7 Chinese Manufacturing Firms' Overseas Direct Investment:

Patterns, motivations and challenges

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Introduction

The widespread perception of industrialised countries as homes of multinational corporations (MNCs) and emerging markets as hosts of MNCs has been firmly rooted. These were, however, MNCs in the past, which were nowhere near as active or visible as they are today. In recent years, China and India, major Latin American economies such as Brazil and Mexico, and South Africa have all spawned their own MNCs (Dunning et al. 2007).

The well-established explanation for the emergence of MNCs from developing and transitional economies is the investment development path—a concept first proposed by Dunning (1981a). This put forward the idea that the rise of a country's income per capita would initially draw in increasing amounts of foreign direct investment (FDI), and subsequently lead to outward direct investment (ODI).

While it is well known that FDI has been one of the important factors contributing to the Chinese economic miracle, it is perhaps less well known that China is now an important player in the global scene of ODI as well. From 2003 to 2009, Chinese ODI flows grew at 55 per cent annually on average. This growth exceeded that of FDI into China during the same period, although the stock of Chinese ODI is still limited.

Studies of Chinese ODI are relatively new, but growing rapidly in number. Most studies have been descriptive in nature, reviewing historical trends, changing composition and the evolution of government policies (see, for instance, Deng 2003, 2004; Wu and Chen 2001). Some have focused on in-depth case studies, especially of high-profile ODI cases (such as Liu and Li 2002). A number of recent studies examined empirically the determinants of Chinese ODI (Buckley et al. 2007). All these analyses provided valuable insights into understanding the pattern and characteristics of Chinese outward investment.

Systematic research on the role of China as an outward direct investor remains, however, insufficient and incomplete. For instance, we do not have an accurate measure of the distribution of Chinese ODI in manufacturing by different types of firms, across either countries or industries. We also do not know much about the performance of Chinese ODI firms. This is largely because of the unavailability of comprehensive disaggregated data. The only official data comprehensively reporting Chinese ODI are published annually by China's Ministry of Commerce, which reports only aggregate data.

To partially fill this vacancy, we collect approved ODI projects reported on the National Development and Reform Commission (NDRC) web site with disclosed investment amounts from 2003 to 2009. The collected number of Chinese ODI projects is 226, in which 104 are made by manufacturing firms. Among these 104 projects, we exclude 30 projects, which invest in mining, quarrying and petroleum, and use the remaining 74 projects as the sample in this chapter.¹

Based on these data, the questions this chapter explores are: what is the pattern of Chinese manufacturing firms' ODI? Do Chinese manufacturing firms possess competitive advantages like those from industrialised economies when they began to internationalise, and, if not, what are the advantages of Chinese manufacturing firms? What is their purpose of investing abroad and how do they realise that? And what are the challenges they face?

In this chapter, we find that Chinese ODI in manufacturing is quite different from that in other sectors. The main investors are private firms rather than state-owned enterprises (SOEs). And the majority of investments in manufacturing have gone to industrialised economies. We also find that Chinese manufacturing firms' ODI is dominantly motivated by seeking technology and other strategic assets—mainly brand names. To achieve this goal, setting up overseas research and development (R&D) centres and joint ventures with incumbent firms, clustering and going abroad, and mergers and acquisitions (M&As) of overseas firms have become the most widely used methods for Chinese firms to invest overseas.

We argue that unlike yesterday's MNCs from industrialised countries, Chinese MNCs rarely have firm-specific ownership advantages—notably, core technology, organisational and management skills, and brand names. What they do have is a variety of home-country specific advantages, such as financial support from the Government and comparative advantage in certain labour-intensive industries. Compared with ODI by industrialised countries half a century or more ago, Chinese firms today face totally different circumstances—characterised by globalisation in general and China's integration into the world in particular.

We also argue that the success of Chinese manufacturing firms' ODI rests with their capacity to consolidate and to operate the acquired strategic assets, and with their ability to set up win-win relationships with not only target firms but also the local community in the host country.

Scale, investor and destination

Before 2004, the size of Chinese ODI was rather trivial. Since then, it has grown significantly, alongside dramatic expansion of China's current account surplus and the appreciation of the renminbi (RMB). Total ODI flow increased from US\$2.9 billion in 2003 to US\$56.5 billion in 2009, registering an average growth rate of 55 per cent (Figure 7.1). As a result, its global share rose from 0.5 per cent to 5.1 per cent during the same period. In 2009, China was not only the largest developing-country investor but also the fifth-largest investor in the world, following the United States, France, Japan and Germany.

