



The Cases for and Against Foreign-domestic Joint Ventures in the Chemical Industry in China

Dr. Kai Pflug, Management Consulting – Chemicals (kai.pflug@mc-chemicals.com)

Multinational chemical companies active in China have never been particularly keen on joint ventures with local partners, except of course in those cases (such as in petrochemicals) such an organization was mandatory. On the other hand, foreign-domestic joint ventures are certainly not on the way out – in fact, new ones are still being established, and anecdotally there seems to be a slight surge in interest particularly among those Western companies which have only entered the Chinese market fairly late and thus have limited own local resources and knowledge.

Some examples of JVs recently established or extended include the following:

- In February 2017, Asahi Kasei and ChemChina subsidiary Bluestar agreed on two JVs for the production and sale of modified polyphenylene ether in China, combining Bluestar's production technology for 2,6-xylenol and PPE with Asahi Kasei's compounding technology and application knowledge

- In August 2017, Korean company SK Global announced the set-up of a 50:50 joint venture with Chinese TCL Group for the production of chemicals for chips and displays

- In September 2017, Kemira signed an agreement with Shandong Tiancheng Wanfeng to form a JV for the production of AKD wax, which is used in board and paper making, and its raw material fatty acid chloride

- In November 2017, Clariant and private domestic light-stabilizer producer Tiangang Auxiliary purchased a site in the Cangzhou chemical park which will be the location of a new production joint venture for process and light stabilizers

- In December 2017, a JV between BASF and Shanghai Huayi Fine Chemical inaugurated a new automotive coatings factory in Shanghai, an investment of about Euro 140 million that is an expansion of an existing automotive coatings plant

A specific segment in which JVs play an important role is that of industrial gases. A few recent examples are:

- In June 2017, Sinopec and Linde signed a 50:50 JV agreement covering the supply of industrial gases to a Ningbo industrial park, doubling Linde's local capacity in Ningbo. This is already the sixth JV between the two long-term partners, indicating a certain level of mutual satisfaction

- In July 2017, Sinopec and Air Liquide agreed on a new 50:50 JV, Air Liquide-BYPC Gases, which will supply industrial gases to Sinopec Beijing Yanshan

- In September 2017, Lu'An Clean Energy and Air Products agreed on a US\$1.3 billion JV for air separation units producing oxygen, nitrogen and steam at the Lu'An site in Changzhi, Shanxi. This JV will be majority owned (60%) by Air Products, will supply syngas to Lu'An under a 20-year contract, and will in turn receive key raw materials and utilities from Lu'An.

- Similarly, in November 2017, Yankuang

and Air Products formed a joint venture (majority controlled by Air Products) to build and operate a plant for production of oxygen and syngas. These gases will be used by Yankuang subsidiary SFEC to produce chemicals, while SFEC itself supplies key input materials (coal, steam, power) to the JV plant

The case of industrial gases has some specifics that make the JV ownership structure particularly attractive for both parties. The capital investment is large and can only be justified if the industrial gases plants are utilized for long periods of time – accepting the local chemical producer as JV partner therefore reduces the investment risk for the industrial gases companies as they give the local players an incentive to utilize the gases plants. In addition, such plants often have essentially only one customer (the local JV partner) and may also depend on this JV partner for essential input such as coal, steam and power as well as site services. On the other hand, industrial gases companies rightly regard the air separation technology as their core asset and therefore will not be willing to let the local customer run the industrial gases plants on their own.

Whether industrial gases or not, all these examples of recently started or expanded JVs – some by companies with long experience in China both inside and outside of JVs, such as BASF and Clariant – show that the JV model still has its attractions. These attractions seem to be strong enough to compensate for some of the negative experiences with chemical



JVs in the past, such as the 2009 exit of Lanxess from its JV with Weifang Yaxing (via a sale of its 55% share to the Chinese partner in the production of hydrazine hydrate) and the 2012 exit of Evonik from its Evonik Sanzheng JV following a report in a German business magazine on improper payments and gifts at the joint venture.

