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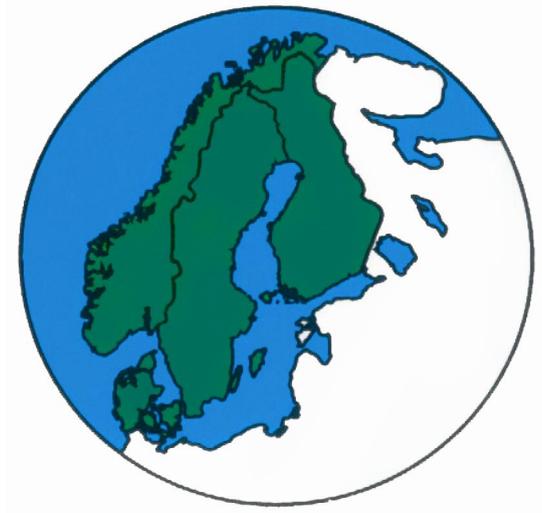
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# Forest industry foreign investments: case study of three companies in China

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## Abstract

Internationalization of operations constitutes an important part of the global forest industry integration process over recent decades. As a resource based industry, drivers of corporate expansion have been defined as both resource seeking and market seeking in the global context. China is regarded as one of the most dynamic countries with development potential concerning both resources and markets to attract foreign direct investment (FDI). From 2004 to 2008, FDI in the forest industry in China has doubled and FDI projects have maintained around 550 cases annually. The high density of investments has raised critical issues with respect to business ethics including corporate environmental sustainable development and interactions with communities at the local level. The aim of this study is to use a case study approach to compare the process of FDI in the forest industry in China and to explore the sustainability of operations from corporate governance viewpoint. Three case companies headquartered in Europe, North America and Asia were chosen. Corporate FDI strategies, financial performance, cooperation with local community and stakeholder involvement were evaluated and compared. Finally, managerial suggestions will be given case by case referring to the corporate sustainable operations in China.

**Keywords:** Foreign investment, forest industry, China

## 1 Introduction

Forest industry has undergone a dynamic consolidation process in last three decades at the global scale. In this process, corporate international expansions constitute an important role in resources and markets seeking. The most significant structural change in the forest industry is that large-scale production plants and sales activities were established in the developing and transition countries, which have gradually substituted the traditional production and sales networks in the developed countries. China, Brazil, India, and Eastern Europe have becoming the new emerging economies to attract

FDI in the forest industry driven either by their large domestic markets, by the abundant natural resources or both.

China, ranked as the global second largest economies with USD 7 trillion GDP in 2011 (the World Bank, 2012), attracts plenty of foreign investments in terms of commerce, resource and service. The rapid development speed (average GDP growth 9.9% per year since 1995) provides various market demands and opportunities, labor supplies and consumptions in China (the World Bank, 2012). In order to absorb foreign investments, Chinese government has significantly improved infrastructures in terms of transportation, water supply, electricity and natural gas. In addition, relevant laws, regulations and policies have been revised according to requirements of market economy and the WTO membership. The stable investment environments, attractive investment policies, good availability of low-cost labor forces and huge market potentials have become significant advantages to attract foreign investment in China.

The forest industry only accounts for less than 1% of GDP in China. However, its gross output value maintained at a high growth rate and increased almost three folds in this decade from RMB 93.9 billion to RMB 259.6 billion (China Statistical Yearbook, 2011). In terms of the paper and paperboard sector, from 2005 to 2009, the production amount increased from 60 million MT to 90 million MT with an annual growth rate of 10 percent and the consumption amount maintained at the growth speed of 9 percent (Figure 1). However, the average consumption amount in China (67 MT / 1000 capita) still lags behind the European (126 MT/1000 capita) and the US (226 MT/1000 capita) levels (FAO, 2011). In terms of the wood pulp sector, from 2005 to 2009, the pulp production capacity accounts less than half of the consumption ability in China (Figure 2). The continuous huge demands in paper and pulp sectors evoke the strong market seeking motive to invest in China.

