# Globalizing China: The Rise of Mainland Chinese Firms in the Global Economy

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**Forthcoming in *Eurasian Geography and Economics*, 2008, Vol.49(1).**

**Acknowledgement**

We would like to acknowledge the following institutions for funding the fieldwork of this project: National Natural Sciences Foundation of China (No.40571047) and the National University of Singapore (R-109-000-050-112). We are also grateful to the Editors of *Eurasian Geography and Economics* for their very helpful comments and encouragement. All errors and mistakes are, however, our own responsibility.

**11 February 2008**

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**Abstract**: In recent years, some of China's leading firms have made headlines through their proposed or realized acquisitions of significant corporate entities abroad in the US, Africa, Europe, and elsewhere. This new wave of corporate globalization from mainland China has so far attracted limited attention in international business studies, the leading discipline studying the emergence of transnational corporations. Our paper aims to contribute to this lacuna in the existing literature by examining the changing trends of China's outward foreign direct investment. Based on original fieldwork materials and published studies, we shed light on the main mechanisms through which these leading mainland firms have successfully ventured abroad. In particular, we argue for a political-economy approach to the understanding of "globalizing China", a complex phenomenon in which the Chinese state is strategically and intricately entangled with the corporate interests of its leading business firms.

JEL Classification: F23, L21, L22, M16

Key words: Globalization, transnational corporations, foreign direct investment, political economy, China

## INTRODUCTION

The globalization of business firms from developing economies throughout the world has become an increasingly important topic for academic research and media interests (Yeung, 1999a; 2007; Khanna and Palepu, 2006; Aulakh, 2007; Tolentino, 2007; Tung and Luo, 2007; UNCTAD, 2007a; Gammeltoft, 2008; Sauvant, 2008). UNCTAD (2006) recently dedicated the entire issue of *World Investment Report 2006* to providing a wide range of empirical evidence pointing to the rapid emergence of transnational corporations (TNCs) from developing and transition economies (DTE) throughout the world. In 2005, these 20,000 or more DTE TNCs invested a total stock of foreign direct investment (FDI) at US$1.4 trillion or 13% of the world total. More importantly, a vast majority share of this FDI by DTE TNCs

went to other developing and transition economies, a long-standing phenomenon known as "South-South FDI" (Aykut and Ratha, 2004). Indeed, UNCTAD (2006: xxiv) further estimated that this annual flow of South-South FDI increased dramatically from US$2 billion in 1985 to US$60 billion in 2004. While this annual flow may not be as visible in comparison with developed countries (e.g. US$119 billion outward FDI from the Netherlands and US$165 billion inward FDI into the UK alone in 2005), it does constitute a very significant source of capital, technology, and employment opportunities for the recipient economies in the Global South.

This emerging phenomenon of outward foreign direct investment (OFDI) from such developing economies as Hong Kong and Singapore and transition economies as China and Russia should not be entirely surprising. In the case of mainland China, the past three decades have witnessed its rapid economic development and transformations that in turn allow many mainland Chinese firms to accumulate sufficient firm- and location-specific advantages before they venture abroad. To date, China has joined the newly industrialized economies (NIEs) of Asia and Latin America to produce many competitive TNCs (see UNCTAD, 2007a). As noted by Wu (2007: 445), "[r]ecent high-profile international acquisitions and takeover bids by mainland Chinese companies have dramatically shifted media attention from spotlighting China as a 'giant sucking vacuum cleaner' for global inward foreign direct investment (FDI) to characterizing the country as a cash-rich 'predator' embarking on a global buying binge". Albeit a little prematurely, Alon (2008: 2) similarly proclaims that "The next frontier in the economic battlefield [for global leadership] is the globalization of Chinese enterprises".

The rise of China as a major economic powerhouse in the global economy should therefore be analyzed in relation to this phenomenon of outward FDI, as its own national firms are increasingly internationalizing into the regional and, in some instances, the global

