AN ASSESSMENT OF SELECTED INVESTMENT RISK EXPOSURES OF JOINT VENTURES IN CHINA FOR MULTINATIONAL COMPANIES HEADQUARTERED IN HONG KONG OR THE UNITED STATES

A Dissertation

Presented to the

Graduate Faculty of the

School of Business and Management

United States International University

In Partial Fulfillment

of the Requirements for the Degree of

Doctor of Business Administration

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by

Stephen Preston Preacher

San Diego, 1986

Abstract of Dissertation

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by

Stephen Preston Preacher, D.B.A.

United States International University

Committee Chairman: Mohamed A. Khalil, Ph.D.

THE PROBLEM. The research required an investigation into and an assessment of selected investment risk exposures of multinational companies headquartered in the United States and Hong Kong which have engaged in or planned to participate in joint ventures within the special economic areas or mainstream economy of China.

THE METHOD. A data sample of forty-five companies (twenty-two in Hong Kong and twenty-three in the United States) was obtained from a population of 187 published listings of parent companies with verifiable joint ventures. A questionnaire was mailed to top-level corporate managers responsible for or vitally involved in the joint venture investment decision. Each respondent was asked to provide opinion data by individually rating twenty-three risks on a continuum which indicated the degree of concern for each risk. The risks were classified as political, foreign exchange, or commercial.

The data for joint ventures in China's special economic areas and mainstream economy were analyzed using percentage comparisons, rank orders, and t-tests. Tabulations also were provided to illustrate demographic data.

THE RESULTS. It was found that the political risk of primary concern for the special economic areas was the possibility of an excessive and unanticipated rise in taxes. For the mainstream economy, the highest concern expressed was the possibility of antagonistic attitudes developing toward foreign investment. The foreign exchange risk which received the highest priority was identical for both local groups. This concern involved the potential for financial loss from the restriction of currency exchange. This factor also was rated the greatest concern of all the risks evaluated in the survey. The primary commercial risk for the special economic areas was that of an inconsistent interpretation of the Chinese legal and regulatory structure. For the mainstream economy, the greatest commercial risk was found to be the failure or inability of the Chinese suppliers of raw materials to meet delivery schedules.

It was concluded that joint ventures in China are faced with a moderate level of investment risk exposures. As a result of the two-tiered legal structure, the mainstream economy was reported to present a slightly higher political and commercial risk profile than was noted for the special economic areas.

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In loving memory of my mother,

Grace Littleton Preacher

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CHAPTER ONE

The Research Problem

Since China began its foreign investment drive in 1978, among the major uncertainties encountered by potential investors have been the risks of doing business in an environment that formerly was hostile to the free enterprise system. The United States Department of Commerce (1983) observed that investment in the People's Republic of China (PRC) through a joint venture with a Chinese partner involves a long-term commitment of capital and resources, both complex and broad-scaled. Consequently, the risk exposure has made joint ventures the least popular of the principle methods of investing. The special economic areas designated by China to encourage foreign investment were described as governed by regulations and requirements which generally do not apply to the mainstream economy. In effect, these free enterprise areas have been identified as an anomoly in a Communist society and the investment risk parameters which accompany trade within these areas must be evaluated within the context of these special areas as a microcosm.

The purpose of this study was to assess selected investment risk exposures of multinational companies headquartered in the United States or Hong Kong who have engaged in or plan to participate in joint ventures within the special economic areas or mainstream economy of China. In order to provide a focus, the following research question was established:

How do selected investment risk exposures (political, foreign exchange, and commercial) compare for Hong Kong and United States-based joint ventures located in both the special economic areas and the mainstream economy of China when evaluated by the responsible managers of parent multinational companies that signed joint venture agreements prior to June 1, 1985?

Delineation

The research was conducted within the context of American and Hong Kong multinational companies which have negotiated agreements for joint ventures within the PRC. The majority of the joint ventures in China were noted to have Hong Kong partners and to be situated within one of the special areas for economic development. Several large joint ventures, however, were located outside of these designated free enterprise areas. The short operating history of joint ventures in China and the cyclical pattern of economic and political policy swings have made an assessment of the pertinent risks which accompany such agreements a matter of particular interest, both to the multinational companies already involved and to prospective foreign investors.

Variables and Relationships

Research Question. The research question required the examination of the three independent variables (political risk, foreign exchange risk, and commercial risk) relative to joint ventures in China. For the purposes of this study, the following definitional paradigms were developed:

Special Economic Areas. The special economic areas included the four Special Economic Zones, fourteen coastal cities, and Hainan Island. These areas officially were designated as key locations for economic development, and have been accorded preferential "market oriented" treatment, legal regulations, and foreign investment incentives.

Mainstream Economy. The mainstream economy included the greater part of China which has not otherwise been designated as a location for special economic development. This economy has been described as controlled by a socialist economic system operated on the principles of Marxist-Leninist-Mao Zedong thought. Such a system reportedly lacked regional incentives specifically designed to attract foreign investors.

Joint Venture. Some confusion has been noted among the Chinese and Westerners alike concerning the meaning of the terms "contractural joint ventures", "cooperative project", "co-production venture", and "joint equity venture". The scope and definition of these terms also has been confused by the language barrier during business negotiations (Brehm, 1983:16). For the purposes the current study, the term "joint venture" has been used and defined as a partnership between the Chinese and one or more investors in which the management, capital, profits, and losses are shared on the basis of a mutual agreement.

Joint Venture Agreement. The current study defined a joint venture agreement as a formal document agreed upon by the joint venture parties regarding the main principles of establishment and operation of the venture. Such an agreement was negotiated and signed after the project proposal and feasibility study had been submitted for final examination and approval by the appropriate authority.

Multinational Company. A multinational company was defined as a firm which owned and managed business operations in two or more countries (Jacoby, 1970:38).

Political Risk. As defined by Wu (1983:13) political risk involves the disruption of foreign business activities by unanticipated political fluctuations to the point where substantial profit losses would be incurred by the affected business. Based on research conducted by Mandel (1984), eight observable elements of political risk have been for the purposes of the current study:

1. Confiscation of property - the government takeover of a foreign investment without any form of reimbursement.

2. Civil unrest - riot, war, or hostile warlike actions, revolution, rebellion, or insurrection.

3. Economic nationalism - as defined by Chao (1984), implies a lack of economic cooperation, and a shifting away from the Chinese principle of equality and mutual benefit.

4. Excessive taxation - an unanticipated rise in taxes above the preferential rates levied on joint ventures by the provisions of the income tax laws.

5. Change of regime - a change in ruling leadership involving the reversal of investment policies, or an alteration of attitudes toward foreign investment.

6. Loan restrictions - government directed bank or credit limitations imposed on foreign investors which may serve to retard normal business activities.

7. Production restrictions - production quotas or limitations on imports of components or commodities used in production.

8. Export restrictions - limitations on the export of commodities or commodities identified as strategic goods.

Foreign Exchange Risk. Mandel (1984) defined foreign exchange risk as the possibility of financial loss arising from the following three observable elements:

1. Currency devaluation - the loss of purchasing power of a local currency either as the direct result of government action to devaluate or, indirectly, as the result of sustained inflation.

2. Restriction on currency exchange - the result of irregularities, deviation in the administration, or unanticipated changes in the Regulations for Exchange Control of the People's Republic of China.

3. Delay in repatriation of funds - a delay in the transfer of funds or profits to the foreign parent company as the result of local bureaucratic inefficiencies or official policy changes. Funds has been defined as including profit, payment on loans (interest as well as repatriation of the loan), royalties, payment for managerial expertise or technical assistance, transfer pricing, and equity capital.

Commercial Risk. For the purposes of the current study, commercial risk was designated as the possibility of financial loss arising from two selected elements. These elements were identified as(1) market conditions, and (2) casualty exposure (fire, theft, accident, explosion, or liability).

1. Market conditions:

a. the failure or inability of the Chinese joint venture partner to meet contractual obligations made with the foreign investor as governed by the <u>Economic Contract Law of the People's Republic of China</u>;

b. the failure or inability of the Chinese suppliers of raw materials to meet delivery schedules;

c. the scarcity of internal economic and market data necessary to forecast and track market behavior (Ruggles, 1983);

d. price controls on finished products;

e. unproven control over future material costs (Ruggles, 1983);

f. unproven control over labor rates (Ruggles, 1983);

g. business interruptions and the subsequent loss of earnings;

h. variance in the operational interpretation of the evolving legal and regulatory structure (Ruggles, 1983); and

i. loss of control over trademarks or patent rights.

2. Casualty exposure - Wai-Kown, et al (1984) described risk exposure as limited to the following three categories in which the first two elements were selected from a survey conducted by the American International Group identifying 590 United States companies either doing business or contemplating doing business in China:

a. damage to plant and assets (from fire, theft, accident, or explosion) including mobile equipment, inventory, and raw materials, machinery, finished products, and property, buildings, and structures;

b. employer liability arising from injuries to expatriated workers; and

c. employer liability arising from catastropic industrial accidents.

The Research Approach

The research approach adopted for the current study was descriptive-elemental, since this approach describes characteristics or elements of phenomena that already exist in and of themselves. Hypotheses were neither formulated nor tested, since the rationale for a descriptive-elemental study requires the researcher to seek factual information which can provide the answer to research questions. For the present study, the purpose was to determine what degree of exposure to selected risks is perceived to exist for American and Hong Kong joint ventures in China.

Criteria for the Data Sources

The criteria for the data sources featured in the current study specified:

1. the collection of the survey data from the responsible manager in charge of foreign investment decisions (i.e., the chief financial officer) for each selected multinational company (MNC);

2. that the respondents provide opinion data based on a personal assessment of the selected risks impacting on the company decision to invest in a joint venture with China;

3. that the respondents were employed by one of the selected MNC's headquartered in the United States and Hong Kong which have signed agreements prior to June 1, 1985, for at least one joint venture involving operations based in China;

4. that the NMC's surveyed must have agreed to establish a joint venture which can be classifed in one of two locational categories:

a. one of the experimental "free market" areas designated for economic development, wich included the Special Economic Zones (SEZ's), consisting of Shenzhen, Zhuhai, Shantou, and Xiamen; the fourteen coastal cities (Dalian, Qinhuangdao, Tianjin, Yantai, Quindao, Lianyungang, Nantong, Shanghai, Ningbo, Wenzhou, Fuzhou, Guangzhou, Zhanjiang, Behai) or Hainan Island; or

b. the mainstream economy, which included Beijing and the remaining provinces and autonomous regions not otherwise designated as special areas for economic development;

5. that the joint ventures must fall under one of the industrial categories specified by the Implementing Regulations for the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment (formulated by the State Council, 1983):

a. energy, building materials, chemical, metallurigical;

b. machine manufacturing, instruments, meters, petroleum exploration equipment;

c. electronics, computers, communications equipment;

d. light industry, textiles, foodstuffs, medicine, medical apparatus, packaging;

e. agriculture, animal husbandry, aquaculture; and

f. tourist and service industries.

Background

The attention of the commercial world has been focused on China and the attempts made by this Asian nation to integrate a free market system into a centrally controlled economy. The concept of free markets, however, is not new to China. For many years, local producers and buyers have transacted daily business in what China officially has termed "peasant markets". Even after Mao's conquest in 1949, these activities have continued, although with interruptions. At the beginning of the Cultural Revolution in 1966, however, free markets were outlawed and existed only in an underground economy. During this period, government-run State stores monopolized domestic commerce (Reeder, 1983).

The fabled "China Market" has intrigued Westerners since the time of Marco Polo. Today, China's mystique, together with the commercial potential of a nation populated by over a billion people once again has captured the imagination of the world business community. China has had a long history of political instability and upheaval. In addition, China's ideology traditionally has been antagonistic toward Western attempts to introduce capitalism and there continues to be a lack of symmetry between the Chinese perspective on trade and investment and that of capitalistic enterprises.

Fung (1986) observed that, regardless of periodic readjustment, Chinese leaders anticipate that the process of economic reform will continue. To this end, Fung noted that during periods when foreign exchange is badly needed, the patterns of decentralized control were reversed, thus serving as a strong reminder that enterprises are not free to borrow, spend, and import at will. The government was reported to be far more interested in exporting goods than in throwing open the doors of the world's largest industrial and consumer market. The reality of this has become even more acute in a period of depressed oil prices, since crude oil exports represented as much as one-fourth of China's foreign-exchange earning capacity. Fung anticipated that economic development will continue to stress foreign capital investment in an effort to provides for a minimum of Chinese expenditure with a maximum of domestic control. Consequently, the Chinese government was reported to prefer that foreign direct investment be in the form of a joint venture and has structured a significant proportion of the nation's investment policies around this organizational form. The China International Consultants (1984:305) concurred with this view and noted that:

> The aim of joint ventures is to expand economic and technical cooperation with other countries, attract foreign investment, introduce advanced technology and equipment, and accelerate China's modernization programme.

In 1978, China initiated the Great Leap Outward. Reeder (1983) observed that this new series of economic reforms were initiated by the post-Mao leadership of Deng Xiaoping in a concentrated drive to modernize the economy. The views expressed by Reeder, however, indicated a cautious reservation regarding the compatibility between Communist ideology and the pragmatism of economic liberalization. Indeed, some experts were reported to believe that the apparent softening of the Stalinist-Leninist-Maoist style of socialism constitutes a pragmatic scheme for gaining economic and political strength. Cline (1986) noted that the fact that living standards have been raised, in this view, offer support for the continuing totalitarian political control of the group in power.

The risk factor has represented an area of primary concern for any enterprise seeking to participate in a direct investment in the PRC. According to Banker (1983:157):

> Nothing is more important to maintaining the profitability of international companies than the successful management of exposure to political, economic, and financial risk.

Banker observed further that, while managers have access to country risk data from outside organizations, this information is at best basic and must be integrated with the manager's own experience and understanding.

In response to the evolving investment conditions in China and the short operating history for joint ventures, managers have had to base risk analysis projections on general assumptions. Before such risks could be effectively managed, however, Banker (1983) cautioned that each must be identified properly and evaluated within the immediate context. Research addressing specifically the risk exposure specific to joint ventures within either the special economic areas or the mainstream socialist economy of China has not been observed in the literature reported to date.

Summary

The chapter presented the framework in which the People's Republic of China has sought to strengthen and modernize its economy using Chinese and foreign investment. The joint venture was reported to represent the form of investment preferred by the Chinese, whose previously hostile attitudes toward Western capitalism have provided a contrasting backdrop to the current drive for economic reform. The purpose of the study was described as the examination of specific investment risks as reported by managers of American and Hong Kong multinational companies. Each of these companies was observed to have made agreements to establish joint ventures either in China's special economic areas or the mainstream economy.

A single research question was formulated for the current study and a definitional paradigm was developed which included selected elements of political, foreign exchange, and commercial risks. The approach for the research was specified as descriptive-elemental, in which answers to the questions of "what", "how much", and "where" were sought. After establishing the criteria for data sources, a brief background for China's economic reforms was discussed in which the importance of risk factors impacting the viability of foreign joint ventures was established.

CHAPTER TWO

Review of Selected Literature

The purpose of the chapter was to provide a review of the literature related to the investment risks which affect joint ventures in China. Five major divisions have been established to create a framework for the study.

The first section provides an overview of research which deals with the importance of economic reform in China, thus creating the setting for joint venture investments. It was within this context that the significance of risk assessment has been examined in the second section, which presents a discussion of the available tools employed for risk management.

The three remaining sections represent the selected risk categories and the observable elements presented in the definitional paradigms of Chapter One. These categories were specified as including political, foreign exchange, and commercial risk factors associated with the establishment of joint ventures in China.

Background for Chinese Economic Reform

In recent years, a shift in the economic center of gravity has been taking place, thrusting the Pacific Basin countries of Asia to center stage. The phenomenal development of Japan, Taiwan, and other East Asian countries has brought these nations to the status of competitors with the United States and Europe in world markets. According to Chang (1985) this shift may continue for the balance of the next century. It was this success that has accentuated the lack of economic progress made by the People's Republic of China during Mao's regime. Chang observed that, indeed, a major effect of China's Cultural Revolution (1966-1976) was the devastation of its economic base. After Mao's death, however, Deng Xiaoping, who previously had been denounced and subjected to public humiliation for capitalist leanings, assumed the helm of power. In 1978, during the Third Plenary Session of the Eleventh Central Committee of the Communist Party, China emphasized new reform programs by "opening to the outside world". This emphasis was described as representing a break with the economic policies of the past which while proclaiming self-reliance, actually had resulted in isolationism. Deng's new policy was noted to foster a rapid and sustained pattern of balanced economic growth. Chang reported that, under Deng, a transition occurred which shifted the focus in China from the strict adherence to ideology to the implementation of pragmatism. Harding (1984) agreed with Chang's observations and delineated fundamental changes in philosophy. Harding first pointed out that modernization and national unity took precedence over class struggle, while the mobilization of the masses had given way to a more rational structure of organizations and political institutions. Social and economic problems were reported to be handled pragmatically, with a relaxation in the controls over intellectual and cultural expression. Harding also reported that, in recent years China has evidenced a higher tolerance for social inequity, managerial bureaucracy, specilization and an increase in international interdependence has been permitted and even encouraged.

In order to increase efficiency of production, DeWulf (1985) noted that China's mandatory central planning of the past increasingly has been limited to those major products which directly affect the economy. This policy shift was reported to promote the development of an incentive environment designed to vest the responsibily for the profits and losses, survival or failure of each independent enterprise on the individual business. Emphasis was moved from heavy industry to light industry, small farmers were allowed to keep profits made after state quotas had been met, and small enterprises run by craftsmen began to burgeon. While formal property rights were observed by Knight (1983) to have undergone no major changes, the relaxation of centralized control was noted to have resulted in 810,000 individually operated enterprises by 1980 (up from 300,000 in 1979) and over 1.1 million by 1981. DeWulf (1985) reported that, by 1983, private sector trade had grown to 18 percent of the total retail sales, which clearly indicated that this contribution was an irreplaceable element in the drive to raise China's living standards and further highlighting the failure of state and collective production. By 1984, China was observed to have experienced an economic growth rate of 12 percent and already to have reached the goals established by the Sixth Five-Year Plan (1980-1985). These and other phenomenal results, according to DeWulf, led some observers to wonder if China would embrace capitalism to the extent that socialism might be abandoned altogether. During this period, the moderation of ideological tenets seemed to be tempered with pragmatism as was reported by the Editoral Department, Red Flag (1982). This official source observed that, despite the long supported view that politics must take precedence over economic interests, the basic tenets of Marxism affirm the necessity for both inter-influence and interaction between these forces. It was noted further, however, that, of the two, it is the state of the economy which determines politics.

On October 20, 1984, the Third Plenary Session of the Twelfth Central Committee of the Chinese Communist Party issued several extraordinary statements indicating an apparent reversal of former policy. Included was the decision that enterprises must be judged and evaluated directly by a broad segment of consumers in the marketplace. Excellent ones will remain and inferior ones will be weeded out.

The Asian Wall Street Journal (1985a) observed that China continues this momentum upon embarking on the Seventh Five-Year Plan (1986 through 1990). Having achieved an economic growth of 23.1 percent during the first six months of 1985, one of the tasks foreseen was the necessity for preventing the economy from overheating. By targeting a balanced and sustainable growth of 6 to 7 percent a year, concentration was found to be focused increasingly on investments in telecommunication, transportation, and electrical power. This, to a large degree, represented an attempt to alleviate major obstacles to reform which already have begun to occur as a result of infrastructure bottlenecks.

The Asian Wall Street Journal (1985b) reported further that investors from the world's developed nations are viewing China's drive for economic reform as an opportunity to gain entry into a market with over a billion potential consumers. Li Yuego and Liu Shigang, Chinese economists and directors of the State Commission for Restructuring the Economic System, were cited as observing that over $17.2 billion in foreign funds have been absorbed by China since 1979. Of this amount, $13 billion was gained as a result of foreign loans, with the remainder placed in direct investments. These sources also alleged that, during the first half of 1985, contracts were signed for an additional $1 billion in loans, with another $2 billion added to direct investment and the establishment of at least 687 joint ventures.

Statistics which specify the exact amounts of funds invested and projects initiated were found by the Asian Wall Street Journal (1985c) to vary widely. Moreover, a sizable credibility gap also was observed to exist. This source cited Zhang Yuejiao, an official in the Ministry of Foreign Economic Relations and Trade (MOFERT), in reporting that foreign funds have been invested in 1,618 joint ventures. Other reports were noted to have been even bolder. As suggested in 1985 by the Peking Review, 4,773 foreign investment projects had been approved, but only 34 percent had been implemented. Of this number, 51 percent of the approved projects were described as joint ventures. The same report pointed out that 3,800 projects were in the coastal provinces of Guangdong and Fujian. The highest percentage of the investors were described as based in Hong Kong and Macao, followed by Great Britain, Japan, the United States, France, Singapore, West Germany, and Australia. According to the Asian Wall Street Journal (1985d), private businesses have grown from 686,000 only five years ago to nearly ten million in 1985. Most of these businesses, however, were shown to employ less than five people.

Bennett (1985) contended that the Chinese investment figures have been inflated through the inclusion of letters of intent and even simple expressions of interest which may never materialize. Output figures were described as distorted, gains were characterized as exaggerated. Rags to riches stories and foreign investment bonanzas were noted to be the result of fabrications that are impossible to verify. Bennett cited a Chinese scholar as saying that the Chinese were proficient in convincing foreigners to believe the information which the public was intended to believe. The problem of distortion was described as being ever present for others attempting to assess progress and also was confirmed by a Western embassy official in Beijing who expressed concern for the accuracy of the information provided even by official sources.

Hu Yaobang (1982) supported these observations and observed that the veracity of China's investors may be clouded by dazzling statistics and the wooing of foreigners to provide an infusion of high-technology industry. Since the economic reforms began, the optimistic Western media were observed by the Asian Wall Street Journal (1985d) to have minimized the importance of statements such as those made by Hu Yaobang before the Twelfth National Congress of the Communist Party in 1982. Hu cautioned against the adoption of capitalistic ideas, and the tendency to regard as superior to Chinese tradition the products and services offered by Western markets.

In a report by the Asian Wall Street Journal (1985d) it was stated that Deng Xiaoping still contended that the means of production will continue to be owned by the state, and that capitalism will remain a tool to be used as China ultimately progresses from socialism to commuinism. This observation was shown to reaffirm Article 53 of the Joint Venture Regulations which provided an enterprise permission to use a site but not obtain ownership of a site. In view of such statements, the importance of a careful and accurate assessment of the investment environment should not be minimized. The author emphasized that it is not sufficient to discount such ideological assertions as a strategy to placate internal critics.

Two major concerns of the Japanese investors were expressed by Shimakura (1985): (1) that the violence of China's policy swings from deregulation and decentralization to a more controlled structure have been pursued at an astonishing rate, and (2) apprehension regarding whether China will, in fact, continue on its course of liberalization after Deng passes from the scene. These concerns were described as expressing the general context in which a joint venture must operate, and as formulating the basis upon which environmental risks should be evaluated.

Risk Assessment

Banker (1983) asserted that for international companies, the most important element in maintaining profitability is the ability to successfully identify and manage exposure to political, economic, and financial risks. The problem was identified as the lack of development to date of precise methods for managing such exposure. Banker noted further that, as a result of this lack, companies continued to rely on "secret formulas and cookbook solutions" developed by outside organizations which also were found to have poor track records. Little, if any, of a company's own experience was included as a factor. Banker also noted that all countries have varying degrees of risk as well as profit potential, the only difference was associated with the degree of risk. Although consulting and rating organizations were noted to provide basic information, Banker emphasized that each manager must understand the risk factors of the operating environment of each company. Further, those risks were shown to require individual handling and involvement by senior line executives.

While Banker presented a general classification of risk (political, economic, and financial), Leavy (1984) suggested a wide range of several hundred elements, including socio-culture factors. Risk assessment was acknowledged to represent an immature and imprecise discipline, with an interchangeable use of relevant terminology. The inclusion of applicable factors to any specific country was described as dependent on the purpose of the assessment and on the individual responsible for performing the evaluation. Leavy distinguished three basic approaches commonly used as including: (1) sovereign risk assessment, which was described as a terminology employed by bankers when granting loans to foreign governments, (2) political risk assessment, which was said to incorporate a broad variety of meanings from political stability forecasts to all the non-business risks involved in both the social and political environment, and (3) country risk assessment, a broad term intended to include the sphere of total risk, both non-business (alpha-risk) and business (beta-risk) encountered by investors in a foreign country. Leavy noted, however, that, while many businessmen increasingly acknowledge the need to employ "rigorous and systematic approaches", only a minority actually have instituted such provisions.

