

A Study on the Opportunities and Risks in Chinese Construction Market for Foreign Enterprises

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Abstract

Chinese construction industry has been enjoying a good opportunity for development which appeals to lots of foreign investment. However, the difference in socioeconomic environment and legal environment brings difficulties to foreign enterprises. This paper analyses the institution environment in Chinese construction market. The main objective is to form an insight of Chinese construction environment, and to identify critical factors that may block the way of foreign enterprises.

Keyword : Construction Market, Foreign Investment, China

1. Introduction

Since the reform and open-door policy started in China in 1978, it has brought about a sustained and rapid development in national economy. As the foundation of the national economy, construction industry has been playing a very important role, having made impressive progress and been developed at an amazing speed. Now China has been the third largest construction market in the world. America, Japan and China make up 47% of the total global output.

Although a significant number of foreign enterprises have rushed into Chinese construction market along with lots of others planning, they worried a lot about the investment risk. The related data indicate that China is a place where you can enjoy a considerable profit under a high risk. It is reported that because of

the inadequate investigation of Chinese construction market, many firms failed to accomplish desired outcomes, and they are adjusting the scale and proportion of the investment.

Based on statistic data, questionnaire data and nation laws, a research about the socioeconomic environment and legal environment of Chinese construction market was developed to find some external factors that may have influence on investment strategies for foreign construction enterprises.

2. Socioeconomic Environment

Socioeconomic environment involves both social and economic factors. With 5000 years history of civilization, Chinese culture, tradition, and value system are quite different from those of other countries. They have a significant impact on the operation of businesses in China. Also, as the world's third large country in area, China is geographically divided into many regional centers cross the nation, economic situations vary from area to area.

2.1 Economic Development

Since economic reform in China, there has been a

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This work was supported by Sustainable Building Center of Hanyang University which was supported the SRC/ERC program of MOST (R11-2005-056-03001)

remarkable growth in GDP to 9.5 percent per year on average, and the growth of construction is much faster than GDP with average annual added value rate over 25%. China's construction industry realized 4097.5 billion CNY (1 USD equals 7.5 CNY recently) in total output value in 2006 accounting for 19.6 percent of the national GDP, which is almost two times as much as that in 2002. It is predicted that the total output of construction industry will reach to 380 billion dollars in 2010.

Meanwhile the coastal regions of eastern China benefited greatly from the reform and door open policy, and their economies quickly developed. The western China, however, lagged behind severely. According to statistics, among China's Top 500 construction enterprises, there are 318 enterprises located in the eastern China, and the rest are in the central China and western China. And more impressively, Zhejiang Province and Jiangsu Province from the eastern China contributed 25% of the national construction output value.

To balance the great economic distance, the Chinese government adopts different strategies to different regions including China Western Development, Rise of Central China, Revitalize Northeast China, and The Wealth East Coast shown in Figure 1. The government's policies have drastically increased the development of the western China and northeast China. China's western regions have reported an annual average economic growth rate of 10.6% for recent six years in a row.



Fig.1. Policies to different regions in China

To investigate the area with great potential in China, a research was conducted. The research data were gathered from questionnaires: (1) In your opinion which province is the most proper place for foreign enterprises

to invest in China? (2) List the three cities you are interested in this province. A total of 25 persons have been selected to answer two questions. Among these people, 12 from Asia, 8 from North America, 5 from Europe. They are all experienced foreign managers or executives who are familiar with Chinese construction market. According to results in Table 1, Shanghai, Beijing, Zhejiang, Jiangsu and Guangdong are ranked top 5 in China. The five provinces are all in the range of the eastern China as shown in Fig 1. It is suggested that the competition among foreign construction firms within this region will be very intense.

Table 1. The potential areas for foreign investor

Rank	Province/ Municipality	City		
		No.1	No.2	No.3
1	Shanghai	-	-	-
2	Beijing	-	-	-
3	Zhejiang	Hangzhou	Ningbo	Shaoxing
4	Jiangsu	Wuxi	Suzhou	Nanjing
5	Guangdong	Guangzhou	Shenzhen	-

With advanced industrial foundation, higher technical skill, better social credit, market system and administrative efficiency, much overseas investment fund in search of higher returns has flowed into the eastern China. However, the growth of one company often comes at the expense of another. Too many competitions imply that it is not an appropriate region for newly-set-up small and medium enterprises. On the other hand, the outlook of the western China is quite promising. Cheap labor force, huge demand, few capital required and policies to entice foreigners all attract investors. Many foreign construction enterprises consider shifting their business to the western China.