economy. Even though China is one of the largest recipients of FDI by TNCs from other economies, it is also a significant home of OFDI and TNCs now and in the near future. As China is further liberalizing its domestic economy and deregulating cumbersome rules and policies (see Yang, 2004; 2006), we expect this broader process of globalization and liberalization to create more opportunities for mainland Chinese firms to internationalize their operations and to take advantage of their proximity and familiarity with neighbouring Eurasian economies. This paper seeks to provide an informed analysis of this phenomenon of "globalizing China" by examining the OFDI of mainland Chinese TNCs (MCTNCs).[1] Unlike OFDI by TNCs from developed countries, however, the Chinese case needs to be analyzed in relation to China's unique and changing political-economic contexts. Through respective economic planning agencies and centralized political bureaucracy, the Chinese state has been able to charter and govern the strategic orientation and trajectories of its national economic development. Since the late 1990s and the early 21st century, the Chinese state has been actively governing significant outflows of investments by national firms that often have direct or indirect government links. This phenomenon calls into question the nature and governance of this state-driven form of economic diplomacy, particularly when these outward investments are emerging from such a socialist transitional economy as mainland China. As Deng (2004: 14) argues, "the [Chinese] government has, to a great extent, played a crucial role in shaping the structure of China's approved outward investment".

In this paper, we define *economic diplomacy* as interstate economic relations manifested through firm-specific activities. While these economic activities are conducted through national firms, they "carry" with them certain distinctive elements of political and diplomatic overtures. These economic-diplomatic activities therefore cannot be conceptualized as pure market-based transactions often found in prevailing economic theories of FDI and TNCs (see Caves, 1996; Ietto-Gillies, 2005). Instead, they should be viewed as institutionally mediated

interactions between different nation-states that go beyond profit maximization and economic efficiency. This paper thus situates the experience of China's massive OFDI in recent years in relation to these political-economic considerations. Specifically, we examine the main drivers, determinants, and motives for outward FDI by MCTNCs in the context of significant variations between host countries and industries. We also discuss the reasons for variations between MCTNC strategies in light of their characteristics and thereby implications for home and host countries. Our empirical analysis is based on primary data collected through personal interviews with several MCTNCs in China, Hong Kong, and Southeast Asia, and postal surveys of their local distributors in Southeast Asia in 2003 and 2004.[2] We also rely on secondary data published by the Ministry of Commerce, China, and the UNCTAD (2006; 2007a; 2007b)[3] and on in-depth analyses in several recent research and consultancy reports (e.g. Von Keller and Wei, 2003; APF Canada, 2005; 2006; Battat and Aykut, 2005; Antkiewicz and Whalley, 2006; Boston Consulting Group, 2006; Woo and Zhang, 2006; Pamlin and Long, 2007), general books (e.g. de Trenck, 1998; Gu, 2005), and limited published academic studies (e.g. Cai, 1999; Quan, 2001; Wu and Chen, 2001; Wang, 2002; Wu and Yeo, 2002; Deng, 2003; 2004; 2007; Wong and Chan, 2003; Hong and Sun, 2004; Warner et al., 2004; Child and Rodrigues, 2005; Yang, 2005; Buckley et al., 2007; Li, 2007; Wu, 2007; Alon and McIntyre, 2008).[4]

The next section develops theoretically a political economy analysis of OFDI from mainland China. This is then followed by section three that examines the main drivers, motives, and strategies for OFDI by MCTNCs. Because of the great diversity in TNCs from China and the relative immaturity of the literature on this major issue, we take a more general empirical approach rather than offering detail case studies. In fact, existing case studies of MCTNCs tend to focus on a few celebrated cases of the "usual suspects" in the consumer electronics sector – Haier, Huawei, TCL, and Lenovo (e.g. Liu and Li, 2002; Zeng and

Williamson, 2003; Child and Rodrigues, 2005; Khanna and Palepu, 2006; Deng, 2007; 2008; Li, 2007; Liu, 2007; Wu, 2007; Simmons, 2008), ignoring a wide range of other state-owned enterprises (SOEs) and private Chinese firms in different service, manufacturing, and extraction industries. UNCTAD (2007a: 65) thus raises the fundamental issue of "indeed whether there is such a thing as 'typical' Chinese TNCs". Our general approach thus allows us to accommodate the wider range of drivers, strategies, and performance among emerging TNCs from China. The concluding section assesses the implications of "globalizing China" for both China and host countries.