In research conducted by Blank (1980), six assessment tools were ranked in order of company preference. These evaluation strategies were listed as including:

1. standardized checklists,
2. scenario developments,
3. structural qualitative formats,
4. statistical analysis,
5. computerized investment models, and
6. delphi techniques.

Leavy (1984) noted that serious complications arise when any attempts are made to formulate a numerical rating for comparisons between countries. The reason for these complications, according to Leavy, was that in every country, risk exposure largely is dependent upon the specific industry and project under consideration. Leavy cited as an example, that an extra active industry might be more prone to expropriation than a high-technology industry dependent upon foreign expertise and proprietary knowledge. In addition, it was noted that, while many industries might be successful to political instability, the same condition could provide a profitable opportunity for the armaments industry.

In a study conducted by Mascarenhas and Atherton (1983) it was determined that most executives generally are satisfied with whatever system currently is in use. Executives were found to have little confidence in sophisticated techniques and believed that the appearance of scientific precision gave a sense of false security.

Kobrin(91980) further contended that many analyses performed by political specialists were haphazard and devoid of formal assessment procedures. The actual use of integrated evaluations in which objective consideration is given to political and social environments was described as rarely incorporated into strategic decision-making. Rummel and Heenan (1978) concurred with this view and argued that an integrated approach must be taken which incorporates both subjective factors of a given environment, together with quantifiable data, in order to derive a total perception or Gestalt.

The present quantification and statistical systems, according to Casassus (1985), have produced disappointing results and the models have no power to predict reliably the situations which could develop. Country risk rankings were reported to be no more useful than a general indicator to be scanned in order to determine where detailed political and economic study should be performed. Casassus further contended that conclusions derived by the staff of the IMF and a few government agencies engaged in the analysis of economic developments have been kept secret. While some information has been released to banks and other organizations, some fear has been expressed that widespread knowledge in the marketplace would create a self-fulfilling scenario.

Baliga's study (1984) asserted that a subjective world view, or Wellanschauung, should be developed by managers who need to obtain accurate and up-to-date socio-cultural and political information when planning operations in a developing nation. Such world view was described as including not only economic rationality, but also a combination of personal and organizational expertise, values, beliefs, and culture. This type of perspective, according to Baliga, has influenced the preassessment of the investment environment as well as the decision-making method that ultimately is used. Baliga cautioned that a corporation employing executives with preconceived notions or biases about foreign countries could be left at a competitive disadvantage compared to a company with a world view for investing in developing nations.

Political Risk

Wu (1982) advised that, when developing a scheme for political risk protection, a country assessment is merely the first step. Executives must then utilize all available information to formulate an investment strategy as well as create contingency plans to deal with the risks. According to Wu, it is not enough for firms to rely upon periodic evaluations derived by local managers. Since local managers typically are part of the local elite, a good working relationship usually has been established between these individuals and the regime in power. This relationship usually makes difficult the acquisition of an independent perspective of the philosophy of opposition groups which potentially could gain control of the political system.

Political risk, according to Rummel and Heenan (1978:72) "remains one of the most misunderstood and misrepresented aspects of multinational operations". Exacerbating this problem, according to Dougherty and Specter (1982), is the reality that developing countries are susceptible to political disturbances and wide policy swings that are unpredictable. Thus, these researchers cautioned that the political factors involved in a given period should not be treated as constants, as is usually the case with econometric forecasting models.

Wu (1982) report that, in order to provide some reasonable safeguard for an international investment, a number of methods should be employed, with the realization that each had serious drawbacks. Four approaches for managing political risk were listed. These included:

1. buying political risk insurance,

2. obtaining political assessment reports from local managers on a periodic basis,

3. employing the services of professional risk analysts, and

4. maintaining a subscription to a country risk index.

Wu indicated further that the most popular of the country risk indexes included Business International's <u>Country Assessment Services</u>, Frost and Sullivan's <u>World Political Risk Forecast</u>, and Haner's <u>Business Environment Risk Index</u>.

Haner (1979) developed a system of political forecasting which analyzed ten factors. The first eight examined causes and the last two considered symptoms. These factors were listed as follows:

1. fractionalization of the political spectrum and power of resulting factions;

2. fractionalization by language, ethnic or religious groups, and power of resulting groups;

3. restrictive measures required to retain power;

4. xenophobia, nationalism, inclinations to compromise;

5. social conditions, including extremes in population density and the distribution of wealth;

6. organization and strength for a radical left government;

7. dependence on or importance to a hostile major power;

8. negative influence of regional political forces;

9. society conflict; and

10. political instability.

Wu concluded that the People's Republic of China is currently a moderately low risk country for foreign direct investment. While admitting to being optomistic, the author cautioned that the business environment, remains yet to be tested and recommended that profits and assets should be protected by whatever means available.

The lack of an operating history in China's newly established investment environment was noted by Cohen (1982) to have assumed a particular significance for long term joint ventures (ten to thirty years). After that, Cohen pointed out, the factory reverts to the Chinese. Thus, joint ventures were described as continuing to be the least popular form of investing in China. The main reasons for this, according to Cohen were that such enterprises are more complicated to create, involve the coordination of joint organization and management, involve partners from different economic systems representing different circumstances, and have different goals.

Banker (1983) pointed out that it generally is true that investors are afforded some degree of loss control by the securing the vested interest of a local partner. In the case of joint ventures in China, however, Mark (1985) observed that all activities of the firm are governed by Chinese law. Thus, in China, the firm was typified as a legal person and therefore entirely dependent upon that law for protection. China's evolving regulatory and legal structure, designed to attract and protect foreign investments, was described as having made significant progress. Banker (1983) pointed out in addition that concession agreements, even when legislated by the host government, run a high risk of emasculation or outright repudiation among the less developed countries. Nonetheless, many companies interested in admission to China's domestic market were noted to regard joint ventures as the only assured means of doing so (Mark, 1985a).

Wu (1982) identified economic reasons which support the assumption China will continue to seek foreign direct investment during the modernization phase. These reasons were noted to include:

1. the need for expanded employment opportunities for a large labor force,

2. the need for foreign capital to fund domestic industrialization,

3. the need to generate foreign exchange, and

4. the need for methods of scientific management and large-scale production.

The Chinese economist, Lou Yuanzheng (1980) agreed with Wu's findings and advanced the rationale for direct investment using joint ventures as the best way of accelerating construction, acquiring high-technology, and funding these efforts either principally or entirely with foreign capital.

Chinese authorities, according to Copper (1985), expect the reform program to enable the country to be on an equal footing with the developed nations by the middle of the next century. Copper predicted that if this reform program becomes a reality, the world political and economic balance would be vastly different. China apparently will pursue whatever avenues necessary in order to accomplish the listed development objectives, as evidenced by the warming of relations with the Soviet Union. Not only were the Soviets reported to be participating in new development projects but in July of 1985, this nation also was observed to have signed a $14 billion, five-year commercial agreement.

Copper asserted further that China's internal politics make the Beijing government one of the world's most unpredictible, especially as far as relations with the Soviet Union are concerned. Three possible roles which China could assume in the future were identified. Copper conjectured that China could emerge as the leader of the third world, a regional power, or a "swing" power that could influence United States-Soviet relations.

Preceding the Sino-Soviet Agreement, in January, 1984, Merry (1985) observed that President Reagan and Premier Zhao Ziyang signed the Industrial and Technological Cooperation Accord, thus establishing a framework for Sino-American cooperation in specific industrial sectors. While this was viewed as enhancing China's expectations of receiving development assistance from the United States, it was said to offer no further protection for direct investment. Joint ventures still were described as dependent upon Chinese law and political risk insurance for protection. Merry observed that the United States has not yet been able to persuade China to sign an investment treaty which would safeguard American businesses from discrimination or arbitrary practices. Such a treaty was described as requiring the following provisions:

1. a guarantee that investors would be afforded equal treatment with Chinese investors,

2. assurance that American companies could remove earned profits from the country of China, and

3. protection from expropriation in the event of a change in regime.

While the United States has attempted to negotiate such a treaty for years, Merry pointed out the Chinese have resisted on the grounds that it would compromise sovereignty.

The United States Department of Commerce (1983) observed that on October 30, 1980, the United States signed an investment incentive agreement with China which provided political risk insurance coverage through the Overseas Private Investment Corporation (OPIC). This was described as an independent government corporation organized under the laws of the United States. OPIC was noted to offer rather narrow coverage, which is limited to expropriation, war, revolution, insurrection, and incovertible currency. While joint ventures were reported to be eligible, coverage was specified as applying only to those projects or activities which have been approved by the government of China. Furthermore, under the conditions of this agreement investors were required to register for coverage prior to a commitment to invest.

Wu (1982) viewed as unfortunate the exclusive focus of OPIC coverage since this limitation rules out risks which, while not major, still threaten foreign investment. Even though there are some gaps which can be covered by private companies, Wu observed that it is impossible to obtain total coverage for overseas exposure since OPIC, unlike an investment treaty, does not obligate a foreign government to reimburse losses incurred by investors. The principle of subrogation, however, was reported to allow OPIC to reimburse for losses, thus acquiring the rights of the aggrieved company and effectively making the dispute an issue between governments. Such a dispute was held likely to be undesirable politically for the offending country.

Mandel (1984) conducted a study which surveyed 140 American corporations utilizing OPIC insurance. The findings indicated that 125 projects were OPIC insured, while more than 1,400 operations were classified as non-OPIC overseas projects. The results of the study determined that the availability of OPIC insurance did not have a significant impact on the decision to invest overseas. It further was concluded that, for the majority of firms surveyed, the use of OPIC insurance had no effect on the intensity of political risk analysis. An even greater number (87 percent) indicated that having the insurance did not reduce concern for the need to use other loss-minimizing measures. A comparison of the data reported for the OPIC insured and non-OPIC insured projects, revealed that the OPIC projects had twice the risk and were more vulnerable to politically oriented risk factors than were the non-OPIC projects. Furthermore, respondents were observed to have stated that the highest concern was expressed primarily for risks of an economic nature (i.e., currency devaluation and repatriation of profits) rather than risks of a political nature (i.e., terrorism and communism). According to the study findings, the best management strategy for dealing with risk exposure (preferred by 68 percent of the survey respondents) was the establishment of a joint venture rather than risk analysis or risk insurance.

Government Confiscation

In research directed toward a determination of the nature of political risk, Mandel (1984) defined government confiscation as involving the take-over of a foreign investment without any form of reimbursement. This was acknowledged to represent a more radical action than expropriation, which was observed to allow for some form of compensation. Mandel's study indicated that confiscation of property was ranked third among risks of greatest concern for the forty-seven OPIC-insured corporations responding to the survey. The study further noted that companies utilizing OPIC insurance did so for projects which had twice the risk factor as non-OPIC projects. Wai-Kown, et al (1984) pointed out that more than one-half of the American companies doing business in China had no insurance coverage. These data were obtained from a survey of 590 United States firms involved in or interested in doing business with China.

Article 2 of the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment, according to Cohen and Horsley (1983), states that the Chinese Government affords legislative protection of the resources invested by a foreign participant in a joint venture. The general language used in this legislation was noted to leave expropriation or confiscation as matters to be handled with bilateral treaties negotiated between China and foreign governments. According to the provisions of the law, if such an agreement has not been negotiated, foreign investors must seek protection by the terms of the existing contracts or with political risk insurance.

In addition to OPIC which was reported by Stepanek (1981) to make available insurance coverage to American companies, the People's Insurance Company of China (PICC) also was observed to provide protection against confiscation. Stepanek cautioned that protection is excluded, however, for any enterprise found to have violated the law. While this insurance was reported to offer protection against an eminent domain action by a governmental department, Cohen (1982) observed that little assurance is provided in the event that China changes its overall policy towards foreign investors. In view of this stipulation, it was deemed advisable that a joint venture structure the contract so that significant funds from the operation are maintained in a bank account external to China in order to assure accessibility.

Civil Unrest

Civil unrest was defined by Dougherty and Specter (1982) as including riot, civil war or hostile war-like actions, revolution, rebellion, or insurrection. In contrast to the danger of an overall policy change which could result in government confiscation, the term civil unrest was employed to describe conflicts between the masses and the ruling power. Such occurrences, however, were acknowledged to represent an indication of an unstable political situation, affording a visible factor with a mid- to long-term impact on the national economy and real GNP growth.

The Regulations of the People's Republic of China regarding Contracts of Property Insurance were observed by Chastain (1982) to provide that the description of the risk associated with civil unrest be extended to include strikes which may be precipitated by commercial or political reasons. These regulations were reported to apply to coverage obtained through the PICC. Insofar as the modernization program continues on course, according to Chastain, popular support for the reforms and the party in power will continue if results are manifested by a continuing higher standard of living. To date the circumstances were noted to have supported this view, thereby seeming to minimize the risk of civil unrest for the present time.

Shifting Away from Economic Cooperation and Mutual Benefit

The risk inherent in a potential shift away from economic cooperation and mutual benefit according to Mandel (1984) involves increasing nationalism, self-reliance, and an unwillingness to facilitate the needs of foreign investors. In the case of China, Mandel anticipated that such a risk would be exhibited by an erosion of the principle of equality and mutual benefit expressed in Article 1 of China's Joint Venture Law.

Business China (1980) reported one of the major concerns among foreigners is how long China will continue the present Open Door Policy. The possibility of adverse change in political and economic policy was cited as a major worry among Japanese companies in 1980. A survey conducted by the Long Term Credit Bank of Japan found that the vast majority of the 235 companies surveyed believed this to be the biggest obstacle to investment in China.

Since 1980, however, Mark (1985a) observed that much of this fear has been allayed, and an increasing amount of investment by the Japanese has occurred. Mark (1985a) stated that United States businessmen have found a stronger commitment to the Open Door Policy among officials at the local level. Policy swings still remain a concern, however, and China has not been without a history of vascillation on this issue. During 1980-1981, shortly after the reforms were initiated, several major contracts worth billions of dollars were cancelled by China when the leadership responded to internal concern regarding over-extended resources. In 1984, however, much of the decision-making had been decentralized in favor of greater autonomy for local provinces and cities. Mark noted further that in 1985 fears of over-spending caused a reversal of this trend, delaying many joint venture operations, drastically reducing foreign exchange expenditures, and placing a tight clamp on profit repatriation.

While this was viewed by some researchers as retrenchment and stabilization within the overall context of reform, Ignatius (1985) warned that China's self-serving history should not be ignored. Many observers were noted to look to Hong Kong's reunification with China in 1997 as the ultimate test of China's intentions. Ignatius also reported that in 1930, after completing a thirty-two year lease, Britain returned Weihaiwei, a coastal district located in Shandung, to China. An agreement had been signed stating that the area's preferential tax rates, administrative system, and free trade status would be preserved. After Britain had relinquished control, however, the agreement was ignored. High taxes and rigid government regulation were imposed. Weihaiwei lost all significance in the international marketplace.

Adherence to stated policies also was viewed as questionable in light of an observation made by Shimakura (1985) which noted that several socio-economic cycles have occurred in previous attempts to reform China's economic system. Since the founding of the People's Republic of China in 1949, Shimakura observed that reform has been attempted at least three times, but added that each time the reforms had failed and the system had reverted to the pre-reform status.

The pattern also was noted by Shimakura to have been characterized by Chinese economists as an over-arching cycle of death, release, chaos, and control. This economic cycle was defined further as follows:

1. centralization and tightening of economic control (resulting in stagnation or "death");

2. economic rigor mortis (regarded as the "release" phase);

3. decentralization of authority and the relaxation of economic control ("chaos");

4. economy in confusion (leading to the "control" phase); and

5. return to centralization and economic control.

Shimakura predicted that the cycle will continue to repeat until government effectively is separated from business.

Unanticipated and Excessive Rise in Taxes

The Joint Venture Income Tax Law and the detailed rules for its implementation were promulgated in 1980. These regulations provided for a 30 percent tax on overall net income, with a 10 percent surcharge levied by the province in which the venture operates. In addition, the legislation levied a 10 percent withholding tax on all profits repatriated from China, although joint ventures were exempted from tax until a profit actually is realized after deducting accumulated losses of previous years. The first profit-making year also was exempted from tax, while the following second and third years were specified as eligible for a 50 percent deduction in taxes. The regulations further provided that, if the foreign partner reinvests profits for five years, application can be made for a 40 percent reimbursement of taxes paid on the portion of profits reinvested.

The United States Department of Commerce (1982) has not viewed the tax incentives as very effective in eliminating the perceived difficulties of a joint venture operating in China, or in competing with the more attractive incentives of other Asian countries. The department pointed out that, since each investor individually negotiates details for incentives included in the contract, not only are negotiations difficult but also the range of incentives is limited.

Business forms other than joint ventures have not been afforded access to this tax incentive and have been regulated under the Foreign Enterprise Income Tax Law. Cohen (1982) conjectured that it is not known how long the Joint Venture Income Tax Law will remain intact as such, although tax authorities have announced plans which would combine these two laws into one system.

Change to a Regime with Antagonistic Attitudes toward Foreign Investment

Mandel (1984) observed that shifts in leadership which result in attitudes unfavorable toward risk could result in the reversal of China's present policies designed to encourage foreign investment. In order to help sustain the liberalized direction of reforms, Mandel noted that Deng made sweeping changes in the Communist Party hierarchy calling for older officials to retire and give a place to younger and better educated officials. Hu (1982) stated that by the end of 1986 about two million cadres will have been replaced. Mark (1985b) indicated that 189 younger officials already have taken over positions in the Central Committee and that seven new replacements have been elevated to the Politburo. This dramatic action took place at a special party conference (the second held since 1949) only one week after 131 senior military officers and cadres stepped down.

Ching (1985) pointed out that, while conditions appear stable and trends for future rule seem relatively assured, some observers have remained cautious. Ching noted that Deng, even without titles, remains the acknowledged leader of China, outranking 69-year-old Hu Yaobang as party chief and 65-year-old Zhao Ziyang as premier. Ching suggested further that this represents a highly undesirable situation, and that Hu and Zhao constitute the implementers of Deng's policies, incapable of running China on their own initiative. It was conjecture that a power vacuum could occur after Deng's demise.

Harding (1984) questioned the capacity of Hu and Zhao to exercise the political sagacity of Deng, and suggested that the future of the reforms could depend upon present efforts to reduce internal opposition and build support for the programs. The observation also was made that the Soviet Union was not able to sustain the reforms begun in China. While Harding considered it highly unlikely that a return to utopian Maoism could occur, little improvement in the chances of a sustained liberalization of political policy was anticipated. The Leninist-Stalinist system was viewed as benefiting ultimately as a result of the current unrest observed in response to the pressures brought about by both Mao and Deng. Harding pointed to several factors which could burgeon into strong opposition to reform. Among these were the growing confidence crises among young people which were regarded as having been aggravated by a decay in the social order brought about by the introduction of corruption, crime, pornography, and prostitution. In addition, it was feared that an unfavorable attitude could develop as inequalities continue to rise between the peasants, and skilled and unskilled laborers. The party leaders could become increasingly concerned about erosion of ideology, while the Army could become resentful as military authority is diminished.

Dougherty and Specter (1982) identified six events as impacting seriously on the economic success of developing nations: the rise and reign of a strong leader, the decline of a strong leader, internal strife, elitist power struggles, socialist pervasion, and/or a military seizure. These conditions also were observed to serve as a credible context for the dynamics of opposition and a subsequent change of regime.

Knight (1983) observed that socialist countries have an inherent resistance to reform. During China's Cultural Revolution reliance upon market forces was described as incompatible with socialism. Knight found that this attitude was fueled by fears of inflation, unemployment, and high prices -- all of which have been associated with reforms.

Wu (1982) predicted that, in spite of continued official assurances, China's investment policy will be long-term. This assurance was attributed to China's virtually total dependence upon a continued rule of pragmatists. In the event that an elitist struggle should arise, Wu cautioned that radical Maoism could be revived, resulting in drastic changes of China's policy directed toward the support of direct foreign investment.

Imposition of Unfavorable Loan Restrictions

Government directed bank or credit restrictions imposed on foreign investors were cited by Fung (1985a) as creating the risk of retarding normal business activities. Fung's research also pointed out one of the emphases in the Seventh Five-Year Plan (1986-1990) will be to place reliance on interest rates in an effort to guide economic reform at micro-levels. Article 78 of the Joint Venture Regulations was noted to permit joint venture enterprises to apply to the Bank of China for foreign loans, as well as for Renminbi loans. The guildelines for doing so were established in the Provisional Regulations for Providing Loans to Joint Ventures Using Chinese and Foreign Investment. A joint venture also was noted to be permitted to borrow foreign capital in Macao, Hong Kong, or from overseas banks.

According to Fung (1985a), in the latter part of 1985 the rules for obtaining loans from the Bank of China were tightened and interest rates were raised. Further complicating higher interest rates was the fact that an enterprise needing to defer repayment of a loan could be required to pay interest at a level as much as 20 percent above the lending rate.

Verzariu and Stein (1982) noted that joint ventures needing financing must negotiate loans based on the plans of the enterprise and the ability to guarantee the loan with marketable goods or commodities. Commercial credit was described as prohibited. According to Gelatt (1985), another major problem is how to obtain adequate financing. The Bank of China was described as preferring to provide joint ventures with short-term loans for working capital rather than financing for fixed assets. This practice generally resulted in forcing the ventures to apply for loans from international banks. Gelatt observed further that when a guarantee for such a loan is sought from the Bank of China, funds are guaranteed only for the Chinese partner's portion of the loan based on an equity participation. Joint ventures thus were described as facing difficulties in obtaining financing in the absence of backing by a larger asset base since the foreign party must guarantee the loan to the extent of the non-Chinese equity.

Additional government controls imposed in 1985 to monitor credit growth, according to a report issued by International Banking (1985), indicate that Chinese banks will be required to sustain independently any losses incurred. This requirement was anticipated to result in greater difficulties in securing a loan for potential borrowers.

Production Restrictions

Production restrictions were reported by the United States Department of Commerce (1982) to include the risks dealing with the financial setbacks which could arise from the imposition of production quotas or restrictions on imports of components or commodities used in production. Articles 56 through 61 of the Joint Venture Regulations were noted to allow a venture to develop independently a production and operating plan subject to the approval of the Board of Directors. The Department confirmed that the production requirements are determined more by contract negotiation than by the strict enforcement of the generalized regulations which spell out performance requirements. The law was observed to state specifically that government administrative departments (at any level) shall not issue directives on production or operating plans. It was expected, however, that first priority should be given to purchasing materials in China.

Verzariu and Stein (1982) contended that the expectation, on the part of the Chinese planners, that a venture should utilize native components or commodities frequently results in a failure of understanding relative to the negative impact which the unavailability of materials can create. In addition, the Chinese partner's concept of planned production was noted to result often in functional conflict with the marketing goals of the foreign party, thus creating a lack of flexibility in adapting to the changing conditions of the market.

Leung (1985) reported the disruption of the market when the government exposed an import scandal on Hainan Island. This exposé involved $570 million in hard currency which had been spent illegally on consumer goods for resale on the mainland black market at tremendous profit. The import controls imposed in response to this discovery resulted in the failure of some joint ventures which fell behind manufacturing schedules.

Export Restrictions

Article 60 of the Joint Venture Regulations, according to Verzariu and Stein (1982), promoted the sale of Chinese products on the international market. Thus, while most foreign investors were noted to enter China with long-range expectations of access to domestic consumers, the Chinese government was reported to favor investments with the primary objective of generating foreign exchange through export. Domestic sales were reserved primarily for items urgently needed by China. Verzariu and Stein warned that serious problems could arise if an enterprise engaged in a product plan which did not require a United States export license and later encountered the need for such documents as a result of subsequent changes in product lines. Further, in the event that a joint venture was engaged in high-technology, the possibility that newer developments could render production obsolete, thereby forcing the venture to modify the product or change to a different line altogether, was noted to represent a potential problem. Either situation could compel the venture to apply for a new export license which consequently might not be approved. This was described as especially serious if the modifications required subparts from the United States which, for strategic reasons, might not be approved for export. The export from China of non-strategic and/or urgently needed items was not viewed as an issue among joint ventures due to the strict controls and guidelines established by the Joint Venture Law. Article 5 of the Implementing Regulations was noted to specify that approval for establishing a joint venture will not be granted if any company activities are viewed as a threat to China's sovereignty, are in violation of the law, or are counter-productive to the development of the Chinese economy.

Verzariu and Stein (1982) acknowledged some inherent risks to export, in response to barriers erected by other countries. Protectionist measures on behalf of the United States' textile industry, for instance, were reported to have had serious effects on textile ventures in China.