Figure 7.1 Chinese ODI flows (ODIF), 1982–2009

Notes: In ODIF1, data from 2002 to 2005 are non-financial ODI, while data from 2006 to 2009 are all the ODI. In ODIF2, data from 2002 to 2009 are all non-financial ODI from China.

Sources: Data from 1982 to 2001 are from UNCTAD (2005); data from 2002 to 2009 are from MofCOM (various years).

Chinese ODI in manufacturing has, however, not increased that much during this time. After a sharp increase in 2005, which was probably a result of Lenovo's acquisition of IBM's personal computer (PC) business, Chinese ODI flow in manufacturing returned to about US\$1 billion in 2006. There was a further jump in investment in 2007, reaching US\$2.1265 billion. Then, under the influence of the global financial crisis, Chinese ODI in manufacturing contracted about 17 per cent in 2008, but quickly rebounded to a new high in 2009.

Figure 7.2 Chinese ODI flow in manufacturing, amount and share (of total non-financial ODI), 2003–09

Source: MofCOM (various years).

As a result of its relatively slow growth, the share of manufacturing in Chinese total ODI decreased from 21 per cent in 2003 to 5 per cent in 2008 and 2009 (Figure 7.2). This compares with 24 per cent for industrialised countries and 15 per cent for developing economies (Table 7.1). Accordingly, China has more investment in the primary sector, mainly in mining, quarrying and petroleum, and the service sector.

The decreasing share of Chinese ODI in manufacturing is partly because of the large scale of Chinese ODI in resources such as oil and iron ore. Also, although the administrative procedure of examination and approval on ODI has been streamlined, it is still a slow process. To invest abroad, Chinese firms must first get approval from the National Development and Reform Commission (NDRC), the Ministry of Commerce (MofCOM), China Customs and the State Administration of Foreign Exchange at various levels. This process is clearly deleterious for facilitating Chinese manufacturing firms investing abroad, and might result in many missed opportunities. One side effect is that an estimated 50 per cent of private firms in Zhejiang Province bypass the official approval procedure when investing abroad (Huang 2010).

Table 7.1 Industry distribution of ODI flows, 2006–08 (per cent)

Sector/industry	Industrial country	Developing economy	World	China
Primary	7.8	8.4	8.0	18.7
Agriculture, hunting, forestry and fishing	0.0	0.3	0.1	0.6
Mining, quarrying and petroleum	7.8	8.1	7.9	18.1
Manufacturing	24.1	15.0	23.2	4.7
Services	60.0	69.3	60.9	76.6

Source: Huang and Wang (2011).

The only official data comprehensively reporting Chinese ODI are published annually by China's Ministry of Commerce, but they report only aggregate data.² To get more detailed information, we collect approved ODI projects reported on the NDRC web site with disclosed investment amounts from 2003 to 2009. We focus below on the 74 overseas investments made by Chinese manufacturing firms.

The pattern of Chinese ODI in manufacturing has some special characteristics in comparison with that of other sectors. First, the main investors in manufacturing are private firms rather than SOEs, with 62 per cent of the total number and 64 per cent of the total amount of investment made by private firms (Table 7.2). In contrast, the main investors in Chinese ODI as a whole are SOEs, which accounted for 72 per cent of total Chinese ODI on average between 2006 and 2009. Second, the majority of investments in manufacturing go to industrialised economies rather than to developing economies. For private firms, industrialised economies were the destination of 65 per cent of projects and 81 per cent of the total amount of investments. For SOEs, these shares were even greater, reaching 87 per cent and 95 per cent, respectively (Table 7.2). In contrast, from 2003 to 2009, the average Chinese ODI in industrialised economies accounted for only 40 per cent of China's total ODI.

Table 7.2 Selected destinations of Chinese manufacturing ODI, 2003–09

Private firms			SOEs		
Economies	Number	Amount (US\$100 m)	Economies	Number	Amount (US\$100 m)
United States	6	19.310	South Korea	2	5.999
South Korea	2	3.828	France	2	4.086
Hong Kong	6	3.734	Italy	1	2.500
Laos	1	1.972	Australia	1	1.776
Vietnam	5	1.770	Austria	1	1.389
Bermuda	1	1.350	United States	5	1.195
Germany	10	1.251	Germany	7	0.953
Japan	2	1.096	United Kingdom	1	0.870
India	1	0.600	Netherlands	1	0.478
Singapore	1	0.550	Laos	2	0.390
Russia	2	0.489	Egypt	1	0.350
Canada	1	0.350	Czech Republic	1	0.300
Cambodia	2	0.338	Luxembourg	1	0.293
Mexico	1	0.276	India	1	0.291
Australia	1	0.098	Japan	1	0.046
Italy	1	0.068			
Ethiopia	1	0.050			
Nigeria	1	0.020			
Mali	1	0.015			
Total	46	37.164	Total	28	20.9
Share of all (%)	62.2	64.0	Share of all	37.8	36.0
Developing	16	6.880	Developing	4	1.031
Share of private (%)	34.8	18.5	Share of SOEs	14.3	4.9
Developed	30	30.284	Developed	24	19.884
Share of private (%)	65.2	81.4	Share of SOEs	85.7	95.1

Source: Authors' calculations based on data collected from NDRC web site.

