of foreign firms in China.

In other instances, a market-return-based location decision can not be made due to the Chinese government regulations. For example, a Canadian life insurance company wanted to enter the North China market in 2002.

“Under China Insurance Entry regulations at the time, the China Insurance Regulatory proposed the city of entry. Beijing was not available. In the case of Shanghai, there was already over competition for the size of the market. Tianjin was a highly desirable choice. We were the first foreign joint venture. It is a sizeable attractive market. It offered a well-educated work force, strong local government support and close proximity to Beijing” (Service Company No.6).

In fact, as soon as Beijing was open to foreign life insurance companies in the following year (2003), the company established a branch in Beijing and moved its business focuses to the capital city, which has much more high-income population than Tianjin.

8.3.2 Challenges in the Market

8.3.2.1 Intense local competition

Along with China’s market openness to foreign services providers and the growth of local competitors, a major challenge for Canadian investors in the service sector was the intense level of local competition from domestic companies as well as foreign companies from other countries. As one interviewee in the insurance industry put it,

“The main cause (of my difficulties in accessing to potential customers in China) is the intense level of domestic company competition. Domestic competitors have dominant market positions and are not always driven by the same profit dynamics as Western, publicly traded
companies. (We have) to overcome (the difficulties) through longer-range thinking about capital investments and what is necessary in shorter-term returns” (Service Company No.6).

Apart from long-term strategy, another way of meeting market challenge has been for this company to combine its own advantages - insurance experience, resources and technology with those of its Chinese partner, which has “strong local and national government connections, plus access to their other companies” (ibid).

Similarly, Canadian companies in the computer and software related services industry also must rely on their advanced technology to win the market. “There are quite a few local competitors. However we believe we have better overall technology that is leading by a few years” (Service Company No.9).

For some small- or medium-sized companies in non-high-tech industries, targeting niche markets turns out to be an effective way to stay competitive over local competitors. Below is an example of a Canadian moving company operating in China.

“Our market entry point is serving expatriates of TNCs and foreign embassies, helping them move from their home country to China. This industry is much more personal and customized than moving products, equipments with cargo. There is not much competition here in China (in this niche market). Expatriates prefer foreign companies to helping them move. So although there are some Chinese companies doing this business, they are not that successful. That is why we come in and become successful” (Service Company No.1).

For some Canadian companies offering Canadian high-school education program in China, local competition mainly comes from other western countries, especially the United Kingdom and Australia. The UK is the most active country that invests in China's education industry.

"In the UK, education is a business. But in Canada, education is education. It is just a different mindset. So the British push the education overseas investment very diligently. There is a huge organization in the British Embassy in China promoting the UK's education" (Service Company No.4).

The second active country is Australia. Canada ranks third, despite the fact that Canada was often the first choice for Chinese students, according to this interviewee, who set up a school in China offering high-school education program licensed by province of British Columbia. Living
costs for students in Canada were generally cheaper than that in UK, and after graduation, students could apply for immigration, and take advantage of the diverse job market in North America. The biggest obstacle for Canadian education service providers in China, according to this interviewee, was that education is a provincial responsibility in Canada. This was because each province was in charge of its own education system and programs. The federal government did not have the right to issue accreditation and so on, and thus there was no incentive to promote overseas education by the Canadian Embassy. When students came to Canada, they could choose any university in Canada. So when a province such as British Columbia promoted education in China, it may not end up with increasing overseas students in its own province. This made individual provinces reluctant to invest in education promotion in China.

To tackle the fierce competition from their British and Australian counterparts, this Canadian education provider chose to invest in the second tier cities of China with 2 or 3 million population (“absolutely not Beijing or Shanghai”), e.g. Shijiazhuang, capital city of Hebei province, and Taiyuan, capital city of Shanxi province).

“Each city has rich people. All I need for student enrollment into my program is less than 100, so I am not worried that I don’t have large number of students in second tier cities” (Service Company No.4).

Furthermore, besides teaching the BC school program, this company also has other programs such as English pre-school and short-term training program and so on.

8.3.2.2 Lack of market knowledge

Obtaining good market knowledge about local customers’ tastes and preferences is particularly important for foreign services providers in China. Unlike their manufacturing counterparts in China, whose customers are mainly other companies or government organizations, Canadian services providers have to deal with individual customers whose tastes
and purchasing patterns are more affected by local culture and customs, as well as local economic development levels. Consequently, it is a common challenge for Canadian services providers to obtain a deeper understanding of market knowledge and where necessary to find a good Chinese partner. In this context, understanding local culture and language is of particular importance for Canadian services firms to succeed in the Chinese markets. As discussed previously, there exist in China wide variations in government regulations and customer tastes. As an interviewee in the corporate training industry commented,

“There is no such a single market in China. Every province and every city has their own culture, customs, and ways of seeing and doing things. Since we have offices in many different cities, we have to deal with the cultural differences in different places.” (Service Company No.5)

It may be because of the importance of cultural understanding that two thirds of chief representatives or general managers of Canadian services companies I interviewed in China were Canadians with a Chinese origin (see Table 8.5). These interviewees admitted that their mastery of the Chinese language and Chinese history and culture assist them with their business in the China market greatly.

“It definitely is a big help for my business, because training and coaching is dealing with human beings directly. Sharing the same cultural origins and languages is very important to find and keep clients. It will be very difficult, if possible, for a white face to succeed in this profession in China” (Service Company No.5).

However, understanding local culture and ways of doing business in China sometimes becomes a ‘double-edge’ sword for high-level managers stationed in the Chinese market. On the one hand, the understanding of and adapting to the local culture benefits their business in China. On the other hand, they face a big problem when dealing with their superiors in the Canadian headquarters, who still see things in the Canadian way. Consequently, they often could not understand why their managers in China did not do things as they were expected – mainly based on Canadian business norms. How did local managers solve this ‘caught-in-the-middle’ situation
having to meet both Canadian and local Chinese expectation?

“I figured out later that the best way to solve this (problem) is to bring as many people from headquarter to China as possible. Even for a short period of time, it is still worth it because by doing this, they will become able to more understand the cultural difference and learn to appreciate what I and my colleagues have achieved in China” (Service Company No.9).

Another interviewee who was educated both in China and Canada offered me another angle of dealing with this type of dilemma.

“Well, if I have the same opinion as theirs (Canadian superiors), they may not want to hire me. But on the other hand, if I always object the board’s decision, I will be fired. Being a management personnel educated both in China and Canada, I play a role more like a bridge connecting the both ways of doing business” (Service Company No.2).

8.4 A Success Story

The success story in the service sector I want to share here involves a Canadian business service company, or more precisely a human resources training and coaching company. The company was established in Vancouver in 1995 by a Hong Kong Canadian educated both in Hong Kong and Canada. According to its CEO, the purpose of establishing this company was to especially target the Chinese market with his capital and expertise in training and coaching. Thus the company does little business in Canada. Since 1996, the company has expanded into Hong Kong, Macau, Guangzhou, Shenzhen, Shanghai, Beijing and Singapore. Its standard of excellence and performance has enabled it to attain the ISO 9001:2000 certification in International Quality Assurance in 1999. In 1997 the company first set up a representative office in Shenzhen, and later registered a subsidiary in Guangzhou, the capital city of Guangdong province. In this early stage, its clients were mostly expatriates working for TNCs in China. Without a license, the company could only undertake corporate training, and was not allowed to offer services to the public and individuals. China was at that time a ‘closed door’ to foreign-invested companies in this profession. In 2002, the company was given the license for coaching, the first ever awarded by the Chinese government to a foreign company. By 2005 the
company had set up offices in over ten cities in China and became ‘a pioneer practitioner of coaching in Asia’. Most of its clients were local Chinese, usually business owners, CEOs and senior managers of TNCs.

I met the CEO of this company (I call him John here in my thesis) during a networking reception organized by CCBC (Canada China Business Council) in Beijing in 2005. The company has encountered similar difficulties and challenges as other Canadian services firms in China. And the success of the company can be mainly attributed to the following four factors.