Furthermore, technology transfer from the parent country to the foreign joint venture partner also was reported to involve export risks of a strategic or proprietary nature.

Foreign Exchange Risks

Siyi (1985) pointed out that Chapter 10 of the Joint Venture Regulations stipulates that all matters concerning foreign exchange shall be handled by the Interim Regulations on Foreign Exchange Control. After receiving a business license, it was noted that a joint venture is expected to open foreign exchange deposit accounts and Renminbi deposit accounts with the Bank of China or other designated banks. The bank next was observed to assume the responsibility for supervising the receipts and expenditures including income and payments. Siyi pointed out that, as a general rule the law stipulates that the joint venture must maintain a balance between these accounts. Except when dealing with the sale of products which China urgently needs, a joint venture was required to export sufficient products to generate foreign exchange to meet foreign obligations since Renminbi is inconvertible. This was interpreted to mean that adequate foreign currency derived from the sale of exports must be kept on deposit to cover the salaries of expatriate workers, as well as to pay for imported commodities, profits, royalties, and interest charges. According to Siyi, the regulations have been relaxed recently in order to facilitate the acquisition of foreign exchange from domestic sales, especially for items intended to serve as import substitutes. This was reported to apply only to a few joint ventures.

China was described by Lachica and Bennett (1985) as having experienced setbacks from dwindling foreign exchange reserves between 1984 and 1985. In September, 1984, reserves were observed to have peaked at $17.3 billion prior to falling to $11.9 billion in March of 1985. Lachica and Bennett reported that reserves may even have dropped below $10 billion. One Chinese investment manager observed that, as a result of the cutbacks in import orders, China could face problems as serious as those faced by Argentina unless careful budgeting practices are instituted.

Fung (1985b) observed that low reserves had forced Beijing to postpone temporarily the establishment of foreign joint ventures. Furthermore, the reform principle encouraging the transfer of foreign exchange spending authority to provincial enterprises was reversed. The action came in response to what Beijing viewed as indiscriminate spending for consumer goods, thus draining China's foreign exchange reserves. In 1985, the central government resumed control over spending and required all enterprises to gain approval from Beijing before spending foreign exchange which was to be conducted through the Bank of China.

A joint venture's need for foreign exchange was viewed as a serious issue by Leung (1985). In some cases, the need to import the necessary technology was observed to demand large amounts of foreign exchange not available locally. There also was observed to be a danger that production utilizing a high percentage of import content could eliminate a joint venture's competitive price edge. Another problem described as encountered frequently by joint ventures was the under-estimation of operating costs. The effect of this failure was said to be export earnings which were inadequate to reach a break even point. Joint ventures that have attempted to negotiate concessions from the government or seek permission to exchange Renminbi for dollars also were reported frequently to have been met with a request for patience.

Banker (1983) asserted that financial risk is the most frequently encountered risk to daily operations. While both political and economic risks were noted to occur sporadically, financial risk was observed to be ever present. Banker pointed out that when a company leaves the United States a drastic change, from an environment where capital and a variety of flexible vehicles in a long-term stable market are available relatively readily, is experienced. In facilitating this transition, Kennedy (1985) suggested that multinational companies should focus on two primary issues when investing abroad. The first issue was described as the necessity for the preparation of a risk/return analysis of existing foreign exchange conditions. Kennedy also advocated relating the parent company's strategic planning efforts to the plans developed by the foreign operations.

The United States Department of Commerce (1984) listed several financial factors of primary importance to be considered when evaluating foreign investment. Among these were:

1. the convertibility of resources;

2. the availability of foreign exchange;

3. the sources of local capital available for joint ventures;

4. the availability of funds or other resources from third country operations;

5. currency exchange rates and controls; and

6. capital repatriation and remission of profits, licensing fees, royalties, and other profits.

Mandel (1984) identified three foreign exchange risks as major concerns in conducting research into the problems faced by OPIC-insured corporations. These were observed to include currency devaluation, restriction on currency exchange, and delays in the repatriation of funds.

Currency Devaluation

Veraziu and Stein (1982) observed China's currency is the Renminbi, while the basic monetary unit was identified as the yuan. In 1982, the exchange rate, which is announced by the State General Administration for Exchange Controls (SGAEC) was 1.945 yuan to one United States dollar. The rate was reported to be based on a basket of twenty-four other internationally traded currencies, and is adjusted whenever the yuan deviates by 0.5 percent. In 1984, the yuan was noted to have risen from 2 to 2.8 to the United States dollar, while 3.19 yuan to the United States dollar was noted in December, 1985. Brauchli (1985) observed China has maintained a two-tiered system for foreign exchange. This meant that enterprises within China would purchase foreign exchange at an internal settlement rate, which was higher than the rate afforded to tourists and foreign businesses. The two rates were merged in January, 1985, in an effort to decrease China's trade gap and to boost foreign exchange reserves. Successive devaluations during the year brought the yuan in October of 1985, to a level 21.9 percent lower than was observed a year earlier. In the opinion of some bankers this also could stimulate foreign investment and help reduce the effects of inflation, which was reported to be ranging around 20 percent in the Special Economic Zones and in some urban areas earlier in 1985.

Banker (1983) stated that the most critical aspect of currency change is timing and pointed out that each country responds to different criteria which will affect its currency change. Five factors impacting the potential and size of change were identified. These included the balance of trade, reserve position, external debt, interest rates, and politics. The most important of the five factors affecting currency change was identified as politics, which often was identified as the source of a "catalyst" or significant event precipitating such change. Banker emphasized the critical importance of understanding each investment environment and the related risks, together with a thorough knowledge of the business intending to make the foreign investment.

Restriction on Currency Exchange

Chiang (1983) pointed out that China's currency, the Renminbi, is inconvertible. For the most part, a joint venture needing foreign exchange thus must generate the requisite funds through exports. Companies have been required to establish a balance between exports and domestic sales in order to pay foreign obligations, while producing enough Renminbi from domestic sales to pay for local labor and domestically sourced materials. Chiang found it very rare that a company has been able to convert yuan into foreign exchange for the purpose of taking it out of the country.

While in the past some joint ventures have been able to convert yuan into foreign exchange on marginally legitimate or "gray" markets, Fung (1985c) reported that the tighter controls imposed in 1985 have banned such practices. This was observed to have hurt companies which already had established operations in China.

Among the most serious problems cited by investors in China were foreign exchange restrictions. In addition to the fear that it may be difficult to earn enough foreign currency to meet various payments, Leung (1985) noted the accumulation of huge reserves of yuan which cannot be converted. This has become a major concern for corporate treasurers.

Gelatt (1985) reported that the provision that a joint venture may sell urgently needed products on the domestic market for yuan which can be exchanged for foreign currency rarely has been implemented. Gelatt suggested that other solutions should be sought and included the following recommendations for enterprises engaged in joint ventures:

1. Leave the local currency profits in the joint venture until foreign exchange becomes available.

2. Sell joint venture products to entities that can pay in foreign exchange.

3. Purchase Chinese products with the yuan in order to export. This was acknowledged to be difficult, however,

since the producer is likely to want to handle its own exports.

4. Allocate the yuan to local labor costs.

Berghoef (1984) noted that near the end of 1984, OPIC had not yet written any coverage for inconvertibility in China, but was considering exceptions under certain circumstances. Although OPIC was reported to provide coverage on the assumption that currency is convertible at the time the insurance is issued, the transfer status quo (except for exchange rates) was observed to remain frozen. Although Berghoef acknowledged that the Renminbi is not convertible to foreign currency, it was pointed out that OPIC will make an exception if the Chinese authorities have given an investor the legal right to convert Renminbi within a specified period. The United States Department of Commerce (1982) reported that many potential investors have been reluctant to establish operations in China due to the restrictions placed on the Renminbi.

Delay in Repatriation of Funds

The effect of this risk was said to focus on the possible delay in the transfer of funds or profits to the foreign parent company as the result of local bureaucratic inefficiencies or official policy changes. According to Heyden (1985), the principle of the time value of money causes loss exposure because of the unavailability of funds to the parent company for other productive purposes.

Permission to remit foreign exchange outside China was addressed in Articles 10 and 11 of the Joint Venture Law. Application must be made to the Bank of China, but all taxes and expenses first must be deducted. Net profit was described in Article 7 of the Law and was derived in the following manner: (1) expenses are deducted from gross profit, (2) income taxes are paid, and (3) deductions must be made for three funds -- the reserve fund, the bonus and welfare funds for workers and staff members, and the expansion fund.

Heyden (1985) observed the requirement for the distribution of the net profit between the partners in proportion to the share of registered capital held unless other arrangements have been specified in the contract. Also noted as negotiated and stipulated in the contract was the percentage contributed to the three funds.

The issue of profit repatriation has been considered one of the most difficult problems to overcome and a major disincentive for investing in China. Even if a venture could sell readily the products on the domestic market, Heyden (1985) noted that the yuan profits remain inconvertible.

Mark (1985a) pointed out that another problem affecting profit repatriation has been the requirement that a venture may have made a contract commitment with export earnings to import raw materials already available in China at less expense. Further, Mark observed attempts to rectify this type of situation have proven difficult. When a joint venture terminates operations and the foreign partner prepares to sell its share to the Chinese partner, adequate foreign exchange to cover the purchase of the foreigner's share and to provide for repatriation of capital should be assured. The contract should include procedures for this eventuality as well as contingency arrangements if there is not enough foreign exchange available at that time. Cohen (1982) suggested this could be done by accessing previous earnings or by providing additional products to sell overseas.

Commercial Risk

For the purposes of this study, commercial risk has been divided into two categories under which an enterprise may sustain the possibility of financial loss. The first category included the selected elements of market conditions, while the second focused on property, casualty, and liability exposure.

Market Conditions

Chen and Lee (1984) observed that underlying the elements of exposure to the vagaries of market conditions is the prospect of Chinese exports to the United States and other countries at a sustainable level. It was observed that if China continues to concentrate exports within certain basic categories, the nation will become more vulnerable to changes in the international market as well as increasing protectionist sentiment in the developing nations importing Chinese goods. Further, as China continues to modernize, more of the exportable items were expected to be consumed internally, thus threatening the capacity for generating foreign exchange. In order to maintain past levels of growth, Chen and Lee found that China must focus on rapidly diversifying equipment and machinery exports.

Meeting Contractual Obligations

The failure or inability of the Chinese joint venture partner to meet contractual obligations made with the foreign investor, according to Verzariu and Stein (1982), could cause a substantial setback in production scheduling. These researchers observed that, while the Chinese party may make a sincere effort to ensure the success of the enterprise, this effort could be hindered seriously as a result of difficulties in the ability of the Chinese to understand and adapt to new techniques and situations. As a result, performance capacity could be over-estimated.

The new legal system of China was described by Kraiem (1985) as designed to implement the policies of the leadership. The state was noted to expect Chinese contractors to fulfill contractual obligations while, at the same time, government policies may allow for the assertion of rights which could prove counter-productive. The Foreign Economic Contract Law, which came into effect in 1985, was said to permit foreigners to operate in accordance with the original contract terms even if these terms are not consistent with laws subsequently enacted. This, however, was not observed to be the case between Chinese organizations. Kraiem pointed out that, under new regulations, contracts made between Chinese parties can be terminated when state policies affecting those contracts are changed. This stipulation resulted in the possibility of serious ramifications if a joint venture is dependent upon a Chinese organization which has contracted with another Chinese party for goods or services. This also was shown to result in the impossibility of performance for the Chinese party contracting with the foreign investor.

Failure to Meet Delivery Schedules

The risk of financial loss was observed by Kwok and Overholt (1985) to arise in some instances from the failure or inability of the Chinese suppliers of raw materials to meet delivery schedules. This uncertainty could be affected directly by the exposure created from the previous risk concerning contractual obligations or shortages resulting from abortive price reforms.

Article 9 of the Joint Venture Law declared that first priority should be given to obtaining raw material from local Chinese sources. Should an enterprise require import materials, Verzariu and Stein (1982) pointed out the requirement that these must be purchased with foreign exchange. The option to procure foreign materials was advised to be included in the contract, while careful consideration to the timing of needs also was advocated. According to Cohen (1982), access to raw materials poses a frequent problem for joint ventures. It was suggested that the joint venture contract should provide for the establishment of a ceiling price on locally sourced materials which should not exceed that of the international market. Cohen proposed that, in instances wherein the cost of materials rises above this price, the joint venture should be free to procure materials elsewhere.

Chiang (1984) proposed that access to materials should figure strongly in the decision of where to locate the joint venture. The greater availability of materials in usable form was noted to occur near the strong industrial bases, which also were observed to be more likely located in or near the coastal cities rather than the four Special Economic Zones. As a result of these acknowledged geographic limitations the zones were described as having had to import most of the raw materials, technical talent, and skilled labor required to develop a strong industrial base.

Another obstacle to materials availability has been caused by administrative barriers, which DeWulf (1984) described as being lifted slowly. Several factors were identified as affecting the problem. DeWulf pointed to the negative impact on past productivity of an irrational and multi-tiered distribution system, over-burdened administrative and transport facilities, the maintenance of excessive inventories, and the prevalence of small, high-cost regional producers. Improvement was noted to have been slow due to the pressures brought about by vested interests locally as well as the result of jurisdictional protectionism brought into force by inefficient enterprises against outside competition.

Scarcity of Data

The scarcity of the internal and market data necessary to research consumer buying patterns was described by Ruggles (1983) as problematic for foreign firms engaged in joint ventures with Chinese enterprises. Further complicating this difficulty was the pressure of enthusiastic Chinese companies seeking joint venture partners in order to begin manufacturing high demand consumer items such as basic household appliances. In view of the scarcity of reliable data, Bennett (1985) pointed out that this condition has created a major hazard for Western businesses. Bennett also cautioned that the implications of China's planned economy should not be overlooked. It was noted to be very difficult to buy or sell products which were not included in the plan, however, those that were included were noted to move quickly. Siyi (1985) reported that Chinese authorities regard the plan as representing a commercial secret and observed that it is virtually impossible for foreigners to deterimine the contents.

Knight (1983) observed that in a centrally planned economy there exists not only poor or irrelevant indicators of supply and demand, but also the efficiency of an enterprise. Although efforts have been made to decentralize decision-making, Knight noted no assurance that this necessarily will improve economic efficiency. Furthermore, a formal economic analysis of existing projects in China was observed to remain unavailable. Knight concluded also the absence of a standard by which to compare projects for feasibility proposals.

Price Controls

According to Cohen (1982) prices for finished products sold on the Chinese domestic market have been required to correspond with state set prices. These products also were noted to require a quality rating and payment in Renminbi. The joint venture was observed to have power to set prices only on export products. Nonetheless, this freedom could be restrained as a result of a Chinese competitor's receipt of subsidies by the state. In this event, Cohen reported, the contract should include a non-discrimination clause to help compensate for the extra costs borne by the Chinese companies. Verzariu and Stein (1982) added that the contract also should provide for the assessment of fees and charges imposed on a joint venture which could be added in the future. This report advised that negotiations should be made in advance to accommodate such added costs in the sales price and the party to be responsible for payment should be specified.

While China was described as not wanting to stifle foreign investment with price controls, Cohen (1982) emphasized that neither are foreigners allowed to make so much money that it appears China is being exploited. This was feared as politically dangerous for the leaders in power. Cohen noted that a good rule of thumb for pricing should be a 15 percent after-tax return on goods sold in China. Others, however, were acknowledged to consider 20 percent on invested equity before taxes to be a reasonable expectation.

One of the overall objectives of China's modernization program, according to Knight (1983) has been the introduction of price reform into the system. These efforts, however, were noted to have encountered a loss of momentum as a result of the 1981 stabilization program. Among the negative effects of distorted prices were the inequities of reward for economic efforts reflected in profit as well as the effect of market disequilibrium. These influences also were noted to involve some painful readjustment for entrenched monopolistic enterprises. Many commercial and industrial prices were set years ago and therefore were acknowledged to reflect prices established in arbitrary and variable relation to costs.

According to Wood (1984), the discrepancies between profitability and economic returns long have been accepted in China. Instead of relying on profitability as a critical feature of investment decisions, planners have emphasized a project's economic contribution to the goals of the state plan.

China was described by Fung (1985d) to be moving very cautiously in the area of price reform. In 1984, some factory subsidies were removed, creating the effect of soaring production. Fearing a flare-up of inflation and consumer unrest, however, authorities forced the respective enterprises to absorb the costs rather than raise prices to accommodate them.

The 1984 Decision on the Reform of the Economic Structure emphasized the urgency for price reform. DeWulf (1985) predicted that changes in the pricing structure will occur gradually and emphasized that if any true stability is to be achieved, a new monetary policy must be implemented. The far-reaching impact of price reform was noted to make difficult issues of all modernization efforts. The flow of funds as well as the profitability of enterprises were expected to feel the impact, thus putting at risk the lines of production of some enterprises and the survival of others. Fung (1985d) anticipated that, while the leadership has been reluctant to tackle this undertaking, it is expected to be a major effort of the Seventh Five-Year Plan (1986-1990).

Control over Future Material Costs

Article 65 of the Joint Venture Regulations was reported by Cohen and Horsley (1983) to specify the pricing method applied to six raw materials, including gold, silver, platinum, petroleum, coal, and timber. Any of these materials used in production for export purposes were noted to be priced according to world market levels and paid for either with foreign exchange or Renminbi. These and other materials, including the cost of utilities, however, were described as available at state-set prices and for purchase with Renminbi if purchased for the direct use in production for sale on the domestic market. Cohen and Horsley also reported that some flexibility is permitted regarding the price of export materials and noted that, in one instance, a textile venture was allowed to purchase wool for export at state-set prices in order to make the venture more profitable.

Chiang (1983) noted that if needed materials cannot be sourced locally, firms may encounter risks in the delay of shipment resulting from the congested infrastructure, increased costs, and unreliable availability. The quality of such materials also were reported to be unsatisfactory by some firms.

As capital construction has increased, Fung (1985e) reported the increased tendency for projects to have been confronted with increased prices caused by shortages. The problem was described as compounded further by inflation and poor quality. Fung anticipated that the future cost of material will be affected further in an erratic way as price reform is pursued in the Seventh Five-Year Plan.

Control over Labor Rates

The wages for joint venture workers were reported by Horsley (1984) to have been established by the Joint Venture Regulations at levels 20 to 50 percent higher than those paid by similar state-run enterprises. The "real wage" was acknowledged to vary among localities, depending upon the custom and standard of living in the area. The definition of the "real wage", however, was noted to be subject to interpretation. Some sources were reported to define "real wage" as what workers are actually paid by the state enterprises, while other sources, including the government rules, have contended that this definition should include the costs for labor insurance, medical expenses, and other benefits subsidized by the state. The Joint Venture Regulations have addressed these subsidies separately, which could imply that the related costs have not been included in the same computation. Bonuses and welfare costs have not been paid out of special funds, however, and have not been considered to be part of the "real wage". Nonetheless, the net effect of the subsidies paid by the joint venture could result in a wage that is as much as three and one-half times higher than the wages paid in a comparable state enterprise. Chiang observed that, while wages have been negotiated within guidelines, it is a very difficult process since there is no reliable information on costs and practices. Horsley (1984) pointed out that many of the relevant laws have not been translated into any language other than Chinese. Chiang (1983) concurred with this view and noted that the joint ventures themselves have been very secretive about the actual amounts of salaries and wage scales.

Joint ventures, were reported by Cohen (1982), to negotiate labor agreements with a union organized within the venture. It was described as not unusual for the union representatives to quote excessive costs in the early stages of negotiation. The foreign investor therefore was cautioned to be wary of this practice and to understand that unrealistic figures could be proposed either as a result of inexperience or simply as a bargaining tactic.

The Joint Venture Regulations (Article 93) provided that workers are entitled to performance-related bonuses. DeWulf (1985) observed that the purpose of the bonuses often has been undermined by managers who have awarded such incentives in an egalitarian manner. The counter-productive effects of this practice, however, were expected to be reduced in the future in response to the recommendations of the 1984 Decision on the Reform of the Economic Structure. This reduction was intended to allow for wider differentials between the wages stipulated for different jobs as well as the educational levels required to perform them. The 1984 Decision also suggested that wages will continue to increase, thus providing the necessary purchasing power to absorb the greater productivity generated by the reforms.

Adding to the complexity of labor costs, according to the United States Department of Commerce (1982), is the tendency of the Chinese to want the foreign partner to employ the very latest technology in production. In a labor-intensive society, this was noted to cause much waste of capital in addition to the fact that the new technology often has been designed to minimize the number of workers required.

Business Interruption

The possible loss of earnings due to business interruption seldom has been mentioned in the literature. Strikes, one of the main causes of business interruption among the developed nations, were not identified as an issue, and Horsley (1984) observed that the use of strikes was mentioned in the new trade union constitution adopted in

1983. According to Horsley, workers may nevertheless defy orders and vacate the premises of a business if conditions appear to be life-threatening. Moreover, short-term strikes were available for use if no other means of expressing worker demands were acknowledged. The official position of China's socialist economy was reported to dictate that domestic businesses belong to the people, hence, strikes have been viewed as against the interests of society.

The Economist (1985) reported the possibility that operations could be interrupted or postponed should a major policy swing occur, as was the case in 1981-1982, when joint venture orders were cut and numerous projects were cancelled. More recently, in 1984, the government was noted to have threatened to stop imports from enterprises which were not willing to transfer modern technology.

Inconsistent Legal Interpretation

Ruggles (1983) observed that much of China's legal system is being codified for the first time. The most important legislation concerning joint ventures was identified as the Joint Venture Law which was adopted in 1979. Designed to augment this, the Regulations for the Implementation of the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment was promulgated in 1983. Since the reforms began in 1979, China was reported to have enacted hundreds of economic laws affecting foreign investors. Thus, it should be understood and expected that problems will airse in the implementation of such an evolving legal framework.

Armacost (1985) observed that the task of developing a new legal system for a nation of over one billion people is daunting. This was exacerbated by a Confucian tradition which was hostile toward public laws and lawyers, considering morality and ritual to be superior.

Compounding this predisposition to law, according to Wu (1982), is the lack of technical and administrative competence of officials, many of whom were appointed in the 1950's. The Cultural Revolution also was noted to have created a lack of concern and disinterest which resulted in a blurring of the division of labor and responsibilities among administrative agencies. Realizing this problem, Harding (1984) noted that Deng Xiaoping has attempted to reduce the size of the bureaucracy and to replace half of the twenty-one million cadres by 1990 with college-educated officials. Nonetheless, the fact that an elaborate legal system is in the process of being meticulously developed should not in itself be viewed as guaranteeing total protection against the possible risks that could arise in China's unstable political environment.

Wei Yuming (1984), Vice Minister of China's Foreign Economic Relations and Trade (MOFERT), has stated that problems the law does not yet address should be included in the joint venture contract. Thus, when the government approves the contract, the agreement would have the same legal force as the law would have. The United States Department of Commerce (1982), however, cautioned that very close attention should be paid to the terms and enforceability of the contract. This agency suggested that, because the legal system will be evolving for some time to come, direct equity investments during this time will not be as safe as are compensation trade and processing contracts.

The process of gaining approval for a contract, which is essential before it can take effect, was described by Kraiem (1985) as not without problems. Although a joint venture contract must be approved by MOFERT, this was noted to constitute only the first step. Other agencies were noted to give approval on such provisions as preferential tax treatment or considerations involving foreign exchange procedures. Furthermore, the law was reported to state that any contracts deemed to be against the social and public interest are "invalid". This concept was described as similar to the public policy rule followed in Western countries. Both Kraiem and Gelatt (1985) pointed out that, under China's socialist regime this could be interpreted much more broadly, thus giving the government the right to intervene in contract negotiations at its own option. If subsequent legislation with adverse effects is enacted, continued Gelatt and Kraiem, there may be no promise of protection. In that event the most favorable alternative was conjectured to be the renegotiation of the terms of the contract. While these and related issues have created great concern, the Foreign Economic Contract Law, enacted in March, 1985, was anticipated to help enable contract negotiations to proceed with a reasonable degree of autonomy.

Macneil (1985) suggested that the series of recently enacted laws has provided guidance in what has been described as a legal void. The legal system was noted to have been developed to keep foreigners at arm's length by establishing special investment zones and by preventing foreign influence from having a deep impact upon China's economic system. The resulting Chinese-foreign sphere of operations largely has been kept on the outskirts of the economy. Macneil asserted that China has established a separate legal regime which includes the following assumptions:

1. foreign investor activities are confined to a gray peripheral area,

2. the domestic legal system is not adequate to handle the increased economic activity stimulated by foreign investment, and

3. the domestic legal environment continues to be handled separately because it operates under central

planning. Foreign enterprises operate under free enterprise principles with separate regulations.