Multinationals without advantages

Existing theory asserts that ODI firms have to possess some kind of unique and sustainable competitive advantage in exploring foreign markets (ownership-specific advantages).

- Those relating to the possession and exploitation of monopoly power that stem from, or create, some kind of barrier to entry to final product markets by firms not possessing them (Bain 1956; Hymer 1976).

- Those relating to the possession of a bundle of scarce, unique and sustainable resources and capabilities, which essentially reflect the superior technical efficiency of a particular firm relative to those of its competitors (Dunning 1958; Safarian 1966)—for example, patents, a recognised brand or production process capabilities.
- Those relating to the competencies of the managers of firms to identify, evaluate and harness resources and capabilities from throughout the world and to coordinate these with the existing resources and capabilities under their jurisdiction in a way that best advances the long-term interests of the firm. These advantages are especially stressed by organisational scholars such as Bartlett and Ghoshal (1989) and Prahalad and Doz (1987).

In addition to these ownership advantages (O), Dunning (1981b, 2001) proposes the eclectic paradigm and incorporates another two advantages—location and internalisation—that qualify a firm to go abroad. Location-specific advantages (L) refer to the benefits of locating in a particular foreign country that are conducive to a firm creating or utilising ownership advantages. Internalisation-specific advantages (I) arise from a firm's managerial, organisational and institutional capabilities to efficiently exploit its ownership-specific assets.

Chinese firms, however, do not appear to possess these firm-specific advantages. Their competitive capability after three decades of reform is still painfully weak in relation to the global giants. They are weak in technology, management capability and brand name. For SOEs, they are still under the administrative constraints of government agencies. For some non-state enterprises, while they have shown some degree of entrepreneurship, they still do not compete globally (Nolan 2001).

China's advantage in manufacturing has been focusing on non-technologically famous products, such as steel, coal, cement, televisions, washing machines, refrigerators, airconditioners, microwaves and motorbikes. But even for these products, Chinese firms contribute mainly assembling and manufacturing, as they do not possess the core technologies. On the contrary, they rely heavily on importing core components and technology. For example, Galanz is now the world's largest microwave manufacturer, but it still depends on importing the key component, 'permatron'; and while China has now become the world's largest airconditioner manufacturer, cabinet-type airconditioners still rely on a scroll compressor made by US companies and convertible frequency airconditioners still rely on Japanese technology.

As a result, China's foreign technology dependency ratio is more than 50 per cent, while that of industrialised economies is no more than 30 per cent, and that of the United States and Japan is roughly 5 per cent (Lu and Zhang 2007). More than half of the 'Made in China' products rely on foreign technology—mainly from the United States, Japan and Germany (Li 2007). This situation means that China's manufacturers enjoy only a fairly small profit margin, with most of the profits accruing to foreign MNEs for their provision of technology, design and other services. It further results in the passive role of, and ability for, Chinese firms to engage in core technology and R&D.

China also lacks world-famous brands. As seen in Table 7.3, according to the '100 World Best Brands in 2009', eight of the top 10 were US companies, and not one brand out of the 100 belongs to a Chinese company. Looking at the top-10 Chinese brands, with the exception of Haier, the other nine brands are owned by the Chinese Central Government, concentrating on monopolised and highly controlled industries such as finance, energy, telecommunications, petrochemicals and space. The only private firm is the household electrical appliances producer Haier. Its brand value is, however, relatively low, amounting to US\$9.4 billion.

Table 7.3 The world's and China's top-10 brands, 2009

2009 world's best brand				2009 Chinese best brand		
Rank	Name	Value (US\$ billion)	Country	Rank	Name	Value (US\$ billion)
1	Coca-Cola	68.7	US	1	ICBC	18.3
2	IBM	60.2	US	2	State Grid	17.5
3	Microsoft	56.6	US	3	CCTV	15.9
4	General Electric	47.8	US	4	China Mobile	15.6
5	Nokia	34.9	Finland	5	China Life Insurance	12.1
6	McDonald's	32.3	US	6	China Aero Space	10.5
7	Google	32.0	US	7	Sinochem	10.1
8	Toyota	31.3	Japan	8	China Railway	10.1
9	Intel	30.6	US	9	Haier	9.4
10	Disney	28.4	US	10	BOC	9.3

Sources: The world's best brand is reported by Interbrand Consulting Group; China's best brand is reported by the World Brand Lab.