China has opened the domestic market to international investors since the economic transition initiated from 1978. From 2004 to 2008, FDI in the forest industry in China has doubled from USD 357 million to USD 834 million and FDI projects have established around 550 cases annually (SFA, 2004; 2008). The country's industrial upgrading and relocation pushed the old state-owned paper and paperboard companies from the government planning system to the market mechanism. According to the Chinese 12th Five-Year Plan for the Paper Industry (2011), more than 10 million tons of outdated papermaking capacity will be eliminated in 2015. Corporate mergers and acquisitions, joint ventures (J&Vs), and FDI are recommended aiming at energy saving and emission-reducing production.

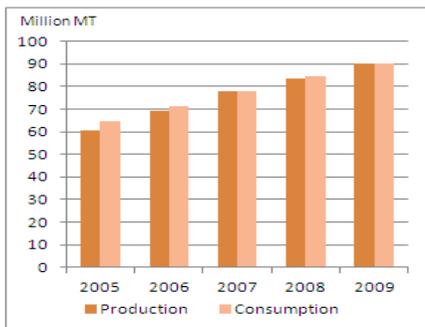


Figure 1. Paper and paperboard production and consumption (Million MT) in China from 2005 to 2009. (FAO 2011)

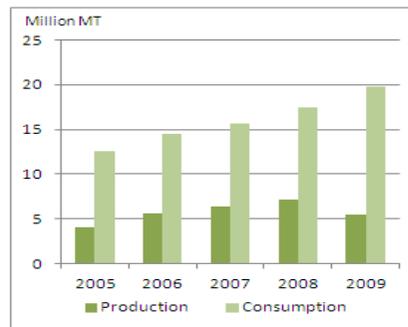


Figure 2. Wood pulp production and consumption (Million MT) in China from 2005 to 2009. (FAO 2011)

The prosperity of China as an investment destination evoked plenty of research concerning policy, governance, macro economy, and technology spillover perspectives (Cole et al., 2009; Han et al., 2004; Huang and Tang, 2012; Wang, 2007). However, from corporate operational point of view, we find that studies referring to multinational companies' (MNCs) foreign investment in the forest industry in China are still very limited (Zhang et al., 2012). Hence, the aim of this study is to explore the current status of MNCs in China referring to financial, operational and managerial aspects.

## 2 Theoretical background

Internationalization is regarded as “the process of adapting firms’ operations (strategy, structure, resource, etc.) to international environments” (Calof and Beamish, 1995 p.116). In Zhang et al. (2012) we summarized the internationalization theories into four categories, which are internalization & transaction cost theory, resource based theory, industrial organization theory and managerial incentives theory. Corporate expansion motivations have been defined either as resource seeking, market seeking or efficiency seeking to pursue corporate internationalization through variable expansion ways of FDI, J&V, licensing or exporting (Behrman, 1981; Mudambi, 2002). The scale and paths of corporate internationalization have been influenced by both macro environment and corporate management factors, in which economy, policies, culture, technology, labor forces, infrastructure, corporate products, R&D ability, and managerial structure may be included. We believe that corporate internationalization is a cyclic process, through which company gradually gains the operational and financial efficiency, improves the competitive advantages and may realize sustainable development goals in the global context (Zhang et al., 2012).

### **3 Methods and data**

In this study, we choose the comparative qualitative case study as method to have a glance at MNCs' operations in China. The case companies include UPM from Finland, Asia Pulp & Paper (APP) from Indonesia and International Paper (IP) from the US. Three case companies finely represent different cultural backgrounds originating from different continents and we hypothesize that these differences to some extent have impacts on corporate investment strategies and their implementations in China.

We mainly rely on the documentary information in this study. Company information comes from sources of corporate annual reports, financial fillings, sustainable reports, corporate websites and brochures. General information includes all relevant digital channels of newspapers, journals, magazines and NGO publications focusing on the time period 2002 - 2012.