8.4.1 Cultural Understanding

As we discussed above, market knowledge, especially understanding local culture and customer tastes, is crucial for the success of foreign services companies in China. In this respect, CEOs who are Canadian immigrants with origins in Hong Kong or China have certain advantages. Both the founder and the CEO of our case company were born and raised in Hong Kong and educated in Hong Kong and Canada. They speak fluent Cantonese and English, and have a certain level of understanding of Chinese culture. The company’s success lies in the combination of western advanced training and coaching concepts and techniques based upon local Chinese culture.

In fact, the company represents a typical type of Canadian small and medium-sized services company: essentially those run by immigrants from Hong Kong, Taiwan, or Chinese Mainland in Canada who returned to China to do business using their familiarity and knowledge of China to explore the Chinese market. This type of company is usually headquartered in Canada, but mainly does business in China with capital transferred from Canada to China. One third of Canadian services companies I interviewed fell in this type. They are engaged in education, business consulting, and coaching profession respectively (Service Companies No.3, 4 and 5). All of them agreed that their understanding of Chinese culture assisted them do well in the
China market.

8.4.2 Gradual Market-Exploring Strategy

It is precisely because of the importance of understanding local culture and market that the company in our case study explored the Chinese market gradually, starting from the most familiar market. Because of CEO John’s origins, this company set up its first branch in Hong Kong, the hometown of the founders, and in adjacent Macau. The first point of entry in mainland China was in Guangzhou, which shared the Cantonese language. Despite this prudent and gradual expansion strategy, the company still encountered numerous difficulties.

“But, if getting started in Hong Kong was difficult, taking our business to mainland China was even harder. At the time, coaching was a very new concept in Asia. Promoting it in Hong Kong was difficult enough, but promoting it in China, where the principles and culture were in many ways so different from ours, was a serious challenge. In fact, we didn't really understand China, but our deep emotional ties with the place encouraged us to make a commitment (emphasis added). Our first stop was Guangzhou, and our Hong Kong contacts generously shared the details of their friends and colleagues in the southern Chinese city. We visited each and every one of them, and introduced them to coaching techniques. We were met with skepticism, doubt, misunderstanding, and rejection, and it was an experience that left us in low-spirits and exhausted.”

However, with more and more people exposed to the new technology of personnel training and coaching, this company started to stand firm in the southern China market, attaining the ISO 9002 certification in International Quality Assurance in 1999 and establishing a WFOE in Shenzhen in 2000. It later went north and formed subsidiaries in Shanghai and Beijing. When interviewed in 2005, John told me that they were going to expand their business in the western China region, probably to Chengdu and Chongqing.

8.4.3 Doing a Good Job in GR (Government Relations)

After several years of conducting business in China, John became friends with many local government officials, including lawyers and judges. This was the way that John tended to
promote his business by ‘doing homework’ with government relations, and he admitted that it was very effective.

“In China, rule of law is not a problem. The biggest problem is law interpretation, which in most cases is up to judges. So if the judge sees you as a friend, you will get trust from him, and thus a favor of him when he makes the case.”

It does not necessarily mean John had to corrupt government officials though. John stressed that his company had followed the laws and regulations of China very strictly (e.g. a clean financial record, and he would never do business without a license or government approval), because he was going to list his company in the near future.

The founder of another Chinese-Canadian company in China, who used to work and do business in China for about two decades before immigrating to Canada, offered another way of building good government relations.

“To succeed in China, Canadian firms need to understand the Chinese culture, especially the impact of the Cultural Revolution (emphasis added) on people. Because those who were affected by this event are now aged from 45 to 60, occupying the most important positions in all government agencies. Only when you understand the impact can you know how to build a good relationship with them” (Service Company No.3).

Another success experience of John’s company was to hire a local law firm to deal with the company’s legal affairs. When John’s company first entered China, it, like other TNCs in China, hired a foreign law firm to handle its legal affairs. However, later John found that while the foreign law firm still depended on its China branch to handle his case, it charged him with much higher (at least double of local firms) legal fees. Apart from the monetary cost, communication was also very slow, as everything had to go through the firm’s headquarters outside of China. So after becoming familiar with local laws and legal environment, John decided to abandon the foreign law firm, and hired a local law firm, which had better understanding of Chinese laws than their foreign counterparts.
8.4.4 Setting up Professional Standards in the China Market

The last but definitely not the least important factor for the success of John’s company was that it helped many local governments set the standard of the coaching profession in China.

As noted earlier, corporate training and coaching is a new profession in China. At the same time it has great potential demand as more and more people and entrepreneurs are interested in improving themselves and making a successful career. John’s company was the first foreign company to bring the idea of corporate coaching into China, doing a pioneering job of introducing the concept and practice of corporate training and coaching to the Chinese market. It has been very active in cooperating with local government authorities to set up standards and regulations of the coaching profession. The involvement with governmental standard setting helped John make good connections with local government officials on the one hand, and gave the company access to more customers and earned more trust and reputation in the market. Consequently, it was perhaps no surprise that the company in 2005 occupied the biggest market share in this sector and enjoyed a high reputation among its competitors.

8.5 Summary

If government (including regulations and intervention) and the market (local business environment) comprise two ends of a spectrum, and Canadian companies in the mining sector and manufacturing sector are more challenged mainly in either the government or the market/business environment side, respectively, then the challenges of Canadian services providers lie in between, facing challenges from both government regulations and the market or local business environment. One the one hand, FDI in services sector has been highly regulated in China and subject to many different regulations, despite the recent relaxation after China’s accession to the WTO. On the other hand, due to the very nature of services sector (i.e. local
market driven), foreign service providers also face challenges from the market and individual customers such as different customer tastes, intense competition, and insufficient market knowledge. Thus, it is fair to say that the analytical framework in Figure 2.2 has been most useful in explaining the challenges of Canadian firms in China’s service sector. Especially for the host country factors, both the Chinese state and Chinese market forces / business environment, have caused difficulties for Canadian services firms in the country. Regarding the home country factors, the ownership advantages of Canadian services firms may more lie in their advanced technical and management skills, as well as their market experience and expertise in certain areas. Most theoretical frameworks of FDI, such as Hymer’s and Dunning’s, have been drawn from the experiences of large manufacturing conglomerates from the US or other developed countries, and thus not that applicable in explaining the experiences of services firms investing overseas. For instance, many Canadian services firms in China were established by Chinese Canadians, who take advantages of their knowledge of both the Chinese and Canadian markets. And this aspect is not covered by Dunning’s model.

It should be noted that services sector is highly diversified, and companies in Canadian services industries may face many unique challenges. An example has been given here of a successful Canadian service provider in the coaching profession business. In the next chapter, more comparisons between these three different sectors examined in Part III (mining, manufacturing, and services) will be discussed.
PART IV

9 Conclusion

Part IV comprises the conclusion chapter (Chapter 9) and examines the relative balance of home and host country factors at work. It also summarizes the differences between the three industrial sectors chosen for analysis and discusses the theoretical and policy implications of the thesis, as well as the limitations of the research.

Since the Reform and Opening-up Policy implemented in the late 1970s, China has been reconnected to the world economy and has become a major player on the world stage, especially in terms of trade and FDI inflows. In 1993 it became the largest FDI recipient among all developing countries, and it was ranked the first in the world in terms of FDI inflow in 2002.