Nevertheless, this does not mean that Chinese firms investing abroad do not have any advantages. In fact, Dunning (2000) accepts that the competitive advantages of MNCs from developing countries are probably different to those considered by the prevailing theory. The *World Investment Report* (UN 2006) summarises three segments of the competitiveness of the MNCs from developing countries.

- The first types are expertise and technology-based ownership advantages in a number of industries, including consumer electrical and electronic products, food and beverages, heavy industries and transportation equipment.
- The second types are advantages gained from access to home-country resources and activities where the government could exert great influence. Some of these advantages derive from early application of new technologies (a latecomer advantage). Others come from the availability of cheap funds, which are ultimately the result of high saving rates, trade surpluses, or high commodity prices.
- And the third type is achieved through specialisation in part of the production value chain. This is often seen in industries such as electronics, automobile components, and garments.

For China, compared with the primary and service sectors, the manufacturing sector has a revealed comparative advantage in terms of performance in export markets and development in the domestic economy (Huang and Wang 2011).

On the one hand, with 60 years of development, China has established a mature manufacturing system. It has standard, if not necessarily up-to-date, technology in certain industries such as mechanical manufacturing, metal smelting, household appliances, and textiles (Li 2007). The mature technology in these industries is well matched to the requirements of China and other less developed economies.

On the other hand, Chinese ODI firms enjoy strong support domestically. China itself is a huge market, which means that firms losing profits in overseas markets can be compensated by selling their goods in the domestic market. For instance, Chinese consumer electronics producer TCL has been losing profits in overseas markets, but it survives with the profits from selling in the domestic market. The Chinese Government has attached a high strategic role to China's 'going global' strategy. To facilitate Chinese ODI, government policy centres on five areas: creating incentives for ODI; streamlining administrative procedures, including greater transparency of rules and decentralisation of authority to local governments; easing capital controls; providing information and guidance on investment opportunities; and reducing investment risks (Buckley et al. 2008; Lu et al. 2010; Luo et al. 2010).

Chinese private firms have their own particular advantages. They are small with simple management structures and good adaptability and entrepreneurship. They concentrate in highly competitive, labour-intensive industries and they tend to have higher productivity than their SOE counterparts (Dougherty et al. 2007). They are also more easily accepted compared with SOEs by host countries, particularly when investing in strategic resources and high-technology sectors.

Chinese manufacturing firms' industry-specific and home-country-specific advantages do, however, make up for their lack of firm-specific or ownership-specific advantages. On the contrary, the former advantages could well be a double-edge sword.

In particular, such government involvement can be a hazard as well as a boon for at least three reasons. First, firms sometimes have to make a balance between the funding support from the Government and the possible loss of freedom (Child and Rodrigues 2005). Second, government involvement might be resisted by the host countries' authorities, who might be concerned by the political motives of Chinese investors. And third, strong government financial and policy support might induce domestic firms to rush into ODI, with their investment decisions being based on the available cheap state bank credit and state subsidies, rather than on their own technology and managerial capabilities and the investment opportunity itself (Lu et al. 2010).

Motivation and entry strategy

Should Chinese firms conduct ODI after accumulating enough firm-specific or ownership-specific advantages? The answer is: not necessarily. The existing FDI theory is based on the experience of MNCs from industrialised countries. Dunning's OLI framework, however,

does not explain how MNC latecomers from developing countries achieve initial competitive advantages, and how MNE latecomers catch up with MNE early movers over time (Li 2003; Li 2007; Matthews 2002, 2006; Yeung 1994).

With the rise of Japan and Asia's four 'Little Dragons' (Taiwan, South Korea, Hong Kong and Singapore), it is found that multinational firms from these areas did not begin with core competitiveness. Instead, they began from a resource-meagre position seeking connections with the technological and business mainstream (Matthews 2002). Moreover, compared with ODI by industrialised countries half a century or more ago, Chinese firms are now facing totally different circumstances.

Economic globalisation, for one thing, means the progressive removal of barriers to cross-border flows of goods, services, capital and labour, which reduces the cost of operating overseas. This, combined with the Chinese Government's encouragement by providing cheap funds and fiscal subsidies, and the host country's attractiveness by offering preferential policies, leads Chinese firms to conduct ODI well before they have accumulated enough firm-specific or ownership-specific advantages to become well-established players in their own industries.