### **4 Results**

#### **4.1 Comparison of case company operations in China**

Among the three companies, UPM is a leading Finnish company in doing fiber and biomass-based business aiming at create values from renewable and recyclable materials. UPM was established in 1995 through a merger of Kymmene Corporation, Repola Ltd and its subsidiary United Paper Mills Ltd. After two decades of development, UPM comprises of three business groups (energy and pulp, paper, and engineered materials) and operates its production plants in 16 countries all over the world.

UPM expanded its business into China in 1998 by setting a wholly owned subsidiary in Changshu, Jiangsu province. After 14 years of development, UPM has invested a paper mill, a labelstock factory and an Asia R&D center in Changshu production base and a RFID factory in Guangzhou with a total of 1367 employees. Until 2010, UPM has accumulatively invested 802 million Euros in China in business areas of paper, label materials, plywood, saw timber and RFID tag products serving both Chinese and Asia Pacific markets. UPM has sales offices covering the southern and eastern part of China. Besides, UPM owns a jetty in Changshu, which ensures the efficiency of products exporting and raw materials importing from Indonesia, South America, Finland and Canada.

APP is a family based company established in 1972 and subordinates to the Sinar Mas Group which is one of the largest conglomerates in Indonesia. The main business areas of APP are paper, pulp and packaging. APP has dedicated to be the best pulp and paper manufacturer on international-standards to provide the superior value to its stakeholders. APP operates its plantation and production units mainly in China and Southeast Asia.

APP entered China in 1992, which is the earliest among three case companies. Unlike UPM, APP set up J&V with Chinese company at the initial stage of expansion, and then gradually started to invest its subsidiaries. APP continuously implements the “plantation-pulp-paper integration” development strategy and operates business areas of plantation, pulp, fine art paper, industrial paper and household paper in China. After two decades of operations, assets of APP in China has reached USD 13 billion by owning 18 pulp and paper enterprises and over 20 plantation farms (more than 300,000 hectares of plantations) in Yangtze and Pearl River Delta with total employees of 8,900.

IP is the world’s largest paper, packaging and forest products company. It was founded in 1898 and is one of only four listed companies with more than 100 years history in the US. IP focuses on business areas of printing paper, industrial packaging and consumer packaging by operating production plants in more than 20 countries. In 2011, its global sales reached around USD 26 billion and ranked 387 of top 500 largest companies in the world.

IP started its Chinese business since 1994 and has already accumulated USD 2 billion assets. IP has owned 19 production and sales plants operating consumer and industrial packaging business in 17 cities of China. Besides, IP has J&V business with Shandong Sun Paper producing the coated carton board. IP has no plantation areas in China right now and raw materials are imported from IP’s plantations all over the world.

The Table 1 and 2 summarizes the operational information concerning three case companies (UPM, APP and IP) in general and in China in particular.

**Table 1.** Background information of case companies

	<b>UPM</b>	<b>APP</b>	<b>IP</b>
<b>Headquarter</b>	Helsinki	Singapore	Memphis
<b>Founded year</b>	1995	1972	1898
<b>Business areas</b>	Energy & pulp Paper Engineered materials	Paper Pulp Packaging	Printing papers Industrial packaging Consumer packaging
<b>Global sales</b>	10,068 million Euros (2011)	N.A.	26,034 million Dollars (2011)
<b>Return on Equity</b>	6.3% (2011)	N.A.	18.2% (2010)
<b>Global employees</b>	23,909 (2011)	N.A.	61,500 (2011)
<b>Number of operating countries</b>	16 (2011)	3	More than 20

#### 4.2 Comparison of environmental and social related activities

Forest industry has been considered as the high pollution, high resource consumption but low efficiency industry in China. As world leading enterprises in the forest industry, UPM, APP and IP have made plenty of efforts in environmental protection in China. For example, UPM has accumulatively invested USD 36 million in advanced facilities including waste water treatment, air emission treatment, and solid waste recycling. In UPM Changshu mill, the solid waste is 100% recycled and the waste water and air emissions were much lower than the Chinese National Standard. APP continuously implements the plantation-pulp-paper integration strategy and has invested USD 865 million in environmental protection in China, which is the highest among three case companies. However, doubts concerning APP's environmentally damaging logging activities have never ceased. IP has dedicated to manage natural resources and reduce the environmental footprint in China. The core sustainability philosophy in IP is that it pursues a business success while sustaining a better world for generations.

