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The Role and Importance of the Chinese Government for Chinese Outward Foreign Direct Investments

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The Role and Importance of the Chinese Government for Chinese Outward Foreign Direct Investments

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Chinese outward foreign direct investments show a strong positive trend over recent years and have attracted considerable attention from academia and the business press. Many observers and commentators express interest in the role the Chinese government plays in the activities and decision-making of Chinese multinational enterprises (MNEs) in connection with their foreign direct investments (FDI).

This article makes a contribution by investigating the relationship between the Chinese government and MNEs in connection with their outward foreign direct investment (OFDI). We present a 2x2 matrix where one dimension includes the interest (high/low) of the Chinese government and the other the interest of MNEs (high/low). We argue that, in market-seeking and strategic asset-seeking, both interests are aligned and high, while for efficency-seeking motives Chinese company interests are high but government interests are relatively low. In regard to resource-seeking motives and balancing foreign currency reserves, Chinese government interests are high but company interests relatively low. Our matrix allows us to understand the role and interests of the Chinese government in the decision-making process as well as the relationships with Chinese companies in outward foreign direct investments.

Trends and Patterns in Chinese FDI

China's OFDIs have shown a strong positive trend over recent years. At the beginning of the 1990s, outflows were only marginal, at about US$ 800 million (UNCTAD WIR, 2009). But since 2003, Chinese OFDI has demonstrated impressive growth, increasing from US$ 2.8 billion in 2003 to US$ 52.2 billion in 2008 (UNCTAD WIR, 2009: 53). However, while Chinese OFDI is clearly accelerating, it is still small by any relative measure. In 2006, Chinese OFDI accounted for only 1.5 percent of the world's total FDI. In 2008, China's share of world FDI reached 2.8 percent (UNCTAD WIR, 2009).

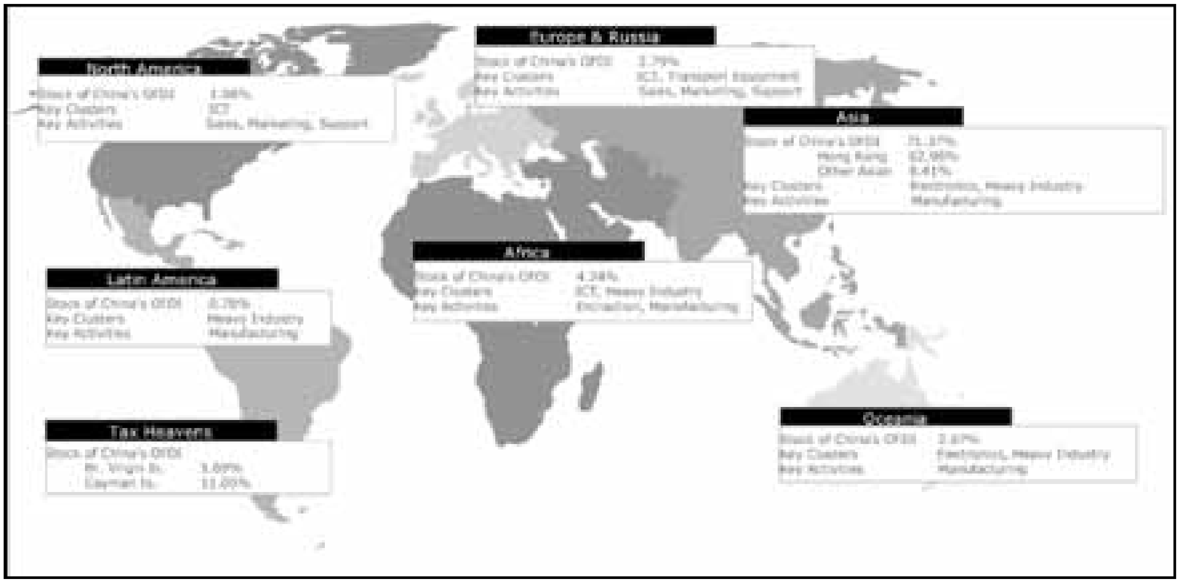
Most Chinese OFDIs are in neighbouring Asian countries, especially those in the Association of Southeast Asian Nations (ASEAN) (MOFCOM, 2008: 67-68). China's Special Administrative Region, Hong Kong, attracts by far the highest amount of OFDI. In 2008 it was the preferred destination of 63 percent of Chinese OFDI (MOFCOM, 2008: 67). A significant amount probably constitutes round-tripping investments or investments to offshore financial centres or to re-investments back to China due to favorable tax situations in Hong Kong and other countries. Therefore, Hong Kong and other offshore financial centers are transit points for Chinese ODFI that need to be factored into the reported statistics and analyses.

