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Samphantharak, Krislert (2011), The Rise of China and Foreign Direct Investment from Southeast Asia, in: *Journal of Current Southeast Asian Affairs*, 30, 2, 65-75.
ISSN: 1868-4882 (online), ISSN: 1868-1034 (print)

The online version of this article can be found at:
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Published by
GIGA German Institute of Global and Area Studies, Institute of Asian Studies and Hamburg University Press.

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The Rise of China and Foreign Direct Investment from Southeast Asia

Krislert Samphantharak

Abstract: This paper discusses foreign direct investment from Southeast Asia to China. With the exception of some government-linked companies, most investments from Southeast Asia have been dominated by the region's overseas Chinese businesses. In addition to cheap labour costs, large domestic market and growing economy, China has provided business opportunities to investors from Southeast Asia thanks to their geographic proximity and ethnic connections, at least during the initial investment period. However, the network effects seem to decline soon after. As the Chinese economy becomes more globalised and more competitive, the success of foreign investment in China will increasingly depend on business competency rather than ethnic relations.

■ Manuscript received 28 May 2011; accepted 15 September 2011

Keywords: China, ASEAN, FDI, Overseas Chinese businesses

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Introduction

The rise of China on the global economic landscape during the past three decades almost requires no introduction.[1] Although still considered a middle-income country, the Chinese economy has grown at an average rate of approximately 10 per cent per year between 1978 and 2007, at least according to the official statistics. Even after the global economic crisis began in 2008, the economy still managed to grow and regained a growth rate of approximately 10 per cent in 2010. [2] Although foreign direct investment (FDI) has never been more than 15 per cent of total gross fixed investment in China, it has been considered as one of the driving forces behind China's rapid economic growth during this period. Despite its virtual nonexistence since the establishment of the People's Republic of China in 1949 until the implementation of economic reforms in 1978, inward FDI to China reached one billion USD in 1984, 4.4 billion in 1991, 41 billion in 2000, and peaked at 108 billion USD in 2008 before declining in 2009 due to the global financial crisis. By 2009, China has accumulated more FDI stock and received annual FDI inflows more than either Brazil, India or Russia. FDI in turn feeds back into China's economic growth by contributing to capital accumulation, new technology, and those export markets already familiar to the foreign multinational corporations (Davies 2010).

Although most FDI inflows to China in the initial period were in greenfield investment, the reforms of state-owned enterprises and business regulations in the late 1990s led to an emergence of mergers and acquisitions (M&A) FDI in the past decade. In general, there are two main reasons for inward FDI to China from the perspective of foreign investors: market-seeking and efficiency-seeking incentives. As the world's most populous economy with rapid growth and rising incomes, China has enormous and growing domestic demand for goods produced by foreign firms. Also, China's large labour supply with relatively low wages attracts firms that outsource their labour-intensive production activities. Both large M&As and recent greenfield investments tend now to focus on China's domestic demand rather than export markets. In terms of sectoral distribution, most FDI inflows to China have been in manufacturing (46.1 per cent of China's total FDI inflows in 2008), followed by real estate (17.2 per cent) (Davies 2010).

[1] This paper was presented at the annual conference of the Association for Asian Studies in Honolulu, Hawaii, in March 2011. I would like to thank participants for useful comments.

[2] The numbers are based on the National Bureau of Statistics of China.

Foreign Direct Investment from Southeast Asia to China

The largest sources of FDI to Mainland China are Hong Kong and Macau (34 per cent during 2006-08) while Japan and the US have been competing for the second and third places (8.8 and 7.6 per cent during the same period, respectively). Besides Hong Kong and Macau and Japan, FDI inflows from other Asian economies have originated from Taiwan, Korea, and Singapore. With the exception of Singapore, total FDI from Southeast Asia to China has been relatively small compared to total FDI inflows to China. The total cumulative contractual FDI inflows to China from all ASEAN countries during 1979-2006 was only 6.1 per cent of total FDI to China (5.1 per cent for realized FDI). Among ASEAN economies, FDI from Singapore account for 65 per cent of total FDI from ASEAN to China.[3]