## THE POLITICAL ECONOMY OF GLOBALIZING CHINA

The role of the nation state has been a key issue in the theorization of TNCs and their global operations. Two streams of theoretical literature can be identified in the study of the relationships between nation states and TNCs: (1) mainstream neoclassical economics and (2) radical political economy (Pitelis, 1991; Ietto-Gillies, 2005; Dicken, 2007). There is, however, a general lack of consensus on the role of the state in these two schools of thought. This theoretical impasse arises primarily from their different conceptualization of the nature of the state and the economic system. Mainstream neoclassical economics is concerned with explaining the existence of market failures and the subsequent emergence of firms or hierarchies (Williamson, 1975; 1985; 1996). Market failures exist when the market mechanism fails to perform its role as the "invisible hand" in the allocation of resources. The lack of clearly defined property rights and the existence of imperfect information are examples of market failures. These market failures will increase the transaction costs of production when individual producers are engaged in a large number of arm's-length market transactions. Instead of relying on individual producers based on the market mechanism, producers may respond to higher transaction costs by internalizing production within the firm. Historically, market failure has been one of the key explanations of the emergence of national

firms and the so-called "managerial capitalism" (Chandler, 1977; 1990). When this process of internalization takes place across national boundaries, the firm is transformed from a nationally based firm to a transnational corporation (Buckley and Casson, 1976; Dunning, 1988; 1993; 2006; Caves, 1996; Ietto-Gillies, 2005).

What then is the role of the nation state in this neoclassical explanation of the raison d'être of TNCs? Accordingly, the existence of the state is a potential source of market failure that compels national firms to enter international production. There are two ways through which the state can create market failures. First, the regulatory activities of the state epitomize market failures because these activities tend to prohibit the efficient allocation of resources through the market mechanism. Second, the state can create market failures by participating directly in economic activities through public enterprises and other means of direct market interventions. Direct state interventions in the domestic economy are often seen as counter-productive because these activities do not coincide with the profit maximization objectives of private capitalist institutions. In the context of TNCs and their global operations, the activities of nation states often pose as obstacles to their international production. A host country state may impose certain restrictions on the participation of foreign firms in the domestic economy. It may forbid foreign firms to invest in specific sectors and/or firms. It may also nationalize the domestic operations of some foreign firms to attain its nationalistic goals.

The political economy perspective conceptualizes the nation state as a capitalist institution whose existence ensures the reproduction of the capitalist mode of production. The capital logic school of international political economy, for instance, views the state as a collaborator of capitalists (Palloix, 1975; 1977; Eden and Potter 1993; Chen, 2004; Eden and Dobson, 2005; Ietto-Gillies, 2005). The state is seen as possessing a certain degree of autonomy and helping capital to achieve its aims. This is possible because the internationalization of capital is a contradictory process in which there is a continuous tension

between homogenization and differentiation (Picciotto, 1991; Kobrin, 2001). The emergence of TNCs is partially attributed to the existence of national protectionist regulations and/or state-driven strategic initiatives. Capital internationalizes itself via TNCs to accumulate further and fulfill its self-expansionary mission. On the one hand, capital, as represented by TNCs, needs a system of nation states to defend its global interests. Pitelis (1991: 144) notes that "all transnational capital, state functionaries and labour have some interest in the persistence of the nation-state". On the other hand, the growing internationalization of capital tends to increase the relative power of TNCs vis-à-vis nation states. By virtue of their global presence, TNCs want to take advantage of their global scanning capabilities in exploiting spatial differences that transcend national boundaries. The internationalization of capital further reproduces uneven development within countries (e.g. different regions) and between countries (e.g. different levels of development).

This paper is informed by these two epistemologically and theoretically different perspectives. Though it is almost impossible to synthesize them, it is useful to point out some possible middle grounds that serve as a framework for analyzing the role of the state in "globalizing China" (see also Mathews, 2002; 2006; Child and Rodrigues, 2005; Li, 2007). In a recent paper, Buckley et al. (2007: 514) found strong empirical support for an institution-based theory of OFDI from China and noted that "Chinese outward investors clearly present marked contrasts from the conventional model in key respects". How then do we understand the role of key home country institutions such as the state in shaping OFDI by national firms? Pitelis (1991; 1993) has proposed a collusion-and-rivalry framework that appears to be useful in analyzing the changing relationships between states and TNCs. Nation states are conceived as relatively autonomous institutions in the framework. The framework focuses on the relative advantages of different institutional arrangements in explaining the actual or potential coexistence of nation states and TNCs. Collusion here refers to the mutual dependence and

induced cooperation between the state and the TNC. Rivalry, as opposed to conflict, exists because both states and TNCs share the common objective of raising the global surplus of capital by exploiting the benefits from the division of labour and team work. The framework suggests that the state-TNC relationship reflects their extent of collusion and rivalry. In other words, we would expect the state-TNC relationship to vary over time according to different configurations of their collusion and rivalry tendencies. States and firms rival each other in order to secure a better position in global competition (Stopford and Strange, 1991; Sally, 1995; Gilpin, 2001).

