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Study on China’s outward FDI

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Abstract

In TNCs have been changing and reshaping the world’s economies. Recently more and more new companies are coming from developing and transitional economies. This case study starts with a description of the history development of China’s outward FDI in the past several years, and presents the current situation of China’s outward FDI. Then, analysis of the problems existing in Chinese outward FDI will be discussed. Finally, some strategies and suggestions on the related problems will be given.

1. Introduction

Mining TNCs have been changing and reshaping the world’s economies. Recently more and more new companies are coming from developing and transitional economies. Also there are some distinctive features for the expansion of firms from developing and transition economies, which are the noteworthy speed of TNCs’ growing, the wide spreading of the process, and the industrial scope of the process.

• Emerging sources of FDI

Today, a range of data shows that there is growing number of firms from developing and transition economies. They play more and more roles in globalizing of the world’s economy. A number of data shows that the investments from developing and transition economies have been increasing dramatically abroad. At the same time, cross-border M&A becomes an important mode for the firms from developing and transition economies enter into other countries. Furthermore, Greenfield projects and expansion of existing projects are forming the developing and transition economies. There has been changing for the composition of FDI geographically over time, which mainly reflects the increasing importance of Asia as a source region. Services are the leading sectors in the developing and transition economies. In 2004, the
outward FDI in services accounted for 81% of the total outward FDI stock of the developing and transition economies. Low-income countries play a more and more important role in the rising of FDI from developing and transition economies. It is suggested by UNCTAD estimates that South-South FDI has overspread fast over in the past decade.

Numbers of parent companies from developing and transition economies indicate that their outward FDI grows fast recently, most of which are relatively small TNCs with a limited geographical reach. However, there is growing number of large TNCs from developing and transition economies. A feature of these companies is some of them are on the lists of the largest companies in the world. In South Africa, TNCs from South Africa have the most outward investment, and Egyptian TNCs have been the major players among the North Africa. In Asia, the sub-region of East and South-east Asia is the main source to most of the top TNCs; For example, Hongkong(China) and Singapore as trade and financial centers are home to some TNCs in service, Taiwan(China) pursues a number of large TNCs in manufacturing, TNCs from South Korea are very competitive in automotives, chemicals, electronics, etc. For TNCs from South Asia, India has been at the dominating position with the increased openness of the economy since the mid-1990s. For TNCs from West Asia, Turkey, which is a non-oil producing country, is the leading source of FDI from West Asia. In Latin America and Caribbean, the leading players are in Brazil and Mexico. In South-East Europe and CIS, the main players are TNCs from the Russian Federation, also there are some companies from Azerbaijan, Croatia, and Romania.

When it comes to the salient features of TNCs from developing and transition economies, there are some key points should be noted: first, countries from which the major TNCs originate are highly concentrated; Moreover, different industries are revealed differently in terms of industrial distribution; Finally, private ownership is the most universal way of TNCs in developing and transition economies.

**Drivers and determinants**

The IDP theory is the basic theory to explain how the outward and inward FDI position of a country is related to a country’s level and structure of economic development. It is suggested by IDP theory that countries tend to go through five stages: First, there is little inward and outward FDI; Second, the inward FDI starts to rise, while the outward FDI remains low; Third, the inward FDI’s growth rate starts to decline, and that of outward FDI to grow fast; Fourth, outward FDI stock should exceed or equal the stock of inward FDI. Fifth, the net investment position of a country tends to fluctuate around zero.

When it comes to TNCs’ competitive advantages, the UNCTAD global survey suggests that the most important advantage for firms is from production process capabilities, networks and relationships, ownership advantages, and effective organizational structure. The advantage of production process is more concentrated by TNCs in primary sector than the tertiary sector. At the industry level, it’s suggested that firms’ advantages are different according to the different sectors. There are a number of ways to classify drivers to internationalization, one of which is in terms of “push”, that means home country drivers. They refer to conditions that affect companies invest in other countries, which include four main types: market and trade conditions, costs of production, local business conditions and home government policies. The other type of drivers is called pull factors, also host country drivers, which is the most important determinant of FDI in particular in host economies. The last type of drivers is push-pull drivers, which is market and policy related drivers. There are some types of motives of FDI for TNCs from developing countries: one is market-seeking, which is the most common type of strategies; Another one is efficiency-seeking, which varies considerably among developing-country TNCs. The third one is resource-seeking, which is rated to be of moderate significance in survey; Last one is created asset-seeking, which is relatively the modest motive for developing-country TNCs in the survey.