Compared to FDI from developed western countries, FDI from emerging Southeast Asian economies has some unique characteristics. First, these emerging economies have expertise in production technology that fits well with China's development strategy. For example, most of them have experience in labour-intensive and capital-intensive production (as opposed to research and development based production). They are also specialized in production for export. In fact, although western firms produce more output in terms of total sales, Asian firms investing in China produce more for export markets (Ampalavanar-Brown 1998). They also have knowhow in some sectors traditionally not specialized by either Chinese or western firms, e.g. agrobusiness or hospitality services. Investments in feedmill, farming, and food processing manufactures from Thailand's Charoen Pokphand (CP) group or investments by Shangri-La hotels in China, led by a Malaysian business tycoon Robert Kouk, illustrate this pattern. Second, financial liberalisation in emerging Southeast Asian economies during the late 1980s and early 1990s allowed corporations in Southeast Asia to invest abroad. China's geographic proximity, together with its low labour costs, and large domestic market, made it an ideal destination for investment from Southeast Asia. Third, corporate sectors in these Southeast Asian economies have been dominated by overseas Chinese businesses, which frequently have connections to relatives of their ancestors in Mainland China. These connections were beneficial for overseas Chinese businesses in Southeast Asia who wanted to invest in China, at least during the initial period. Finally, economic

[3] Nyaw 2008. Note also that the number of FDI projects from ASEAN to China could be well understated as some investments were made through Hong Kong or other offshore financial centers.

cooperation between ASEAN and China, including international investment, has been encouraged and supported since Deng Xiaoping's "Southern Tour" to Southeast Asia in 1992. China also has viewed Singapore as a model for development, combining free markets with a strong state.

Overseas Chinese Businesses in Southeast Asia: A Brief Background

Although their contribution to the economies of the fast-growing Southeast Asian economies is debatable, the overseas Chinese have undeniably controlled the corporate sector of the region. Given the share of people of Chinese origin in the region, this phenomenon is paradoxical. With the exception of Singapore where 70 per cent of total population is of Chinese origin, only 30 per cent of Malaysian population are Chinese. In Thailand, Indonesia and the Philippines, the percentages are even lower at 10 per cent, 3 per cent and 1 per cent, respectively.[4] These percentages are a long lasting remnant of two important historical events in this region: the migration of overseas Chinese into Southeast Asia and the colonisation of the region by western powers.

Although migration from China to Southeast Asia could be dated back to the 16th century and continued through the colonial era, the mass migration happened in the 19th century. On the one hand, the Industrial Revolution in Europe had led to a high demand for primary products from Southeast Asia. These products included spices, sugar, rubber, tobacco, coconut, coffee and minerals such as tin. Expansion of agricultural plantations and mining called for more labourers, which were often imported to the region from China and India, hence creating the pull factor for migration into Southeast Asia. During the same period, both economic difficulties and political unrest in Mainland China, especially the Opium Wars (1839-42; 1856-60), as well as the pressure from high population densities on China's limited arable land, generated the push factor for people to migrate out of China.

Initially many Chinese immigrants were poor and worked as labourers in plantations or mines. Many later moved upward socially and economically and worked in services and trade, while the native people remained largely in agriculture and the westerners operated large enterprises. Since the Chinese immigrants were initially interested in accumulating wealth and then going

[4] Yoshihara 2000. Note that these numbers are approximate and the numbers of people of Chinese origin in Thailand, Indonesia, and the Philippines are hard to pin down due to interracial marriages over many decades.

back to China, they had little desire to settle permanently. This sojourner status consequently allowed them to accumulate wealth while not threatening the control of the western or local rulers (although suppression of businesses owned and run by the Chinese did exist). This wealth accumulation was not the case for the indigenous people.

The entrenchment of overseas Chinese businesses became more evident during the Second World War when western businesses were disrupted due to the invasion and occupation of Japanese troops. When the war was over, the markets that previously belonged to the western firms had often been taken over by Chinese firms. Moreover, the post-colonial, anti-western, nationalist policies adopted in most part of Southeast Asia, e.g. nationalisation of Dutch assets in Indonesia during the Sukarno period, also led to the shortage of goods and services previously provided by western firms, which, again, were filled in by Chinese businesses.