To link the globalization of MCTNCs to their home country state, we need to understand better the role and nature of the state in China's economic transformations during the past three decades (see a recent debate in Rowen et al., 2007). As will be exemplified much further in the next section, this political-economic influence of the home country state on the internationalization of its firms can be analyzed at two spatial scales – the national and the local (see also Yeung, 2000). This central-local nexus is perhaps the most significant issue in understanding contemporary China's incredible economic dynamics and market transition (Naughton, 1995; Walder, 1995; Oi and Walder, 1999; Zweig, 2002; Yang, 2004). The structural shift in post-Mao Chinese institutional context has very important implications for understanding the strategic governance of China's economic diplomacy via the globalization of its firms. The *national scale* refers to the space in which the central government exercises what Yang (2006: 149) terms "authoritarian leadership". It is in this national space that large SOEs and national champions are explicitly encouraged to venture into the global marketplace. Since the second half of the 1990s, the central state has stepped up its efforts to re-regulate the national space-economy in order to curb the spread of the Chinese-style of federalism. The restructuring of central-local fiscal relations is particularly important in this regard. The central state has regained significant control and regulation of different sources of

taxes that in turn allow it to finance major national economic initiatives and economic diplomacy. As noted by Yang (2006: 159), these "incessant efforts to enhance its fiscal prowess, boost regulatory institutions, and strengthen its overall governing ability can be understood as part of a quest for stability in a rapidly changing external environment".

Meanwhile, the *local scale* refers to new and fragmented spaces in which a great variety of MCTNCs are nurtured and supported. The earlier process of economic reform since the late 1980s has led to the decentralization of "many decisions to the firm level, or at least to the local government level" (Gordon and Li, 1991: 202). The restructuring of the state sector has contributed to the rise of local economic elites and cadre entrepreneurs who were former party secretaries in charge of SOEs and local governments (see Tong, 1989; Pearson, 1997; Guthrie, 1999; Wank, 1999; Zweig, 2002). In what Pei (2006) calls a "decentralized predatory state", economic reform has made it much easier for local governments, collectives and individuals to spin off state assets and to set up their own enterprises outside of the state planning structure, leading to the emergence of town and village enterprises (TVEs) that are essentially undertakings by local municipal governments and their collective enterprises. The new fiscal system introduced in 1985 allowed the local government treasury to retain profit taxes from locally controlled firms and some state firms. Other tax payments, such as the product tax and the value-added tax, were still shared with the central government. Within these local "spaces of manoeuvring" and local corporatist initiatives, the role of *guanxi* or personal relationships in securing the assistance and support of cadres and local governments is particularly important. Indeed, a large number of MCTNCs grow from these private entities founded by party cadres and entrepreneurs and TVEs.

What then is the determining factor in explaining these different spatial configurations of state-TNC relationships? We argue that it is local contingency that shapes the causal relationships between home nation states and TNCs. For example, in Dunning's (1988; 1993;

2006) eclectic framework, he argues that for a TNC to engage in international production, it must simultaneously enjoy three sets of advantages: ownership-specific (O) advantages (e.g. possession of capital and technology), location-specific (L) advantages (e.g. availability of cheap labour), and internalization (I) advantages (e.g. asset specificity and lack of clearly defined property rights). We argue, however, that while the existence of these OLI advantages is necessary to enable cross-border operations by TNCs, they are not sufficient in explaining the success of these transnational operations (see Ietto-Gillies, 2007). In a recent reappraisal, Li (2007: 297) "doubt[s] if the OLI Model is readily applicable to MNE [multinational enterprise] latecomers from the developing countries because it fails to explain how MNE latecomers from the developing countries achieve initial competitive advantages, and how MNE latecomers catch up with MNE early-movers over time". In particular, the realization of these OLI advantages in the host countries is highly contingent upon local institutional factors. On the one hand, some local factors may be formidable obstacles to international production. For example, the existence of intricate webs of local social and political relationships in many developing countries poses a major location-specific *dis*advantage to evolving domestic firms. In fact, these relationships among local firms and government authorities may significantly increase the transaction costs of entering into the host countries and thereby reduce the interest in FDI activity by foreign firms. Excessive reliance on these relationships may also lead to the lack of firm-specific advantages among domestic firms, resulting in a "latecomer syndrome" (Child and Rodrigues, 2005; Li, 2007; Sun et al., 2008).