Canadian direct investment abroad (CDIA) has grown rapidly in the past decades, and has exceeded the growth of the FDI into Canada since the mid-1970s (Rugman, 1987). Indeed, Canada is a major FDI source country, with CDIA ranked 9th in total FDI outflows in the world in 2003. However, Canadian FDI in China has been insignificant during the past three decades since China’s opening-up in 1978. By the end of 2002, Canada was ranked 14th among all foreign investors in China and the rank dropped to 15th in 2006 (Ministry of Commerce of China, 2007). Canada’s FDI stock in China has accounted for less than 1 per cent of China’s total FDI stock since 1978, while Canada’s global share of FDI outflows reached an average of 5 per cent annually during 2001 and 2004. Canada has apparently underperformed in China in terms of FDI flow. However, when considering the relatively small size of the Canadian economy, the performance of Canadian FDI was quite impressive, ranking third among G7 countries in terms of the percentage of FDI stock in China by 2004 against GDP in the 2004 (see Table 1.1).
A major issue triggering this thesis was “why had so little CDIA been invested in China, given the fact that China has been a major FDI destination and Canada a major FDI provider in other world regions in past decades?” Informed by the literature reviewed in Chapter 2 as well as the subsequent empirical analysis, I argue that the low levels of Canadian FDI in China can be partly understood by distinctive features found in both home country and host country factors, particularly within the latter where state regulations, market, labor, and culture have all played an important part. Based on this understanding, an analytical framework was developed to help structure the empirical sections of the thesis (Figure 2.2). While one aspect of the lack of Canadian FDI in China concerns the lack of Canadian enterprises who even attempted to go to China, another aspect concerns the real difficulties of Canadian firms who have taken the step of opening a business within China, which is also the focus of this study. However, in order to explain the lack of Canadian firms in China, a survey of Canadian investors’ intentions to invest in China (as the one conducted by APFC and CME, 2006) would be a necessary and complementary study to my survey of Canadian business operations in China for this research.

The three case studies examining the mining, manufacturing, and services sectors revealed that Canadian firms in different sectors encountered different types of difficulties and challenges in terms of state regulation and market forces / local business environment. Indeed, the empirical analysis reminds us that Canadian firms in China are not a homogeneous group and their experiences and challenges can only be understood in the context of the particular sector that they are engaged in. The analysis also demonstrates that it has been largely the host country factors that were at work in causing difficulties for Canadian companies operating in China. These include issues such as regulatory restrictions on market access or on the operation of Canadian mining and services firms, as well as market and business environment impediments, such as problems with local suppliers and customers, for Canadian manufacturing companies. On the other hand, the home country factors, particularly the small size of Canadian firms in
China, have also played an important part in affecting the operations of Canadian firms in China.

The chapter begins by re-iterating the four research questions raised in Chapter 1 and summarizing the main empirical findings from home and host country effects as well as the comparison of the three particular sectors. The usefulness of the analytical framework posted in Figure 2.2 is discussed at the end of the section. In the second section, I reflect on the utility of the macro-level frameworks drawn from Dunning’s eclectic model (Dunning, 1977) and Kobrin’s bargaining approach (Kobrin, 1987) discussed in Chapter 2. The contribution of this thesis to the existing literature is also discussed in this section. The third section concerns the policy implications of this research and calls for more government support to Canadian SMEs investing in China. Lastly, I recognize the limitation of this research and points out some possible directions for future research.

9.1 Summary of Findings

The four research questions posted in Chapter 1 were: First, on balance are Canadian or Chinese factors at work in causing difficulties for Canadian companies already in China? Second, what are the distinctive ‘home country’ attributes of Canadian companies, and what are the distinctive ‘host country’ attributes of the Chinese economy and FDI regulatory framework that shape the flows of CDIA in China, specifically for the natural resource, manufacturing and service sectors? Third, how do these ‘home country’ and ‘host country’ features interact in the Chinese market and how do they affect the performance of Canadian firms in China? Fourth, what are the impacts of the Chinese state (mainly regulations) and market and business conditions (including suppliers, customers and the workforce)) on three specific sectors - mining, manufacturing, and services? This section tries to answer the above questions by summarizing the main findings of the thesis.
9.1.1 Canadian Home Country Effects

There are three types of private corporations in Canada: Canadian subsidiaries of foreign TNCs, large domestic conglomerates, and indigenous small and medium sized enterprises (SMEs). The last type of corporations, the indigenous SMEs, comprised the majority of Canadian corporate organizations in 2005, not including those firms in the mining and banking sectors. It is not surprising therefore that the majority of Canadian firms in China have been small and medium-sized and have penetrated the ‘niche’ markets of China (e.g. injection molding equipment manufacturing, corporate training and coaching, and moving services for foreigners in China).

SMEs comprised two thirds of companies I visited in China. These firms were usually run by families or entrepreneurs with limited financial support and little international business experience. Indeed, being small and having inadequate resources to conduct business in the often difficult Chinese market were the major reasons that caused the difficulties in the Chinese operation of Canadian SMEs reported in this thesis. Exceptions to this general finding included those companies engaged in the mining and financial sectors, which are usually capital intensive and comprise large corporations.

One major characteristic of Canadian corporations in China has been their strategic conservativeness and lack of risk-taking spirit. In fact, the conservativeness of Canadian firms compared with other home country TNCs, e.g. Japan, US and UK, was a common comment made by my interviewees when asked why so few Canadian firms invested in China. As one interviewee noted,

“Canadians tend to be more conservative and lack of venture spirit. They are too comfortable staying at home. Even if they want to invest abroad, the first choice would be its neighbor the US, and the South America, which has the same time zone and similar culture and language as Canada. Actually, Americans are also very conservative. That is why that at the beginning of China’s reform and opening-up years, more Japanese and Germans came in, followed by Americans, then Canadians…” (Service Company No.7)
This characteristic may be related to the less competitive business environment in the Canadian domestic market. The other explanation may be the strong attraction of the adjacent US market to Canada and the closeness of US and Canadian business culture, which is a blessing for Canadian business on the one hand, and a ‘curse’ on the other as most Canadian firms will not bother to explore other growing markets far from home. A good comparison is Australia, which shares many similarities with Canada but has no large American market next door. Australia has vigorously pursued closer cooperation with the Asia Pacific region in terms of trade, tourism, foreign investment and international education (Edgington, 2004).

Another major home country effect of the Canadian economy on patterns of FDI in China is shown in the industrial structure of Canadian firms in China, which is mainly occupied by firms in Canadian competitive industries, such as mining, finance, insurance, and engineering consulting (see Chapter 5: Figure 5.6).

9.1.2 Host Country Effects

While the characteristics of corporate structure in the home country (Canada) are very influential on the decision-making and overseas operations of TNCs, the present study found that in the case of Canadian firms in China, host country factors, such as the nature of the host state, the nature of the host market, and the host business culture, have likely played a far more important part in deterring Canadian firms from investing into the China market and present difficulties for existing Canadian companies in China. Similarly, one study on Canadian firms doing business in Asia during the 1990s points to a variety of obstacles mainly arising from host country state and host market conditions in Asia (Conference Board of Canada, 1994). These obstacles, shown in the order of significance of the obstacles, include lack of local market information, dealing with local bureaucracy, cultural differences, tariffs and trade regulations, language differences, economic infrastructure, availability of financing, recruitment of local
personnel, uncompetitive product price, and geographic barriers (ibid.).

The discussion of the regulatory environment for FDI in China revealed both the ‘strong’ and ‘weak’ state of China. On the one hand, China has made great progress in building a relatively complete and consistent regulatory framework to govern the global FDI into this country. On the other hand, the central government and the courts are rather weak in terms of law enforcement, mainly due to the one-Party controlled, yet highly fragmented, political system of China. Such a regulatory environment for business operations is very different from that formed in Western developed countries, such as Canada. The case studies on the three sectors suggested that the state institutions held an upper hand over Canadian firms in China, especially those in mining and services sectors, which are highly regulated.

Another important aspect of host country factors concerns the cultural issues. The cultural differences between China and Canada have posed great challenges to Canadian companies in China. Cultural differences can be manifested in various ways, such as different ways of doing business, working with Chinese partners, communicating with Chinese staff, and different customer tastes and customs. The interviews with Canadian companies found that a focal point was the issue of guanxi or connections. As one interviewee commented,

“It (personal relationship) is everything in China……. The biggest cultural difference between Canada and China is that in China, there is no fair playground for everyone to compete. No proper rules or regulations to ensure such a fair playground, so everything depends on your network of personal relationship. In Canada, although personal relationship is sometimes important in getting a position or winning a contract, overall it (the country) is all constructed under the rules of laws, and everyone has his/her chance for success without possessing any personal relationship” (Service Company No.3).

Guanxi was also often thought of as the single most important concept when dealing with China and the Chinese in any social context, including business (Ambler and Witzel, 2000). In fact, the impact of cultural difference was found across all the three sectors examined. This finding in turn confirms the notion of the continuing relevance of geography and locality, which
is socially produced and culturally embedded, as reviewed in Chapter 2 of this dissertation.