Globalisation also means the integration of national economies into a single global economy. This results in intense competitive pressures at home, with firms no longer able to shelter behind protectionist barriers (Bartlett and Ghoshal 2000). This is especially the case for Chinese private manufacturing firms, which face severe competition from foreign-invested firms and do not enjoy the many government-provided benefits of SOEs (Buckley et al. 2002; Child and Rodrigues 2005). This gives private firms—especially in highly competitive industries—a strong motivation for going abroad to strategically acquire those assets such as R&D facilities, technologies, brands, distribution networks and managerial competencies. This type of ODI is identified as 'asset augmentation', in contrast with the more traditional 'asset exploitation'.

In addition to seeking technology, brands and distribution networks, Chinese manufacturing ODI firms also have numerous other motivations.

- 'Institutional escapism' (Witt and Lewin 2007): Many Chinese firms go abroad to avoid competitive disadvantages incurred by operating exclusively in the domestic market (Boisot 2004). Such disadvantages include regional protectionism, limited access to capital, lack of developed intellectual property rights and under-provision of training and education (see, for example, Zhang 2005).
- Market seeking: The Chinese domestic market has become saturated for a large portion of manufactured products, such as mechanical and electrical products, and household appliances. It is estimated that the overcapacity of the Chinese manufacturing sector has reached 40 per cent (Li 2007). Those manufactured products are, however, still demanded in other countries, and this needs to be satisfied through exports. Despite the progress in liberalising trade, non-trade barriers and trade protectionism still exist, especially after the global financial crisis, and are often targeted at China (Peng et al. 2008). To bypass these trade barriers, firms with more export experience are likely to engage in ODI (Buckley et al. 2008).

- **Efficiency seeking:** China's continuous high-speed growth has been attributed to its cheap labour. In recent years, however, labour costs in China have been increasing, along with rising industrial land-usage fees. There are also much stricter requirements for environmental protection. All these factors increase Chinese manufacturing firms' production costs at home and force them to seek cheaper locations for production. For example, China is now the largest foreign investor in Vietnam.
- **Natural resource seeking:** With limited domestic resources and rising world prices, Chinese manufacturing firms have the motivation to exploit host countries' endowments such as oil, gas, and timber.

To see what kinds of motivations dominate Chinese manufacturing firms' ODI, we classify the 74 projects collected from the NDRC web site based on the definitions by Buckley et al. (2006) and Dunning (1993), and shown across the columns in Table 7.4.

As seen in Table 7.4, technology seeking is the dominant motivation for Chinese manufacturing firms' ODI. This is true for both private firms and SOEs. Market seeking is the second important motivation of Chinese manufacturing firms—accounting for 28 per cent of projects and 15 per cent of the total.

Comparatively, seeking natural resources is a less significant motive. Only 6.5 per cent of private firms and 3.4 per cent of SOEs conduct ODI for this reason. This finding does not contradict the eye-catching Chinese firms buying oil, iron ore and other resources around the world. As already mentioned, the 74 projects collected exclude those investing in mining, quarrying and petroleum, which are usually made by large enterprise groups rather than pure manufacturing firms.

Seeking efficiency is the least consideration for investing abroad, especially for SOEs. Only 4.21 per cent of investment overall and 1.2 per cent of investment by SOEs is for efficiency seeking (Table 7.4). This phenomenon is perhaps because there is a huge hinterland in China. Facing rising production costs in coastal areas, Chinese firms could choose to reallocate their production to the central and western regions.

Table 7.4 Motivations of Chinese manufacturing firms' ODI^a

		Market seeking	Natural resource seeking	Technology seeking	Other strategic asset seeking ^b	Efficiency seeking
Private firms	Number	10	3	14	9	10
	Per cent	21.7	6.5	30.4	19.6	21.7
	Amount	3.09	2.938	6.217	22.722	2.193
	Per cent	8.3	7.9	16.7	61.1	5.9
SOEs	Number	11	1	13	2	1
	Per cent	39.3	3.6	46.4	7.14%	3.5
	Amount	5.72	1.776	10.425	2.743	0.25
	Per cent	27.35	8.49	49.85	13.12	1.20
Total	Number	21	4	27	11	11
	Per cent	28.38	5.41	36.49	14.86	14.86
	Amount	8.815	4.714	16.642	25.465	2.443
	Per cent	15.18	8.12	28.65	43.85	4.21

^a The motivation of institutional escapism is hard to identify without an in-depth case study, so we do not include this in the calculations.

^b 'Other strategic asset seeking' refers to extending and augmenting the current stock of firm-specific advantages rather than being used to exploit new markets directly. Such FDI is normally aimed towards the acquisition of brands and improved access to distribution channels and tacit assets.