2.2 Social relationship

China is still partly a command economy where the government plays an important role in the economy. The establishment of the policy and investment environment, the approval of the foreign enterprises, the design for commercial project, and even the negotiation with other enterprises can have something to do with the government. A good relationship with the government can further deepen your relation with other social relationships too. Take the relationship with media for example. Despite the progress of political democratization, social diversification and media liberalization, the Chinese government still maintains its priority to access to media. If an enterprise wants to erect its company image or broaden its market though

the media, a regular communication with the media is demanded, but a long-term relationship with government is more necessary.

Influenced by Chinese ancient culture, administrative departments can be very flexible and quite different. Compared with the eastern China, the western China seems more conservative, cautious, slow-paced and complicated. That is why many investors are hesitated to enter the western market.

Although difficulties exist for foreign investors dealing with bureaucracy at several different levels (i.e. local, regional, and national government functionaries), there have been a large number of successful cases. Commonly it is effective to build up the relationship with the help of Association of Enterprises with Foreign Investment, leaders of big companies, social agencies or other industry unions. Many members in those associations are active in government departments, and familiar with the operation of public affairs. They can point out a shortcut to what you want.

Anyway, a good relationship with the government helps you stand a higher chance of achieving a better outcome.

3. Law environment

The Chinese government has made great effort to improve to construction laws after December 11th, 2001 when China entered World Trade Organization (WTO). On one hand, the government encourages foreign investment and promotes foreign trade. On the other hand, the government had to protect local enterprises. The comprehension of legal system and its application in reality should be based on Chinese social and cultural background. The main laws and regulations related to foreign construction enterprises that were legislated after China entering WTO are listed in Fig 2.

Laws and regulations set many legal obstacles for foreign firms mainly in the following aspects:

- The limitation of entering certain markets for wholly foreign-owned enterprises;
- Large amount of registered capital;
- The qualification of foreign-service providers
- The experience of operating China's projects;
- The uncertainty of the regulations.