Looking at Chinese FDI in terms of stock flows, leasing and business services are the most popular sectors, accounting for US$ 54.5 billion, followed by the financial sector (US$ 36.7 billion), wholesale and retailing (US$ 29.8 billion) and mining with US$ 22.8 billion in 2006 (MOFCOM, 2008: 80). The importance of the financial sector may be illustrated by the fact that, according to MOFCOM (Chinese Ministry of Commerce), Chinese state-owned commercial banks had established 47 branch offices, 31 affiliated institutions and 12 representative offices in 19 countries in 2006, including the United States, Japan and Great Britain (MOFCOM, 2006: 51). Our data for this article are based mostly on official data provided by MOFCOM, but some authors cite a lack of disclosure and transparency in data sources about Chinese foreign direct investments (see article from Derek Scissors in this issue).

The best way to understand the strategies of Chinese MNEs is to link their preferred investment destinations with their main investment sectors since a close relationship exists between the sectoral and geographical distribution of Chinese OFDI. Figure 1 illustrates that Chinese OFDI in the Middle East and Africa targets mainly extractive industries. According to UNCTAD (2008), the Chinese government supports the development of Chinese firms' activities in Africa, especially in sectors such as energy and resource exploitation. OFDI in manufacturing is prevalent in Eastern Europe (especially transport equipment), Latin America (mostly heavy industry) and Asia (electronics). Sales, marketing and support activities are generally performed in Western European countries and in North America. International mergers and acquisitions are the primary mode of entry of Chinese firms in developed economies. However, Chinese firms have not yet invested heavily in manufacturing and sectors with high added value. As far as production activities, transport is the key sector in Western Europe, while ICT plays an important role in North America.

Figure 1 suggests that Chinese MNEs follow a regionalization strategy rather than a global one (Rugman & Doh, 2008: 134 ff.). The 12 largest Chinese firms have the highest average percentage of intraregional sales and assets. This observation is not specific to Chinese MNEs but refers to most MNEs as Rugman (2008) found out (see also Sukpanich & Rugman, 2009). This contrasts with the inference of the press that Chinese OFDI is a global strategy led, or at least influenced, by the government.

Figure 1: Share of Chinese OFDI in the World



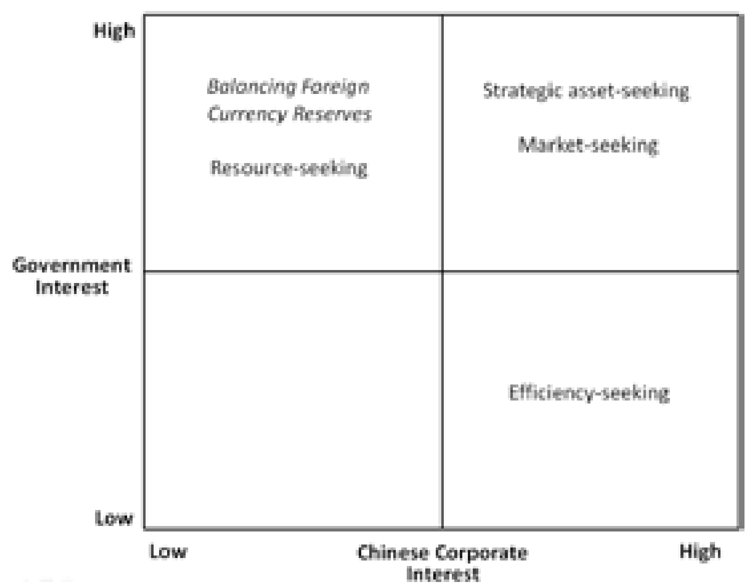
Source: Own illustration based on MOFCOM, Statistical Bulletin on Chinese OFDI, 2008.