Source: Authors' calculations based on data collected from the NDRC web site.

For Chinese manufacturing firms, there are generally four strategies for seeking technologies and brand names.

The first strategy is to set up overseas R&D centres. Establishing R&D subsidiaries, especially in industrialised countries, is not only conducive to accessing foreign technological assets, but also captures the externalities created by host-country technology clusters and centres of innovation (UNCTAD 2005). Huawei Technologies of Shenzhen has established 17 research institutes in countries including the United States, Germany, Sweden, Russia and India since 1999. It has also established more than 20 innovation centres with world-leading operators such as Intel, Texas Instruments, Freescale Semiconductor, Qualcomm, Infineon, Microsoft, IBM and HP. Assisted by these ventures, Huawei ranked second after Ericsson in terms of market share in the global tetherless access market in 2009. Galanz, China's leading manufacturer of microwaves, airconditioning and small home appliances, has invested more than \$20 million in an R&D centre in Seattle in order to improve its own proprietary technological capability (Deng 2007). Haier Group, the leading Chinese home appliance manufacturer, has also set up design and R&D centres in Los Angeles and Boston to develop, acquire and transfer technology to help the head office develop home appliances that meet the needs and wants of local consumers (Deng 2007).

The second strategy is setting up joint ventures with incumbent firms, mainly located in advanced economies. This strategy is exemplified by TCL, China's largest television firm. In November 2003, TCL and Thomson SA of France announced the creation of a joint

venture known as TCL-Thomson Electronics (TTE) to produce televisions and DVD players worldwide. TCL took a 67 per cent stake in the joint venture, with Thomson SA holding the rest of the shares, and it was agreed that televisions made by TCL-Thomson would be marketed under the TCL brand in Asia and the Thomson and RCA brands in Europe and North America. The joint venture, TTE, enables TCL to take advantage of Thomson's longstanding foothold in North America and Europe, and core proprietary technology such as RCA, owner of the well-recognised Nipper trademark. The joint venture, TTE, also enables TCL to have access to Thomson's world-class R&D capabilities in Singapore, Mexico and Villingen/Angers in Europe. In April 2004, TCL announced the creation of another joint-venture firm. It injected €55 million in setting up a mobile phone joint venture with French mobile company Alcatel for a 55 per cent shareholding. Through this transaction, TCL gained access to the European cellular phone market and secured the technological basis for TCL's differentiation advantage (Deng 2007).

The potential risk for this strategy is that the Chinese firm might be subject to the dominance of its foreign partner in terms of technology and identity, and it might incur the opposition of the foreign partner if it launches its own brand and turns into a competitor (Child and Rodrigues 2005).

The third strategy involves M&As of overseas firms. This strategy has become one of the most widely used methods for Chinese firms, largely because it provides rapid access to proprietary technology, brand names and quicker establishment of R&D capabilities. This strategy also could pre-empt similar moves by competitors.

The most well-known example is Lenovo's US\$1.75 billion purchase of IBM's PC business in 2005. After the acquisition, Lenovo became the third-largest PC producer in the world. From the transaction, Lenovo also acquired the 'Think' family of products, which was frequently ranked as a premium brand leader and best-in-class in the global PC industry. Moreover, Lenovo has been able to take advantage of IBM's advanced worldwide distribution and sales network, and PC research centres in Raleigh, North Carolina. Meanwhile, Lenovo was recognised as the preferred supplier of PCs to IBM and allowed to use the IBM brand for five years.

Lenovo's transaction was just a prelude to Chinese manufacturing firms' overseas M&As. Between 2005 and 2009, according to incomplete statistics, there were 15 transactions, with a total amount of US\$904.7 million (Table 7.5). Almost all target firms of these M&As are located in industrialised countries, especially Germany and the United States. Industries such as machine tools, household electrical appliances, automobiles and parts, textiles and concrete machinery are of particularly great interest to Chinese manufacturing firms for overseas M&As (Table 7.5).