The establishment of the People's Republic of China in 1949 changed the attitudes of many overseas Chinese and they no longer desired to return to the Mainland China. At the same time, they were facing with increasing discrimination against their businesses and social practices. These policies were made explicitly in Malaysia's New Economic Policy (NEP) that was implemented after serious race riots in 1969. The NEP gave several privileges to the ethnic Malays (*bumiputera*) and their businesses at the expense of the Chinese. Indonesia introduced similar policies although they were less explicit than in Malaysia. Even in Thailand where the Chinese assimilated quite well with native people culturally, nationalist policies discriminating against the Chinese were imposed by Marshall Pibul in the immediate post-war period. Such vulnerability, faced by many Chinese businesses, led to the formation of the government-business alliances between indigenous politicians and Chinese capital. These connections gave the Chinese businesses several privileges including monopoly licenses to import, or to start businesses. In turn, wealth accumulated by the Chinese was shared with the politicians. This symbiosis has been the hallmark of Southeast Asia's corporate sector since the 1950s. In much of the region, there has been rapid expansion and domination of overseas Chinese businesses in many economic sectors.[5]

Globalisation during the past few decades has also had important implications for overseas Chinese businesses in Southeast Asia. Not only did the large overseas Chinese business conglomerates expand their operations domestically, they were also increasingly engaged in investing in foreign

[5] For more details on overseas Chinese and colonialism in Southeast Asia, see Jomo and Folk 2003 and Booth 2007.

countries. The opening of the Chinese economy to the global economy, together with their comparative advantage of doing business in China discussed earlier, led to increasing investment and cooperation between Southeast Asian businesses and those in Mainland China. Initially, the investment from Hong Kong, Macau, Taiwan, and Southeast Asia focused only on small and medium sized enterprises in the Pearl River delta. This investment was mainly in consumer product industries for both domestic markets and exports. There were some exceptions; for example, the Charoen Pokphand group from Thailand invested in a large joint-venture in agrobusiness in the special economic zone of Shenzhen in 1979. In 1984 the Shangri-la group from Malaysia opened a hotel in Hangzhou, the first one outside Southeast Asia. Recent investments from Southeast Asia in China have been extended into consumer products, automobiles, minerals, telecommunication, and retail and wholesale trade.

Southeast Asian Investors in China

Although there are no concrete statistics, most FDI from Southeast Asia to China has been from both the private sector and from government-linked enterprises. Unsurprisingly, private sector investors are mostly overseas Chinese business conglomerates, the dominant players in the corporate sector in most parts of Southeast Asia who also have cultural ties to Mainland China. Many of the investments by Southeast Asian firms are in the form of joint-ventures with western and Japanese multinational corporations, Chinese domestic private firms, or China’s state-owned enterprises. In order to get a better picture of Southeast Asian investors, we consider some of their businesses in China briefly in this section.

One of the first foreign investors in China was the Charoen Pokphand group (CP) from Thailand, which continues to be the most dominant Thai investor in China to the present day. CP initially focused on agrobusinesses which ranged from animal feeds, corn, vegetable oil, livestock, to biotechnology. But CP later expanded to other sectors as well. For example, in 1990 it formed a joint-venture with Shanghai Beston Petrochemicals to produce leather and sheet plastics, non-toxic PVC roller blinds and plastic fencing, and rainwear for outdoor work and leisure. In the mid-1990s, CP started a venture with three Makro outlets, supplying a wide range of products to wholesale and registered retail customers in China. Those outlets were later wholly taken over by the CP Group and integrated into Lotus Supercenter, CP’s retail stores. A Lotus store was first opened in 1997 in Shanghai, and there are currently more than 70 stores throughout China. In 2002 CP also opened a Super Brand Mall in Shanghai, one of the largest downtown and commercial retail centers in China. Other Thai investors in China are also mainly large overseas Chinese business conglomerates, including Saha-Union, Kasetrungrueng (Soon Hua Seng), Red Bull, Bangkok Bank, Thai Farmers Bank, M-Thai Group, Mitphol Group, and Central Group, among others (Manarungson 2009).