9.1.3 Differences between the Three Sectors

The case study of the three sectors sought to understand more detailed research questions such as “what are the impacts of Chinese state (mainly regulations) and market (including suppliers and customers) on the three sectors?” “To what extent does the impact on these three sectors differ from each other?” To make a good comparison, the three case study chapters were structured in similar ways, starting with a description of Canadian firms in each sector and including their major characteristics and profiles in China. This was followed by a discussion of the regulatory environment on FDI in each sector and the daily operation difficulties of Canadian firms in each sector based on interviews and observations, and finally each concluded chapter with a success story of Canadian firms in each sector to further sharpen the analysis. Table 9.1 presents the major differences of both Canada and China impacts on Canadian firms in mining, manufacturing, and services sector of China.
Table 9.1 Summary of Findings in the Three Case Studies

<table>
<thead>
<tr>
<th>Characteristics of Canadian firms</th>
<th>Mining</th>
<th>Manufacturing</th>
<th>Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>World’s leading exporters of minerals and mineral products; Rich experience and expertise in mining activities; Strong fund raising capability.</td>
<td>High level of foreign ownership in Canada; Foreign-owned firms are more active in R&amp;D; Most indigenous firms are ‘niche’ producers with a single small-scale plant.</td>
<td>Dominant in generating Canadian GDP and employment; Producer services playing a larger role, such as finance, insurance, transportation, and communications.</td>
<td></td>
</tr>
<tr>
<td><strong>Profile in China</strong></td>
<td>Among the major foreign investors; Focus on gold mining; Mainly located in western provinces.</td>
<td>Two-thirds were SMEs; Over 80% were in low-tech industries; The lower Yangtze River Delta region, including Shanghai and Jiangsu, was the most popular location.</td>
<td>Firms in business consulting services dominated in quantity; Strong presence of financial institutions; Big cities such as Beijing, Shanghai and Guangzhou were most popular.</td>
</tr>
<tr>
<td><strong>Regulatory environment</strong></td>
<td>Highly regulated; Many barriers remained to FDI in terms of law interpretation and implementation;</td>
<td>Favorable policies; Restrictions on geography and investment vehicles have been relaxed gradually; Regulations changed from ‘super-national treatment’ to ‘national treatment’.</td>
<td>Historically heavily regulated, but relaxed gradually after WTO; Obstacles remained in investment mode, geographic scope, business scope, and market access.</td>
</tr>
<tr>
<td><strong>Success story</strong></td>
<td>A company in the onshore oil industry: small is powerful</td>
<td>A small family-run plant in equipment manufacturing</td>
<td>A company in human resources training and coaching</td>
</tr>
</tbody>
</table>

Differences can be found in firm characteristics, their profile in China, Chinese regulations, challenges of daily operation and features of success stories. Figure 9.1, which was drawn from the findings in Table 9.1, demonstrates that Canadian firms in mining sector have been subject more to the pressure arising from the Chinese state, while firms in manufacturing sector have been subject more to the factors surrounding the Chinese market and business environment.
Firms in the service sector have fallen in between, and have been subject to both factors of the Chinese state and Chinese market.

**Figure 9.1 Impact of Host Country on Canadian Firms in Different Sectors**

![Diagram showing the impact of host country on Canadian firms in different sectors]

Note: □ represents Chinese factors; ○ represents Canadian firms.

Above all, firms in these three sectors were influenced by Chinese culture, typically shown in difficultes of dealing with Chinese partners and Chinese staff. Hofstede (2001) model of cultural grouping turned out to be quite ambiguous in explaining the behavior of Chinese staff working in Canadian firms in China. For instance, according to Hofstede’s model, Canadians are more individualistic and Chinese more collectivistic. However, the job-hopping of Chinese employees from a SOE to a foreign firm (e.g. the Canadian mining company discussed in Chapter 6) demonstrates the disloyalty to their former collectives and an action more of individualistic rather than collectivistic. Indeed, the cultural grouping of Hofstede’s model is rather static and general, representing more of a business culture (thus more applicable in guiding firm strategy and decision-making) than a national characteristic or citizens’ behavior and norms. Thus it is not surprising that the model encountered limitations in grasping the
slippery and changing features of local cultures and customs as well as individual behavior.

However, it should be reiterated here that culture is only one of the many factors that have impacted the business operations of Canadian firms in China, although culture is inevitably intertwined with other factors, such as economic, political, social, historical, and institutional factors. The overall influence of ‘culture’ is a large and difficult issue to address fully, and perhaps I can only ‘come to grips’ with this by comparative research - which is beyond the confines of a single PhD! Moreover, the three ‘success stories’ reveal that the fate of Canadian DFI does not hinge solely on cultural factors (home country or host country) but also on the very real efforts that companies make to understand the local reality; to see China as it is (not as a ‘pot of gold’) is surely the first step towards success.

Natural resources in China are regarded as part of a national strategy and thus the mining industry has been highly regulated, especially when it comes to the issue of inward FDI. Despite the recent progress in relaxing foreign investment regulations, foreign mining firms have encountered numerous difficulties both from the regulatory regimes and the daily operations in the field.

Manufacturing has attracted most Canadian direct investment in China compared with other sectors, despite the fact that Canadian manufacturing companies do not have much relative advantage in both global and domestic market. This phenomenon can be largely attributed to the favorable and gradually relaxed regulatory framework on manufacturing FDI in China. As a result, most difficulties Canadian manufacturing firms encountered arose not from regulatory restrictions or institutional barriers, such as in the mining sector. Instead, they were generated mainly from challenges posed by the local market and production management issues, including relations with customers, local suppliers, and local staff.

If government (including regulations and intervention) and market factors are two ends of a spectrum, and if Canadian companies in mining sector and manufacturing sector are more
challenged in the government and market side respectively, then Canadian services providers lie in between, facing challenges from both government and market. FDI in the service sector has been highly regulated in China and subject to many different regulations, even despite the recent relaxation after China’s accession to WTO. On the other hand, due to the very nature of the services sector, Canadian firms in this sector also face challenges from the market and individual customers, such as difference in customer tastes, intense competition, and insufficient market knowledge.

The above discussion demonstrates that the utility of ‘home country – host country’ framework shown in Figure 2.2 has great variations in explaining challenges faced by Canadian firms in different sectors in China. For instance, from the host country perspective, factors arising from the Chinese state are more useful in interpreting challenges of Canadian firms in the mining and services sectors, while the Chinese market and business environment can better explain difficulties of Canadian firms in manufacturing and services sector as well. From home country perspective, the case study in the mining sector shows that sometimes the small size of firms did not cause difficulties for their operation in China (e.g. the mining company in the success story of Chapter 6). Instead, it may be critical in the success of these firms in China under certain circumstances.

9.2 Theoretical Reflections and Contributions

This study is perhaps the first systematic research of Canadian FDI and Canadian firms in China. Previous studies on Canadian FDI either concentrate on Canadian inward FDI and its impact on Canadian economy, or on Canadian outward FDI in the southern neighbor of the US or South America (especially for the mining firms). This study presents a relatively complete profile of Canadian firms in China, and examines the challenges that these firms faced in China using a mix of statistical data analysis and empirical studies.
This study of Canadian FDI in China has focused on the home and host country effects on TNCs and builds on the work of John Dunning’s eclectic model of FDI and Kobrin’s bargaining approach. In this study, TNCs act as intermediates on which home country and host country interact with each other. This particular case study of Canadian companies in China helps us reflect on a number of existing theories and research approaches.

### 9.2.1 Relevance of Geography

As reviewed in Chapter 2, there are two distinct notions of globalization and its consequences. One arises from neo-liberal ideologies, which accentuate the power of free-flowing investment, footloose industries and placeless TNCs. This notion often exaggerates the bargaining power of TNCs with their host nation states. The other opposite notion of globalization is the continuing relevance of geography and local distinctiveness within the context and the general dynamics of globalization (Cox, 1997).