Macneil (1985) found the result of these restrictions to be an untenable situation which will continue to lead to conflicts of law as foreign enterprises expand their needs for supplies and marketing influence beyond the confines of the special economic areas. In an effort to eliminate conflict between regulations, Macneil proposed that one legal system should be adopted. The progress made toward the development of an integrated legal system was proposed as an indication of China's ability to continue the current modernization drive into the future.

At the same time, Wong (1985) observed that China's policies have vacillated so much that managers have experienced difficulty in making adjustments. These policies were described as the product of secret deliberations, with the accompanying changes and implementations imposed without warning. Even ministry officials themselves were reported to have provided advice to ventures without knowing a change has occurred.

Loss of Control over Trademark or Patents

Until recently, foreign investors had no legal protection for industrial property rights beyond those which could be negotiated in the contract. Feinerman (1985) pointed out, however, that trademarks now are covered under the Trademark Law of 1982 and the Trademark Implementing

Regulations of 1983. Patents were noted to be covered under the new Patent Law enacted in 1985.

The previous lack of protection in this area was viewed by Feinerman as a major obstacle to foreigners considering a Chinese investment. Even though the new regulations have been passed, some problems with the frustrating vagueness in various portions of the law as well as questions concerning enforcement were noted. If a translation discrepancy arises, Feinerman observed that the Chinese version will take precedence. It was viewed as noteworthy, however, that the Patent Law, unlike many other regulations, applies uniformly throughout China without separate codefication for the mainstream economy and the special economic areas. A peculiar aspect of the Patent Law which could be a source of apprehension to foreigners was the inclusion of a "world novelty test". In addition to this is the provision for compulsory licensing.

Before these laws were enacted, Cohen (1982) cautioned that implementation would provide no guarantee against a joint venture partner stealing proprietary information, and that such a situation could long go undetected. While Beijing was noted to want to establish a reputation for good faith, it was not viewed as inconceivable that a joint venture partner could be ordered by a higher authority to provide secret sub-licensing to other Chinese enterprises without the foreign partner's knowledge. Therefore, the key to the success of these regulations was reported to remain in the good faith of the Chinese. Anything short of this was described as counter-productive to the objectives of the reform program.

Casualty Exposure

Casualty exposure was defined by Mandel (1984) as involving the risk of financial loss arising from damage to the plant and assets of a joint venture or the incursion of employer liability created by injuries or catastrophic accidents. These risks were described as faced in common by both solely Chinese operated enterprises and by joint ventures.

Damage to Physical Plant and Assets

Damage to an enterprise's physical plant and assets could arise from fire, theft, accident, or explosion. Brouchli (1985b) noted that a joint venture seeking property and casualty insurance coverage cannot insure projects and investments directly with a foreign company and, advised that this must be done through arrangements made with the People's Insurance Company of China (PICC). Nonetheless, it was noted that authorities are giving consideration to allowing overseas insurance companies operating privileges in the Special Economic Zones. Currently, joint ventures must pay higher premiums for coverage than do domestic enterprises, which are given tax breaks because of the added expense. This was acknowledged to create an undesirable situation, as surveys have indicated that at least one-half of the foreign enterprises operate without any insurance. The expectation of many of these companies is that the Chinese government will cover any losses but this may not be true.

Wai-Kown, et al (1984) maintained that companies which do carry insurance often have an unrealistic assumption that ocean marine and inland marine coverage will be adequate for their needs, on the basis of worldwide protection. The problem with this kind of insurance, however, was the exclusion of several types of risks. The PICC has been the only "admitted" carrier in China and the only company permitted to insure joint ventures. Other types of enterprises have been permitted to seek coverage through foreign firms, although those firms have not been allowed to solicit business. The PICC has been permitted to write all types of coverage, including political risk insurance, but because it is state-owned, political risk coverage has been a source of potential conflict. This also was reported to be true in the case of coverage for worker's compensation, business interruption, and contract repudiation. The authors recommended that such insurance should be supplemented by other firms where possible. It was proposed in any case that joint ventures should obtain coverage for plant, equipment and raw materials, extended cargo coverage, and automobile insurance.

Liability for Injuries to Expatriate Workers

Employer liability arising from injuries to expatriate workers was described by Wei-Kown, et al (1984) to pose greater risk exposure than liability to Chinese nationals. Because the state provides worker's compensation for nationals, joint ventures have not been required to purchase this coverage. This relief has not eliminated the need for liability insurance which should cover both nationals as well as expatriate workers. If the responsible venture is headquartered in the United States, the Jones Act was observed to permit any injured worker to sue for damages in a United States court, where settlements were viewed as likely to be much larger than those awarded overseas.

Liability for Catastrophic Accidents

According to Brauchli (1985b), the risk of employer liability arising from the possibility of catastrophic industrial accidents was emphasized dramatically by the toxic gas leak at the Union Carbide plant in Bhopal, India. This resulted in a much higher demand for liability insurance among companies in China, especially joint ventures involved in offshore drilling operations. Brauchli pointed out that if an injured party is Chinese and sues another Chinese for damages, the parties are expected to resolve the dispute through friendly negotiation. Actions taken against a foreigner, however, were noted frequently to result in suits seeking exorbitant damages.

Cohen and Ladman (1984) pointed out the absence of a tort law in China and observed that, because legislation involves third party arbitration, a company using a Chinese insurance carrier usually stands a better chance of obtaining a more favorable settlement. If that company was identified as multinational, as may be the case with the foreign joint venture party, Cohen and Ladman noted that the individual seeking damages is permitted to sue in the foreign partner's home country. Should this be the case, it was noted to be important that the carrier have experience in international claims settlement.

Summary

The chapter presented a review of the literature pertaining to selected investment risks of joint ventures in China. Five major sections were established. The first section dealt with the background, progress, and outlook of China's economic reform program. Section two addressed the scope and methods of risk assessment within that operational environment. The last three sections surveyed the relevant exposure of political, foreign exchange, and commercial risks encountered by foreign enterprises in China.

The history of joint ventures in China was described as short, and conditions were observed to have been changing rapidly. This was found to have had a direct effect upon both the range and magnitude of risk exposure. The current literature was reviewed in order to provide an accurate reflection of those changes.

CHAPTER THREE

Method

The following chapter has delineated the methods employed to accomplish the objective of the study. A description of the data sources, the survey instrument, implementation procedures, data analysis, research assumptions and delimitations have been provided.

A comparative survey was used to characterize data from Hong Kong and United States multinational companies (MNC's) which had signed agreements to locate joint ventures within China. A self-administered questionnaire was mailed to top level managers responsible for, or vitally involved in, foreign investment decisions. A mail survey method was selected in response to the dispersion of the sample, the improved likelihood of access to major corporate executives, and to provide the respondents the option of anonymity (Emory, 1980). This technique also provided a larger sample than would have been feasible through the use of interviews.

The sample was drawn from published listings of foreign joint ventures which either were already established in China or were being negotiated. When combined, these listings represented the closest approximation of the total population for Hong Kong and United States companies as could be obtained reliably.

The data resulting from the survey enabled the researcher to determine the perceived investment risk exposure of both Hong Kong and United States joint ventures located in China's experimental free enterprise areas as reported by executives involved in joint venture enterprises. Also possible was a comparison of the input for Hong Kong and United States joint ventures located within the mainstream economy.

Utilizing a descriptive-elemental approach, the following research quetion was formulated: How do selected investment risk exposures (political, foreign exchange, and commercial) compare for Hong Kong and United States-based joint ventures located in both the special economic areas and the mainstream economy of China when evaluated by the responsible managers of parent multinational companies that signed joint venture agreements prior to June 1, 1985?

Collection of Data

Data Sources

The criteria for the data source specified first that the study participants must serve in the capacity of chief financial officer (or other top level manager) responsible for foreign investment decisions and provide opinion data based upon an independent evaluation of the selected risks impacting the joint ventures of each selected multinational company. Each of the designated multinational companies were headquartered in either the United States or Hong Kong and had signed agreements before June 1, 1985, to establish at least one joint venture within China. The joint venture enterprises were identified as operating in China either in the special areas for economic development or in China's mainstream economy. Each selected organization was classified under Chapter 1, Article 3 of the industrial categories permitted by the Regulations for the Implementation of the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment.

In order to obtain the names of multinational companies with joint ventures in China, numerous publications, independent authorities, and government agencies (including those of the People's Republic of China, Hong Kong, and the United States) were consulted. The three sources which identified specifically the organizations which conformed to these criteria were identified as:

China Resources Trade Consulting Co., Ltd., The Almanac of China's Foreign Economic Relations and Trade, 1984. Hong Kong, 1984.

China International Economic Consultants, Inc., The China Investment Guide 1984/85. Essex, England: Longman Group, Limited, 1984.

National Council for U.S.-China Trade. The China Business Review. Washington, D. C. (all issued from 1979 through March-April, 1985).

The China Business Review, (The CBR), published bi-monthly, provided a comprehensive, though not necessarily all-inclusive, updated international listing of business arrangements and direct investments in China, including data drawn from Chinese and foreign media reports. While joint ventures were mentioned in other sources consulted, most of the same investments, in addition to the most recent, also were listed in the issue of The China Business Review under "China Business". Not only was the name of the parent company and its country supplied, but also the joint venture product, industry type, investment value, and date of agreement. This publication also was noted to confine the published listings primarily to joint ventures for which equity shares have been issued. While The CBR was observed to have attempted to report accurately the information relevant to joint ventures headquarted in Hong Kong, some company names and/or addresses later proved to be unverifiable, incorrect, or unobtainable. This was attributed to difficulties resulting from the translation from Chinese to Wade-Giles or Pinyin spellings. Thus, although Chinese sources have claimed that thousands of investment agreements have been arranged, the actual percentage of which evolved into legitimate joint ventures has remained unclear and adequate documentation has been either fragmentary or unavailable. The Economist (1985) observed that as many as one-third of the agreements reported by the Chinese should be discounted as unverifiable.

For the purpose of defining the survey population, the total group of Hong Kong and United States companies reported to have contracted joint venture agreements prior to June 1, 1985, and were listed in the designated issues of The China Business Review were included. This provided an initial population of 217 companies for which addresses could be obtained. After mailing, however, thirty of the Hong Kong surveys were returned as undeliverable, resulting in a verifiable population of 187 companies.

It was determined that from this population, if the survey provided a data-producing sample of 20 percent, an adequate representation would be obtained. According to Emory (1980:16):

> The smaller the population dispersion, the smaller sample needed to give a representative picture of population members.

A total of sixty-four usable responses were received, resulting in a data-producing sample of forty-five companies. Of this number, twenty-two were headquartered in Hong Kong and twenty-three were headquartered in the United States.

Instrumentation

A semi-structured questionnaire was developed to obtain the data required to answer the research question. The instrument was designed to allow the respondent to evaluate and prioritize selected investment risks to which each joint venture would have had some degree of exposure. The first part of the instrument was designed to generate information indicative of the nature and the perceived severity of the political, foreign exchange, and commercial risks encountered by the respondents in directing the initiation and subsequent day-to-day operations of a joint venture agreement with the Chinese. The second part of the instrument provided demographic information detailing the amount of funds invested in the arrangement, together with the location and type of industry operated by each company.

The first section of the first part of the questionnaire utilized a numerical rating scale delineating nine intermediate points along a continuum of zero to ten. The respondent was asked to provide a rating for each of twenty-three risk elements along this continuum, in which the figure zero indicated "no concern", and the figure ten, "utmost concern". These elements were followed by three blanks, each corresponding to the same numerical continuum. In this way, the respondent was provided the opportunity to insert and rate additional risks on other issues of concern perceived to be significant to that particular joint venture. This rating scale provided numerical data specific to each potential risk so that each could be assessed qualitatively and ranked for comparison purposes.

The second section of Part One featured three blanks. From the total of the preceding items, the respondent was requested to select and list three risks or issues of particular concern, prioritizing each in order of relative importance.

The third section was designed to project future sensitivity to risk exposure. The respondent was asked to prioritize, in the blanks provided, the risks anticipated to be of greatest concern to the company's joint venture over the next three years.

Procedure

The total listing derived from The China Business Review which identified those Hong Kong and United States companies which had signed joint venture agreements was subjected to preliminary verification. This was accomplished by obtaining addresses for the United States companies, together with the names of the appropriate executives from the Dun and Bradstreet directories.

Mailing addresses for the Hong Kong companies were verified using the 1985 Hong Kong Business Telephone Directory. As was described in the discussion of data sources, some companies were not listed and, therefore, were unobtainable. This was attributed either to discrepancies in translation or to the possibility that the actual parent company was not reported accurately in the data sources. These procedures resulted in an initially identifiable population of 217 companies.

Based on the survey technique advocated by Murdick and Cooper (1982), representatives of each identified company was contacted. During the month of June, 1985, the chief financial officer of each company in the survey population was provided, by mail, a survey package including a cover letter, the questionnaire, and a prepaid return envelope. As an incentive to respond, each potential participant was promised a summary of the results of the study and was assured that individual responses would remain confidential. To help ensure a higher response rate, a follow-up mailing was completed one week later. This second contact was a postcard which served both as a thank you and a reminder. Two weeks after the first mailing (three weeks in the case of the Hong Kong companies) an additional complete survey package was mailed to non-respondents, together with a letter repeating the basic appeals for cooperation. Ten days after each of the third mailings, another thank you and reminder postcard was sent to the remaining non-respondents.

Analysis of Data

The research data were grouped into two categories and sub-categories. These categories were identified as:

1. United States companies which had negotiated joint ventures:

    a. within the special economic areas, or

    b. within the mainstream economy; and

2. Hong Kong companies which had negotiated joint ventures:

a. within the special economic areas, or

b. within the mainstream economy.

The data were analyzed using percentage comparisons, rank-orderings and t-tests. The statistical calculations were conducted with the aid of a computer and provided accuracy to fifteen decimal places.

The first phase of analysis addressed comparisons of the degree of concern for each of the twenty-three identified potential risk exposures. The raw data were tabulated by deriving counts and percentages at the three levels of concern (little, moderate, and great) for the special economic areas. These calculations included the results for the Hong Kong companies, the United States companies, and the totals for both groups. The same procedure was followed for the companies located within the mainstream economy, as well as the overall combined sample, regardless of location. This last classification included one Hong Kong respondent who did not specify a joint venture location.

Although the forty-five respondents rated each of the twenty-three risks individually, there was no uniformity in response for the self-prioritizing sections of the questionnaire in which additional concerns were listed. Furthermore, several respondents elected not to complete these questions. Calculations were performed on the basis of the actual number of available responses recorded for each survey item.

The second phase of analysis involved the rank-ordering of the means calculated for the perceived risk exposure reported for the firms operating in the special economic areas and in the mainstream economy. For each of these two locational categories the responses of the Hong Kong and United States firms were combined because of the sample size. The data provided by the single Hong Kong respondent who did not specify a joint venture location were not represented among the remaining forty-four responses utilized for this data display.

The F-test was applied to test the accuracy of the assumption of equivalent variances between the two locational categories. The values for F were calculated using the count and standard deviation data. The level of significance for a low probability (P) of F was established at or below the 0.05 level.

The t-test also was performed in order to test the comparisons that the responses for the participants representing the special economic areas differed significantly from those of the representatives of the mainstream economy. When the observed t-values were compared with t-tables, no significant differences were found between the means of the two groups at or beyond the 0.05 level of confidence.

The third phase of analysis was conducted on the demographic data procured by the survey instrument. This procedure provided tabulations for data pertinent to the parent companies and for the ventures relevant to the special econmoic areas, the mainstream economy, and the overall combined sample of forty-five respondents. The categories of analysis were specified as: the geographic distribution of joint venture operations, the year in which the joint venture agreement was affirmed, the number of joint ventures in operation as of 1985, the approximate value of the foreign partner's contributed capital, each company's percentages of joint venture equity participation, and the primary types of business for joint ventures.

The fourth phase of analysis required grouping the additional risks or issues of concern to management. The data were compiled according to the three major categories of selected risks (political, foreign exchange, and commercial), were illustrated in tables, analyzed, and reported in the findings. Data also were illustrated and treated to illustrate the management and personnel problems, infrastructure deficiencies and cultural transition stresses encountered by the study participants.

Research Assumptions and Delimitations

Research Assumptions

For the purposes of the current research, it was assumed that:

1. the descriptive-elemental approach was appropriate for answering the research question;

2. the questionnaire was valid and the elements contained were appropriate for an analysis of the investment risk exposure common to joint ventures in China;

3. the respondents understood the purpose of the questionnaire and answered accurately to the best of their ability;

4. the respondents had a basic understanding of the company's risk exposure before signing the joint venture agreement; and

5. the legal and regulatory environment of the special economic areas basically was uniform and applied generally to all foreign joint ventures from the Chinese perspective.

Delimitations

The study was limited to multinational companies (irrespective of size) headquartered either in the United States or Hong Kong which have signed an agreement for at least one joint venture within China. These joint ventures were distinguished further by two geographic classifications: (1) those intended to operate within the special areas for economic development, and (2) those intended to operate within the mainstream socialist economy.

While the same free enterprise framework was applied to all the special economic areas, the recent inclusion of the fourteen coastal cities has not been effective long enough to create a wide distribution of foreign investments, particularly in the case of joint ventures. In some of the more under-developed cities there was little or no joint venture representation.

Capital contributions made by foreign partners was observed to have varied widely. Also, parent company involvement ranged from the planning to the operational stages. The emphasis of the study, however, was focused on the evaluation of selected investment risks as they pertain to joint ventures under present environmental conditions. These evaluations were limited to the subjective judgments of the managers who either were involved in, or responsible for, investment decisions. The study made no provision to measure the accuracy of these judgments or the sophistication of the information from which the evaluations were derived.

Summary

The chapter outlined the methods employed to conduct the study. The rationale for the survey technique was presented, followed by a restatement of the research question and a description of the data sources. The construction of the survey instrument (a semi-structured questionnaire) was detailed, together with a description of the procedures followed for the implementation of these procedures. A portion of the chapter then was devoted to a discussion of data analysis procedures, which included percentage comparisons, rank-orderings, t-tests, and tabulations of the demographic data. Finally, the research assumptions were stated and the delimitations presented.

CHAPTER FOUR

Findings

The research identified for the current study addressed the concerns expressed with regard to various aspects of selected investment risks pertinent to joint ventures implemented in the People's Republic of China. Forty-five multinational companies which had negotiated joint venture agreements responded to a survey questionnaire. These companies were headquartered either in Hong Kong or the United States. The two survey groups were categorized on the basis of whether joint venture operations were located in the special economic areas (including the four Special Economic Zones, fourteen coastal cities, and Hainan Island) or in the mainstream socialist economy. Twenty-three investment risks creating exposure to the possibility of financial loss were included in the survey instrument and were evaluated by top level managers involved in the decision to establish one or more joint ventures in China. These risks were subdivided into three categories, including political, foreign exchange, and commerical risks. The commercial risks were classified further as those pertaining either to market conditions or to casualty exposure. For each of the twenty-three listed risks, the respondents were asked to provide a rating on a scale of zero to ten, with zero to three indicating a range of little or no concern; four to seven moderate concern; and eight to ten, the range of great concern. Following this listing, the respondent was asked to indicate and rate any additional risks or issues considered important. Provision also was made to allow for a self-ranking of the overall top three concerns under existing conditions as well as for projections covering the next three years.

The data were analyzed using percentage comparisons, rank orderings, and t-tests. The findings then were organized into four sections. The first section (Tables 1 through 23) dealt with comparisons of the exposure for the risks in each category as perceived by the Hong Kong and United States company managers involved in the joint venture investment decision. Section two (Tables 24 through 29) presented the ranking derivied for the risks for the designated survey categories and section three (Tables 30 through 36) provided an analysis of the demographic data pertinent to the joint ventures. In the fourth section of the chapter, additional concerns submitted by the respondents have been stated. While these issues were not necessarily considered risks they, nonetheless, represented important management concerns often closely related to the investment risk or their effects. In addition to the political, foreign exchange, and commercial risk categories, issues also addressed in the study included management and personnel problems, infrastructure deficiencies, and cultural transition stresses. Where applicable, these considerations have been included in relation to the analysis of the risk variables.

Concern over Political Risk

Table 1 illustrates the degree of concern over the risk of government confiscation of joint venture operations located in the special economic areas of China, as well as those located in the mainstream socialist economy. The joint ventures in these two regions further were differentiated as headquarted either in Hong Kong or in the United States of America.

The data indicated that 85 percent of the Hong Kong joint ventures located in the special economic areas expressed little concern regarding the political risk of government confiscation of the joint venture operations. Some 15 percent, however, expressed moderate concern. The single Hong Kong joint venture respondent located in the mainstream economy, a textile operation, expressed little concern with regard to political risk factors.

Of the United States joint ventures located in the special economic areas, 46.2 percent expressed little concern, while 53.8 percent stated moderate concern. In marked contrast, however, 9 percent of the United States joint ventures in the mainstream socialist economy expressed little concern while only one respondent, a computer manufacturing operation, indicated moderate concern.

An examination of the data reported for the overall combined sample, regardless of location, indicated that 73.3 percent expressed little concern, while 26.7 percent reported moderate concern regarding the potential threat of government confiscation. None of the joint venture representatives surveyed reported any great degree of concern relative to the risk of government confiscation.

Table 2 illustrates the survey data which suggest the degree of concern over the risk of civil unrest causing a disruption of operations. As was observed in Table 1, this factor was not viewed as a priority risk by most of the Hong Kong respondents located in the special economic areas. Seventy-five (75) percent reported little concern, as did the single textile operation located in the mainstream economy. Another anonymous textile venture, however, was reported to have responded at the high end of the spectrum. This joint venture was located in Zhuhai Special Economic Zone and indicated great concern over the possibility of civil unrest.

The overall level of apprehension regarding the potential for civil unrest in the special economic areas was higher for the United States-based joint ventures. Although approximately one-half the respondents expressed little

TABLE 1

Concern over the Political Risk of Government Confiscation for Joint Ventures Headquartered in Hong Kong or the United States

Location of Joint Venture	Degree of Concern							
	Little		Moderate		Great		Total	
	N	%	N	%	N	%	N	%
Special Economic Areas								
Headquartered in Hong Kong	17	85.0	3	15.0	-	-	20	100.0
Headquartered in United States	6	46.2	7	53.8	-	-	13	100.0
Total	23	69.7	10	30.3	-	-	33	100.0
Mainstream Economy								
Headquartered in Hong Kong	1	100.0	-	-	-	-	1	100.0
Headquartered in United States	9	90.0	1	10.0	-	-	10	100.0
Total	10	90.9	1	9.1	-	-	11	100.0
Overall Combined*	33	73.3	12**	26.7	-	-	45	100.0

* Overall combined includes total sample regardless of location

** One Hong Kong Joint Venture did not specify a location

concern, 38.5 percent described moderate concern and another venture expressed great concern regarding this risk.

Concern over civil unrest was found less acute in the mainstream socialist economy than in the special economic zone where 70 percent of the United States joint ventures reported little concern. None of the joint ventures from either the Hong Kong or United States group expressed any great concern over the possibility of civil unrest in the mainstream economy.

The level of concern expressed by the study participants relative to the risk of a Chinese policy shift away from the present policy of economic cooperation and mutual benefit has been illustrated in Table 3. The majority of the United States-based respondents operating in the special economic areas expressed moderate to great concern that the present economic policies promulgated by the Chinese could deteriorate into more unfavorable conditions. One of the respondents, a computer manufacturer, evidenced great concern by ranking this risk as the top concern over the next three years. The other United States-based joint venture reporting great concern was reported to be an offshore drilling operation based in the coastal city of Guangzhou. In conjunction with the risk of a shifting away from the policy of economic cooperation and mutal benefit, this respondent stated that the number

TABLE 2

Concern over the Political Risk of Civil Unrest for Joint Ventures
Headquartered in Hong Kong or the United States

Location of Joint Venture	Degree of Concern: Little N	Little %	Moderate N	Moderate %	Great N	Great %	Total N	Total %
Special Economic Areas								
Headquartered in Hong Kong	15	75.0	4	20.0	1	5.0	20	100.0
Headquartered in United States	7	53.8	5	38.5	1	7.7	13	100.0
Total	22	66.7	9	27.3	2	6.1	33	100.0
Mainstream Economy								
Headquartered in Hong Kong	1	100.0	-	-	-	-	1	100.0
Headquartered in United States	7	70.0	3	30.0	-	-	10	100.0
Total	8	72.7	3	27.3	-	-	11	100.0
Overall Combined*	31**	68.9	12	26.7	2	4.4	45	100.0

* Overall combined includes total sample regardless of location

** One Hong Kong Joint Venture did not specify a location

two concern overall for the company was the slow and deliberate erosion of economic benefits to the non-Chinese partners by an evolution of new interpretation to the joit venture contract, tax, and licensing procedure.