Similarly, overseas Chinese business tycoons from Malaysia have been active in investing in China. Robert Kuok, the richest man in Malaysia, is best known in China for his Shangri-La luxury hotel chain. Like Thailand's Charoen Pokphand, Shangri-La entered the China market relatively early, opening the first Chinese Shangri-La hotel in Hangzhou in 1984. This hotel was only the third Shangri-La to be opened, the first two being built in Singapore and Malaysia. Since then, the Shangri-La chain has gone global. Of more than 270 Shangri-La hotels and resorts currently in operation worldwide, more than 30 are located in China. Another Kuok company, Kerry Property, established in 1978 in Hong Kong, has also operated in China as a property investment and development firm, focusing primarily on commercial and luxury residential projects in Mainland China. In 1984, Kerry Property committed to building the China World Trade Center in Beijing, which was completed five years later to form the centerpiece of Beijing's Central Business District. More recently, the Shangri-La brand and Kerry Property have formed a joint-venture and agreed to invest in hotel, commercial and residential projects in Mainland China. The blending of brands has continued with the recent debut of a new five-star luxury "Kerry Hotels" brand in Shanghai in February 2011, under Shangri-La management. Another Malaysian conglomerate, Guoco Group, made a slow and quiet entrance into the property market in the late 1990s. GuocoLand is the property investment arm of the group, which is also a member of the Chinese-Malaysian Hong Leong Group. GuocoLand developed its first commercial building in Beijing in 1998. More recently, the company began to develop sites in Shanghai, Tianjin, and Nanjing, through aggressive bidding. The company's recent strategy appears to have been to acquire development contracts during the recession, speculating on the near future recovery of the economy (Clubb 2011). Other Malaysian overseas Chinese conglomerates that have been investing in China include Lion (the Parkson department store chain), Genting (oil and gas exploration), KLK (palm oil), IOI (palm oil), Rimbunan Hijau (logging), and MUI (retailing, hospitality). Additionally, there also exist a large number of smaller scale Malaysian-Chinese businesses that direct their investments regionally in the provinces of Guangdong, Fujian, and other coastal areas of China (Lee and Lee 2006).

In addition to private firms, public investors from Southeast Asia are also involved in investment in China. These investors include Temasek

Holdings, and the Development Bank of Singapore (both from Singapore). Similarly, Thailand's Siam Cement group also falls into this category even though it is not owned and run by the Thai government but rather by the Crown Property Bureau. Unlike investment from privately held firms, investment from Southeast Asia's government-linked companies in China possesses different advantages and disadvantages. In most cases, these government-linked Southeast Asian companies have knowledge of investment and operation in specific industries as they are usually a leading company in these industries in their home country. They also have abundant capital. This is evident in the case of Temasek Holdings. With its accumulated capital over the past decades, Temasek has transformed itself from a conglomerate to a global sovereign wealth fund. Its Chineseness and the close connection between the Singaporean and Chinese governments make Temasek a unique investor in China.

But being owned by foreign states does not come without disadvantages as these government-linked companies could be seen as a foreign government's investment arm, raising the issue of national security in China. One of the solutions to this adverse perception has been a partnership established between these companies and some private overseas Chinese businesses that bring synergies from both sides. For example, in 1994 Temasek invested in Beijing Riviera, a residential real estate development, jointly with Hong Leong Holdings (an overseas Chinese conglomerate based in Singapore, Malaysia, and Hong Kong) and Keck Seng group (another overseas Chinese business group based in Malaysia and Hong Kong). In addition, this development was also made jointly with the Beijing East Suburb Agriculture Industry Commerce United Corporation, a Chinese partner. On the one hand, Lingming Guo, a leader of the Hong Leong Group Singapore, has rich experience and expertise in asset development, finance, and hotel industry. He also has extensive networks of contacts in China. On the other hand, the partnership from Temasek brought transparency and a professional image to the investment project, which helped to mitigate the perception of bad corporate governance among family firms in Southeast Asia. The Beijing Riviera development has been considered one of the earliest, largest, and most profitable projects by a Singapore consortium in China.[6]

[6] See <http://www.hongleongholdings.com.sg/about_milestones.html>.