The experience of Canadian firms in China again confirms the latter notion of globalization in which place and space still cast extremely important influences on transnational corporations. Not only were the ownership advantages of Canadian firms formed by the cognitive, cultural, social, political, and economic characteristics of Canada, but also these firms encountered numerous challenges imposed by Chinese regulations, market, and business culture. This study finds that capital is often geographically embedded in distinct national social or institutional structures. TNCs are not placeless at all. Instead, they are nurtured and shaped by their home country characteristics and at the same time they are regulated and influenced by their host country including state regulations, market condition, and local culture and practices.
9.2.2 Ownership-advantages Theory

Dunning’s eclectic paradigm (Dunning, 1977), from the TNC perspective, provides a general framework that encompass the impact of the ownership, internalization (which was not covered by this thesis), and locational advantages to explain the occurrence of FDI. Dunning’s paradigm was tested and confirmed in our case study of Canadian firms in China.

My study shows that Canadian firms have had a strong presence in the mining sector of China and also in the services sector. According to APFC data, by 2005, about 58 percent of Canadian firms invested in the service sector in China, 19 percent in manufacturing, and 17 percent in mining and oil and gas extraction industry (see Figure 5.6 in Chapter 5). By comparison, the service sector accounted for 25 per cent of total FDI inflows in China in 2003, 69 per cent in manufacturing, and less than 4 per cent in mining (see Section 3.3.4 in Chapter 3). Apparently, the industry composition of Canadian firms in China follows the ‘ownership-advantages’ pattern of Canadian firms, making disproportionately high level of investment in services and mining sectors in China. The ‘ownership-advantages’ mainly lie in advanced mining technology and the ability to sell minerals on world markets, together with the provision of sophisticated services, and high-technology manufacturing.

Overall, manufacturing is not a sector in Canada that possesses Dunning’s firm-level ownership advantages. However, Canadian companies have made slightly larger investments in manufacturing sector (19%) compared to its domestic presence (16% of total GDP in 2006). Furthermore, between 1984 and 1996, 72% of Canadian-funded enterprises in China were engaged in the secondary sector. These findings suggest that possession of ownership advantages is not the only condition that stimulates TNCs going abroad. Instead, local advantages in the host country, such as low labor cost, favorable investment policy, and growing purchasing power, have played a very important role in attracting manufacturing FDI in China,
including those not a traditionally strong sector in their home country such as Canada.

The interviews with Canadian firms also point out some limitation of Dunning’s framework in explaining the success of certain Canadian firms in China. For instance, small scale is usually deemed as an ownership-disadvantage in Dunning’s model. However, while the small scale of Canadian firms has caused difficulties for their overseas operation, it was exactly the small scale and the consequent efficient management that led to the success of the Canadian mining firms in China’s on-shore oil and gas industry (the success story in the mining sector). Also, the overseas investment made by Chinese Canadians is hardly explained by Dunning’s model, as these ethnic entrepreneurs mainly take advantage of their knowledge of both the Canada and China market. These examples remind us that some notions of macro-level frameworks of FDI (e.g. Dunning’s model) may be challenged when applied in the actual case studies of Canadian firms in China.

9.2.3 Bargaining Power and the Strong State of China

Previous studies on FDI, especially those in business management field, were often undertaken at the firm level and examined the process of firm strategy and decision-making process. For those studies that look beyond firms themselves, focus has often been laid on the role of state in attracting FDI. The distinctiveness of the current research from previous studies is the emphasis of the role of state in both home and host countries and the examination of the impact (mostly negative in this study) of state regulation and market forces on the firms investing overseas.

In theories of the bargaining relationship between TNCs and host countries, e.g. by Kobrin (1987) and Dicken (2003), it is generally agreed that TNCs hold an upper hand over developing countries, which are in more eager need for capital, technology, and trade. However, my study suggested that in the case of Canadian firms in China, it was the Chinese government that held a stronger hand over Canadian firms and posed tremendous challenges to them. For example, the
Chinese state heavily regulated incoming FDI in the mining and services sector, despite recent relaxation measures. Even for firms in the manufacturing sector, which faced much less regulation and enjoyed more incentives, business operations were still quite difficult on the ground, for instance when dealing with their Chinese partners, customers, suppliers, and so on. The distance between China and Canada in terms of political conditions, economic development levels, business practices, cultural backgrounds, and social environments has set numerous obstacles for Canadian firms operating in the Chinese market.

The Chinese state is still engaged in economic activities and market intervention, despite the fact that China abandoned its planned economic system some thirty years ago. Its intervention in the private economic activities, including those of both domestic and foreign firms, has been very strong. If we take the onshore oil industry as an example, then besides National Petroleum Corporation (CNPC) and China Petrochemical Corporation (Sinopec), no other domestic investors, state-owned or private, have been allowed to enter the industry. This sector was opened to foreign investors in 1993 when China became a net oil importer, because foreign oil companies could bring in capital and technology that the industry severely lacked. Even so, as explained in this thesis, foreign oil investors still encountered numerous difficulties caused by state regulations and local practices.

The case study of three different sectors also revealed that the degree of state intervention in economic activities varied in different sectors and industries. Thus one should be careful when talking about the strong status of the Chinese state. Similarly, Canadian firms were not a homogenous group. They faced different challenges and a varying array of difficulties, partly because of their own experiences and partly because of the industry they were engaged in.

It should be noted here that the bargaining concept used in this study has been rather broad, emphasizing the general balance of the power resources between Canadian firms and the Chinese nation state. It turned out to be very difficult to capture any information about any real
‘bargaining’ (or negotiating) process made between Canadian firms and governments in China, as most of these bargains take place at the local level, and most of interviewees saw the process as a business secret. Indeed, it is more likely that the ‘bargains’ between the government and incoming Canadian firms may be carried out by local rather than national government bureaucrats in China. Therefore, a feature of further research would be to distinguish between national level regulations in China and how they are implemented in reality by local governments.

9.3 Policy Implications

The identification of difficulties and challenges that Canadian firms encountered when doing business in China is a crucial preliminary step in the design of policy instruments that might facilitate wider participation of Canadian companies in the Chinese economy. Smaller Canadian firms are much in need of government help during their investment activities, especially at the beginning of their operations, including finding business partners, obtaining market knowledge, and dealing with government relations. Unfortunately, my research found that they received little official help, if any, from Canadian government agencies in China (see Table 9.2). Table 9.2 indicates that 13 out of 18 firms (72%) received little government support.

One common question I asked during my interviews with Canadian large and small companies in China was what type of support they gained from the Canadian government during their operation in China. In response, the Canadian SMEs in China that I interviewed complained about the lack of government support in their operation in China. Some of the companies in my survey were even poorly treated by Canadian officials in China. For example, an Embassy official came to check on Mike’s factory (the success story in Chapter 7) after it was decided that Prime Minister Jean Chretien would visit the factory during his stay in China in 2003. The Embassy official asked Mike arrogantly, “So, how do you feel taking employment
out of Canada?” The assumption was that investment in China somehow destroyed jobs in the export sector in Canada. However, in reality since Mike built his factory in China, his Canadian plant had expanded from 40 staff to over 80 staff in 2005. Since he could produce cheaper machines in China, his Canadian company was able to install cheaper equipment for their customers in North America and so grew and gained a higher market share.