On the other hand, the same set of local factors may be turned into key strategic advantages for home country TNCs that are capable to tapping into these local networks and relationships in their international ventures. To do so, many domestic firms need to collude with home authorities for mutual gains. Through this process of mutual dependence, many domestic firms are able to build up their political leverage and, very often, dominant position

in the home countries. As these domestic firms become well entrenched in the home country, they can cross-subsidize their international operations and therefore overcome their initial disadvantages. In other words, collusion with home institutions leads to international emergence over time. More specifically, this emergence correlates to Tolentino's (1993; 2007) three-stage model of OFDI by firms from developing economies (see also Li, 2007). In the first stage, these TNCs are postulated to concentrate largely on resource-based and simpler manufacturing and service investments because they do not possess sufficient technological sophistication to compete with their counterparts from developed countries in the global market. Their investments therefore tend to be directed to neighbouring and ethnically-related territories.

In the second stage, the trend is towards localized technological innovation. An increasing sectoral complexity is observed when more TNCs from developing countries relocate abroad and they are engaged more in downstream processing of primary resources in the host countries. Production, in the simple forms of manufacturing and associated service investments, is still concentrated in several neighbouring and/or ethnically-related countries or in other non-ethnically-related developing countries. Lower production and transport costs and close psychic distance, as well as the presence of favourable investment opportunities and the desire to make fuller use of regional economic integration, seem likely to explain significant direct investments within distinct regional groupings at this stage of development (see Cai, 1999). As in the first stage, the technological advantages in the second stage are based on an adapted product or process innovation obtained through experience in developing countries, which can be applied to other developing countries at a lower stage of development. In the final stage, the geographical scope of investment activities becomes more diverse when some technologically innovative firms from developing countries begin to invest in developed countries to gain access to their technology and market. Both import-

substitution and export-promotion industries receive much attention in the investment strategy of these higher-end TNCs from developing countries. In short, there is a case for us to examine empirically the political-economic contexts in which mainland Chinese firms grow and evolve beyond their home economy.

## ACCOUNTING FOR THE RISE OF MAINLAND CHINESE FIRMS IN THE GLOBAL ECONOMY

This section focuses on describing the main characteristics of OFDI by MCTNCs in relation to their main drivers, internationalization strategies, entry modes, and competitive performance. Insofar as possible, the uniqueness of these MCTNCs and their FDI behaviour will be emphasized. More importantly, we analyze the key factors and mechanisms that account for these drivers, strategies, and competitive performance of MCTNCs in the global economy.

### China's Outward Foreign Direct Investments

For more than a decade, China has been widely known as the largest recipient of inward FDI among developing countries, with an average annual FDI inflow of more than US$50 billion from 1996 to 2006. Few people have noticed, however, China now becomes one of the largest global investors among developing countries (see Cai, 1999; Wong and Chan, 2003; Deng, 2004; 2007; Hong and Sun, 2004; Buckley et al., 2007). In APF Canada's (2005: 12) web-based questionnaire survey of a sample of some 296 Chinese firms conducted in May-June 2005[5], some 85.8 percent did not have OFDI activity. Of the remaining 14.2 percent, the earliest report OFDI project started in 1990 and only 4.7 percent of the respondents had OFDI during the 1990-1998 period. In short, the vast majority of OFDI activity by MCTNCs has occurred since the new millennium. A follow-up survey by APF Canada (2006) of 235 Chinese firms in September-October 2006 shows a rising trend of OFDI activity among the respondents. In 2006, China's non-finance OFDI flow amounted to US$17.6 billion, ranking

first among developing countries  In terms of OFDI stock, China's figure of US$90.6 billion was still lower than that of Russia (US$120.4 billion) and Singapore (US$110.9 billion)**.** But China's position as a large investor from developing and transitional economies will only become more important in the next ten years. Indeed, the last several years have already witnessed a massive surge of OFDI from China, with an annual growth rate as high as 60 percent between 2002 and 2006 (see Figure 1).