Discussion

Scholars studying overseas Chinese businesses in Southeast Asia have long argued that the growth of those business empires was mainly due to the symbiosis between business tycoons and domestic politicians. Some studies point to the interconnected networks among overseas Chinese businesses that have facilitated fund raising for business expansion and provided insurance during difficult political times. For example, Bangkok Bank was known to be a financier of several overseas Chinese businesses throughout Southeast Asia, both inside and outside Thailand. The migration of overseas Chinese business tycoons in Burma to other countries after General Ne Win took control of the country in 1962 also exemplified the so-called "bamboo networks" in this region (Studwell 2007). Such political connections and bamboo networks still exist although they seem to be in decline, especially after the 1997-98 Asian financial crisis that led to changes in political regimes (the fall of Suharto, for example), corporate governance reforms, and the bankruptcy of inefficient businesses which previously relied mainly on political connections.

Since political connections and bamboo networks still seem to matter for overseas Chinese businesses in Southeast Asia, one may wonder whether such connections and networks have helped the overseas Chinese to invest and grow outside Southeast Asia, and especially, in our context, in Mainland China. On the one hand, it could be argued that investment decisions in China would be made more carefully than domestic investment because the businesses enjoy fewer privileges through political connections in China than they have been accustomed to at home. They have less monopoly power and more competition from other businesses in China, both domestic firms who are likely to have better political connections and western firms who are presumably more efficient. On the other hand, it is not clear that Southeast Asia's overseas Chinese businesses operating in China are all self-reliant and do not depend on assistance from their home governments. Some privileges, including financing, from Southeast Asian governments have been extended to businesses investing in Mainland China. This would not have been the case if they had invested in western economies. Examples include loans and consultancy provided by the Development Bank of Singapore (DBS) to Singaporean's businesses (Ampalavanar-Brown 1998). Also, the increase in FDI in China by Southeast Asian investors in the early 1990s was partly due to the flood of cheap capital in Southeast Asia during the credit boom. The ready supply of cheap funds in their home countries tended to encourage companies to engage in investment projects in speculative sectors or in sectors where they had little experience. When the cheap funds dried up during the Asian financial crisis, several Southeast Asian Chinese businesses in China had to abandon some or all of their operations.

Finally, the most important question we should ask is whether the successful Southeast Asian businesses in Mainland China succeeded as a result of their ethnic connections or their business competence. It seems that connections through the so-called bamboo networks might have been beneficial in the initial phase. This is reflected in the fact that initial FDI from Southeast Asia to China was mainly concentrated in the coastal, southeastern regions where the ancestors came from. However, soon after that initial period, investment spread to other locations where business opportunities existed. For example, Thailand's CP group started feedmill production in coastal Shenzhen in 1981 but soon expanded into poultry and pig farming, as well as into prawn and fish aquaculture across the China. Currently CP is operating agriculture-related facilities in 29 of China's 31 provinces and autonomous regions, including Inner Mongolia (Manarungsan 2009). Likewise, M-Thai group invested in mobile telephone networks in 1995 by forming a joint-venture with Sichuan Electronics. This pattern suggests that the advantages of ethnic connections through the bamboo networks are no longer significant and business opportunities have become the major driving force for investors. At the same time, the business environment in China has become more and more competitive. Some businesses that entered China in the early stages based on family connections are now facing more competition from newly emerging local firms or from other foreign competitors, leading to a decline in profitability. As an example, the CP group has recently experienced a drastic drop in sales and closed more than fifty per cent of its animal feed production facilities, even though it was one of the first foreign investors in China and has been a dominant player in the sector for several decades (Pananond 2006). This anecdotal example suggests that business competence becomes increasingly more important while kinship and ethnic connections may not guarantee business success in the globalising Chinese economy.[7]

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[7] Note that although the effects of kinship and ethnic connections seem to matter less over time, studies have shown that the connections with politicians still matter for doing business in China. See Li, Meng, Wang, and Zhou 2008 in the context of domestic Chinese firms, for example.

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