**Table 9.2  Canadian Firms Interviewed with/without Government Support**

<table>
<thead>
<tr>
<th>Company code</th>
<th>Industry</th>
<th>Interview place</th>
<th>Government support</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Mining Company No.1  onshore oil and gas exploitation</td>
<td>Beijing</td>
<td>No</td>
</tr>
<tr>
<td>2</td>
<td>Mining Company No.2  gold mining</td>
<td>Beijing</td>
<td>No</td>
</tr>
<tr>
<td>3</td>
<td>Mining Company No.3  gold and zinc mining</td>
<td>Beijing</td>
<td>No</td>
</tr>
<tr>
<td>4</td>
<td>Manufacturing Company No.1  food processing equipment</td>
<td>Hebei</td>
<td>No</td>
</tr>
<tr>
<td>5</td>
<td>Manufacturing Company No.2  aluminum processing and manufacturing</td>
<td>Beijing</td>
<td>Yes</td>
</tr>
<tr>
<td>6</td>
<td>Manufacturing Company No.3  medical software sales and development</td>
<td>Shanghai</td>
<td>No</td>
</tr>
<tr>
<td>7</td>
<td>Manufacturing Company No.4  GSM and CDMA base station components</td>
<td>Suzhou</td>
<td>No</td>
</tr>
<tr>
<td>8</td>
<td>Manufacturing Company No.5  injection molding equipment</td>
<td>Shanghai</td>
<td>No</td>
</tr>
<tr>
<td>9</td>
<td>Manufacturing Company No.6  equipment manufacturing and export</td>
<td>Suzhou</td>
<td>No</td>
</tr>
<tr>
<td>10</td>
<td>Service Company No.1  logistics service</td>
<td>Beijing</td>
<td>No</td>
</tr>
<tr>
<td>11</td>
<td>Service Company No.2  Venture capital investment</td>
<td>Beijing</td>
<td>Yes</td>
</tr>
<tr>
<td>12</td>
<td>Service Company No.3  business consultant service</td>
<td>Beijing</td>
<td>No</td>
</tr>
<tr>
<td>13</td>
<td>Service Company No.4  education</td>
<td>Beijing</td>
<td>No</td>
</tr>
<tr>
<td>14</td>
<td>Service Company No.5  corporate training and coaching</td>
<td>Beijing</td>
<td>No</td>
</tr>
<tr>
<td>15</td>
<td>Service Company No.6  insurance</td>
<td>Beijing</td>
<td>Yes</td>
</tr>
<tr>
<td>16</td>
<td>Service Company No.7  low-interest loan and investment</td>
<td>Beijing</td>
<td>Yes</td>
</tr>
<tr>
<td>17</td>
<td>Service Company No.8  banking</td>
<td>Beijing</td>
<td>Yes</td>
</tr>
<tr>
<td>18</td>
<td>Service Company No.9  business consultant service</td>
<td>Shanghai</td>
<td>No</td>
</tr>
</tbody>
</table>

As shown in Table 9.2, Canadian mining companies, which were usually large and well-funded, have received little government support during their operations in China. The reason may be found in the following response to my request from a Canadian Commissioner Brandon Geithner working in the Canadian Embassy in China in early 2005.
“By and large these mining houses are well funded with their own network. So in my experience, I have not been approached to assist in finding a JV (joint venture) partner for any mining company. Remember that the Chinese mining companies are large SOEs, which makes them easy to spot. Often partners are also local players with guanxi in the province of origin” (Email exchanges with Brandon Geithner on March 3, 2005).

Compared with SMEs, Canadian large firms in China were generally satisfied with the Canadian government’s support and high-level public relations. For instance, whenever they needed help from the Embassy, they could always receive assistance. As one interviewee from a large Canadian company investing in China remarked, “I think it all depends on the size of the project, not the company. The project has to be big enough to mobilize the Embassy people” (Manufacturing Company No.2).

In sum, Canadian SMEs have received little, if any, help from the Canadian government with their business development in China and the results of this study suggest that it could be usefully extended. For example, there is no official Canadian Chamber of Commerce in Mainland China. At present, the Canada China Business Council (CCBC) shoulders the task of helping Canadian companies doing business in China. But due to their limited financial and personnel resources, the CCBC sometimes can only help large firms who can pay higher consultant fees (personal interview with CCBC Beijing Chapter manager, February 23, 2005). Canadian International Development Agency (CIDA), and more recently the Export Development Canada (EDC) were able to provide limited aid or technical assistance and insurance to Canadian projects in developing countries. However, these agencies devoted only a limited percentage of their resources to promoting SMEs’ business in China (Fujita, 1993; personal interview with China Region Manager of the EDC, June 1, 2005).

Another important Canadian agency in China has been the trade commission program of the Canadian Embassy in Beijing. However, the Embassy had only 30 trade commissioners in 2005. Furthermore, helping Canadian firms to invest in China was not included in their mandate. As trade commissioner Brandon Geithner wrote to me in responding to my inquiry, “The
Canadian Trade Commissioner Service is committed to supporting Canadian companies who have researched and selected China as a target market for their products, services or technologies. Our focus is twofold, one, enhancing the export of Canadian goods and services to China and two, promoting Chinese investment into Canada” (email exchanges on February 20, 2005). In other words, promoting Canadian investment into China was not included in their mandates.

For the Canadian government, the prominent task should be providing more specific support services for Canadian firms operating in China (such as market information, financial support, and assistance to identify potential partners). This could be carried out for SMEs (small and medium-sized enterprises) free of charge or at a very low price on the principle of providing a ‘public good’. Measures may involve establishment of some organizations or agencies that exclusively support SME projects in developing countries such as China (e.g. a Chinese Investment Commission in Beijing).

To solve the issue of drawing more support for Canadian companies in China, the Canadian government may want to learn from the “New Asia Policy” initiated by the German government in 1993, which aimed at increasing German direct investment in Asia (Wang, 1994). Following the “New Asia Policy” model, the first step could be establishing consulting offices by federal or provincial governments of Canada exclusively helping Canadian SMEs with local market knowledge and information, encouraging provincial-level business exchange, or organizing investment fairs more frequently. However, the most important thing for a successful Canadian investment policy would be to make Asia, particularly China, as a strategic keystone of Canadian trade and investment. The German government recognized the strategic importance of Asia in 1993 as its main solution to become an economic superpower in the 21st century (ibid). It is still not too late for Canada to do so even now.
9.4 Implications for Future Research

9.4.1 Limitations of This Research

This dissertation comprises a study of transnational corporations investing from a developed country (Canada) to a developing country (China). Since the research employs a methodology combining statistical data analysis with personal interviews, we cannot escape the limitations brought by this methodology as well as the views taken from our interviewees.

One major limitation of the study was that it was only conducted on the Chinese side, without interviews with corporate head offices in Canada. The views of Canadian managers working in China might be very different from those of their colleagues and executives in Canadian head offices. Actually, many interviewees pointed out that difference in views between the head office and the local office in China was also one of the major difficulties of their operations in China (see a quote from Service Company No.9 in Chapter 7). So to reiterate, the problems of Canadian companies in China discussed in this study were mainly from the points of view of Canadian managers working in China, which may be very different from their bosses back in Canada. It is also reasonable to expect that the Chinese managers in Canadian-invested companies in China may have very different views from their Canadian colleagues too.

Also, it should be noted that the sample size of this study - 18 firms - was small. They are not statistically representative of all Canadian firms in China, and thus may skew the results of the research. However, the face-to-face interviews have allowed me to capture the actual experience of these Canadian firms, which could not be obtained by conducting a large-scale questionnaire survey. The interviews were sufficiently in-depth that they revealed certain important themes that were significant in shaping the success (or otherwise) of Canadian firms in China, and the interviews also showed some interesting differences in conditions facing different types of firms - mining, manufacturing and services.
Regarding the Canadian managers in China, one should also be aware that they are far from a homogeneous group. In fact, their personal knowledge about, connection with, and experience in, China are all playing important parts in shaping their opinions of their business operations in China. One typical example is that the opinion of Canadian managers with Chinese origins and that of Caucasian Canadian managers were very different, due to differences in cultural background and cultural understanding. For instance, on June 5, 2005, I interviewed the CEOs of two Canadian manufacturing firms in the Suzhou Industrial Park (SIP). One interviewee was a Caucasian who had never worked in China before, and the other was a Chinese Canadian, born in Hong Kong, and who had grown up in Canada. Working in the same industrial park, these two CEOs shared similar difficulties and problems caused by the Park, such as rising cost of doing business in the SIP, the problem of labor attraction and retention, the issue of government corruption, the lack of transparency and so on. However, the Caucasian manager was very pessimistic about the operation of his company in Suzhou. He attributed all his difficulties to the endemic problem of the one-Party-ruling system of China, and he did not see any hope of China in the future if China kept the same system. On the contrary, the Chinese Canadian CEO did not state many complaints about the situation of his company in Suzhou. Instead, he looked at the whole situation with a more understanding view from a historical and cultural aspect.