Table 7.5 Major Chinese manufacturing firms' overseas M&As, 2005–09

Investing firm	Investment (US\$ m)	Target	Host country	Year
Shanghai Electric Industrial Company	1.2	Wohlenberg, leading company in producing CNC heavy turning machines and CNC machine tools	Germany	2005
TCL	10.0	Go Vedio Company's 20 trademarks and 24 patents	US	2005
Nanjing Automobile Group	87.0	MG Rover Group	UK	2005
Shanghai Baolong Industries	4.0	Dill, one of the world's first tyre-valve manufacturers	US	2005
Danyang Dare Technology Group	7.0	VCampus Corporation	US	2005
Zhejiang Hongsheng Group	5.0	GROSS Textile Machinery	Germany	2006
Suntech Power Holdings	107.0	PV Manufacturer MSK	Japan	2006
Hangzhou Machine Tool Group	7.5	ABA Z&B Grinding Machine Co. Ltd	Germany	2006
Dalian Machine Tool Group	13.8	German Zimmermann Company, world-leading manufacturer of five-axis gantry milling	Germany	2006
Sichuan Century Shuanghong Display Devices Co. Ltd	99.9	ORION PDP Co. Ltd	Korea	2006
Harbin Measuring & Cutting Tools	13.0	KELCH, high-end CNC tool and cutter producer	Germany	2007
Goldwind Science & Technology	60.4	Vensys Energy AG	Germany	2008
Changsha Zhonglian Heavy Industry Technology Development Co. Ltd	250.0	Forme Acciaico SpA, concrete machinery manufacturer	Italy	2008
Xi'an Aircraft Industry Group	138.9	FACC, Boeing aircraft parts company	Austria	2009
Beijing Jingxi Heavy Industries	100.0	Delphi, auto parts supplier	US	2009

Source: Authors' calculations based on data collected from the NDRC web site.

The fourth strategy is 'clustered going abroad'. This strategy is gaining importance among Chinese private small and medium enterprises (SMEs). Chinese private SMEs are characterised as small scale with widespread distribution and flexible operations. When going abroad, they usually make full use of the network of overseas Chinese migrants. This helps them to be better informed of the local opportunities and challenges and to overcome the disadvantages of foreignness. The Chinese Government has played a critical role in helping these small firms to cluster their investments abroad by setting up overseas industrial and scientific and technological parks.

Most of these facilities are located in developing countries as a way of shifting Chinese labour-intensive industries and/or industries with overcapacity abroad. Some are located in industrialised economies to take advantage of local technological spill-over effects and the knowledge of host-country producers and consumers.

As an example, Tianjin Business Industrial Park was set up in 2004 in South Greenville, Carolina, in the United States. This industrial park covers 30 million sq m, with a total investment of US\$10 million, and has assisted Chinese SMEs in seeking investment opportunities and setting up marketing and sales networks across the United States. Two years later, the Tongling Technology Group invested US\$30 million to set up the Science and Technology Industry Zone in Atlanta, Georgia. In addition to the United States, China also set up an industrial park in Korea in 2007, aiming to attract high-tech enterprises in fields such as information technology, electronics, biological engineering and new materials.

Challenges ahead

Despite the dramatic growth of Chinese ODI, the overall performance of those investing firms to date is not all that promising, with recent research indicating that only 30 per cent of Chinese ODI firms make a profit, 40 per cent break even, and the remaining 30 per cent make a loss (Ding 2007). One example is TCL's joint venture with French mobile company Alcatel, which has resulted in huge losses for TCL.

Investing abroad involves huge risks for any firm, and especially for Chinese firms. Lacking ownership or firm-specific advantages, a large number of Chinese manufacturing firms have invested abroad for asset augmentation rather than asset exploitation. Even in the case of asset-augmenting ODI, however, as Dunning (2000) points out, firms should also possess some unique, sustainable resources and capabilities.

These resources and capabilities are positively associated with a firm's absorptive capacity, which refers to the firm's ability to recognise the value of new, external information, to assimilate it, and to apply it to commercial ends (Cohen and Levinthal 1990). In fact, the real challenge pertains to post-acquisition difficulties. These include: how to build up win-win relationships with foreign stakeholders; how to reconcile different cultures at the national and corporate levels; how to organise globally dispersed complex activities; how to deal with foreign regulators, unions, employees and local communities; how to absorb the acquired technology; and how to operate acquired brand names.

Chinese manufacturing firms do not have sufficient ability and experience in handling the above problems. The differences in institutional backgrounds between China and the host country make Chinese firms more likely to have conflicts with foreign stakeholders, local regulators, employees and communities with regard to managerial philosophies, corporate culture, incentive schemes, leadership styles, and formalised managerial procedures (Luo and Tung 2007).

The poor corporate governance and management skills of Chinese firms weaken their ability to consolidate, absorb and operate the acquired strategic assets. For Chinese SOEs, due to unclear definition of property rights, their owners are often absent and vague, while managers do not have enough incentives to operate well and are without sufficient and effective supervision. These defects might obstruct corporate governance in the foreign subsidiary. For Chinese private firms, despite clearly defined property rights, they are usually under the tight rein of individuals or families, which is unfavourable for absorbing talented people and forming professional management.