**Impacts on home and host developing economies**

When it comes to the implication of outward FDI to host countries, the main beneficial impacts are gained from the access to resources and markets that their foreign affiliates get because of being part of the international production systems. Also, TNCs from developing-countries can bring amount of capital,
which can be supplement of domestic investment. Furthermore, TNCs from developing-countries bring advanced technologies and skills to local firms in host countries. However, there are also some risks that are brought by outward TNCs to host countries, for example, it can result in crowding out of domestic firms if the latter are less competitive or if the foreign affiliates operate in oligopolistic markets with weak regulatory frameworks. There is a limitation of spreading technology and knowledge in host economy because TNCs from developing-country may not establish strong linkages with domestic enterprises. Moreover, there might be short of norms and standards established by TNCs from developing countries.

2. Case study: Study on China’s outward FDI

Since implementation of reforming and opening up policies in China, Chinese GDP has been boosting quite fast, and has achieved remarkable improvement in process of economic development. What drive China’s economic growth so fast? Inward FDI has been considered one of the greatest drivers for China’s increased GDP. In 1993, China’s inward FDI was the second largest recipient among the world, following the US. However, China’s outward FDI also contributed a lot to China’s economic growth in recent years. Moreover, several big acquisitions made China a source country of FDI, for instance, Lenovo’s acquisition of IBM’s PC in December of 2004 could be one of the compelling examples, electronic appliance manufacturer TCL’s acquisition of France’s Thomson Electronics in 2004, white-goods manufacture Haier established its affiliates in US in the late 1990s, and Nanjing Automotive acquisition of UK’s MG Rover Group in 2005, etc. These stories all have made good efforts to boost China’s outward FDI development[1].

2.1. Background of China’s outward FDI

China’s economic system had been controlled by the government since the establishment People’s Republic of China in 1949, and the economic development was quite slow at the beginning of these years. However, Chinese economic growth had been increasing really fast since the Chinese “open door” policies’ carrying out in 1978. At the beginning of 1980s, there were quite few proportions of outward FDI among the total FDI in China. And most of the outward FDI mainly concentrated on transports service, engineering contract, catering service and financial insurance. “Only 77 non-traded projects with a total investment of 50 million $US were approved between the year 1979 and 1983”[2]. Many activities abroad were boosted quite fast by Chinese government in order to promote the local economic development after 1984. And in Hongkong, China became their largest investor in 1987 with a total investment amount of 10 billion USD and over 2000 affiliates there.

When it entered into 1990s, there were the second generation of Chinese TNCs, whose competitiveness was mainly in manufacturing industries, electronics, information and communication technologies, such as Haier, TCL, Lenovo, Huawei and ZTE, etc. China became one of the largest outward FDI countries in 1995. Chinese FDI outflow was around 6 billions USD, which achieved its second peak in 2001. In 2005, there was an overall decline of outward FDI from most of the other developing and transition economies, but the outward FDI from China increased dramatically because of an 83% increase in the value of cross-border M&As.

2.2. Analysis of current situation and problems existing of Chinese outward FDI

- Analysis of current situation of Chinese outward FDI

As it is shown in Fig.1& Fig.2, there had been a huge growth of Chinese outward FDI stock since 2000s, which increased from amount of 29.9 billion USD in 2002 to 183.9 billion USD in 2008. At the
same time, the outflow of Chinese outward FDI had experienced an increase trend totally except in the year of 2007 because of the financial crisis, but it was boosting again from the middle of 2007[3].