In fact, it is very common among my interviewees (over 80% of them) that those who have Chinese origins, or who have more connection with and knowledge about China, dealt with their difficulties in China in a more optimistic way. Essentially, they could adapt to their role in China more easily and quickly than Caucasian managers. This is an important finding that Canadian companies should be aware of when assigning expatriates to their Chinese subsidiaries.

In this study of Canadian FDI in China, Canadian firms act as an intermediate with interactions between their home and host country characteristics. In this process, Canadian firms constantly negotiated with their host state agencies, partners, customers, suppliers, as well as
other actors in both home (e.g. executives in headquarters) and host countries in many different ways, as demonstrated in the three case study chapters. However, as discussed in Chapter 1, I could not catch in interviews the actual bargaining process between Canadian TNCs and local officials as well as other market actors, as this was deemed to be in the category of ‘business secrets’, and consequently my respondents were reluctant to reveal any details.

9.4.2 Future Research

The scope of research (whether be narrow or broad) is always problematic in the sense that in the end, one always feels his/her research is not narrow or broad enough. This dissertation is a rather broad in nature as it covers three different sectors of Canadian economy, and makes a comparison between them. On the other hand, this study is also quite narrow and down-to-earth, as it touched on the real life of Canadian firms operating the Chinese market and the feelings expressed by Canadian managers working in China.

Future studies of Canadian companies in China could proceed in two different directions, either broader or deeper. On the one hand, since the current study only interviewed less than 20 Canadian managers in China, further research could undertake a larger survey, reaching as many Canadian firms in China as possible. Based on such a survey, more statistical analysis could be undertaken and a more convincing pattern of Canadian investment in China may emerge. Of course, such a study would need more financial assistance and it would have to involve more actors in the process, as outlined above. Moreover, opinions from actors other than Canadian managers in the management team of Canadian companies in China might be taken into account in order to draw a more complete picture of the experience of Canadian firms in China. These actors should include Chinese managers in China, Chinese partners of Canadian companies, and Canadian managers in Canadian headquarters (see APFC and CME, 2006). On the other hand, future studies could probe deeper by focusing on particular industries, such as the gold-mining
industry, the auto parts industry, the business consulting industry, education, finance, and so on. Since this study found that each industry has its own particular regulatory and business environment, it would be interesting to draw different patterns and share experiences of Canadian firms in a wider number of industries.

Other results in this study do suggest a strong national-factor bias. Canadian country factors, such as the typically small-scale risk aversive firms, are likely to affect the investors’ profile very much and play a part in their strategies as well. Chinese regulations and an unfamiliar business environment make investment expensive. Canada is a useful case study to look at the experience of western investors in China and this study has laid a good foundation for future comparative researches. Interviewing investors from other parts of the world and comparing their performance in China with that of Canadian firms in similar sectors is the natural extension of the research. In this way, it would be easier to understand what part of the results is driven by country-specific determinants and what is instead independent of them.
Bibliography


Quorum Books.


Appendices

Appendix 1 Sample Question List

1. When was your company set up in China?

2. Why did your company invest in China?

3. Has your company invested in other countries?

4. How many people are employed now in your company? What is the percentage of local Chinese employees? Is the CEO Chinese-Canadian, or a local Chinese person?

5. How do you compare the quality of your Chinese employees with those in Canada?

6. How competitive is your company in your industry in the China market? Are you making profits now?

7. What were the major difficulties during the formation and operation of your company in China?

   (a) Cultural factors: Are there any special cultural differences when dealing with local suppliers, customers, and your own workers? Or are there any special cultural problems in the ways of doing business here in China?

   (b) Institutional factors: have you experienced problems with corruption, excessive bureaucracy, lack of transparency, hostile legal environment (contract enforcement), or changing regulations?

   (c) Economic factors: have you experienced problems with poor infrastructure, low labor quality, or restrictions on currency exchange?

8. What were your solutions to overcoming these problems?

   (a) Cultural factors
   (b) Institutional factors
   (c) Economic factors

7. Do you have any local suppliers?
   a) How did you find them?
   b) Are there any problems dealing with them?
   c) Any are they any quality problems in their raw materials or other supplies?
   d) Are they reliable?

8. Do you export your products?
   a) Are most of your products consumed in the China market?
b) Does this facility mainly serve the China market or the global market?

9. What do you do if your business partners do not honor their contract?

10. Have you got any help from the Canadian government (e.g. the Embassy) when entering as well as operating in China?

11. How helpful were they?

12. Do you have any plan to establish another facility in China?

13. How do you see your future in China?

14. What would you suggest to other Canadian firms that want to invest in China?
# Appendix 2 List of Canadian Companies Interviewed

<table>
<thead>
<tr>
<th>Title of interviewee</th>
<th>Chinese origins?</th>
<th>Company code</th>
<th>Sector</th>
<th>Date of Entry</th>
<th>Interview place</th>
<th>Interview date</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 President</td>
<td>Yes</td>
<td>Mining Company No.1</td>
<td>onshore oil and gas exploitation</td>
<td>1994</td>
<td>Beijing</td>
<td>June 10, 2005</td>
</tr>
<tr>
<td>2 CEO</td>
<td>No</td>
<td>Mining Company No.2</td>
<td>gold mining</td>
<td>1994</td>
<td>Beijing</td>
<td>June 21, 2005</td>
</tr>
<tr>
<td>3 Chief Representative</td>
<td>No</td>
<td>Mining Company No.3</td>
<td>gold and copper mining</td>
<td>2004</td>
<td>Beijing</td>
<td>June 25, 2005</td>
</tr>
<tr>
<td>4 President and General Manager</td>
<td>No</td>
<td>Manufacturing Company No.1</td>
<td>food processing equipment</td>
<td>1994</td>
<td>Hebei</td>
<td>April 20, 2005</td>
</tr>
<tr>
<td>5 Chief Representative</td>
<td>Yes</td>
<td>Manufacturing Company No.2</td>
<td>metal processing and manufacturing</td>
<td>1986</td>
<td>Beijing</td>
<td>April 22, 2005</td>
</tr>
<tr>
<td>6 General Manager</td>
<td>Yes</td>
<td>Manufacturing Company No.3</td>
<td>medical software sales and development</td>
<td>2004</td>
<td>Shanghai</td>
<td>June 8, 2005</td>
</tr>
<tr>
<td>7 Factory Manager</td>
<td>No</td>
<td>Manufacturing Company No.4</td>
<td>Telecommunication equipment</td>
<td>2002</td>
<td>Suzhou</td>
<td>June 3, 2005</td>
</tr>
<tr>
<td>8 General Manager</td>
<td>No</td>
<td>Manufacturing Company No.5</td>
<td>Transportation equipment</td>
<td>1996</td>
<td>Shanghai</td>
<td>June 8, 2005</td>
</tr>
<tr>
<td>9 General Manager</td>
<td>Yes</td>
<td>Manufacturing Company No.6</td>
<td>equipment manufacturing and export</td>
<td>2003</td>
<td>Suzhou</td>
<td>June 3, 2005</td>
</tr>
<tr>
<td>10 General Manager</td>
<td>No</td>
<td>Service Company No.1</td>
<td>logistics service</td>
<td>2004</td>
<td>Beijing</td>
<td>April 19, 2005</td>
</tr>
<tr>
<td>11 Chief Representative</td>
<td>Yes</td>
<td>Service Company No.2</td>
<td>Venture capital investment</td>
<td>1993, 2004</td>
<td>Beijing</td>
<td>March 31, 2005</td>
</tr>
<tr>
<td>12 President &amp; CEO</td>
<td>Yes</td>
<td>Service Company No.3</td>
<td>business consultant service</td>
<td>1997</td>
<td>Beijing</td>
<td>May 11, 2005</td>
</tr>
<tr>
<td>13 President &amp; CEO</td>
<td>Yes</td>
<td>Service Company No.4</td>
<td>education</td>
<td>2002</td>
<td>Beijing</td>
<td>June 22, 2005</td>
</tr>
<tr>
<td>14 CEO</td>
<td>Yes</td>
<td>Service Company No.5</td>
<td>corporate training and coaching</td>
<td>1996</td>
<td>Beijing</td>
<td>April 6, 2005</td>
</tr>
<tr>
<td>15 General Manager</td>
<td>No</td>
<td>Service Company No.6</td>
<td>insurance</td>
<td>2002</td>
<td>Beijing</td>
<td>May 24, 2005</td>
</tr>
<tr>
<td>16 Regional Manager</td>
<td>Yes</td>
<td>Service Company No.7</td>
<td>low-interest loan and investment</td>
<td>1979</td>
<td>Beijing</td>
<td>June 1, 2005</td>
</tr>
<tr>
<td>17 Chief Representative</td>
<td>Yes</td>
<td>Service Company No.8</td>
<td>banking</td>
<td>1982</td>
<td>Beijing</td>
<td>May 27, 2005</td>
</tr>
<tr>
<td>18 General Manager</td>
<td>No</td>
<td>Service Company No.9</td>
<td>business consultant service</td>
<td>2003</td>
<td>Shanghai</td>
<td>June 7, 2005</td>
</tr>
</tbody>
</table>
Appendix 3 Milestones in Canada-China Relations