Government Primacy over Foreign Direct Investments

A number of points need to be raised to outline the relationships between the Chinese government and the private sector for Chinese OFDI. For many years, typical private sector business was non-existent in China. With the economic liberalization and the introduction of private ownership in the 1980s, private sector activities took root. They were partially built on individual entrepreneurial initiatives and state policies such as the one on privatization (Gugler & Boie, 2009). Some companies are identified as future "national champions", and most have a close relationship with the government (Morck et al., 2007). Since the "going global" strategy adopted by the government at the end of the 1990s, both Chinese State-Owned Enterprises (SOEs) and private enterprises are engaged in FDI. But most of the large-scale investment projects that weigh heavily in FDI statistics have so far been executed by Chinese SOEs. The shares of FDI flows coming from SOEs under the Central Government in recent years were 73.5 percent (2003), 82.3 percent (2004), and 83.2 percent (2005). The remaining shares of FDI flows are split among investments of SOEs administered by regional governments, non-SOEs owned collectively, and privately-owned companies. The success of SOEs abroad is quite limited due to their lack of competitiveness and know-how and because the acquisitions usually reflect a political agenda rather than business needs.

Neither the trends nor motives for Chinese OFDI can be understood without reference to government policies and the role of the Chinese government. This is especially true in the case of China. China's OFDI is still highly regulated, even though policies have shifted from prohibition to gradual opening and finally to active promotion, at least for some SOEs in strategic sectors or industries (Gugler & Boie, 2009: 29-30). Morck et al. (2007) assessed the connections between government and business in China, confirming the government's central role in OFDI. FDI by any Chinese firm requires approval by the Chinese authorities, including MOFCOM, the State Administration of Foreign Exchange (SAFE), and the National Development and Reform Commission (NDRC). Through this approval process, the Chinese government ensures that all investment activities, even if executed by privately owned companies, conform to government policies and goals.

Clearly, this needs to be taken into consideration when analyzing the motivations and strategies of Chinese MNEs investing international. The following Figure 2 illustrates a conceptual framework outlining the interests of the government versus the interests of Chinese companies. This 2x2 matrix maps the four motives of OFDI (market seekers, efficiency seekers, resource seekers and strategic asset seekers [Dunning & Lundan, 2008: 67 ff]) as well as the huge trade surplus and the management of extensive currency reserves Chinese companies, state-owned or private, hold.



Source: Own illustration. Based also on Gugler and Boie, 2008.

Model Implications

(1) Our framework suggests that an area of increasing OFDI might exist where government and company interests are high, such as *market-seeking* and *strategic asset-seeking*.

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As noted by UNCTAD, "*market-seeking FDI is by far the most common type of strategy for developing-country TNCs in their process of internationalization*" (UNCTAD WIR, 2006: 158). Several recent studies point to the rise of *market-seeking* motives driving Chinese MNEs toward large markets (Zhang, 2003). The FIAS/MIGA global survey confirms the prevalence of Chinese market-seeking FDI. In their study of Chinese FDI from 1984 to 2001, Buckley et al. (2007) show that market-seeking was a key motive for Chinese FDI. However, during this period, Chinese firms moved away from market-seeking strategies in nearby foreign markets toward securing raw materials in riskier markets (Buckley et al., 2007). Chinese companies that have invested abroad for market-seeking purposes include Haier, TCL, and Huawei Technologies. They have all made repeated efforts to enter the more affluent developed economies such as the US.

While the UNCTAD global survey indicates that *strategic asset-seeking* FDI is a relatively modest motive for developing-country MNEs (14% compared to 51% for market-seeking FDI), the situation is quite different for Chinese MNEs (UNCTAD WIR, 2006: 162). Among Chinese MNEs, 51 percent regard strategic asset-seeking as an important motive for their FDI, compared to 85 percent for market-seeking, 39 percent for efficiency-seeking and 40 percent for resource-seeking FDI (UNCTAD WIR, 2006: 168). Strategic asset-seeking often seeks to acquire information and knowledge on how to operate internationally. However, as the experience of Chinese firms in this area grows, their goal has turned toward intangible assets, such as advanced proprietary technology and intangible strategic assets such as brand names (Buckley et al., 2007: 505). Chinese firms increasingly use mergers and acquisitions to acquire strategic assets with a view to building their competitive advantage. The acquisition of foreign technologies and brands is often regarded as a shortcut to establish a company as an international player. Prominent examples include Shanghai Automotive Industry Corporation (SAIC) acquiring MG Rover, Lenovo acquiring IBM's PC division, or the recent acquisition in 2010 of Volvo by Zhejiang Geely Holding Group. However, the success of these investments remains to be seen.