When it comes to the characteristics of Chinese outward FDI in recent years, there are some key points should be followed: first, the outflow of Chinese outward FDI broke through 50 billion USD for the first time in 2008, scale of which was twice times as that of the previous year; Second, capital from M&A accounts for almost half of the total outward FDI capital; Third, activities in outward FDI in finance increased more than that in other industries, and the outward FDI outflow in business services, finance, retailing, mining and transportation accounts for 90% of the total outward FDI outflow. Fourth, from the view of destinations of Chinese outward FDI, I found Asia has the largest Chinese outward FDI, and the second largest recipients of Chinese outward FDI are some countries in Latin America, then following with Africa, Oceania, Europe, and North America, which can be seen in the Fig.3.

In 2008, the amount of Chinese outward FDI in Asian countries was 43.6 billion USD, mainly focused in Hongkong(China), Singapore, Macao, Kazakhstan, etc. The total outward FDI in Latin America was 5.5 billion USD, which increased to 249% than that of the last year. For the African and Oceania, the
amount of outward FDI was 3.7 billion USD and 1.9 billion USD separately, and which in Europe and North America was 0.9 billion USD and 0.4 billion USD respectively. The top twenty recipients of China’s outward FDI stock since the end of 2008 can be shown in the Table 4. Fifth, Chinese local outward FDI increased steadily, the top three of which are from Guangdong, Jiangsu and Shandong provinces respectively. In 2008, the amount of local outward FDI in non-finance was 5.9 billion USD, the fast growth rate of which occurred in the middle of China, then following by the west of China. Finally, the outward FDI outflow for firms controlled by central government accounts for 85.4% among the total outward FDI in non-finance industries, and which from private firms is only 0.3%[3].

Table 4 Top twenty destination countries of China’s outward FDI stock since the end of 2008.

<table>
<thead>
<tr>
<th>number</th>
<th>Countries/Areas</th>
<th>FDI stock (US$)</th>
<th>number</th>
<th>Countries/Areas</th>
<th>FDI stock (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>China Hongkong</td>
<td>1158.45</td>
<td>11</td>
<td>Pakistan</td>
<td>13.28</td>
</tr>
<tr>
<td>2</td>
<td>Cayman Islands</td>
<td>203.27</td>
<td>12</td>
<td>Canada</td>
<td>12.68</td>
</tr>
<tr>
<td>3</td>
<td>British Virgin Islands</td>
<td>104.77</td>
<td>13</td>
<td>Mongolia</td>
<td>8.96</td>
</tr>
<tr>
<td>4</td>
<td>Australia</td>
<td>33.55</td>
<td>14</td>
<td>South Korea</td>
<td>8.5</td>
</tr>
<tr>
<td>5</td>
<td>Singapore</td>
<td>33.55</td>
<td>15</td>
<td>Germany</td>
<td>8.45</td>
</tr>
<tr>
<td>6</td>
<td>South Africa</td>
<td>30.48</td>
<td>16</td>
<td>The United Kingdom</td>
<td>8.38</td>
</tr>
<tr>
<td>7</td>
<td>The United States</td>
<td>23.9</td>
<td>17</td>
<td>Nigeria</td>
<td>7.96</td>
</tr>
<tr>
<td>8</td>
<td>Russian Federation</td>
<td>18.38</td>
<td>18</td>
<td>Zambia</td>
<td>6.51</td>
</tr>
<tr>
<td>9</td>
<td>China Macao</td>
<td>15.61</td>
<td>19</td>
<td>Saudi Arabia</td>
<td>6.21</td>
</tr>
<tr>
<td>10</td>
<td>Kazakhstan</td>
<td>14.02</td>
<td>20</td>
<td>Indonesia</td>
<td>5.43</td>
</tr>
</tbody>
</table>

Source: Ministry of Commerce of China, 2010

- **Problems in Chinese outward investment**

  there are some problems existing in Chinese outward FDI which are embodied in the following points [4]:

  First, there are relatively few total investments, small scale of firms and slow intensification level in Chinese outward FDI. On one hand, the scopes of the main investors are on the small side, most of which are primary middle-sized and small-sized enterprises; On the other hand, the amount of investment capital is too small. Presently, Chinese TNCs are basically independent with each other, and they don’t have many networks of capital or technology connection. Thus, the increase in scale of Chinese TNCs abroad totally is not at the same pace with the increase of TNCs’ number. Chinese TNCs could hardly ever gain advantages of scale because of the small size of firms. It’s difficult for them to take advanced technology, equipments and have quality ultimate services to gain more economic benefits. Thus, it’ll lead to a vicious circle, which will restrict Chinese TNCs competitiveness[5].