1970
Canada and the People's Republic of China (PRC) establish diplomatic relations.

1971
Canada establishes a Canadian diplomatic mission in PRC, and PRC opens an embassy in Ottawa. Minister of Industry, Trade and Commerce Jean-Luc Pepin leads the first official Canadian delegation to PRC.

1972
Canada and PRC hold the first official sports exchange. China sends table tennis players, swimmers and divers to Canada. Canada sends ice skaters, a basketball team and badminton players to China.

1973
Pierre Trudeau is the first Canadian prime minister to pay an official visit to PRC. During the visit, Canada and China sign an agreement calling for the opening of consular missions in each country.

1979
Canada and PRC sign an economic co-operation protocol to establish a joint committee to review bilateral trade issues, and to promote trade in high technology goods and services.

1984
PRC Premier Zhao Ziyang visits Canada. He is the first Communist leader to address Parliament.

1990
Two-way trade exceeds $3 billion. Capital goods constitute 50 per cent of total Canadian exports to PRC.
1992
Two-way trade reaches $4.6 billion.

1994
Canada establishes its four-pillar policy on PRC: economic partnership; sustainable development; human rights, good governance and the rule of law; and peace and security.
Prime Minister Jean Chrétien visits Beijing and Shanghai with Team Canada: two ministers, nine provincial premiers, the territorial leaders and the head of the Federation of Canadian Municipalities. Chrétien and Premier Li Peng sign a nuclear co-operation agreement and a letter of intent on six development projects in PRC.

1995
PRC Premier Li Peng visits Canada to commemorate the 25th anniversary of bilateral relations and attends Canada-China Business Council annual general meeting in Montreal.

1996
Prime Minister Jean Chrétien, Minister of International Trade Art Eggleton and Secretary of State (Asia Pacific) Raymond Chan visit Shanghai to attend the annual general meeting of the Canada-China Business Council.

1998
Chrétien, Minister of International Trade Sergio Marchi and Secretary of State (Asia Pacific) Raymond Chan visit Beijing (attending the Canada-China Business Council annual general meeting) and Lanzhou (visiting Canadian-funded development projects). Several Canada-China agreements are announced during the prime minister's visit.

1999
PRC Premier Zhu Rongji visits Canada.

2001
Team Canada visits Beijing, Shanghai and Hong Kong. It is the largest trade mission in
Canadian history. Chrétien is accompanied by close to 600 business participants, eight provincial premiers, three territorial leaders, Minister for International Trade Pierre Pettigrew and Secretary of State (Asia-Pacific) Rey Pagtakhan.

2003

Premier Wen Jiabao visits Canada.

2005

President Hu Jintao visits Canada on a state visit and meets with Prime Minister Paul Martin. The two leaders announce a "strategic partnership" and said they would double trade within five years. Martin said he had discussions about human rights with Hu.

2006

After Stephen Harper and his Conservatives win the election in January, the federal government cools its relations with China. Ottawa offends Beijing with a number of moves, including awarding honorary Canadian citizenship to the Dalai Lama, criticizing China's human rights record, accusing it of commercial espionage, long delaying a meeting between foreign ministers and making favourable noises toward Taiwan. The Chinese ambassador to Canada says the two nations can "handle their differences" and build "mutual respect." However, in November 2006, China backs out of meeting between Harper and the Chinese president in a move widely seen as a snub. Beijing later says the meeting will go ahead.

### Appendix 4 China's Liberalization Commitments on Service Sector: Past, Present and Future (Mode 3: commercial presence)

<table>
<thead>
<tr>
<th>PROFESSIONAL SERVICES</th>
<th>1994</th>
<th>2001</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Legal services</td>
<td>No commitments (which means not open to FDI at all)</td>
<td>Only through one representative office which is allowed to engage in profit-making activities, but only in specified cities. Business scope restricted to home country legal affairs for Chinese and China-based clients, and to entrusting, on behalf of foreign clients, Chinese law firms to deal with Chinese legal affairs.</td>
<td>Continued restrictions on business scope Geographic and quantitative limitations will be eliminated by 2002</td>
</tr>
<tr>
<td>Accounting, auditing and bookkeeping services</td>
<td>Through branch offices and CJVs subject to limitations on minimum size, aggregate number (15), and geographical scope (SEZs). Auditing reports are only valid if a Chinese CPA title is obtained.</td>
<td>Fully liberalized except that partnership and incorporated accounting firms are limited to CPAs licensed by Chinese authorities.</td>
<td></td>
</tr>
<tr>
<td>Taxation</td>
<td>Through branch offices subject to limitations on minimum size and geographical scope (SEZs).</td>
<td>Only through CJVs, with majority foreign ownership permitted</td>
<td>None, wholly foreign owned subsidiaries permitted by 2007.</td>
</tr>
<tr>
<td>Architecture and engineering</td>
<td>Only through an EJV or CJV. Registered in own country</td>
<td>Only through an EJV or CJV. Registered in own country and engaged in architecture/engineering services in home country</td>
<td>Wholly foreign owned subsidiaries permitted by 2006</td>
</tr>
<tr>
<td>Urban planning (excluding general urban planning)</td>
<td>unbound</td>
<td>Only through an EJV or CJV</td>
<td>Wholly foreign owned subsidiaries permitted by 2006</td>
</tr>
<tr>
<td>-----------------------------------------------</td>
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<td>--------------------------</td>
<td>-----------------------------------------------</td>
</tr>
<tr>
<td>Medical and dental services</td>
<td>Only through an EJV or CJV with a quantitative limitation based on a needs test and approval by the Ministry of Public Health and MOFTEC. CJV or EJV solely responsible for foreign exchange balance and profits and losses. Majority of personnel must be Chinese.</td>
<td>Foreign majority ownership explicitly permitted, and not required to accept sole responsibility for foreign exchange balance and profits and losses. But still subject to quantitative limitations based on a needs test.</td>
<td>Full foreign ownership not allowed and needs-based quotas.</td>
</tr>
</tbody>
</table>
Appendix 5  Ethical Review Approval Certificate

Certificate of Approval

PRINCIPAL INVESTIGATOR
Edginton, D.

DEPARTMENT
Geography

NUMBER
B04-0632

INSTITUTION(S) WHERE RESEARCH WILL BE CARRIED OUT

CO-INVESTIGATOR(S)
Wang, Baoling, Geography

SPONSORING AGENCIES
Social Sciences & Humanities Research Council

TITLE:
Canadian Firms in China: Impediments and Solutions

APPROVAL DATE
OCT 28 2004

TERM (YEARS)
1

DOCUMENTS INCLUDED IN THIS APPROVAL:

CERTIFICATION:
The protocol describing the above-named project has been reviewed by the Committee and the experimental procedures were found to be acceptable on ethical grounds for research involving human subjects.

Approval of the Behavioural Research Ethics Board by one of the following:
Dr. James Frankish, Chair,
Dr. Cay Holbrook, Associate Chair,
Dr. Susan Rowley, Associate Chair
Dr. Anita Hubley, Associate Chair

This Certificate of Approval is valid for the above term provided there is no change in the experimental procedures