Seventy (70) percent of the United States joint ventures located in the mainstream economy reported moderate (50 percent) to great (20 percent) concern regarding the possibility of a Chinese shift away from the present policy of economic cooperation and mutual benefit. Of the two respondents expressing great concern, one venture, a service industry located in Beijing, indicated this risk as the number two overall concern both for the present and over the next three years. This same venture, which was reported to be in partnership with a major state-run organization, also listed the possibility of a change to a regime with antagonistic attitudes toward foreign investment as the highest priority risk under existing conditions as well as over the next three years.

For the overall combined sample, slightly less than one-half of the study participants were observed to have viewed this risk as of little concern. Another 40 percent, however, reported moderate concern, and 6 joint ventures (13.3 percent) disclosed great concern over the possibility that current Chinese policies could shift away from economic cooperation and mutual benefit. Of this number, four were located in the special economic areas.

TABLE 3

Concern over the Political Risk of a Shift Away from Economic Cooperation for Joint Ventures Headquartered in Hong Kong or the United States

Location of Joint Venture	Degree of Concern: Little N	Little %	Moderate N	Moderate %	Great N	Great %	Total N	Total %
Special Economic Areas								
Headquartered in Hong Kong	12	60.0	6	30.0	2	10.0	20	100.0
Headquartered in United States	5	38.5	6	46.2	2	15.4	13	100.0
Total	17	51.5	12	36.4	4	12.1	33	100.0
Mainstream Economy								
Headquartered in Hong Kong	-	-	1	100.0	-	-	1	100.0
Headquartered in United States	3	30.0	5	50.0	2	20.0	10	100.0
Total	3	27.3	6	54.5	2	18.2	11	100.0
Overall Combined*	21**	46.7	18	40.0	6	13.3	45	100.0

* Overall combined includes total sample regardless of location

** One Hong Kong Joint Venture did not specify a location

The concern over the political risk which could be associated with an unanticipated and excessive rise in taxes for joint ventures headquartered in either Hong Kong or the United States has been illustrated by the data reported in Table 4. Within the special economic areas of China, 55 percent of the Hong Kong-based firms indicated moderate concern, while 30 percent reported little concern. Six firms headquartered in the United States, representing 46.2 percent of the United States-based respondents, concurred with the evaluation of little concern. Also within the total group from these locations, however, were 30.8 percent of the joint ventures headquartered in the United States which expressed great concern over the possibility that the tax status could be changed unfavorably some time after the joint venture had been established. Only 15 percent of the Hong Kong firms were noted to have shared this degree of concern.

The degree of concern noted for the mainstream firms headquartered in the United States followed a pattern similar to that observed for the Hong Kong group which operated in the special economic areas. That is, 60 percent and 30 percent of these respondents indicated medium or slight concern, respectively. With regard to the degree of concern over the political risk of tax increases of an unanticipated or excessive nature, the overall pattern of responses for the firms located in the special economic areas and in mainstream economy were relatively similar. That is, 36.4 percent of these respondents in each joint venture location were not concerned to any marked extent. Between 40 to 55 percent of these groups expressed moderate concern. Another 9 to 21 percent, however, disclosed a great degree of concern that an unanticipated and excessive rise in taxes could occur.

The reported level of concern over the possibility the Chinese regime could develop an antagonistic attitude toward foreign investment has been indicated by the survey responses displayed in Table 5. Almost one-half (46.7 percent) of the overall combined sample of joint ventures surveyed, regardless of the location, responded with moderate concern regarding the possibility that the Chinese regime could change to one with antagonistic attitudes toward foreign investment. Also, of the combined sample, 37.8 percent expressed little concern, and another 15.6 percent disclosed great concern. These responses were almost identical to the responses recorded for the total group representing the special economic areas. In both locational categories (the special economic areas and the mainstream economy) the United States joint ventures expressed primary concern in the moderate range. This approximated 60 percent for those enterprises which operated in the mainstream economy, up from 53.8 percent in the

TABLE 4

Concern over the Political Risk of an Unanticipated and Excessive Rise in Taxes for Joint Ventures Headquartered in Hong Kong or the United States

Location of Joint Venture	Degree of Concern							
	Little		Moderate		Great		Total	
	N	%	N	%	N	%	N	%
Special Economic Areas								
Headquartered in Hong Kong	6	30.0	11	55.0	3	15.0	20	100.0
Headquartered in United States	6	46.2	3	23.1	4	30.8	13	100.0
Total	12	36.4	14	42.4	7	21.2	33	100.0
Mainstream Economy								
Headquartered in Hong Kong	1	100.0	-	-	-	-	1	100.0
Headquartered in United States	3	30.0	6	60.0	1	10.0	10	100.0
Total	4	36.4	6	54.5	1	9.1	11	100.0
Overall Combined*	17**	37.8	20	44.4	8	17.8	45	100.0

* Overall combined includes total sample regardless of location

** One Hong Kong Joint Venture did not specify a location

special economic areas. For both locations, the responses indicating little and great concern were distributed evenly for the joint ventures based in the United States.

As was noted in Table 3, one United States-based respondent (with a 50 percent equity participation between five and ten million dollars) reported that the possibility of a change to a regime with antagonistic attitudes toward foreign investment was the highest overall concern (rating this risk a "ten"). The other United States joint venture, a major food manufacturer, also indicated serious concern and assigned a rating of ten.

While answering the survey, each joint venture respondent also was aksed to state any other relevant concerns not listed on the instrument. Though many of these concerns actually were not risks, there were areas of concern which were considered important to the respondents' individual operations. One Hong Kong joint venture, located in the Special Economic Zone of Shantou, listed among its top three risks of greatest concern overall a change in the organizational structure of the government.

Among the United States-based respondents, the considerations listed as related to an antagonistic change of regime included a concern for an unfavorable local government/landlord attitude. The joint venture which provided this response was noted to have operations in both the Special Economic Zone of Shenzhen and the coastal city of Dalian. Another United States joint venture, located in the coastal city of Tianjin, indicated great concern over the possible effects of the Chinese relationship to United States unilaterally imposed trade restrictions. This respondent also expressed moderately high concern (seven on the rating scale) in anticipation of a deterioration in the relations between the United States and China as a result of Taiwan-related issues.

The results of the joint venture evaluations which indicated concern regarding the possibility that unfavorable loan restrictions could be imposed has been displayed in Table 6. The responses for both the Hong Kong ventures and those based in the United States were almost identical for the firms operating within the special economic areas. The total sample for these two groups revealed that slightly less than two-thirds (60.6 percent) considered the risk of loan restrictions of little or no concern. On the other hand, one Hong Kong-based joint venture disclosed serious concern over this risk (assigning a rating of ten on the ten-point scale). This firm was identified as a printing and packaging operation located in the Special Economic Zone of Shenzhen. Also indicating great concern was a major United States-based food processing plant located in the coastal city of Guangzhou.

TABLE 5

Concern over the Political Risk of an Antagonistic Attitude toward Foreign Investment for Joint Ventures Headquartered in Hong Kong or the United States

Location of Joint Venture	Degree of Concern							
	Little		Moderate		Great		Total	
	N	%	N	%	N	%	N	%
Special Economic Areas								
Headquartered in Hong Kong	10	50.0	8	40.0	2	10.0	20	100.0
Headquartered in United States	3	23.1	7	53.8	3	23.1	13	100.0
Total	13	39.4	15	45.5	5	15.2	33	100.0
Mainstream Economy								
Headquartered in Hong Kong	1	100.0	-	-	-	-	1	100.0
Headquartered in United States	2	20.0	6	60.0	2	20.0	10	100.0
Total	3	27.3	6	54.5	2	18.2	11	100.0
Overall Combined*	17**	37.8	21	46.7	7	15.6	45	100.0

* Overall combined includes total sample regardless of location

** One Hong Kong Joint Venture did not specify a location

For the mainstream economy, the possibility of loan restrictions did not appear to be an issue. The majority of the respondents in this survey group (72.7 percent) expressed little concern. No evidence of great concern over the risk was observed for any of the joint ventures included in the survey sample.

The data reported in Table 7 illustrate the distribution of responses regarding the perceived extent of political risk associated with production restrictions. This risk was noted to involve not only the possible impositions of production quotas, but also any restrictions on the import of components or commodities used in production which could inhibit, either directly or indirectly, the firm's output.

The responses reported for the joint ventures headquartered in Hong Kong or the United States were similar to those reported for the sample total for the respondents included in both geographic categories. The data recorded for the special economic areas revealed that a strong majority (63.6 percent) expressed little concern about production restrictions, whereas 36.4 percent indicated moderate concern.

This pattern also held true for the mainstream economy, where the total respondents specifying little concern was even higher (81.8 percent), with only two ventures (18.2

TABLE 6

Concern over the Political Risk of Unfavorable Loan Restrictions for Joint Ventures Headquartered in Hong Kong or the United States

Location of Joint Venture	Degree of Concern							
	Little		Moderate		Great		Total	
	N	%	N	%	N	%	N	%
<u>Special Economic Areas</u>								
Headquartered in Hong Kong	12	60.0	7	35.0	1	5.0	20	100.0
Headquartered in United States	8	61.5	4	30.8	1	7.7	13	100.0
Total	20	60.6	11	33.3	2	6.1	33	100.0
<u>Mainstream Economy</u>								
Headquartered in Hong Kong	1	100.0	-	-	-	-	1	100.0
Headquartered in United States	7	70.0	3	30.0	-	-	10	100.0
Total	8	72.7	3	27.3	-	-	11	100.0
<u>Overall Combined</u>*	29**	64.4	14	31.1	2	4.4	45	100.0

* Overall combined includes total sample regardless of location

** One Hong Kong Joint Venture did not specify a location

percent) indicating moderate concern. Regarding the specific risk of production restrictions, no joint venture responding to the survey reported great concern.

One United States-based multinational firm with a telecommunications operation in Shanghai volunteered a related issue which was noted to represent an area of serious concern. Prioritizing this risk as the second ranked overall concern under existing conditions, this joint venture stated that there was a lack of economic protection for local industry in response to the threat of direct imports.

The survey responses indicating the participants' views regarding the relative political risk associated with the potential imposition of export restrictions have been presented in Table 8. Within the special economic areas, the number of respondents indicating little concern was identical to that reported in Table 7. Twelve (60 percent) Hong Kong-based joint ventures (60 percent) agreed with nine (69.2 percent) of the United States-based joint ventures that export restrictions were not a significant risk.

One United States operation located in the coastal city of Tianjin, however, reported concern regarding a related risk. While rating export restrictions as a negligible issue (assigning a "one" on the ten-point scale) this firm expressed great concern over possible embargoes imposed by

TABLE 7

Concern over the Political Risk of Production Restrictions for Joint Ventures Headquartered in Hong Kong or the United States

Location of Joint Venture	Degree of Concern						Total	
	Little		Moderate		Great			
	N	%	N	%	N	%	N	%
Special Economic Areas								
Headquartered in Hong Kong	12	60.0	8	40.0	-	-	20	100.0
Headquartered in United States	9	69.2	4	30.8	-	-	13	100.0
Total	21	63.6	12	36.4	-	-	33	100.0
Mainstream Economy								
Headquartered in Hong Kong	1	100.0	-	-	-	-	1	100.0
Headquartered in United States	8	80.0	2	20.0	-	-	10	100.0
Total	9	81.8	2	18.2	-	-	11	100.0
Overall Combined*	31**	68.9	14	31.1	-	-	45	100.0

* Overall combined includes total sample regardless of location

** One Hong Kong Joint Venture did not specify a location

the United States for political reasons unrelated to business. On the other hand, three joint ventures (9.1 percent) of the total group representing the special economic areas, revealed great concern that the Chinese themselves might impose export restrictions. A major United States food processor, whose Guangzhou operation exceeds a $15 million investment (with a 50 percent equity participation) expressed serious concern regarding this risk. This respondent listed the possibility of export restrictions as the number one risk priority both currently and over the next three years since foreign currency generation through freer export ability was noted to be critical to the continued operation of this firm. For most joint ventures, exporting was noted to be the primary means of obtaining foreign exchange. The other two firms, headquartered in Hong Kong, also expressed great concern regarding this risk factor. Each of these joint ventures was described as a textile operation, one being located in the Special Economic Zone (SEZ) of Zhuhai, and the other with locations in the SEZ of Shenzhen as well as the city of Shanghai. In contrast to the above responses, all but one (9.1 percent) of the joint ventures surveyed within the mainstream economy regarded the possibility of export restrictions as a matter of little concern.

TABLE 8

Concern over the Political Risk of Export Restrictions for Joint Ventures Headquartered in Hong Kong or the United States

Location of Joint Venture	Degree of Concern							
	Little		Moderate		Great		Total	
	N	%	N	%	N	%	N	%
Special Economic Areas								
Headquartered in Hong Kong	12	60.0	6	30.0	2	10.0	20	100.0
Headquartered in United States	9	69.2	3	23.1	1	7.7	13	100.0
Total	21	63.6	9	27.3	3	9.1	33	100.0
Mainstream Economy								
Headquartered in Hong Kong	1	100.0	-	-	-	-	1	100.0
Headquartered in United States	9	90.0	1	10.0	-	-	10	100.0
Total	10	90.9	1	9.1	-	-	11	100.0
Overall Combined*	32**	71.1	10	22.2	3	6.7	45	100.0

* Overall combined includes total sample regardless of location

** One Hong Kong Joint Venture did not specify a location

Concern over Foreign Exchange Risks

Table 9 exhibits the degree of concern expressed by the study participants regarding the foreign exchange risk of currency devaluation. In the mainstream economy, 60 percent of the United States-based joint ventures indicated moderate concern, while the responses reported for the remainder of this group were distributed evenly between little concern (20 percent) and great concern (20 percent). The risk did not appear to have been viewed as serious for the United States-based firms located in the special economic areas, where the number of firms reporting little concern rose to seven (53.8 percent) and 39.5 percent expressed moderate concern. While this risk also did not seem to pose a problem for the only Hong Kong-based joint venture in the mainstream economy, the responses were mixed for the Hong Kong operations located within the special economic areas. Approximately one-third (35 percent) of the respondents reported little concern, but almost one-half (45 percent) noted moderate concern. Four respondents (20 percent) expressed great concern over possible currency devaluation. Two of these, both in the Special Economic Zone of Shenzhen, prioritized this risk on the survey instrument as the number one concern under existing conditions as well as for the next three years.

The data which indicated the respondents' perceptions relative to the foreign exchange risk associated with

TABLE 9

Concern over the Foreign Exchange Risk of Currency Devaluation for Joint Ventures
Headquartered in Hong Kong or the United States

Location of Joint Venture	Degree of Concern							
	Little		Moderate		Great		Total	
	N	%	N	%	N	%	N	%
Special Economic Areas								
Headquartered in Hong Kong	7	35.0	9	45.0	4	20.0	20	100.0
Headquartered in United States	7	53.8	5	38.5	1	7.7	13	100.0
Total	14	42.4	14	42.4	5	15.2	33	100.0
Mainstream Economy								
Headquartered in Hong Kong	1	100.0	-	-	-	-	1	100.0
Headquartered in United States	2	20.0	6	60.0	2	20.0	10	100.0
Total	3	27.3	6	54.5	2	18.2	11	100.0
Overall Combined*	18**	40.0	20	44.4	7	15.6	45	100.0

* Overall combined includes total sample regardless of location

** One Hong Kong Joint Venture did not specify a location

possible restrictions on currency exchange have been reported in Table 10. An examination of these data revealed that the degree of concern over this problem was the most acute of all the investment risks included on the survey instrument.

Within the special economic areas, 65 percent of the Hong Kong-based firms expressed great concern over the possibility of restrictions on currency exchange. Five of these respondents listed this risk as the top priority overall under existing conditions, and a textile venture in the Special Economic Zone of Shantou characterized this potential as the result of unpredictable government interruption of exchange policy. Three of the five respondents representing various types of industries indicated that this risk was likely to remain their greatest concern over the next three years.

The United States-based joint ventures located in the special economic areas exhibited an evenly distributed pattern with 46.2 percent reporting moderate concern and 46.2 percent reporting great concern. In the mainstream economy, five of the United States-based firms (50 percent) expressed great concern regarding possible restrictions on currency exchange. Three of these respondents assigned a "ten" rating to the risk, indicating the highest possible level of concern. Of the overall combined sample of forty-five joint venture respondents regardless of location, 55.6

TABLE 10

Concern over the Foreign Exchange Risk of Restriction on Currency Exchange for Joint Ventures Headquartered in Hong Kong or the United States

Location of Joint Venture	Degree of Concern: Little N	Little %	Moderate N	Moderate %	Great N	Great %	Total N	Total %
Special Economic Areas								
Headquartered in Hong Kong	1	5.0	6	30.0	13	65.0	20	100.0
Headquartered in United States	1	7.7	6	46.2	6	46.2	13	100.0
Total	2	6.1	12	36.4	19	57.6	33	100.0
Mainstream Economy								
Headquartered in Hong Kong	-	-	1	100.0	-	-	1	100.0
Headquartered in United States	1	10.0	4	40.0	5	50.0	10	100.0
Total	1	9.1	5	45.5	5	45.5	11	100.0
Overall Combined*	3	6.7	17	37.8	25**	55.6	45	100.0

* Overall combined includes total sample regardless of location

** One Hong Kong Joint Venture did not specify a location

percent revealed great concern regarding the risk that exchange restrictions could have an adverse affect upon successful operations.

The respondents' concerns regarding the perceived relative negative impact of a delay in repatriation of funds have been presented in Table 11. The combined responses for the representatives of the special economic areas indicated that slightly less than one-half of the respondents (45.5 percent) considered the risk of a delay in repatriation as an issue of moderate concern. Another twelve firms (36.4 percent) expressed great concern. In the mainstream economy, the reported level of apprehension was higher, thereby reversing this response pattern. The data indicated that 45.5 percent of the members of this group expressed great concern and another 36.4 percent recorded responses indicative of moderate concern.

Two of the United States-based ventures included in the mainstream economy group (both in the telecommunications industry) self-ranked the risk of a delay in repatriation of funds as their number one concern overall under existing conditions.

Concern over Commercial Risks

Market Conditions

Table 12 suggests the level of concern expressed by the surveyed representatives of joint ventures relative to the ability of the Chinese joint venture partner to meet

TABLE 11

Concern over the Foreign Exchange Risk of Delay in Repatriation of Funds for Joint Ventures Headquartered in Hong Kong or the United States

Location of Joint Venture	Degree of Concern							
	Little		Moderate		Great		Total	
	N	%	N	%	N	%	N	%
Special Economic Areas								
Headquartered in Hong Kong	3	15.0	9	45.0	8	40.0	20	100.0
Headquartered in United States	3	23.1	6	46.2	4	30.8	13	100.0
Total	6	18.2	15	45.5	12	36.4	33	100.0
Mainstream Economy								
Headquartered in Hong Kong	-	-	1	100.0	-	-	1	100.0
Headquartered in United States	2	20.0	3	30.0	5	50.0	10	100.0
Total	2	18.2	4	36.4	5	45.5	11	100.0
Overall Combined*	9**	20.0	10	42.2	17	37.8	45	100.0

* Overall combined includes total sample regardless of location

** One Hong Kong Joint Venture did not specify a location

contractual obligations made withthe foreign partner. While this risk was not interpreted as involving the integrity of the Chinese partner, it was defined as going beyond that to include market conditions which could affect negatively the fulfillment of contractual obligations. On the survey instrument, two United States joint ventures listed related issues that could have an impact upon the severity of this risk. One firm, scheduled to begin assembling instruments in the coastal city of Tianjin, evaluated Chinese sub-contractors as unreliable. In the Special Economic Zone of Shenzhen, a manufacturing operation listed as the primary concern the ability of the joint venture partners to meet local marketing demands.

As Table 12 indicates, 57.6 percent of the joint ventures located in special economic areas expressed a moderate degree of concern. There was no significant difference observed in the responses of the mainstream economy operations. Reflecting virtually the same evaluation (54.5 percent) six of these firms expressed moderate concern regarding the risk that the Chinese joint venture partner might not meet its contractual obligations made with the foreign partner.

Table 13 illustrates the degree of joint venture concern over the risk of failure or inability of the Chinese suppliers of raw materials to meet delivery schedules. Of the thirteen United States firms surveyed in the special

TABLE 12

Concern over the Commercial Risk in Market Conditions of Failure or Inability of the Chinese Joint Venture Partner to Meet Contractual Obligations made with Foreign Partners

Location of Joint Venture	Degree of Concern							
	Little		Moderate		Great		Total	
	N	%	N	%	N	%	N	%
Special Economic Areas								
Headquartered in Hong Kong	5	25.0	12	60.0	3	15.0	20	100.0
Headquartered in United States	1	15.4	7	53.8	4	30.8	13	100.0
Total	7	21.2	19	57.6	7	21.2	33	100.0
Mainstream Economy								
Headquartered in Hong Kong	-	-	1	100.0	-	-	1	100.0
Headquartered in United States	4	40.0	5	50.0	1	10.0	10	100.0
Total	4	36.4	6	54.5	1	9.1	11	100.0
Overall Combined*	12**	26.7	25	55.6	8	17.8	45	100.0

* Overall combined includes total sample regardless of location

** One Hong Kong Joint Venture did not specify a location

economic areas, 69.2 percent expressed great concern. More of the United States-based respondents included in this group were apprehensive over this risk than any other selected risk on the survey. In comparison, only 30 percent of the Hong Kong respondents agreed with this assessment. One of these, a textile operation in the Special Economic Zone of Shantou, stated that one of its top priority concerns over the next three years would be the supply of raw materials from other provinces. Similarly, a United States-based manufacturing joint venture in Tianjin listed access to raw materials, especially steel, among the three greatest concerns under existing conditions.

In the mainstream economy, the ability of suppliers to meet delivery schedules also was noted to be of great concern by the Hong Kong textile venture located in Urumqi, the capital of Xinjiang province. Eighty (80) percent of the United States respondents from this group were evenly divided between moderate concern and great concern. Adding a slightly different perspective to this market risk, a manufacturer of test instruments and computer systems products in Beijing noted that the fluid state of organizations in terms of purchasing channels, distribution channels, etc., constituted an area of relatively serious concern.

The degree of concern over the scarcity of internal and economic market data available to joint ventures has been

TABLE 13

Concern over the Commercial Risk in Market Conditions of the Failure or Inability of the Chinese Suppliers of Raw Materials to Meet Delivery Schedules made with Joint Ventures

Location of Joint Venture	Degree of Concern							
	Little		Moderate		Great		Total	
	N	%	N	%	N	%	N	%
Special Economic Areas								
Headquartered in Hong Kong	4	20.0	10	50.0	6	30.0	20	100.0
Headquartered in United States	1	7.7	3	23.1	9	69.2	13	100.0
Total	5	15.2	13	39.4	15	45.5	33	100.0
Mainstream Economy								
Headquartered in Hong Kong	-	-	-	-	1	100.0	1	100.0
Headquartered in United States	2	20.0	4	40.0	4	40.0	10	100.0
Total	2	18.2	4	36.4	5	45.5	11	100.0
Overall Combined*	7	15.6	18**	40.0	20	44.4	45	100.0

* Overall combined includes total sample regardless of location

** One Hong Kong Joint Venture did not specify a location

suggested by the data presented in Table 14. Most noteworthy was the high percentage of Hong Kong-based firms (70 percent) in the special economic areas expressing moderate concern. In comparison, 46.2 percent of the United States-based joint ventures reporting from the same areas expressed moderate concern, while another five operations (38.5 percent) noted little or no concern.

In the mainstream economy, the percentages reported for the United States-based respondents were distributed in a relatively similar pattern across the three categories of concern, ranging from 30 percent to 40 percent. Of the overall combined sample, slightly over one-half (51.1 percent) of the joint ventures indicated that the scarcity of internal and economic market data should be identified as a risk of moderate concern.