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This large increase in China's OFDI can be attributed to a number of macro-economic factors. First, as a "world factory", China has gained increasing trade surplus since the mid-1990s. By the end of 2006, foreign currency reserve of the country amounted to more than US$1 trillion. This huge reserve from the massive trade surplus creates not only a positive financial basis for Chinese firms to invest overseas, but also political pressure, particularly from the US, on these firms to establish production overseas in order to avoid increasing trade tensions. Second and as indicated in Table 1, the central government has started to implement a strategy of "going overseas" since 2002, encouraging domestic firms to invest abroad either for market expansion or for getting access to strategic natural resources such as oil and minerals. Supportive policy measures include streamlining procedures to speed up approval from the government and foreign currency from state banks. APF Canada's (2006: 14) survey thus found that almost half of the respondents intended to borrow from a state-owned bank in China in order to finance their ODFI activity.

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Unlike many developed country TNCs whose FDI often takes the form of mergers and acquisition (M&As), China's OFDI has a significant share in the form of greenfield

investment and joint ventures. For example, in 2006, only 39 percent of the country's OFDI took the form of M&As (Ministry of Commerce, 2006; see also Antkiewicz and Whalley, 2006; Boston Consulting Group, 2006). Another unique feature of China's OFDI is that a vast majority went into non-manufacturing sectors like mining, business services, finance, and wholesale and retailing. Figure 2 shows that only a small portion of China's OFDI was put into manufacturing industries. In 2006, nearly half of the non-financial OFDI went into mining and extraction industries (mainly in the area of oil, natural gas, and major minerals), indicating China's global sourcing of raw materials in order to supply to the "world factory" (see also Pamlin and Long, 2007). Still, manufacturing OFDI from China is increasing in recent years not only in absolute terms, but also in terms of its share in total OFDI stock. From 2003 to 2006, the share of manufacturing OFDI in the total stock of China's OFDI increased from 6 percent to 8.3 percent. By 2006, manufacturing firms accounted for 53.4 percent of the total number of establishments with overseas investments. Some of the most publicized recent cases include Haier's industrial park established in South Carolina, USA, in 1999 (producing refrigerators), TCL's takeover of Germany's Schneider Electronics AG in 2002 and French Thompson's television business in 2003, Lenovo's takeover of IBM's personal computer business in 2005, NAGC's acquisition of UK's MG Rover Group in 2005, and so on.

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Geographically, China's OFDI is unevenly spread across 172 countries/regions, with a heavy concentration in Asia and Latin America (Figures 3-4 and Table 2). These two regions accounted for 91 percent of China's non-financial OFDI stock in 2006. In Asia, Hong Kong attracted 88 percent of China's non-financial OFDI in the region, indicating Hong Kong's very important role as a bridge for these Chinese firms to go overseas. In Latin America, British Virgin Island and Cayman Island attracted 96 percent of China's non-financial OFDI

in the region. Together, these three onshore and offshore financial centres accounted for 81.6 percent of China's non-financial OFDI stock globally. As these financial centres have a common feature, i.e. a low tax or tax-free business environment, they have become very attractive locations for many mainland Chinese firms to register there and subsequently invest back into China in order to enjoy preferential treatments for inward FDI. Since the early 1990s, much of this "round-tripping" of China's OFDI to become inward FDI into China has substantially diminished the actual amount of China's OFDI (see Chan, 1995; Fung, 1996; Sung, 1996; Low et al., 1998; Xiao, 2004). Yang (2006: 149) therefore argues that "a quick look at the list of domiciles where China's foreign direct investment originates suggests much of this investment is actually Chinese money masquerading as foreign investment". Estimates of this round-tripping of Chinese FDI are hard to come by. A recent work by Xiao (2004: 21) estimates that between 1998 and 2002, some 40 percent of Hong Kong's FDI in China was actually the round-tripping of China's OFDI. This estimate does not even include the type of round-tripping related to capital market transactions such as listing of mainland firms on the Hong Kong Stock Exchange.[6] In terms of ownership, a large amount of China's OFDI originates mainly from state-owned enterprises (SOEs). Although these SOEs accounted for only 26 percent of the total number of establishments with overseas investments in 2006, they contributed to some 82 percent of China's total non-financial OFDI stock. Table 3 lists the ten largest Chinese non-financial TNCs and they are all SOEs. In short, there is no doubt the relative significance of the state and its SOEs in "globalizing China".