**Table 2.** Operational information of case companies in China

	<b>UPM</b>	<b>APP</b>	<b>IP</b>
<b>Initial year in China</b>	1998	1992	1994
<b>Forms of investment</b>	FDI	FDI and J&V	FDI and J&V
<b>Assets in China</b>	802 million Euros (2010)	USD 13 billion (2010)	About USD 2 billion
<b>Sales in China</b>	479 million Euros (2010)	USD 5.9 billion (2010)	USD 706 million (2010)
<b>Number of employees in China</b>	1,367 (2010)	38,900 (2010)	3,500 (2010)
<b>Headquarter in China</b>	Changshu, Jiangsu	Shanghai	Shanghai
<b>Number of facilities in China</b>	3 production plants 1 R&D centre 6 sales offices	18 pulp and paper enterprises Over 20 plantation farms	19 container plant 1 Asia Customer Solution Centre 1 IP-Sun J&V
<b>Certifications</b>	ISO9001 ISO14001 OHSAS18001 CoC of FSC CoC of PEFC	ISO9000 ISO9001 ISO9002 ISO14001 OHSAS18001 CoC of PEFC Certifications of PEFC	ISO9001 ISO9002 ISO14000 ISO14001 ISO18000 CoC of FSC
<b>Plantations in China</b>	No	More than 300,000 hectares of plantations (2008)	No

<b>Source of raw materials</b>	Imports from Indonesia, South America, Finland and Canada	Yunnan province, Hainan province, Cambodia	Imports

Corporate social responsibility has aroused wide concerns over recent years and companies are expected not only to care about its profits, but to care about all its stakeholders. UPM, APP and IP have participated in various philanthropic projects in terms of disaster relief, environmental improvement, community construction and university scholarship in China. UPM mainly focuses its social activities on environmental projects including village drinking water improvement, climate change investigation, water protection, community plantation and fruit plantation etc. In addition, UPM has also actively set more than 10 different kinds of scholarships aiming at help primary school students in poverty areas and outstanding students in universities in China. APP implements its social responsibility mainly in disaster relief and social donation perspective. Up till now, APP has accumulatively donated around USD 94 million in China and set university scholarships in Peking University, Xiamen University etc. IP focuses its social activities mainly in environmental aspect as well. IP has contributed more than USD 100 million to cooperate with China State Forestry Administration (SFA) aiming at exchanging knowledge and personnel to support the development of Chinese sustainable forestry management. IP also participated in the community tree plantation project in Inner Mongolia fighting with desertification. Beside, IP has set the Asia Scholarship to support students in financial need and set IP Asia Holiday Giving by donate clothing, household items to children in poor conditions. Table 3 summarizes main environmental and social activities by case companies in China in recent years.

From the stakeholder point of view, broader opinions can be found concerning operational status of case companies in China. UPM has been awarded by both state and local governments as the environmental friendly enterprise in consecutive years in China. The Greenpeace has also stated its supports since UPM announced that it has no intention to have plantations in China. Besides, UPM was also certified as one of China's top employers by corporate research foundation (CRF) institute, which affirmed its HR strategy and competitiveness in the Chinese labor market. Non negative opinions have been found concerning UPM's operations in China until now, which indicated a well-established recognition, efficient cooperation and friendly communication between UPM and its stakeholders in China.