  Second, the investment structures are not reasonable. One is the unreasonable regional structure in Chinese outward FDI. Although Chinese outward investment spreads in more than 160 countries or areas and most of them are quite concentrated in a few countries or areas, which results to be competitive with themselves in some areas, where there are lots of intensive investments; At the same time, there are relatively few investments in some developing countries. The other one is the unreasonable industrial structures, which are embodied in the over investment in manufacture industry, construction, etc, but there are insufficient investments in high technology industry, such as IT and biology, etc[6].

  Third, Chinese firms don’t have sufficient competitive cored technologies, which is a key factor to decide whether a firm can succeed in competing with other rivals in markets. However, currently most of Chinese firms are at the stage of importing advanced technology from other countries. They still couldn’t act as a counterweight to their rivals especially in some crucial technologies. As a whole, Chinese firms don’t have advantages in technology and couldn’t match the markets’ requirements in some industries [7].
2.3. Strategies and suggestions promoting Chinese outward FDI

For one thing, efforts should be made in expanding the scales of Chinese firms in outward investment. One of ways to achieve this goal is to raise production enterprises with scale of economies by controlling the enterprises’ property rights, such as collaboration, joint-stock, joint adventure, etc. Another way is to collaborate with big TNCs from other countries, by which huge capitals and advanced technology might be used to speed up Chinese firms’ development in order to increase their investments abroad. At the same time, collaborations between firms within China should be encouraged, which can resolve problems of average small scales of Chinese firms. Thus, competitiveness might be gained by Chinese firms as well as successful rate of outward investments might be increased[6].

For another, regional investment distribution and industrial investment structures should be chosen reasonably. Currently Chinese TNCs should take a strategy of making sure that the main investment areas are in Asian-Pacific regions, keep investing in European and American markets, and exploit Eastern European, Latin American and African markets. Regarding to the industries chosen, some points should be focused: one is that investment in high technology industry for learning enterprises should be enhanced in order to learn more knowledge from developed countries. Another point is investments in developing countries should be mainly concentrated on manufacturing industry, by which they can provide competitive products with good quality and low price in markets there. Last, Chinese firms should exploit and develop more investments in real estate and finance, which can be helpful for improvement of Chinese domestic markets[8].

Moreover, Chinese TNCs should enhance their internal management and cultivate more people with high skills in international management and special skills. Currently the total level of management of Chinese firms abroad is still quite low, which should be enhanced as soon as possible in order to survival and development in foreign markets. They can improve this through exploiting and cultivating talent people in international management as well as providing training to the employees to make sure they can fit the requirements of internationalization (Haibin. M, 2009).

Finally, government policies in outward FDI are key factors for promoting Chinese outward FDI, which include law-making in investment abroad, total strategy-making (such as how to choose target markets, target industries, etc.)[9], necessary services providing like foreign related agencies, establishment of risk-pooling systems, and introduction more flexible financial policies and so on [10].

3. Conclusion

As the occurring of global financial economic crisis in 2007, the global economies entered into a knee point, which provides an opportunity of adjustment of investment structures and investment capital as well as an opportunity of global capital re-distribution for Chinese TNCs [8]. However, the precondition is to resolve all the basic problems of Chinese investment abroad, therefore, Chinese outward FDI will provide a better service for Chinese economic development. The aim of this paper is just to learn how is the current situation of Chinese outward FDI, and what types of problems that might affect Chinese outward FDI in the process of Chinese TNCs’ internationalization do they face and how to deal with them? Thus, some related suggestions are given at the end of this paper, hopefully to provide a reference for Chinese government and Chinese TNCs when they make their policies.

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