(2) Another situation occurs where government interests are high and company interests low. One might also argue that because the government interests are so high, there are almost no private companies in that industry and only SOE which are under the government control. Most *resource-seeking* investments fall into this category, as do *investments balancing foreign currency reserves*. The Chinese government clearly has an interest in a strong economy and therefore supports MNEs' international investments. China's powerful economic development machine requires a steady supply of natural resources, including ferrous and non-ferrous materials, precious metals, minerals, oil and gas. But the country is comparatively poor in most natural resources except coal. Chinese companies have therefore been very active in *resource-seeking*. FDI in natural resources is mainly driven by availability rather than proximity. The destinations for Chinese OFDI include resource-rich countries in Africa and Central Asia, together with Australia, Russia and Canada (Buckley et al., 2007: 511). According to UNCTAD (UNCTAD WIR, 2009), the Chinese government and Chinese MNEs generally regard natural resources as an important reason to invest abroad. Because securing resources for their growing home economy is a strategic priority, a large proportion of Chinese MNEs engaged in these efforts are state-owned. The top three Chinese outward investors are all companies in the natural resources field. In 2002 alone, CNPC acquired two oilfields in Azerbaijan and, together with Petrochina, the companies Devon Energy Corp. (Indonesia) and Salyan Oil (Azerbaijan). CNOOC acquired Repsol-YPF SA (Indonesia). Chinese companies also acquired fishery, timber and agricultural products. For example, Huaguang Forest Co.Ltd. acquired the Rayonier Inc. timberland operation (New Zealand).

(3) Finally, there exist investments where government interests are low, but company interests high. Most *efficiency-seeking* investment falls into this category. For Chinese companies, however, efficiency-seeking FDI is relatively unimportant because of low costs in their home economy (UNCTAD WIR, 2006: 160). This result confirms studies indicating that, given the low production costs in China, efficiency-seeking does not play a major role for Chinese MNEs going global (Buckley et al., 2007: 501). But efficiency-motivated Chinese FDIs may increase in the future (UNCTAD WIR, 2006: 160).

Government involvement has negative implications along with the positive. Corporations need the freedom to base strategic decisions on market requirements rather than fulfilling institutional instructions and goals. Foreign partners may take a critical view of strong government intervention. Child and Rodriguez (2005) state that successful international Chinese firms are non-SOEs or companies that have made arrangements to protect themselves from bureaucratic interference.

There are also many deals that fail and deserve further investigation. From 2005 through 2009, China saw at least 40 business deals, each worth US$ 100 million or more, fall through. Prominent failed deals include Chinalco, which bid US$ 19.5 billion for a larger stake in Rio Tinto in 2009; CNOOC attempted in 2005 to buy UNOCAL for US$ 18 billion but was sidetracked by US politicians. In 2008 the China Development Bank's bid for Germany's Dresdner Bank was killed by Chinese regulators.

Concluding Remarks

This article briefly presents and discusses the role of the Chinese government in MNE foreign direct investments. We present a 2x2 matrix where one dimension shows the interests (high/low) of the Chinese government and the other dimension the interest of Chinese MNEs (high/low) for their outward foreign direct investments.

For example, where the interest of the Chinese government and Chinese companies are high and aligned, we expect the scale and the speed in which those investments will be conducted and executed to be large and fast. Lenovo, for example, acquired IBM's PC division while Volvo was acquired by Zhejiang Geely Holding Group.

The matrix allows us to classify and distinguish between different FDI motives and it describes the government role. This helps foreign governments as well as senior executives of non-Chinese companies not only to assess the relationship between them and the Chinese company but the relationship between them and the Chinese government, whether local, regional or national.

But, given the way the Chinese government is using OFDI to strategically support the development of the Chinese economy and companies, it remains to be seen whether this is convincing and the kind and level of foreign government resistance.

Already today, China's pervasive government involvement in its private sector causes foreign policymakers to worry about the impact of non-commercial bidders, national security and economic security. Chinese data on OFDI lack full disclosure and transparency, according to some researchers. We therefore encourage IB researchers to further investigate the relationship among the Chinese government, Chinese companies and their individual and cumulative effect on the success of Chinese FDI. Additional questions for study include: What are the short- and long-term implications for the competitiveness of Chinese MNEs? Is such a tight government involvement in Chinese MNEs sustainable in the long run? What is the role of Chinese SMEs for OFDI? What is the relationship among the different levels of Chinese government and how does it impact Chinese MNE OFDI? These are just a few questions we propose for further investigation.

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