So, what are the pros and cons of chemical joint ventures in China? And what can be done to increase the chance of success of a JV?

Start with the advantages from the perspective of a foreign JV partner. Having a local partner obviously brings substantial knowledge of markets and customers. Even if the local partner does not already have assets to bring into the JV, the speed of market entry of the JV is likely to be higher due to the existing knowledge, relationship with local authorities, availability of staff etc. The participation of a Chinese partner may also offer a certain amount of political protection – for example, Korean chemical companies currently are focusing particularly on JVs in China as they hope this will reduce the fallout from the recent negative reputation of Korean companies in China following political controversies. This particularly applies to JVs between foreign companies and national-level state-owned entities such as Sinochem as these companies have a very good reputation within China and will face much less opposition by local governments than private domestic or foreign companies.

Another advantage is that by agreeing on a JV with a current or potential future domestic competitor, the intensity of competition may be reduced. JVs may also benefit from lower costs, particularly if the local JV partner takes the main responsibility for tasks such as production, for which local standards tend to be lower than the global ones of multinational chemical companies. And finally, in some areas – such as petrochemicals – having a local JV partner is

even mandatory.

From the perspective of the Chinese JV partner, key advantages of forming a JV are the incorporation of technological knowledge brought by the JV partner, the government support that is given specifically to JVs but not necessarily to domestic companies, and often the access to resources that are hard to get in China, e.g., raw materials. In addition, generally the processes of foreign companies in areas such as operations, health and safety, quality control, HR, IT etc. are still regarded as superior, so a JV may benefit from being modelled after the standards of the Western JV partner. A JV may also make a Chinese company more attractive for Chinese talent – not so much due to differences in salary but because young talents still like to adorn their CV with the name of a Western company.

On the negative side, Western companies entering JVs still face some risk of losing intellectual property, though this risk can be substantially reduced by a number of ways such as limiting the depth of production done at the JV. Of course, forming a JV adds complexity as cultural differences will inevitably come up, and decisions may take longer. And in the past, there were some examples of JVs being mostly run in the interest of the domestic partner, up to the point of running secret night shifts.

Obviously, cultural differences and delays in decision making due to conflicting interests may also negatively affect the Chinese JV partners. In particular, the multinational partner in a JV will generally take a global view and will try to optimize investments accordingly, while the Chinese partner will focus more on China and insist on new investments and new technology being focused on China.

In conclusion, JVs still are worth considering whenever the synergies obtainable from bringing complementary capabilities together exceed the costs of the additional complexity. In particular, joint ventures can

still be helpful to accelerate establishing a market position in China, particularly for those multinational companies with limited experience and resources in the country.

On a more practical level, here are a few recommendations for multinational companies considering forming a JV with a Chinese chemical company:

- Domestic companies which are state-owned entities or at least have a recent state-owned background tend to be somewhat easier to manage as JV partners than private companies. Private companies tend to be run by highly entrepreneurial spirits who find it hard to get along with the rule-based system of multinationals. In contrast, employees of state-owned enterprises are used to following rules. Of course, this does not mean that JVs with private enterprises cannot be successful
- Similarly, Chinese partners with international ambitions of their own may make them less suitable as JV partners, as they obviously may want to leverage the JV or parts of its resources for their own overseas activities
- JVs will develop their own culture, which will be somewhere between that of Western and Chinese companies. Multinational companies need to tolerate some deviations from their own standards in order for the JV to work successfully
- An existing JV should not necessarily immediately be acquired 100% once there is a chance. There are advantages of keeping the local partner on board. In particular, his share of the JV will prevent him from establishing a new company (and taking key staff and customers with him)
- As the example of the industrial gases sector shows, JVs are a good way of securing a big customer and thus guaranteeing a baseload of sales and production. Of course, this only applies if the JV partner is selected accordingly (i.e., it is an important customer of the JV). ■