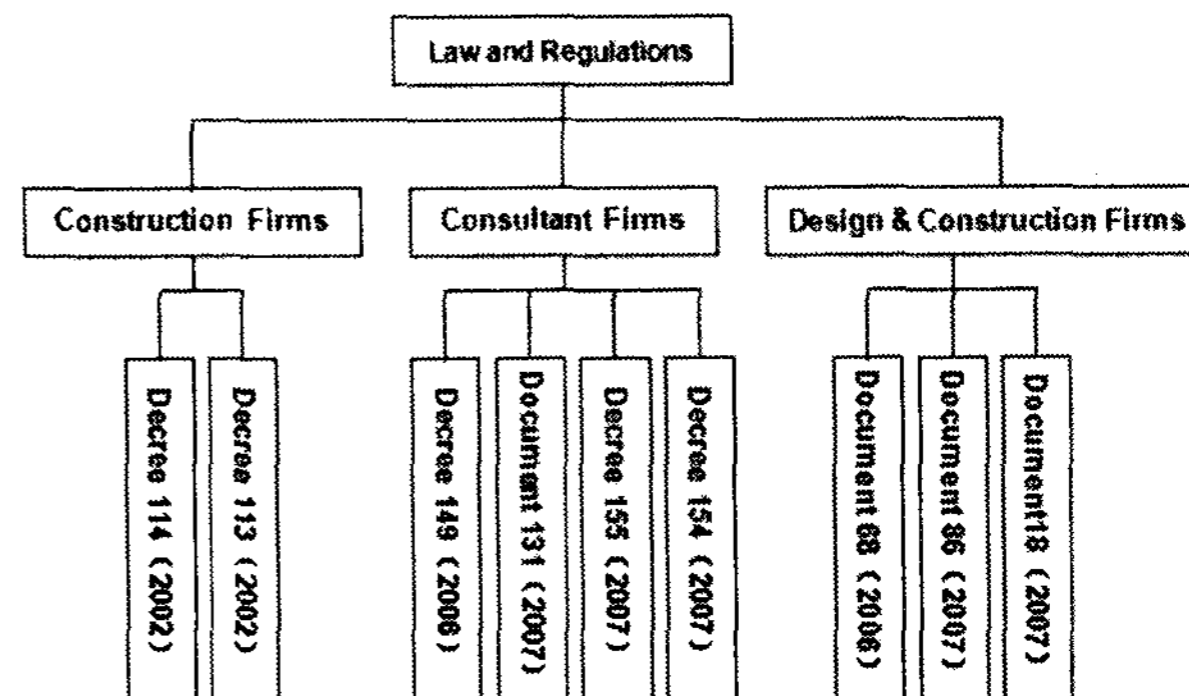


Fig 2. Laws to different types of firms

According to Decree No.113 (Regulations on Administration of Foreign-Invested Construction Enterprises), foreign-invested construction enterprises can establish three types of enterprises: a wholly foreign-owned construction enterprise, or a Sino-foreign equity construction joint venture or a Sino-foreign cooperative construction enterprise. All these enterprises' qualifications shall be censored by a complicated grading and categorization system which strictly required minimum amount of proper experiences, employees and the register capital. The registered capital may vary widely from 8 million CNY to 288 million CNY for bids of different scales and qualities. At the same time, the enterprise should hold assets worth of 344 million CNY.

For wholly foreign-owned contractors they face a problem that they are constrained to certain types of construction works within the scope of their qualifications:

- Construction works funded totally by foreign investments
- Construction projects financed by international financial organizations and awarded through international tendering process in accordance with the provision of the loan agreement
- Sino-foreign joint venture construction projects where the foreign investment is equal to or greater than 50%; Sino-foreign joint construction projects where the foreign investment is less than 50%, but due to technical difficulties, a Chinese contractor cannot undertake the project independently
- China-invested construction projects which Chinese construction enterprises cannot undertake independently due to technical difficulties. Such projects may be jointly undertaken by Chinese and foreign construction enterprises.

Another problem that arises from Decree No.113 is that some foreign-invested construction enterprises have to bring down their qualification grade to contract for

specific projects if they made a consortium with other construction enterprises in lower qualification grade.

Decree No.113 sets the restriction to the enterprise mechanism, while Decree No.114 and the Decree No.73 which is the supplementary to the Decree No.113 set the restriction to the human resource. These decrees require the certain component of the foreign-service providers under the qualification grading criteria and their cumulative resident period for no less than 3 or 6 month each year in China, which increase the cost and the difficulty to hire employees who are fit for the job.

With regard to construction management service enterprises, the situation is a bit complex. Notice No.200 (Trial Measures for Construction Engineering Project Management) stated only enterprises which obtain one or more than one qualification as construction, design, consultant, bid representation, supervisor or survey firms, can subsequently provide a construction management service. The only way to get the qualification is to get license following Decree No.113. Obviously, it is not feasible because of large amounts of registered capital for license.

Fortunately, China passed the post-interim of entry to WTO on December 11th, 2006, which means China would realize its promise to WTO that solely foreign-owned businesses will be allowed gradually to contract projects of all types, and abolishes some limitations to other types of construction enterprises.

Until October, 2006, there were 1189 registered construction enterprises and 233 design enterprises in China from 39 countries and regions, mostly from Hongkong, Japan and America. Many contractors from Top 225 Global Contractors have also carried out project in China.

4. Conclusion

This paper studied the economic development, social relationship and legal restrictions of Chinese construction market. The paper reveals some external factors that deserve the attention of foreign construction enterprises as follows:

(1) With the steady development of the national economy, the construction industry will continue its momentum of growth in the upcoming years.

(2) Generally speaking, the eastern China, especially regions around Shanghai, is still the first choice of foreign construction enterprises. However, foreign capitals are lack of passions to invest into western China other than Chengdu, Xi'an and Chongqing.

(3) The relationship with the government is very subtle and important in China.

(4) There are some entry barriers to Chinese construction market for foreign investor. The Chinese government is very cautious of opening its construction market. The government encourages foreign investors to set up Sino-foreign construction enterprises rather than wholly foreign-owned construction enterprises.

This paper mainly focused on the influence from economy, government and the law which are related to construction market. Other related aspects, such as construction technology, partnership with other enterprises, are yet to be explored. Therefore, future research should consider more aspects and build up sufficient empirical data to support the study of Chinese construction market.

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