**Table 3.** Examples of environmental and social activities of case companies in China

	<b>UPM</b>	<b>APP</b>	<b>IP</b>
<b>Environmental management</b>	<ul style="list-style-type: none"> <li>• USD 36 million in advanced facilities</li> <li>• Minimization of waste water and air emissions</li> <li>• Decreasing water &amp; electricity consumption</li> </ul>	<ul style="list-style-type: none"> <li>• Plantation-Pulp-Paper Integration</li> <li>• USD 865 million in environment protection</li> <li>• Raw materials: fast growing &amp; fertile plantations</li> </ul>	<ul style="list-style-type: none"> <li>• Managing natural resources</li> <li>• Reducing environmental footprint</li> <li>• Building strategic partnerships with stakeholders</li> <li>•</li> </ul>
<b>Social responsibilities</b>	<ul style="list-style-type: none"> <li>• Support for Sichuan earthquake reconstruction</li> <li>• Wuhan Climate Change trip</li> <li>• Yunnan Lijiang water protection task</li> <li>• Village drinking water project in Shanxi</li> <li>• Community plantation in Henan</li> <li>• UPM University Scholarship Program</li> </ul>	<ul style="list-style-type: none"> <li>• Setting scholarships in Universities</li> <li>• Participation in disaster relief, social donation, construction of Olympic venues</li> <li>• Total donation of around USD 94 million</li> </ul>	<ul style="list-style-type: none"> <li>• Tree Planting project to fight desertification in Inner Mongolia</li> <li>• Cooperate with SFA for the sustainable forestry practice and management</li> <li>• IP Asia Scholarship</li> </ul>

In comparison, APP has been receiving both positive and negative stakeholder comments, in which most of supports come from national authorities and local government, but criticisms come from NGOs. The controversy on APP's operations has mainly focused on its plantations and sources of raw materials in China. APP was honored as the excellent corporate citizen, environmental friendly enterprise and low carbon enterprise in recent years by state and local governments. Simultaneously, APP's plantation projects were considered by official media as a positive impulse to stimulate community economic growth. However, through consecutively investigation and research, Greenpeace has announced plenty of evidences to accuse that APP has participated in illegal logging activities and has induced to deforestation of natural forests in

Yunnan and Hainan provinces. Facing these argumentations, Chinese government authorities have a very blur attitude about APP's plantation and logging activities, which keep doubts and debates continuing.

IP has received mostly positive opinions from stakeholders concerning their operations in China. IP was awarded as the world's most ethical companies for sixth straight year since 2006 and honored as the world's most admired companies for ninth straight year since 2002. As the world largest paper and pulp producer, IP has been perceived to implement its sustainable and efficient operations in China well (however, information is not very specific about corporate operations in China and examples found are mainly on the whole company context). Table 4 listed stakeholder opinions concerning the case company's operations in China.

Summing up current operational status of three case companies, we made the SWOT analysis of their operations in China (Table 5). Based on it, UPM has good reputation, advanced facilities, green image and friendly relationship with government authorities, which could be helpful for its expansion in China. However, building up a competitive sales network is still a challenge for UPM's marketing development, due to the constraint of the wholly owned subsidiary and the lack of local market channels. APP has advantages in terms of high degree of localization, high market shares and brand recognition in China. The implementation of plantation-pulp-paper integration investment strategy has brought systematic opportunities for APP's development. However, being reported frequently involved in illegal logging and other environmental unfriendly activities, APP has met challenges not only to enhance its public relationship teams, but also to improve its management structure to be honest and transparent to all stakeholders. IP owns advanced techniques, solid brand and well located production plants serving Chinese customers. The growing Chinese market has offered and will offer plenty of opportunities for IP's continuous portfolio of investments in China. The cooperation with local know-how may be a challenge for IP's operations because of cultural and managerial differences. Besides, the balance of investments between Chinese market and others are also a challenge for this huge business warship.