Another challenge that Chinese manufacturing ODI firms have to face is the possibility of entry barriers in industrialised countries. This is partly because of the differences in ideology between China and Western society, which often results in fairly critical reports about China and its rising economic power. Given that the Western political system is characterised by a separation of powers, with checks and constraints on each other, it is inevitable that the ability of Chinese firms to invest will be influenced by various parties including different government departments, political parties, local government and interest groups (Tang 2009). The unfamiliarity of Chinese firms with this system presents them with a unique challenge to overcome.

The entry barriers Chinese firms face should not be entirely blamed on the host country; Chinese firms could also do with some self-examination. The problem both for SOEs and for private firms associated with weak corporate governance is their lack of transparency. As a result, outsiders in the host country know little about these investing firms. In turn, many Chinese firms do not communicate sufficiently with local media and communities. This kind of self-enclosed behaviour inevitably increases the host country's suspicion of the true intent of these firms.

Meanwhile, Chinese firms could also reflect upon what they actually bring to the host country. The Chinese Government has spared no effort in attracting FDI into China because foreign firms bring with them not only capital, but also technology, employment and other positive spill-over effects. Conversely, if Chinese firms going abroad intend only to bring back technology and resources, no wonder the host country is resistant to such investments.

Therefore, the reduction of entry barriers rests with, on the one hand, how sufficiently and effectively Chinese manufacturing firms can communicate and develop public relations with host country's involved parties, media and community. On the other, it also rests on whether Chinese firms can successfully establish win-win relationships with not only the target firm, but also the local community, and with better consideration of the benefits for the host country more generally.

Conclusions

While the emergence and integration of China into the global economy has attracted worldwide attention, systematic research on the role of China as an outward direct investor is still insufficient and incomplete. This chapter has made an attempt to fill this gap, focusing on Chinese ODI in manufacturing in particular.

Unlike in other sectors, Chinese ODI in manufacturing is dominated by private firms investing in industrialised economies, rather than by SOEs in developing economies. Unlike the MNCs of industrialised countries in the past, Chinese MNCs rarely have firm or ownership-specific advantages, such as core technology, management skills and brand names. While the private firms have shown some entrepreneurship, they are yet to become globally competitive, while the SOEs also still suffer from the administrative constraints of government agencies.

We found that, instead of these traditional advantages, Chinese manufacturing firms' ODI is motivated predominantly by seeking technology and markets. A range of strategies was identified for achieving this goal, with mergers and acquisitions of overseas firms becoming the dominant one in recent years.

What Chinese manufacturing firms do have is a variety of home-country specific advantages, relating to preferential policies under the Chinese Government's 'going global' strategy, a well-established manufacturing system, and comparative advantage in certain industries. Whether these are ultimately advantages, however, depends on the capacity of each firm to consolidate, operate the acquired strategic assets, and bridge the various gaps between the firm and the range of relevant parties in the host country.

The share of manufacturing in Chinese total ODI is low and decreasing. This is partly because of the large scale and growth of Chinese ODI in resources such as oil and iron ore. More importantly, it reflects that the channel for Chinese ODI is not smooth, given the cumbersome administrative procedure involved. There is no question that some administrative controls are necessary—particularly to prevent the excessive purchasing of 'junk' firms with low asset prices in the wake of the global financial crisis, and to ensure due diligence before investing. Even so, a reduction in the amount of red tape and further streamlining are required.

China is currently aiming to transform its growth model towards a more sustainable, inclusive and environmentally friendly pattern. Investing abroad, especially by manufacturing firms, is a valuable channel for realising this transformation. It also provides the incentive for the deepening of SOE reforms and for improving the competitiveness of China's domestic private firms. In the current international environment for MNEs—which is quite different from that in the 1980s and 1990s faced by Japanese and Korean firms, and in the 1950s and 1960s faced by American firms—Chinese firms need to find their own way to internationalise their operations. Based on the experience of Chinese economic development, the key principles of gradualism, decentralisation and market-driven engagement should ensure that Chinese ODI takes on the best 'Chinese characteristics', and leaves behind the rest.

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Endnotes

1. Although Chinese ODI in mining, quarrying and petroleum is also of great interest and significance, we do not include that in our analysis for two reasons: first, the nature of such investment is quite different from that of investments in other industries, and as such should be analysed separately; second, a large proportion of investment in mining, quarrying and petroleum is conducted by large conglomerates, whose business scope ranges from manufacturing to other service sectors such as retail and wholesale, trade, real estate, and so on.
2. It reports Chinese ODI flow and stock to each country and each industry, but does not report Chinese ODI flow and stock to each country by industry.