The possibility of joint ventures having price controls imposed on finished products is the risk assessed in the data included in Table 15. The totals for both the special economic areas and the mainstream economy corresponded identically with regard to the degree of concern expressed regarding the imposition of price controls. That is, 45.5 percent in each locational category indicated moderate concern over the possible imposition of price controls on the finished product. Within the special economic areas, however, there was a notable difference in the responses reported for the joint ventures headquartered in Hong Kong

TABLE 14

Concern over the Commercial Risk in Market Conditions of the Scarcity of Internal and Economic Market Data Available to Joint Ventures Headquartered in Hong Kong or the United States

Location of Joint Venture	Degree of Concern: Little N	Little %	Moderate N	Moderate %	Great N	Great %	Total N	Total %
Special Economic Areas								
Headquartered in Hong Kong	3	15.0	14	70.0	3	15.0	20	100.0
Headquartered in United States	5	38.5	6	46.2	2	15.4	13	100.0
Total	8	24.2	20	60.6	5	15.2	33	100.0
Mainstream Economy								
Headquartered in Hong Kong	-	-	-	-	1	100.0	1	100.0
Headquartered in United States	4	40.0	3	30.0	3	30.0	10	100.0
Total	4	36.4	3	27.3	4	36.4	11	100.0
Overall Combined*	13**	28.9	23	51.1	9	20.0	45	100.0

* Overall combined includes total sample regardless of location

** One Hong Kong Joint Venture did not specify a location

TABLE 15

Concern over the Commercial Risk in Market Conditions of Price Controls on Finished Products Imposed on Joint Ventures Headquartered in Hong Kong or the United States

Location of Joint Venture	Degree of Concern							
	Little		Moderate		Great		Total	
	N	%	N	%	N	%	N	%
Special Economic Areas								
Headquartered in Hong Kong	9	45.0	7	35.0	4	20.0	20	100.0
Headquartered in United States	3	23.1	8	61.5	2	15.4	13	100.0
Total	12	36.4	15	45.5	6	18.2	33	100.0
Mainstream Economy								
Headquartered in Hong Kong	-	-	1	100.0	-	-	1	100.0
Headquartered in United States	4	40.0	4	40.0	2	20.0	10	100.0
Total	4	36.4	5	45.5	2	18.2	11	100.0
Overall Combined*	17**	37.8	20	44.4	8	17.8	45	100.0

* Overall combined includes total sample regardless of location

** One Hong Kong Joint Venture did not specify a location

and those headquartered in the United States. Whereas 35 percent of the Hong Kong-based firms indicated moderate concern, 61.5 percent of the United States-based firms indicated moderate concern.

Table 16 illustrates the concern for the commercial risk in market conditions over costs of future materials required by joint ventures. Moderate concern was the response reported for the majority of the firms included in all survey categories. This was reported as 57.8 percent of the overall combined sample. Within the special economic areas the percentages were almost identical for both the Hong Kong- and United States-based respondents, with 60 percent and 61.5 percent, respectively, indicating moderate concern.

For the mainstream economy, 20 percent of the United States-based respondents indicated great concern over potential cost increases for future materials. These companies (both major multinational firms) were identified as in the food processing industry but neither had yet begun operations.

The level of concern over control of labor rates has been represented in Table 17. Moderate concern over labor rates was registered by 45.5 percent of the total samples for both the special economic areas (fifteen joint ventures) and the mainstream economy (five joint ventures). These

TABLE 16

Concern over the Commercial Risk in Market Conditions of Control over Costs of Future Materials Required by Joint Ventures Headquarteree in Hong Kong or the United States

Location of Joint Venture	Little N	Little %	Moderate N	Moderate %	Great N	Great %	Total N	Total %
	Degree of Concern							
Special Economic Areas								
Headquartered in Hong Kong	5	25.0	12	60.0	3	15.0	20	100.0
Headquartered in United States	3	23.1	8	61.5	2	15.4	13	100.0
Total	8	24.2	20	60.6	5	15.2	33	100.0
Mainstream Economy								
Headquartered in Hong Kong	-	-	1	100.0	-	-	1	100.0
Headquartered in United States	3	30.0	5	50.0	2	20.0	10	100.0
Total	3	27.3	5	54.5	2	18.2	11	100.0
Overall Combined*	12**	26.7	26	57.8	7	15.6	45	100.0

* Overall combined includes total sample regardless of location

** One Hong Kong Joint Venture did not specify a location

identical percentages also were consistent with the responses which indicated a moderate level of concern for both the Hong Kong- and United States-based firms within the special economic areas. The balance of the responses for the Hong Kong- and United States-based firms within these location based groups were at opposite ends of the scale provided for the survey instrument. Apprehension over control of labor rates notably was higher for the United States-based joint ventures. The responses reported for 46.2 percent of the firms expressed great concern, while only 15 percent of the responses reported for the Hong Kong-based joint ventures fell within this category.

The responses indicating the perceived severity of the potential commercial risk of business interruption have been treated in Table 18. An examination of the responses reported for the overall combined sample indicated that 53.3 percent of the survey respondents viewed this possibility to be a risk of moderate concern. Within the special economic areas, however, this figure rose to 60 percent for the Hong Kong-based firms in comparison to 46.2 percent for the United States-based joint ventures.

The data reported for the firms which operated in the mainstream economy suggested that the possibility of business interruption elicited the greatest concern for the Hong Kong respondent, a textile joint venture. While none of the United States-based joint ventures indicated this

TABLE 17

Concern over the Commercial Risk in Market Conditions of Control over Labor Rates Required of Joint Ventures Headquartered in Hong Kong or the United States

Location of Joint Venture	Degree of Concern							
	Little		Moderate		Great		Total	
	N	%	N	%	N	%	N	%
Special Economic Areas								
Headquartered in Hong Kong	8	40.0	9	45.0	3	15.0	20	100.0
Headquartered in United States	1	7.7	6	46.2	6	46.2	13	100.0
Total	9	27.3	15	45.5	9	27.3	33	100.0
Mainstream Economy								
Headquartered in Hong Kong	-	-	-	-	1	100.0	1	100.0
Headquartered in United States	3	30.0	5	50.0	2	20.0	10	100.0
Total	3	27.3	5	45.5	3	27.3	11	100.0
Overall Combined*	12	26.7	21**	46.7	12	26.7	45	100.0

* Overall combined includes total sample regardless of location

** One Hong Kong Joint Venture did not specify a location

TABLE 18

Concern over the Commercial Risk in Market Conditions of Loss Due to Business Interruption for Joint Ventures Headquartered in Hong Kong or the United States

Location of Joint Venture	Degree of Concern: Little N	Little %	Moderate N	Moderate %	Great N	Great %	Total N	Total %
Special Economic Areas								
Headquartered in Hong Kong	5	25.0	12	60.0	3	15.0	20	100.0
Headquartered in United States	4	30.8	6	46.2	3	23.1	13	100.0
Total	9	27.3	18	54.5	6	18.2	33	100.0
Mainstream Economy								
Headquartered in Hong Kong	-	-	-	-	1	100.0	1	100.0
Headquartered in United States	4	40.0	6	60.0	-	-	10	100.0
Total	4	36.4	6	54.5	1	9.1	11	100.0
Overall Combined*	14**	31.1	24	53.3	7	15.6	45	100.0

* Overall combined includes total sample regardless of location

** One Hong Kong Joint Venture did not specify a location

degree of apprehension, 60 percent did specify moderate concern over the issue.

Table 19 presents the survey responses indicative of the perceived negative impact of the commercial risk resulting from an inconsistent interpretation of the legal and regulatory structures as applied to joint ventures. Of the Hong Kong-based firms operating in the designated special economic areas, eight respondents (40 percent) expressed moderate concern, while an additional eight firms (40 percent) expressed great concern over this risk. Among the United States-based joint ventures operating in these locations, 38.5 percent concurred with this assessment. One United States-based petroleum blending and packaging operation stated that "people at lower levels (both local government and the Chinese partner) do not understand the principle agreement reached at higher levels, thus creating problems in implementation and rising costs". The same joint venture also listed this issue as its number one concern under existing conditions, and for the next three years, placed it second only to cost in priority.

Sixteen (35.6 percent) of the total group of forty-five joint venture participants responding to the survey regarded the inconsistent interpretation of the legal and regulatory structure as an issue of great concern. An additional 37.8 percent expressed moderate concern over this risk.

TABLE 19

Concern over the Commercial Risk in Market Conditions Resulting from an Inconsistent Interpretation of the Legal and Regulatory Structure as Applied to Joint Ventures Headquartered in Hong Kong or the United States

Location of Joint Venture	Degree of Concern							
	Little		Moderate		Great		Total	
	N	%	N	%	N	%	N	%
Special Economic Areas								
Headquartered in Hong Kong	4	20.0	8	40.0	8	40.0	20	100.0
Headquartered in United States	5	38.5	3	23.1	5	38.5	13	100.0
Total	9	27.3	11	33.3	13	39.4	33	100.0
Mainstream Economy								
Headquartered in Hong Kong	-	-	-	-	1	100.0	1	100.0
Headquartered in United States	3	30.0	5	50.0	2	20.0	10	100.0
Total	3	27.3	5	45.5	3	27.3	11	100.0
Overall Combined*	12	26.7	17**	37.8	16	35.6	45	100.0

* Overall combined includes total sample regardless of location

** One Hong Kong Joint Venture did not specify a location

The participants views relative to the possibility that joint ventures could lose control over trademarks or patents have been reported in Table 20. For the total sample of joint ventures operating within the special economic areas, only 9.1 percent stated great concern regarding the risk of losing control over trademarks or patents. The remaining firms' responses were divided fairly evenly between little concern (48.5 percent) and moderate concern (42.4 percent). One computer manufacturer, which rated this risk at "seven" (the high end of moderate concern) indicated as the number one overall concern under existing conditions the importance of proprietary asset protection, know-how, etc. This well-known multinational corporation was slated to commence operations in the coastal cities of Tianjin and Shanghai by January, 1986.

While slightly more than one-half (54.5 percent) of the total mainstream economy respondents expressed little concern, another 37.3 percent reported great concern. The data reported for the overall combined sample indicated that three of the six joint ventures expressing a high level of apprehension were United States-based food processing operations.

Casualty Exposure

Table 21 presents the data indicating the degree of concern over casualty exposure resulting from damage to physical plant and assets. The fact the possibility of

TABLE 20

Concern over the Commercial Risk in Market Conditions Resulting from a Loss of Control over Trademarks or Patents Held by Joint Ventures Headquartered in Hong Kong or the United States

Location of Joint Venture	Degree of Concern							
	Little		Moderate		Great		Total	
	N	%	N	%	N	%	N	%
Special Economic Areas								
Headquartered in Hong Kong	10	50.0	9	45.0	1	5.0	20	100.0
Headquartered in United States	6	46.2	5	38.5	2	15.4	13	100.0
Total	16	48.5	14	42.4	3	9.1	33	100.0
Mainstream Economy								
Headquartered in Hong Kong	-	-	-	-	1	100.0	1	100.0
Headquartered in United States	6	60.0	2	20.0	2	20.0	10	100.0
Total	6	54.5	2	18.2	3	37.3	11	100.0
Overall Combined*	23**	51.5	16	35.6	6	13.3	45	100.0

* Overall combined includes total sample regardless of location

** One Hong Kong Joint Venture did not specify a location

damage to physical plant and assets was not considered a threat to the viability of the joint venture was affirmed by the fact that 69.7 percent of the respondents assessed this risk as of little or no concern.

Of those respondents with ventures based in the mainstream economy, the Hong Kong textile firm in Urumqi, expressed moderate concern. The remaining 90 percent of the United States-based joint ventures in this category expressed little or no concern. There was, however, a telecommunications operation scheduled to have begun operations in Kunming by September, 1985. This joint venture recorded a rating of "eight" on the ten-point scale, indicating serious concern. The assessment of the overall combined sample of forty-five joint ventures indicated that slightly less than three-fourths (73.3 percent) of the respondents regarded the casualty exposure of damage to physical plant and assets as a risk of little or no concern.

The extent of employer liability arising from injuries to expatriate workers represents the casualty risk assessed in Table 22. When compared to the risk of damage to physical plants and assets treated in Table 21, the potential for financial loss resulting from liability for injuries elicited a higher sensitivity to exposure from the group of Hong Kong-based joint ventures located in the special economic areas. That is, while 20 percent of the Hong Kong firms expressed moderate concern over property

TABLE 21

Concern over the Commercial Risk of Casualty Exposure Resulting from Damage* to Physical Plant and Assets for Joint Ventures Headquartered in Hong Kong or the United States

Location of Joint Venture	Degree of Concern							
	Little		Moderate		Great		Total	
	N	%	N	%	N	%	N	%
Special Economic Areas								
Headquartered in Hong Kong	14	70.0	4	20.0	2	10.0	20	100.0
Headquartered in United States	9	69.2	3	23.1	1	7.7	13	100.0
Total	23	69.7	7	21.2	3	9.1	33	100.0
Mainstream Economy								
Headquartered in Hong Kong	-	-	1	100.0	-	-	1	100.0
Headquartered in United States	9	90.0	-	-	1	10.0	10	100.0
Total	9	81.8	1	9.1	1	9.1	11	100.0
Overall Combined**	33+	73.3	8	17.8	4	8.9	45	100.0

* From fire, theft, accident, or explosion

** Overall combined includes total sample regardless of location

\+ One Hong Kong respondent did not specify a location damage exposure, 40 percent reported moderate concern over employer liability resulting from injuries to expatriate workers. In the same locational category, however, the responses of the United States-based firms regarding these two risks remained unchanged, with 69.2 percent expressing little concern and 23.1 percent reporting moderate concern. Collectively, well over one-third (38.9 percent) of the total group of forty-five respondents with firms located throughout China indicated moderate concern that joint venture operations could be affected as a result of liability arising from injuries to expatriate workers.

The perceived risk of casualty exposure resulting from a possible catastrophic industrial accident has been evaluated in Table 23. This risk was not viewed as an issue for joint ventures located in the mainstream economy. Of the eleven respondents with firms in this location, ten expressed little or no concern. The exception was a United States-based telecommunications joint venture which anticipated initiating operations in Kunming by September, 1985. This firm expressed great concern over the possibility of a catastrophic industrial accident.

Within the special economic areas, the level of apprehension remained somewhat higher for the Hong Kong respondents than for that of those headquartered in the United States, of which more than three-fourths (76.9 percent) expressed little concern. In comparison, 35

TABLE 22

Concern over the Commercial Risk of Casualty Exposure Resulting from Injuries to Expatriate Workers Employed by Joint Ventures Headquartered in Hong Kong or the United States

Location of Joint Venture	Degree of Concern							
	Little		Moderate		Great		Total	
	N	%	N	%	N	%	N	%
Special Economic Areas								
Headquartered in Hong Kong	11	55.0	8	40.0	1	5.0	20	100.0
Headquartered in United States	9	69.2	3	23.1	1	7.7	13	100.0
Total	20	60.6	11	33.3	2	6.1	33	100.0
Mainstream Economy								
Headquartered in Hong Kong	-	-	1	100.0	-	-	1	100.0
Headquartered in United States	8	80.0	1	10.0	1	10.0	10	100.0
Total	8	72.7	2	18.2	1	9.1	11	100.0
Overall Combined*	29**	64.4	13	38.9	3	6.7	45	100.0

* Overall combined includes total sample regardless of location

** One Hong Kong Joint Venture did not specify a location

percent of the Hong Kong firms in these areas expressed moderate concern and 10 percent expressed great concern. In reviewing the data reported for the overall combined sample of forty-five joint ventures, thirty-two firms (71.1 percent reported that employer liability resulting from the possibility of a catastrophic industrial accident was an issue of little concern.

Rankings of Investment Risks

Tables 24 through 27 display the rank orderings of the selected political foreign exchange and commercial risks in order of assigned severity. For purposes of comparison, the overall combined sample of forty-five joint ventures was divided into two groups. The first group included the thirty-three joint ventures located in the special economic areas. These areas included the four Special Economic Zones, fourteen coastal cities, and Hainan Island. The second group consisted of the eleven joint ventures located throughout the mainstream socialist economy. For each group, the responses of the Hong Kong- and United States-based firms were combined. Since one Hong Kong respondent failed to indicate the geographic location of its joint venture, the data reported for that individual were not included in the responses utilized in the rank order comparisons.

Each risk was ranked on the basis of the calculated weighted mean, as assessed on the zero to ten rating scale

TABLE 23

Concern over the Commercial Risk of Casualty Exposure Resulting from a Catastrophic Industrial Accident for Joint Ventures Headquartered in Hong Kong or the United States

Location of Joint Venture	Degree of Concern							
	Little		Moderate		Great		Total	
	N	%	N	%	N	%	N	%
Special Economic Areas								
Headquartered in Hong Kong	11	55.0	7	35.0	2	10.0	20	100.0
Headquartered in United States	10	76.9	2	15.4	1	7.7	13	100.0
Total	21	63.6	9	27.3	3	9.1	33	100.0
Mainstream Economy								
Headquartered in Hong Kong	1	100.0	-	-	-	-	1	100.0
Headquartered in United States	9	90.0	-	-	1	10.0	10	100.0
Total	10	90.0	-	-	1	9.1	11	100.0
Overall Combined*	32**	71.1	9	20.0	4	8.9	45	100.0

* Overall combined includes total sample regardless of location

** One Hong Kong Joint Venture did not specify a location

employed in the data collection instrument. A response within the range of zero to three was identified as representing little concern, four to seven moderate concern, and eight to ten great concern, with ten representing utmost concern. Also displayed in the tables developed to illustrate the relative impact of each risk are the standard deviations as well as the results of the F-tests and the t-tests. The F-test was applied to test the accuracy of the assumption of equivalent variances. The indicated values for F were calculated using the count and standard deviation data. The level of significance established for the low probability (P) of F was established at or below the 0.05 level of confidence.

The tables reported the t-test observed values in order to test the comparison that the responses reported for the special economic areas differed significantly from those reported for the firms located in the mainstream economy. When the observed t values were compared with t-tables, no significant differences were reported between the means reported for the two groups of respondents surveyed.

Rankings of Political Risks

Table 24 reported survey responses which identified the top political risk affecting the investments of the joint ventures in the special economic areas as the possibility of an unanticipated and excessive rise in taxes. The mean for this factor was 4.8 with a standard deviation of 2.5, placing this risk in the range of moderate concern. Second in priority for this group was the risk of a change to a regime with antagonistic attitudes toward foreign investment. Also ranked at the level of moderate concern, this risk was a mean of 4.3 with a standard deviation of 3.0.

The total group of joint ventures located in the mainstream economy ranked the potential for the development of antagonistic attitudes toward foreign investments in the first position, with the mean reported at 5.3. The risk ranked second by members of this group was the closely related possibility of a shift away from China's present policy favoring economic cooperation and mutual benefit. This risk factor was noted to have a mean of 4.5 and a standard deviation of 2.1. The change of an excessive rise in taxes, the top concern for the joint ventures located in the special economic areas, was ranked third by the mainstream group. While each of these risks was assessed at a level indicating moderate concern, the remaining potential political risks reflected relatively little concern according to the survey data reported for both study groups.

Ranking last for the special economic areas ($\overline{X}$ = 2.3, SD = 2.4) was government confiscation. This factor assigned the lowest priority ($\overline{X}$ = 1.4, SD = 1.6) by the group which represented the mainstream economy and was identified as the potential imposition of export restrictions.

The t-test revealed no statistical difference between the means of the two groups. There was, however, a probability of F at or beyond the 0.05 level for the risks associated with a possible shift away from economic cooperation and mutual benefit, civil unrest, and export restrictions.

Rankings of Foreign Exchange Risks

The rankings indicating the relative severity of the selected foreign exchange risks have been presented in Table 25. The order of importance assigned these risks was identical for both the special economic areas and the mainstream economy. Both groups placed the potential for financial loss from restriction on currency exchange in the position of first priority. The responses reported for both groups had means of 7.0, which was at the upper limit of the range for moderate concern. In the upper range of moderate concern were the responses which indicated the perceived level of concern associated with the risk of a delay in repatriation of funds. The joint ventures in the mainstream economy reported a slightly higher mean (6.7) than did those in the special economic areas (6.1). Each group, however, had identical standard deviations (2.6). Ranked third was the level of concern regarding the risk associated with the

TABLE 24

Rankings of Selected Political Risks for Joint Ventures Located in Special Economic Areas and the Mainstream Economy

Type of Risk	Special Economic Areas (N=33)			Mainstream Economy (N=11)			F	t
	$\overline{X}$	(R)	S D	$\overline{X}$	(R)	S D		
Unanticipated and excessive rise in taxes	4.8	(1)	2.5	4.5	(3)	1.9	1.7356	.2535
Change to a regime with antagonistic attitudes toward foreign investment	4.3	(2)	3.0	5.3	(1)	2.7	1.1995	-.9915
Shifting away from economic co-operation and mutual benefit	3.6	(3)	3.1	4.5	(2)	2.1	2.1455*	-.9066
Imposition of unfavorable loan restrictions	3.3	(4)	2.4	2.6	(5)	1.8	1.8076	.8888
Civil Unrest	3.0	(5)	2.6	3.0	(4)	1.2	4.4785*	.0378
Production Restrictions	2.9	(6)	2.2	2.1	(7)	1.7	1.7549	1.1170
Export Restrictions	2.9	(7)	3.0	1.4	(8)	1.6	3.6104*	1.6204
Government confiscation	2.3	(8)	2.4	2.3	(6)	1.8	1.7259	.0770

* $P \leq .05$

possibility of currency devaluation, with means of 4.3 and 4.6 for the special economic areas and mainstream economy, respectively. Although rating lower on the continuum, these means, nonetheless, indicated a moderate degree of concern.

Rankings of Commercial Risks

Table 26 displays the rankings reported for the joint venture representatives' assessments of selected commercial risks in market conditions. The first priority for the firms located in the special economic areas, as well as those in the mainstream economy, was the possible failure or inability of the Chinese suppliers of raw materials to meet delivery schedules. Both groups assigned this risk a rating near the high end of moderate concern. The special economic area joint ventures designated a mean of 6.5, while the mainstream joint ventures recorded an only slightly lower mean of 6.1. Ranked second for the special economic areas was the potentially costly problem of dealing with an inconsistent interpretation of the legal and regulatory structure. For the mainstream economy, however, this risk placed fourth, lower than the difficulties arising from control over labor rates, and the scarcity of internal and economic market data.

Of the nine risks selected for the market conditions risk category, both groups ranked control over future material cost in the fifth position, with only slight variations between the means. This issue, nonetheless, remained one of moderate concern. Also indicating moderate concern, yet placing eighth for both groups, was the possible effect of price controls on finished products. Among the selected market risks, the only one which fell within the range of little concern was loss of control over trademarks or patents, which was ranked ninth by the ventures located in the special economic areas. Ranking lowest for the mainstream economy, but still a risk representing moderate concern (4.2) was the possible loss of earnings due to business interruption.

Table 27 presents the rankings assigned the three selected commercial risks associated with casualty exposure. The highest priority among these risks was assigned to the possible financial loss which could occur as a result of employer liability arising from injuries to expatriate workers. This was observed both for the joint ventures located in special economic areas as well as those in the mainstream economy. The mainstream group indicated slightly more concern regarding the risk of damage to physical plant and assets. These respondents ranked this risk in the second position, while the same risk was ranked third by the joint venture participants within special economic areas. The latter group, on the other hand, assigned second priority to employer liability arising from a catastrophic industrial accident. For both groups, the risks of casualty

TABLE 25

Rankings of Selected Foreign Exchange Risks for Joint Ventures Located in Special Economic Areas and the Mainstream Economy

Type of Risk	Special Economic Areas (N=33)			Mainstream Economy (N=11)			F	t
	$\overline{X}$	(R)	S D	$\overline{X}$	(R)	S D		
Restriction on currency exchange	7.0	(1)	2.5	7.0	(1)	2.7	1.1584	-.0000
Delay in repatriation of funds	6.1	(2)	2.6	6.7	(2)	2.6	1.0644	-.7111
Currency devaluation	4.3	(3)	2.4	4.6	(3)	2.5	1.0368	-.4305

No significant difference

TABLE 26

Rankings of Selected Commercial Risks in Market Conditions for Joint Ventures Located in Special Economic Areas and the Mainstream Economy

Type of Risk	Special Economic Areas (N=33)			Mainstream Economy (N=11)			F	t
	$\overline{X}$	(R)	S D	$\overline{X}$	(R)	S D		
Failure or inability of the Chinese suppliers of raw materials to meet delivery schedules	6.5	(1)	2.5	6.1	(1)	2.8	1.2599	.5119
Inconsistent interpretation of legal and regulatory structure	5.9	(2)	2.7	5.2	(4)	2.9	1.1613	.7654
Failure or inability of the Chinese joint venture partner to meet contractual obligations made with the foreign partner	5.6	(3)	2.6	4.5	(7)	2.3	1.1860	1.2828
Scarcity of internal and economic market data	5.1	(4)	2.6	5.5	(3)	3.0	1.3341	-.3589
Control over future material costs	5.1	(5)	2.2	4.9	(5)	2.4	1.2750	.2352
Control over labor rates	5.1	(6)	2.6	5.6	(2)	2.7	1.0773	-.6030
Loss of earnings due to business interruption	4.9	(7)	2.6	4.2	(9)	2.5	1.1213	.7724
Price controls on finished products	4.4	(8)	2.7	4.2	(8)	2.7	1.0125	.2247
Loss of control over trademarks or patents	3.6	(9)	2.8	4.7	(6)	3.6	1.6830	-.0854

No significant difference

TABLE 27

Rankings of Selected Commercial Risks of Casualty Exposure for Joint Ventures Located in Special Economic Areas and the Mainstream Economy

Type of Risk	Special Economic Areas (N=33)			Mainstream Economy (N=11)			F	t
	$\overline{X}$	(R)	S D	$\overline{X}$	(R)	S D		
Employer liability arising from injuries to expatriate workers	3.2	(1)	2.2	2.5	(1)	2.5	1.3383	.8913
Employer liability arising from a catastrophic industrial accident	3.2	(2)	2.2	2.0	(3)	2.4	1.2527	1.5836
Damage to physical plant and assets (from fire, theft, accident or explosion)	3.0	(3)	2.6	2.4	(2)	2.3	1.2298	.7309

No significant difference

exposure were considered issues of little concern. In each case, however, the response means reported for the special economic area groups were slightly higher than those recorded for the mainstream economy group.