**Table 4.** Examples of stakeholder opinions concern the case companies during 2002-2012

	<b>UPM</b>	<b>APP</b>	<b>IP</b>
<b>Support</b>	<ul style="list-style-type: none"> <li>• The honour of Top Employer (2012)</li> <li>• Greenpeace supports UPM's development strategy in China (2008)</li> <li>• State Environmental Friendly Enterprise (2005)</li> <li>• Environmental Friendly Enterprises of Jiangsu Province (2004)</li> <li>• Top 100 Environmental Projects of China (2003)</li> <li>•</li> </ul>	<ul style="list-style-type: none"> <li>• China Excellent Corporate Citizen (2011)</li> <li>• Environmental Friendly Enterprises in paper industry (2010)</li> <li>• Low Carbon Enterprise in China (2009)</li> <li>• Yunnan Daily: APP plantation project brings job opportunity and economic benefits to local communities (2005)</li> </ul>	<ul style="list-style-type: none"> <li>• World's Most Ethical Companies for sixth straight year (2012)</li> <li>• World's Most Admired Companies for ninth straight year (2011)</li> </ul>
<b>Mistrust</b>	N.A.	<ul style="list-style-type: none"> <li>• Greenpeace: APP destroyed 13% of natural forest in Hainan (2011)</li> <li>• Greenpeace: APP cut down virgin forests in Yunnan (2004)</li> <li>• Zhejiang Hotel Association boycotts APP products (2004)</li> </ul>	N.A.

**Table 5.** SWOT analysis of case company's operations in China

	<b>UPM</b>	<b>APP</b>	<b>IP</b>
<b>Strengths</b>	<ul style="list-style-type: none"> <li>• Good reputation</li> <li>• Advanced facilities</li> <li>• Green image</li> <li>• Good relationship with government</li> </ul>	<ul style="list-style-type: none"> <li>• High degree of localization</li> <li>• High market share</li> <li>• High brand recognition</li> </ul>	<ul style="list-style-type: none"> <li>• Advanced techniques</li> <li>• Solid brand</li> <li>• Well located production plants</li> </ul>
<b>Weaknesses</b>	<ul style="list-style-type: none"> <li>• Thin local sales networks</li> </ul>	<ul style="list-style-type: none"> <li>• Suspicions on illegal loggings &amp; environmental unfriendly activities</li> <li>• Low transparency</li> </ul>	<ul style="list-style-type: none"> <li>• Cultural distance</li> </ul>
<b>Opportunities</b>	<ul style="list-style-type: none"> <li>• Expansion of marketing channels</li> </ul>	<ul style="list-style-type: none"> <li>• Efficient implementation of plantation-pulp-paper integration</li> <li>•</li> </ul>	<ul style="list-style-type: none"> <li>• Expand Chinese market</li> </ul>
<b>Threats</b>	<ul style="list-style-type: none"> <li>• Local competitors</li> <li>• Cooperation with local know-how</li> </ul>	<ul style="list-style-type: none"> <li>• Public relationships</li> <li>• Brand vulnerability in environmentally sensitive markets</li> </ul>	<ul style="list-style-type: none"> <li>• Cooperation with local know-how</li> <li>• Balance between numerous world markets</li> </ul>

## 5 Conclusions

In general, China has been considered as the most important strategic investment market for MNCs in the forest industry and operating in China has already brought in significant financial benefits. However, challenges and threats have also been shown up in MNCs' operations, which are induced not only by corporate background, investment strategy and managerial structure, but also by coping with unique Chinese culture and local circumstances. Hence, we first suggest that MNCs aiming at China have to target a clear business area and specific investment location of their operations. Second, we suggest MNCs localize not only production plants, but management teams and ways of communication as well. Third, MNCs needs to keep close relationships with government authorities, local communities and NGOs to ensure wide stakeholder supports and well-functioning cooperation. Last but not least, due to local differences and uncertainty in world's pulp and paper industry markets (including paper substitution by the means of digital media), MNCs should invest step by step in order to minimize operational risks in China and overcapacity in global markets.

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