Summary Rankings of Special Economic Area Groups' Responses

The top ten selected investment risks reported for the thirty-three respondents operating joint ventures located in the special economic areas have been illustrated in Table 28. The highest ranked risk for this group was the restriction on currency exchange, with a mean of 7.0. Ranked second (6.5) was the possible failure or inability of the Chinese suppliers of raw materials to meet delivery schedules, followed in third place (6.1) by the risk of a delay in repatriation of funds. The investment risks with the lowest rankings for this group were identified as the possible loss of earnings due to business interruption (4.9) and the unanticipated and excessive risk involved in taxes increases (4.8) which were ranked in the ninth and tenth positions, respectively.

Summary Rankings of Mainstream Economy Groups' Responses

Table 29 illustrates the ranks of the top ten selected investment risks, as identified by the eleven respondents, which represented joint ventures operating in the mainstream

TABLE 28

Rankings of the Top Ten Selected Investment Risks for Joint Ventures*
Located in the Special Economic Areas

Type of Risk	$\overline{X}$	(R)	S D
Restriction on currency exchange	7.0	(1)	2.5
Failure or inability of the Chinese suppliers of raw materials to meet delivery schedules	6.5	(2)	2.5
Delay in repatriation of funds	6.1	(3)	2.6
Inconsistent interpretation of legal and regulatory structure	5.9	(4)	2.7
Failure or inability of the Chinese joint venture partner to meet contractual obligations made with the foreign investor	5.6	(5)	2.6
Scarcity of internal and economic market data	5.1	(6)	2.6
Control over future material costs	5.1	(7)	2.2
Control over labor rates	5.1	(8)	2.6
Loss of earnings due to business interruption	4.9	(9)	2.6
Unanticipated and excessive rise in taxes	4.8	(10)	2.5

* 33 joint ventures reported

socialist economy. As was indicated by the data reported for the joint ventures operating in the special economic areas (Table 28) the mainstream area ventures also assigned first priority to the risk associated with a possible restriction on currency exchange. For both groups, this risk was assigned a mean of 7.0 (SD = 2.5) which was at the high end of the moderate concern range. Ranked second and third, respectively, by the mainstream area respondents were the risks associated with a potential delay in repatriation of funds (6.7), and the failure or inability of Chinese suppliers of raw materials to meet delivery schedules (6.1). The rank order assigned these two risks, however, was reversed when compared to the rankings assigned the top three risks by the joint venture representatives which served the special economic areas.

Several of the top ten risks registered by the mainstream joint venture representatives were not listed among those assigned the priority status of the special economic areas (Table 28). These discrepancies included the respondents' views relative to the possibility of the: change to a regime with antagonistic attitudes toward foreign investment, the loss of control over trademarks or patents, and currency devaluations. All ten of these risks had been assigned means well within the range of moderate concern.

TABLE 29

Rankings of the Top Ten Selected Investment Risks for Joint Ventures*
Located in the Mainstream Economy

Type of Risk	$\bar{X}$	(R)	S D
Restriction on currency exchange	7.0	(1)	2.7
Delay in repatriation of funds	6.7	(2)	2.6
Failure or inability of the Chinese suppliers of raw materials to meet delivery schedules	6.1	(3)	2.8
Control over labor rates	5.6	(4)	2.7
Scarcity of internal and economic market data	5.5	(5)	3.0
Change to a regime with antagonistic attitudes toward foreign investment	5.3	(6)	2.7
Inconsistent interpretation of legal and regulatory structure	5.2	(7)	2.9
Control over future material costs	4.9	(8)	2.9
Loss of control over trademarks or patents	4.7	(9)	3.6
Currency devaluation	4.6	(10)	2.5

* 11 joint ventures reported

Demographic Data Summary

Tables 30 through 36 provide demographic information pertaining to the joint ventures with parent companies headquartered in either Hong Kong or the United States. The geographic distribution of the joint venture operations has been described the Table 30. The responses reported by forty-four of the forty-five survey respondents provided complete information indicating the location of the individual ventures. Moreover, since several parent companies had reached agreements with the Chinese to establish more than one operation, a combined total of sixty-three joint ventures have been represented in this table.

The data reported for the firms located within the special economic areas, indicated that twice as many (thirty-five) had parent companies headquartered in Hong Kong as did those (seventeen) with parent companies based in the United States. The greatest single concentration of Hong Kong joint ventures (eleven) was located in the Special Economic Zone of Shenzhen. This zone was identified: (1) as the largest of the four, and (2) to have the most highly developed infrastructure. Shenzhen also was depicted as the favored Special Economic Zone for United States companies, which had established three joint ventures in that location. The data reported for the other special Economic Zones (that is Zhuhai, Shantou, and Xiamen) did not indicate the same degree of interest by the foreign investors. A combined total of five Hong Kong joint ventures and one United States joint venture were reported located in Xiamen. Although Shenzhen's modern facilities and convenient access to Hong Kong have been acknowledged to have major advantages the fourteen coastal cities, as a group, appeared to have received greater locational preference over the individual Special Economic Zones. Fifteen Hong Kong- and eleven United States-based ventures were located among these cities.

Of the thirty-six operations representing Hong Kong parent companies, only one was located in the mainstream economy. In contrast, this location was the choice for well over one-third (ten) of the twenty-seven joint venture operations with parent companies based in the United States.

The distribution of joint venture operations among the fourteen coastal cities has been presented in Table 31. For the purpose of this study, these cities were classifed as special economic areas, since they were reported to offer investment incentives similar to those provided by the Special Economic Zones. Among the forty-four survey respondents providing complete demographic information, the companies headquartered in Hong Kong were reported to have made agreements for a total of fifteen joint ventures distributed among several of the coastal cities, while the

TABLE 30

Geographic Distribution of Operations for Joint Ventures Headquartered in Hong Kong* or the United States

Location of Joint Venture Operations	Headquartered in Hong Kong N	Headquartered in United States N	Total N
Special Economic Areas			
Shenzhen SEZ**	11	3	14
Zhuhai SEZ	2	-	2
Shantou SEZ	2	-	1
Xiamen SEZ	1	1	2
Fourteen Coastal Cities	15	11	26
Hainan Island	2	-	2
Other	3	2	5
Total	35	17	52
Mainstream Economy	1	10	11
Total	36	27	63

* One Hong Kong respondent did not specify a location

** Special Economic Zones

United States-based companies indicated a total of eleven negotiated joint venture agreements.

The Hong Kong-based respondents listed seven cities as joint venture locations. The highest concentration (six) was found to be in Guangzhou. The cities placed in the second and third positions according to the number of joint ventures represented were Zhanjiang (three) and Shanghai (two).

Only four of the fourteen coastal cities were selected for joint venture operations by the respondents headquartered in the United States. These companies reported a total of eleven joint ventures which were distributed among Dalian (one), Tianjin (three), Shanghai (four), and Guangzhou (three). The highest concentration was centered in Shanghai, China's largest industrial and commercial city.

The year in which joint venture agreements were contracted by the parent companies has been identified in Table 32. The first year was identified as 1979, when China opened its doors to foreign investors in order to modernize its economy, develop international trade, and import technology. At that time the joint venture was established as China's preferred means for utilizing foreign investment to accomplish these objectives.

The number of parent company respondents completing joint venture agreements included in Table 32 represent each

TABLE 31

Distribution of Operations Among the Fourteen Coastal Cities for Joint Ventures Headquartered in Hong Kong* or the United States

Location of Joint Venture Operations	Headquartered in Hong Kong	Headquartered in United States	Total
	N	N	N
Dalian	1	1	2
Qinhuangdao	-	-	-
Tianjin	1	3	4
Yantai	-	-	-
Quingdao	1	-	1
Lianyungang	-	-	-
Nantong	-	-	-
Shanghai	2	4	6
Ningbo	-	-	-
Wenzhou	-	-	-
Fuzhou	1	-	1
Guangzhou	6	3	9
Zhanjiang	3	-	3
Behai	-	-	-
Total	15	11	26

* One Hong Kong respondent did not specify a location

year from 1979 through August, 1985. Also indicated are the two local categories established for the present study (the special economic areas and the mainstream economy). Within those categories, the data indicate whether the parent firm was headquartered in Hong Kong or in the United States.

In 1979, two Hong Kong companies in the survey sample were observed to have negotiated agreements to establish ventures within the special economic areas. This was followed closely by the first United States-based company in 1980. The first agreement to locate an operation in the mainstream economy was made by a Hong Kong respondent in 1981. This was a textile venture, and was the only mainstream operation for the entire Hong Kong sample. It was not until 1982 that a United States-based company signed an agreement to place a firm in this location. From that time on, the United States-based companies were observed to have completed at least one joint venture agreement in each subsequent year, with five companies affirming agreements in 1985.

The highest level of joint venture activity was observed in the special economic areas, where eight of the survey respondents signed agreements in 1983 to set up operations, followed by nine in 1984. Based on the agreement dates provided (four companies failed to specify dates), 1984 appeared to have been the most active year

TABLE 32

Year in Which the Joint Venture Agreement Was Made for Joint Ventures Headquartered in Hong Kong or the United States

Year of Agreement	Located in Special Economic Areas			Located in Mainstream Economy			Total		
	HK	USA	ALL	HK	USA	ALL	HK	USA	ALL
	N	N	N	N	N	N	N	N	N
1979	2	-	2	-	-	-	2	-	2
1980	2	1	3	-	-	-	2	1	3
1981	4	-	4	1	-	1	5	-	5
1982	1	1	2	-	1	1	1	2	3
1983	6	2	8	-	1	1	6	3	9
1984	3	6	9	-	1	1	4	7	11
1985	2	1	3	-	5	5	2	6	8
No Date Given	-	2	2	-	2	2	-	4	4
Total	20	13	33	1	10	11	22*	23	45

* One Hong Kong respondent did not specify a location. The joint venture agreement was made in 1984.

overall as ten companies from the combined sample concluded agreements to establish joint ventures in China.

Table 33 lists the number of companies with joint ventures in operation as of 1985. Among those companies having affirmed agreements to establish joint ventures within the special economic areas, eighteen of the twenty Hong Kong-based respondents indicated that negotiated joint ventures already had begun production. Eight of the thirteen United States-based respondents also had initiated operations, bringing the combined total to twenty-six for these areas.

In the mainstream economy, four joint ventures were listed as currently engaged in production. Although a total of eleven mainstream economy joint ventures were represented in the sample, five agreements with United States-based investment partners had been negotiated in 1985. Of the combined total of forty-four respondents which specified joint venture locations, thirty already had begun production in one or more individual locations.

The approximate level of joint venture investment reported for each company has been presented in Table 34. These figures represent the amounts allocated at the time the agreement was entered into and, in some cases, may not be an accurate indication of the amounts actually committed. Furthermore, in the interest of confidentiality, each

TABLE 33

Companies with Joint Ventures in Operation as of 1985 and Headquartered in Hong Kong or the United States

Joint Ventures in Operation	Located in Special Economic Areas			Located in Mainstream Economy			Total		
	HK	USA	ALL	HK	USA	ALL	HK	USA	ALL
	N	N	N	N	N	N	N	N	N
Yes	18	8	26	1	3	4	19	11	30
No	2	5	7	-	7	7	3	12	15
Total	20	13	33	1	10	11	22*	23	45

* One Hong Kong respondent did not specify a location. The joint venture is not yet in operation.

respondent was asked to indicate an investment value within a wide range of United States dollars.

Of the thirty-three companies having joint ventures in the special economic areas, six reported investments under $500,000, while six indicated an amount over $15 million. The most popular range for these locations, however, was between $1 and $5 million. In view of this, one-third (eleven) of the sample indicated that the intended investments fell within this range at the time the agreement was entered into. This same pattern also was exhibited in the mainstrewam economy where four United States-based companies stated a joint venture value of between $1 and $5 million.

Six companies in the special economic areas were noted to have invested amounts in excess of $15 million. Of these, five were based in Hong Kong and each was a joint venture partner in a commercial development (e.g., a hotel or office complex). Only one United States-based company reported an investment which exceeded $15 million in the special economic areas. Within the mainstream economy only two investments exceeded this figure, both of which listed parent companies based in the United States. In examining the overall combined sample, fifteen of the forty-four respondents indicated that the investment intended when signing the joint venture agreement ranged between $1 to $5

TABLE 34

Approximate Value of Company Investment at the Time the Joint Venture Agreement was Made for Joint Ventures Headquartered in Hong Kong or the United States

Investment Value (U.S. Dollars)	Located in Special Economic Areas			Located in Mainstream Economy			Total		
	HK	USA	ALL	HK	USA	ALL	HK	USA	ALL
	N	N	N	N	N	N	N	N	N
Under $500,000	2	4	6	-	-	-	2	4	6
$500,000 to $1,000,000	4	1	5	-	2	2	4	3	7
$1,000,000 to $5,000,000	8	3	11	-	4	4	8	7	15
$5,000,000 to $10,000,000	-	3	3	1	2	3	2	5	7
$10,000,000 to $15,000,000	1	1	2	-	-	-	1	1	2
Over $15,000,000	5	1	6	-	2	2	5	3	8
Total	20	13	33	1	10	11	22*	23	45

* One Hong Kong respondent did not specify a location. The joint venture has an investment value of $5,000,000 to $10,000,000

million, indicating that this range was by far the most popular.

Table 35 illustrates the percentage of equity participation held by Hong Kong- and United States-based companies with joint ventures in China. Article 4 of the Joint Venture Law stipulated that the level of joint venture investment contributed by foreign participant(s) must be in excess of 25 percent, however, four companies indicated equity participation between 10 and 20 percent. These investment levels were noted to reflect either a specially negotiated situation or the participation of more than one foreign partner in the joint venture.

While the sample from the special economic areas included one United States-based company which reported equity participation between 70 and 80 percent, this was noted to have been an exceptional case and the respondent disclosed that the percentages had not yet been finalized. The Joint Venture Registration Regulations was acknowledged to permit increases, cuts, or transfers of registered capital if such changes are registered within one month after the joint venture has been approved by the Foreign Investment Commission. Slightly less than one-half (fifteen) of the other companies operating within the special economic locations listed an equity participation between 40 and 50 percent. The same pattern was observed for the joint ventures which operated within the mainstream

TABLE 35

Percentage of Equity Participation for Joint Ventures
Headquartered in Hong Kong or the United States

Percent of Equity Participation	Located in Special Economic Areas			Located in Mainstream Economy			Total		
	HK	USA	ALL	HK	USA	ALL	HK	USA	ALL
	N	N	N	N	N	N	N	N	N
10% - 20%	3	1	4	-	-	-	3	1	4
20% - 30%	3	2	5	-	2	2	3	4	7
30% - 40%	4	1	5	-	2	2	5	3	7
40% - 50%	7	8	15	1	4	5	8	12	20
50% - 60%	-	-	-	-	2	2	-	2	2
60% - 70%	-	-	-	-	-	-	-	-	-
70% - 80%	-	1	1	-	-	-	-	1	1
No Percent Given	3	-	3	-	-	-	3	-	3
Total	20	13	33	1	10	11	22*	23	45

* One Hong Kong respondent did not specify a location. The joint venture has an equity participation of 33%.

TABLE 36

Primary Types of Business for Joint Ventures Headquartered in Hong Kong or the United States

Type of Business*	Located in Special Economic Areas			Located in Mainstream Economy			Total		
	HK	USA	ALL	HK	USA	ALL	HK	USA	ALL
	N	N	N	N	N	N	N	N	N
Type A	3	2	5	-	1	1	3	3	6
Type B	1	6	7	-	1	1	1	7	8
Type C	2	2	4	-	4	4	2	6	8
Type D	5	3	8	1	2	3	6	5	11
Type E	1	-	1	-	-	-	1	-	1
Type F	8	-	8	-	2	2	9	2	11
Total	20	13	33	1	10	11	22**	23	45

* Type A Energy, building materials, chemical, metalurgical
Type B Machine manufacturing, instruments, meters, petroleum exploitation equipment
Type C Electronics, computers, communications equipment
Type D Light industry, textiles, food stuffs, medicine, medical apparatus, packaging
Type E Agriculture, animal husbandry, aquaculture
Type F Tourist and service industries

** One Hong Kong respondent did not specify a location. The type of business is Type F.

economy, where five of the eleven respondents disclosed the same percentages of ownership. For the total sample of forty-four respondents specifying a joint venture location, twenty reported that the planned equity participation was between 40 and 50 percent.

The primary types of businesses operated under Hong Kong- and United States-based joint venture agreements have been described in Table 36. China limits foreign investors to businesses classified in the joint Venture Implementing Regulations as follows:

1. energy, building materials, chemical, metallurgical;

2. machine manufacturing, instruments, meters, petroleum exploitation equipment;

3. electronics, computers, communications equipment;

4. light industry, textiles, foodstuffs, medicine, medical apparatus, packaging;

5. agriculture, animal husbandry, aquaculture; and

6. tourist and service industries.

Summary

This chapter presented the findings indicating the perceived severity of selected investment risks as evaluated by top level managers of multinational companies involved in the decision to establish one or more joint ventures in China. The companies selected for the study were reported to have been headquartered either in Hong Kong or the United

States and had signed joint venture agreements to locate operations in one of two geographic categories. These categories were delineated as special economic areas (including four Special Economic zones, fourteen coastal cities, and Hainan Island) and the mainstream socialist economy. The special economic areas were those which were designated as key locations for economic development and were described as accorded preferential market oriented treatment, legal regulations, and foreign investment incentives.

Twenty-three investment risks were selected and grouped among the following three categories: (1) political risks, (2) foreign exchange risks, and (3) commercial risks. In the first section of the chapter, comparisons indicating the degree of concern for each risk were made between the Hong Kong- and United States-based joint ventures in the special economic areas and in the mainstream economy. With regard to the mainstream economy, it should be noted that the survey sample provided a random response of only one Hong Kong-based joint venture in that location. While the data indicate a 100 percent response for this classification (one company), these statistics represent the sample only and not the total survey population of Hong Kong-based joint ventures in the mainstream economy even though that population was small.

The second section of the chapter presented the risk rankings calculated for the combined samples for both geographic groups. The political risk of greatest concern for the special economic areas was identified as the possibility of an unanticipated and excessive rise in taxes. For the mainstream economy, the highest concern was observed to be the possibility of antagonistic attitudes developing toward foreign investment. The foreign exchange risk which received the highest priority was identical for both geographic groups. This potential risk was associated with the potential for financial loss from a possible restriction on currency exchange. Of the total group of twenty-three risks submitted to the respondents for evaluation, the one of least concern to the special economic group was the threat of government confiscation. For the mainstream economy, the possible imposition of export restrictions was of least concern.

The third section of the chapter examined the demographic data reported for the joint ventures. These data revealed that the fourteen coastal cities, as a regional classification, were the preferred location for joint venture operations. The most popular city for Hong Kong-based investors was identified as Guangzhou, while for the United States-based firms, Shanghai was preferred. The data reported for the combined sample indicated that an investment which ranged between $1 to $5 million was most common. As a whole, the Hong Kong-based ventures were identified predominantly as associated with light industry, textiles, or tourist and service industries. In contrast, the United States-based ventures emphasized machine manufacturing in the special economic areas, while focusing on electronics, computers, and communications equipment in the mainstream economy.

CHAPTER FIVE

Summary, Conclusions, and Recommendations

The information reported in the following chapter provides an overview of the statement of the purpose of the research approach and methodology used in the study. Also included are a condensation of the review of the literature and a restatement of the findings. Conclusions then were drawn from the findings and recommendations were made for future research.

Summary

The Research Problem

The purpose of this study was to evaluate selected investment risk exposures of multinational companies headquartered in Hong Kong and the United States who have engaged in or plan to engage in joint ventures in China. The joint ventures were designated as located in the areas designated for special economic development as well as China's mainstream socialist economy. In order to research the problem, the following research question was posed:

How do selected investment risk exposures (political, foreign exchange, and commercial) compare for Hong Kong and United States-based joint ventures located in both the special economic areas and the mainstream economy of China when evaluated by the responsible managers of parent multinational companies that signed joint venture agreements prior to June 1, 1985?

The Research Approach. The current study employed a descriptive-elemental research approach. Since the research was designed to describe characteristics or elements of phenomena which already exist in and of themselves, hypotheses were neither formulated nor tested. The study, however, sought factual informtion to determine the perceived degree of exposure to selected risks encountered by Hong Kong- and United States-based joint ventures in China.

Criteria for Data Sources. The data sources for the research were identified as the top level managers of multinational companies based in Hong Kong and the United States who were involved directly in the investment decision to establish a joint venture in China. Where possible, these managers were the chief financial officers. Each respondent was asked to provide opinion data for the degree of concern over selected investment risks that could adversely affect the joint venture. Each joint venture company, whether or not operational, was the subject of an agreement signed with the Chinese government prior to June 1, 1985. A feasibility study (which also implies a corporate risk analysis) was required to have been performed and approved before a joint venture agreement was signed. Two locational classifications were established: (1) the special economic or experimental free market areas, which included the four Special Economic Zones, fourteen coastal cities, and Hainan Island; and (2) the mainstream socialist economy. Each joint venture fell within one of the six industrial categories specified in the Joint Venture Regulations.

Review of Selected Literature

The review of literature was based on a framework which included five major divisions. The first section dealt with China's current drive for economic reform. These reforms were described as resulting in the creation of a new legal system designed to encourage foreigners to invest in joint ventures and other enterprises within the parameters of a free market. Due to the constantly evolving nature of this environment, only the most recent literature was cited in order to provide an accurate portrayal of changing conditions, many of which have had a direct impact on risk exposure. Until the Joint Venture Law was promulgated on July 8, 1979, China was described as having had no codified laws for foreign investment. Following that, most of the literature until 1982 was speculative in nature and focused primarily on a description of the reform program, its impact upon China, and the chances of success. Much attention also was devoted to the gaps and deficiencies of the Joint Venture Law. Many concerns identified as associated with investments in China were answered when the Joint Venture Implementing Regulations took effect in September, 1983. By that time, the relevance of earlier studies largely was outdated.

Most of the significant literature for this research was printed subsequent to 1982 and was beginning to reflect data based on the operating experience of joint ventures, the majority of which were headquartered in Hong Kong and the United States. Chinese sources tended to present an ambiguous or exaggerated representation of the reform program. The single most reliable and comprehensive background data source used in the study was the China Busines Review, published by the National Council for U.S.-China Trade.

The literature regarding risk assessment methodology was diverse and replete with contradicting opinions regarding the most effective methods. The primary emphasis centered on the effect of political conditions, often represented as country risk. The literature on the relative importance of political or socio-cultural conditions was reviewed. Arguments were posed citing that sophisticated risk assessment techniques largely were ignored by executives making foreign investment decisions based on past unreliability of results and the lack of systematic interpretation of procedures. The third section was concerned with political risk. Since the risk profile of countries differ, generalizations were limited with regard to their applicability to China's unprecedented liberalization. Insufficient data contrasting the difference in political risk exposure between the special economic areas and the mainstream economy was prevalent, even though a major focus of China's investment regulations was concerned with special economic areas.

In the fourth section the literature on foreign exchange risk was dominated by multinational translation problems and exchange risk management methods. The effect of the exchange risk of joint ventures in China directly influenced the status of China's foreign exchange reserves. Reductions in these reserves were observed between 1984 and 1985. This resulted in the placement of tight restrictions on the limited exchange flexibility previously afforded joint ventures. Consequently, only the most recent developments were noted to have been of real significance concerning the actual degree of foreign exchange risk exposure.

The fifth section, commercial risk, included research which addressed both market conditions and casualty exposure. Among the most widely analyzed concerns in the literature regarding market conditions were price controls and the interpretation of the legal system. With the exception of China's insurance regulations, the literature on casualty exposure was scarce.

Method

Data were collected through the use of a semi-structured questionnaire. Each potential respondent receiving the instrument was asked to provide opinion data by individually rating twenty-three risks on a continuum indicating the perceived degree of concern for each risk. The mail survey method was selected because of the sample dispersion, the improved likelihood of access to corporate executives, and to afford the respondents the opportunity to remain anonymous.

Collection of Data. The respondents providing the data were identified as the chief financial officers (or other top level managers) responsible for the investment decisions of multinational companies headquartered in Hong Kong and the United States. The appropriate companies initiating joint ventures with China were located using the published listings of joint venture agreements signed prior to June 1, 1985.

A semi-structured questionnaire was administered to the data source, which was requested to evaluate and prioritize selected investment risks for which each joint venture would have some degree of exposure. Mailing addresses for an initial population of 217 companies were obtained and the potential respondents were sent a survey package containing a letter of introduction, a copy of the instrument, and a postage prepaid envelope for the return of the questionnaire.

Analysis of Data. The research data were grouped according to the location of the parent companies (Hong Kong and the United States) and the location of the joint ventures (China's special economic areas or the mainstream economy). The data were analyzed using percentage comparisons, rank-orderings, the F-test t-test. All statistical calculations were performed using a computer, with accuracy specified to fifteen decimal places. The level of significance established at or beyond the 0.05 level.

Findings

The research showed that the political risk of primary concern for the special economic areas was the possibility of an unanticipated and excessive rise in taxes. For the mainstream economy, the highest level of concern was expressed with regard to the possibility of antagonistic attitudes developing toward foreign investment. The foreign exchange risk receiving the highest priority was identical for both groups. This area of agreed concern was identified as the potential for financial loss from the imposition of additional restrictions on currency exchange.

Of the twenty-three risks submitted to the respondents for evaluation, the one reported to have represented the least concern to the special economic group was the threat of government confiscation. For the mainstream economy, the possible imposition of export restrictions was noted to have been of least concern.

The joint venture demographic data revealed that the fourteen coastal cities, as a regional classification, were the preferred location to establish operations. The most popular city for Hong Kong based investments was identified as Guangzhou, while the United States-based joint ventures were noted to have preferred Shanghai. For the joint ventures in the combined survey sample, an investment level which ranged between $1 to $5 million most commonly was observed. As a whole, Hong Kong-based joint ventures were described predominantly as light industries, textiles, or tourist and service industries. In contrast, the United States-based ventures were noted to have emphasized machine manufacturing in the special economic areas, while focusing on electronics, computers, and communications equipment in the mainstream economy.

Additional management concerns were submitted by the respondents which may or may not be classifed as risks. A number of these provided a slightly different perspective to some risks, while others enumerated various impediments encountered during the establishment or operation of a joint venture.

Conclusions

The Research Question

How do selected investment risk exposures (political, foreign exchange, and commerical) compare for Hong Kong- and United States-based joint ventures which are located in both the special economic areas and the mainstream economy of China when evaluated by the responsible managers of parent multinational companies that signed joint venture agreements prior to June 1, 1985?

This question addressed investment risks under three categories. With regard to the elements associated with political risk, it was concluded that the possibility of higher taxes was the primary political concern for the joint ventures located in the special economic areas. A lower tax rate was observed to have been one of the major incentives for locating a joint venture in these areas, however, the possibility of an unanticipated or excessive rise in taxes still was concluded to have generated moderate concern among managers. The respondents also observed that, although the Chinese government may exercise tight control over the profits of foreign investors, after the joint venture has become well-established the initial tax relief is over. The problems resulting from an inconsistent interpretation and application of the tax law in different areas was concluded to have represented an area of general concern as was the considerable uncertainty as to how long the Joint Venture Income Tax Law will remain unchanged.

Since more than one-half of the joint ventures in the mainstream socialist economy expressed moderate concern over the possible change to a regime with antagonistic attitudes toward foreign investment, it was concluded that a clear commitment to support for foreign invest interests would generate increased interest in joint ventures. Among the top ten risks for the mainstream group, this was the only political risk listed. One possible explanation for this uncertainty is the fact that this segment of the economy remains under centralized control of the Communist Party and lacks much of the legal protection developed for the special economic areas. Foreigners are still viewed with suspicion, especially when not confined to the peripheral areas of the coast. In light of China's radical policy swings of the past, nationalist or xenophobic sentiments could be more easily martialed by disgruntled or idealistic cadres in this region which has not experienced the dramatic effects of the modernization program enjoyed on the coast.

Foreign investors have a capital-intensive commitment early in the thirty-year joint venture horizon. Within this period, major policy shifts could leave the mainstream ventures more vulnerable especially in view of Deng Xiaoping's advanced age. It was concluded that a new regime could have greater flexibility to assert control in the mainstream economy and, because of fewer and more isolated ventures, could experience less international criticism for doing so.

The foreign exchange risk of restriction on currency exchange was ranked first among all concerns for both the special economic and mainstream groups. It was concluded that this risk undermines the primary reason foreigners invest in China to make a profit. The inability to exchange currency further was concluded to force joint ventures to rely heavily on exports to generate profits and pay increasing expenses. While most ventures do have limited access to domestic markets, profits are in Renminbi and must remain in China. Another possible reason why this risk was assessed with such apprehension is the fact that the data were gathered not long after China tightened restrictions during the first quarter of 1985. In any case, until additional regulations are promulgated, most ventures have been left only with the option of using Renminbi earnings to expand their own projects. Unless Beijing responds with viable alternatives, this issue alone was concluded to represent a moderately high risk profile and to limit the potential for greater foreign investment in the near term. The speed and facility of implementing such regulations also could be contingent upon China's intention to slow economic growth and boost its foreign exchange reserve. This was concluded to have represented risk factors of relatively serious concern. The possibility that new exchange regulations could discriminate against joint ventures which do not provide the highest levels of technology was concluded to have represented only a limited risk potential, since China needs to focus on labor-intensive industry in order to provide employment and a steady rise in living standards. While the findings supported the probability that exchange restrictions will continue to be a significant problem for several years, it was concluded that the severity of this risk will be reduced gradually as workable solutions are sought, both by joint ventures and the government. Second only to the foreign exchange risks were the commercial risks in market conditions. It was concluded that the most significant market risk both in the special economic areas as well as the mainstream economy involved the failure or inability of the Chinese suppliers of raw materials to meet delivery schedules. This risk created considerably more apprehension for the United States managers than it did for the Hong Kong managers. It was concluded that, possibly due to cultural and geographic differences, Americans are likely to be less patient than their Chinese counterparts, as well as more apprehensive about difficulties in conveying the urgency of meeting production schedules. On the other hand, the Hong Kong managers share a common culture, language, and geographic proximity with the Chinese suppliers and typically have been observed to maintain a well-established network of contacts that can assist in smoothing out logistical barriers.

For the special economic areas, another major concern was the adverse effect of an inconsistent interpretation of the legal and regulatory structure. It was concluded that the most likely reason for this concern was the lack of experience with the new legal system in China and the hundreds of newly introduced regulations. Another possibility complicating the problem to some degree was concluded to have been associated with factionalism among cadres who have been wary of endorsing the reforms too readily, especially should Deng's opponents regain control.

In the mainstream economy, control over labor rates was assessed as a greater potential source of loss than inconsistent legal interpretation. It was concluded that this concern was due in part to differences in the wages for the same work which were noted to be determined primarily on the basis of the standard of living in different geographic regions. As joint venture unions in mainstream firms become more sensitive to the differential paid in the coastal areas, it was concluded that higher wage demands increasingly could affect the cost-effectiveness of the wage structures presently operational in mainstream locations.

Casualty risk was assessed as being of relatively little concern by the managers of ventures in the special economic areas as well as the mainstream economy. Within this assessment, however, employer liability for injuries to expatriate workers was ranked first in both regions, with slightly more concern exhibited for the special economic areas. It was concluded that this was due likely to the higher concentration of expatriate workers present in these areas, together with the greater awareness for legal recourse. It should be noted with regard to the mainstream economy, that the survey sample provided a random response of only one Hong Kong-based joint venture in that location. While the data indicated a 100 percent response for this classification (one company), these statistics represented the survey sample only and not the total survey population of Hong Kong-based joint ventures in the mainstream economy even though that population was small.

Findings Related to Context and Literature

The findings supported the dominant view expressed in the literature cited which found the foreign exchange risk to have been the biggest problem facing joint ventures. While the joint venture operations were themselves observed to have represented a potentially viable success in China, the attainment of the two-fold objectives of the parent companies (accessing the Chinese domestic market and repatriating profits) was agreed to hinge on the relaxation of the foreign exchange restrictions for the long term.

A major theme encountered, which was supported further by the findings of the current study, was the priority of difficulties created by the interpretation of the legal and regulatory structure. This further was substantiated by the concern over the risk of an anticipated rise in taxes within the special economic areas.

Only a small portion of the extensive literature which addressed the subject of political risk was devoted to conditions in China. This was attributed to the short timeframe in which foreign investment has been a feasible option. Nevertheless, that which was expressed urged the tempering of commercial optimism with caution and a strong awareness of China's cultural and political history. Very little research was observed to have explored the long-range commercial or political implications that China's reforms will have on Western civilization if the modernization program can be sustained.

The lack of concern for casualty risk observed in the findings correlated to the dearth of published information available regarding concern for this risk in China. The fact that half of the joint ventures surveyed were uninsured suggested that managers have not been made fully aware of the potentially complications which could arise.

Findings: Implications and Applications

The results of the study imply that joint ventures are faced with a moderate level of investment risk exposures. As a result of the two-tiered legal structure operational in China, the mainstream economy presents a slightly higher political and commercial risk profile than do the special economic areas. The foreign exchange risk for both areas currently is moderately high. There were no significant differences observed in the perceptions reported for the Hong Kong and American managers surveyed, except in areas where cultural similarities with the mainland could prove advantageous for the Hong Kong managers.

The study affords a risk evaluation based on the consensus of managers who already have obtained input from a variety of risk assessment methodologies, as well as resulting from their own experience. This has been supported further by the addeed dimension of the Hong Kong managers who share a common culture with the China mainland and a high level of sensitivity to the associated environmental risks. A potential application for this information could be the development of a guide intended for use by firms considering entry into joint venture agreements. This guide could provide an evaluation of the current risk exposures to be anticipated in China.

It was observed that internal data describing current market and economic conditions in China is scarce and the joint venture operating history has been brief. Therefore, it was implied that the Chinese now are, and will continue to be, in the position of greatest advantage and control as far as foreign investors are concerned. It also was inferred that, insofar as political stability being enhanced further by a rising standard of living and greater economic and popular freedoms, there is no realistic prospect of China becoming a captialistic, democratic economy. It was anticipated that prices, taxation, and credit will play a greater role in reducing, but not eliminating the central control of enterprise. Moveover, it was conjectured that the state will continue to own the land, a fact which is also written into the Joint Ventures Law. The findings supported the view that China's leadership is pragmatic, and implied that, while Deng Xiaoping has made tremendous strides toward modernizing China, this was motivated by the need for economic survival, not a renunciation of Communist ideals. The data implied that China will support the principal of equality and mutual benefit only as long as it is in China's best interest to do so. It nonetheless was acknowledged that cooperation also is in the best interests of those Western nations which exert an economic influence by investing in China. By so doing, increased legal and political stability were implied and exposure to democratic ideals was anticipated to increase hopefully at the expense of Marxist-Leninist doctrine among the third world nations which are looking to China for an example. The trade-off, however, could be the possible rise of a formidable competitor which could upset the economic balance of the free world.

Evaluation of the Research

The design of the research and the instrumentation were viewed as successful in that adequate and reliable data were obtained. The instrument was short enough to avoid discouraging responses to what often was viewed as sensitive or confidential information. One limitation of the study was related to the possible perception of redundancy between rating the risks on the continuum and self-ranking those risks, in addition to any responses not listed. Some respondents did not complete this part of the questionnaire, while others confused risks with their own management concerns. The result of this omission was that this portion of the instrument could only effectively provide a listing of the additional issues. While these issues provided an added perspective for some risks, the diversity precluded a meaningful statistical comparison.

Another limitation to the current study was that the ability of the multinational parent company to sustain possible losses from joint venture operations could affect the severity with which the respondent perceived the risk. No attempt was made to control the basis of the level of the investors' total assets or previous international investment experience.

Recommendations

The research design and method of data collection would be appropriate for future studies designed to identify other risks, provided that adjustments are made for the limitations mentioned. The mail survey method remains the only feasible means of collecting sufficient data due to the wide geographic dispersion of American companies with joint ventures in China. An alternative would be to use the interview technique if the researcher could remain in Hong Kong long enough to administer the data collection instrument since approximately 80 percent of all joint ventures in China have Hong Kong-based partners. The high concentration of ventures in Shenzhen, with its close proximity to Hong Kong also would afford the possibility of scheduling interviews with both the Chinese and foreign partners engaged in joint venture relationships. A comparison of the two perspecitives could prove enlightening if the interviews were conducted independently. An interview approach should be adopted in obtaining data from the Chinese partners, however, due to the difficulties involved in obtaining sufficient data through the Chinese mail.

Additional research designed to explore the impact of the recently imposed foreign exchange restrictions should be conducted with regard to identifying those operational strategies still available under the modified conditions. The sensitive nature of this issue, however, is likely to make local interviews the most reliable means of obtaining adequate data. Additional topics indicated as constituting areas of particular concern to companies either engaged in, or contemplating participation in, joint ventures operating in China which are appropriate for further investigation are the potential risks associated with management and infrastructure related problems.

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APPENDIX A

DATA COLLECTION INSTRUMENT

SURVEY OF PERCEIVED INVESTMENT RISKS
FOR CHINA - JOINT VENTURES

1. For each of the potential risks listed below, please CIRCLE the number which most closely describes your opinion of the degree (extent) to which your company's joint venture could be affected under existing conditions in China.

RISK	NO CONCERN 0					MODERATE CONCERN 5					OF UTMOST CONCERN 10
Government confiscation of property	0	1	2	3	4	5	6	7	8	9	10
Civil unrest	0	1	2	3	4	5	6	7	8	9	10
Shifting away from economic cooperation and mutual benefit	0	1	2	3	4	5	6	7	8	9	10
Unanticipated and excessive rise in taxes	0	1	2	3	4	5	6	7	8	9	10
Change to a regime with antagonistic attitudes toward foreign investment	0	1	2	3	4	5	6	7	8	9	10
Imposition of unfavorable loan restrictions	0	1	2	3	4	5	6	7	8	9	10
Production restrictions	0	1	2	3	4	5	6	7	8	9	10
Export restrictions	0	1	2	3	4	5	6	7	8	9	10
Currency devaluation	0	1	2	3	4	5	6	7	8	9	10
Restriction on currency exchange	0	1	2	3	4	5	6	7	8	9	10
Delay in repatriation of funds	0	1	2	3	4	5	6	7	8	9	10
Failure or inability of the Chinese joint venture partner to meet contractual obligations made with the foreign investor	0	1	2	3	4	5	6	7	8	9	10
Failure or inability of the Chinese suppliers of raw materials to meet delivery schedules	0	1	2	3	4	5	6	7	8	9	10
Scarcity of internal and economic market data	0	1	2	3	4	5	6	7	8	9	10
Price controls on finished products	0	1	2	3	4	5	6	7	8	9	10
Control over future material costs	0	1	2	3	4	5	6	7	8	9	10
Control over labor rates	0	1	2	3	4	5	6	7	8	9	10
Loss of earnings due to business interruption	0	1	2	3	4	5	6	7	8	9	10
Inconsistent interpretation of legal and regulatory structure	0	1	2	3	4	5	6	7	8	9	10

R I S K	NO CONCERN 0					MODERATE CONCERN 5					OF UTMOST CONCERN 10
Loss of control over trademarks or patents	0	1	2	3	4	5	6	7	8	9	10
Damage to physical plant and assets (from fire, theft, accident or explosion)	0	1	2	3	4	5	6	7	8	9	10
Employer liability arising from injuries to expatriate workers	0	1	2	3	4	5	6	7	8	9	10
Employer liability arising from a catastrophic industrial accident	0	1	2	3	4	5	6	7	8	9	10
Others? (Please list below)											
______________________	0	1	2	3	4	5	6	7	8	9	10
______________________	0	1	2	3	4	5	6	7	8	9	10
______________________	0	1	2	3	4	5	6	7	8	9	10

2. Including any risks you may have added to the above list, please prioritize the three risks of greatest concern to your company's specific joint venture under existing conditions.

   # 1 Concern ______________________

   # 2 Concern ______________________

   # 3 Concern ______________________

3. Using the risks listed in question # 1, including those you may have added, list those risks you think are likely to be of greatest concern to your company's specific joint venture over the next three years.

   # 1 Concern ______________________

   # 2 Concern ______________________

   # 3 Concern ______________________

DEMOGRAPHIC DATA

The following information is requested only for the purposes of statistical tabulation.

1. Location of joint venture: (please check one)

Special Economic Zone

( ) Shenzhen ( ) Zhuhai ( ) Shantou ( ) Xiamen

Coastal City or Hainan Island

( ) Dalian ( ) Lianyungang ( ) Fuzhou

( ) Qinhuangdao ( ) Nantong ( ) Guangzhou

( ) Tianjin ( ) Shanghai ( ) Zhanjiang

( ) Yantai ( ) Ningbo ( ) Behai

( ) Quingdao ( ) Wenzhou ( ) Hainan Island

( ) Other (please indicate) ______________________________

2. Date joint venture agreement was made: Month ______________ Year __________

3. Is the joint venture presently in operation? ( ) Yes ( ) No

4. If not, when do you expect operations to begin? Month ______________ Year__________

5. Approximate value of your company's investment in the joint venture at the time of the agreement with China (in $US).

( ) Less than $500,000 ( ) $500,000 - $1,000,000 ( ) $1,000,000 - $5,000,000

( ) $5,000,000 - $10,000,000 ( ) $10,000,000 - $15,000,000 ( ) Over $15,000,000

6. Percentage of your company's Joint Venture equity participation: ____________%

7. In which country is your company headquartered? ______________________________

8. Please specify your joint venture's primary type of business ____________________

9. Comments: ____

If you would like to receive a summary of the research findings, please provide your name and address below:

Name__________________________Title__________________________

Company Name____

CONFIDENTIAL

Address____

____

Country____

APPENDIX B

INSTRUCTIONS FOR COMPLETING AND RETURNING
THE DATA COLLECTION INSTRUMENT

As a pioneer in joint ventures with China, your company has been selected to participate in an international research study. The purpose of this research is to obtain new insights into the risks of investing in China as judged by managers who are actually making the investment decisions.

I am a professor of business at Liberty University in Lynchburg, Virginia, and am completing my doctoral dissertation at United States International University in San Diego. I know that you are often flooded with requests for various types of information, but if you would be kind enough to answer this questionnaire, the results could be quite useful to you. In addition, your cooperation will also serve to further advance university research in international investments.

Since only a sample of joint venture companies has been selected at random, your answers and opinions are extremely important to the validity of the research. It is especially vital that only you or another manager who participated in the Chinese investment decision be the one to respond. Approximately 14 minutes are required to complete the questionnaire.

A summary of the results will be made available to companies responding to the survey. This will enable them to compare their risk assessment with a composite of other multinational corporations. Individual responses and corporate identity will, of course, remain confidential.

For your convenience, a self-addressed envelope is enclosed. In order for you to have your responses included in the final results, please return the questionnaire no later than July 10, 1985.

Thank you for your kind consideration.

Sincerely,

Stephen P. Preacher, Survey Director

458 Horizon Hills Drive
El Cajon, California 92020
U.S.A.

APPENDIX C

THE DATA COLLECTION INSTRUMENT
(FOLLOW-UP CARD)

Dear Sir,

Several days ago you received a SURVEY OF PERCEIVED INVESTMENT RISKS FOR CHINA-JOINT VENTURES. I want to thank you for your assistance if you have already returned it. If you have not yet done so, this is just a reminder that your opinions are extremely important to the validity of the research, and are needed as soon as possible.

Thank you very much for your cooperation.

PROFESSOR STEPHEN P. PREACHER
458 Horizon Hills Drive
El Cajon, California 92020

APPENDIX D

JOINT VENTURE PARENT COMPANIES

JOINT VENTURE PARENT COMPANIES

Headquartered in Hong Kong	Headquartered in United States
Chi Keung	American International
China Overseas	American Motors
Chiu Hwa Electronics	Beatrice
Cosmos Machinery	Bishop Graphics
Da Sing Development	Borden
Duralite International	Brown & Root
Garden Hotels	Core Laboratories
Goodyear Printing Products China	Data General
Grace Garments	Elk Telecommunciations
Hua Chiao Commercial Bank	Foxboro
Javelin	Goodyear
Lark International China	Hewlett-Packard
Nanyang Commercial Bank	ITT-Asia Pacific
Quadrutec Development	Lithcon Petroleum
Peninsula Knitters	Lummus Crest
Rawcott International	Lynch Communications
Santa Fe Transport	Mark Controls
Wang Tak Engineering & Shipbuilding	Nabisco
Wing On	Occidental Petroleum
Xiangyu	Otis Elevator
Anonymous (2)	R.J. Reynolds
	Sedco Forex
	Sperry

APPENDIX E

COMPOSITE SUMMARY OF RELATED CONCERNS

COMPOSITE SUMMARY OF RELATED CONCERNS

Other concerns related to the joint venture operation were recorded which, to some extent, may be classified as a risk. For purposes of summary, these incidental responses were grouped into six categories: political, foreign exchange, commercial, management and personnel problems, infrastructure deficiencies, and cultural transition stresses.

Political Issues

Bureaucratic system and red tape

Interference from cadres

Too many licenses required

Transfer of skilled labor to another oranization without prior notice

Change in the organizational structure of government

Change in the regulations regarding selling finished products to other Chinese provinces

Change of governmental regulation

Legal enforcement

New laws and taxes

Slow and deliberate erosion of economic benefits to the non-Chinese partners by an evolution of new interpretation to the joint venture contract, tax and licensing procedures

Embargoes imposed by USA for political reasons unrelated to business

Retaliation to USA unilaterally imposed trade restrictions

Deterioration of Chinese/USA relations due to Taiwan-related issues

U. S. government "blunders"

Local government and landlord's attitude

Providing the infrastructure to do business without bureaucratic meddling

Foreign Exchange Issues

Curtailment of domestic PRC foreign exchange sales

Currency convertibility

Lack of foreign exchange revenues

Ability of a company to generate its own foreign exchange to meet import growth requirements

Foreign currency generation through a more free export ability

Export requirements and foreign exchange balance

Commercial Issues

Labor control

Supply of raw material from other provinces

Meeting company export targets

Lack of economic protection of local industry against direct imports

Lack of a significant percentage of advantages for local industries against direct import

Access to necessary raw materials

Suitable office or factory space

Fluid state of organizations in terms of purchasing and distribution channels

Protection of proprietary knowledge and assets

Unreliable Chinese subcontractors

Ability of joint venture partners to meet local marketing demands

Ability to sell products in the local Chinese market

Ability to make a profit

Costs

Management and Personnel Issues

Quality Control

Low productivity without incentives

Inablity to manage

Difficulty in obtaining and retaining good managers

Lack of autonomy of the Board and excesive control by the department in charge and the local bureaucracy

Bureaucratic interference in setting personnel policies, especially incentive pay and internal recruiting

Expectations of the local partner in the speed of transfer of know-how in terms of technology and management

Hiring and firing Chinese personnel directly rather than through labor pools

People at lower levels (both the local government and the Chinese partner) do not understand the principal agreement reached at higher levels, thus creating problems in implementation and rising costs

Education and training of people to understand international business concepts

Availability of qualified personnel

Technical skills of workers for plant maintenance

Human relationships

Excessive demands relating to the training and use of Chinese personnel prior to qualification to perform the labor function

Infrastructure Issues

Inadequate power supply

Inadequate communication service

Inadequate transportation service

Development of local support industry infrastructure to achieve local content in products and the local development of products

Ability of the Chinese infrastructure to support a Western enterprise day in, day out, month after month, year after year

Harbor, shipping, and electrical facilities

Cultural Transition Stresses

Lack of recreational facilities for expatriates

Availability and cost of housing for expatriates