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**Drivers and Motives of OFDI from China**

The above macro-analysis points to a mixed of OFDI drivers and motives among MCTNCs. There are clearly important reasons why these drivers must be analyzed separately

in order to understand the nuances of OFDI decisions and choices of host countries and/or regions. The most common driver for OFDI from China is related to *market access*, as confirmed by several empirical studies (see Boston Consulting Group, 2006; UNCTAD, 2007a; Wu, 2007) and our personal interviews. In their 2003 survey of China's 50 largest leading firms, Von Keller and Wei (2003; cited in Wu, 2007: 449) found "seeking new markets" as the overriding imperative for globalization among some 56 percent of their respondents. This "market access" motive may appear to be paradoxical as China is in itself a very large market for global corporations. There are several reasons why these MCTNCs need to develop and exploit new markets in both developing and developed countries. First, some Chinese firms may not possess sufficient firm-specific competitive advantages such as branding, marketing know-how, and managerial competences to internationalize into developed countries in North America and Western Europe. The markets in these developed countries are fairly saturated and highly competitive due to the presence of world class TNCs. However, markets in other developing countries in Southeast Asia, South Asia, Africa, and Latin America may remain relatively untapped and viable. For reasons suggested below, these MCTNCs may sometimes possess sufficient competitive advantages vis-à-vis even world class TNCs in these emerging markets such as Southeast Asian countries (see Wu and Yeo, 2002; Deng, 2004; 2007; Frost, 2004; Hui and Fatt, 2008). Expansion into other emerging markets becomes a compelling business solution to overcome the growing competition in their home market because of the influx of FDI into China. APF Canada's (2005; 2006) surveys found that trading, including import and export activities, has become the most popular field of existing and future OFDI activity from mainland China.

Our empirical study of electronics MCTNCs in Southeast Asia shows that their local sales offices are often directly linked to their manufacturing presence in the host countries (see Table 4). For example, Haier, TCL, Changhong, and Konka have established their own local

sales offices in the same Southeast Asian countries in which they have manufacturing capabilities. Specifically, Haier has experienced some success in setting up its own sales offices and networks. Haier Electrical Appliances (Thailand) is a 55% majority-owned joint venture between Haier and Distar Electric, a Thai-brand appliance company (*Nation*, 6 December 2002). By January 2003, Haier had more than 80 dealers throughout Thailand. Meanwhile, Chunlan seems to be running its sales and marketing functions from its regional headquarter in Singapore. From our field interviews with both MCTNCs and their local distributors, it is clear that the direct sales capability of these MCTNCs in Southeast Asia remains weak and underdeveloped.

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Second, for larger MCTNCs described by Nolan (2001) as "national champions", their expansion into foreign markets is neither necessarily due to their domestic market limitation or saturation, nor a market-defense strategy. Rather, their OFDI activity reflects their maturing organizational capability and competitive advantages (e.g. Haier, TCL, and Lenovo). As these MCTNCs have gained enormous experience from their domestic operations spanning much larger territories, they are capable of venturing into new markets either by cross-subsidizing their foreign operations and/or by developing these foreign activities as standalone operations. They are also investing in developed countries in order to gain access to advanced technology, cutting-edge manufacturing capability, and global brands and management expertise (Tang et al., 2008). As indicated in Table 4, the leading MCTNCs have adopted different approaches to serve the Southeast Asian market. All five Chinese firms, except Chunlan, have direct manufacturing presence in such Southeast Asian countries as Indonesia (Haier, Changhong and Konka), Malaysia (Haier), Thailand (Haier), the Philippines (Haier and TCL) and Vietnam (Haier and TCL). While some of these Chinese firms continue to expand their manufacturing presence in Southeast Asia, other Chinese firms (e.g. Chunlan) have remained

highly interested in developing their manufacturing capabilities in the region through joint ventures and/or acquisitions. Direct investment has clearly become one of the main instruments through which MCTNCs make their market presence in Southeast Asia. Moreover, most Chinese firms in Table 4 serve the Southeast Asian market through OBM (original brand manufacturing) and/or OEM (original equipment manufacturing) in their China factories. This direct manufacturing from China has something to do with the branding preferences and marketing practices of local distributors. In some cases, local firms and distributors in Southeast Asia may not prefer marketing original Chinese brands. Instead, these local firms favour low cost Chinese electronics products that are branded in ways very similar to well recognized brands in the local markets (e.g. Chunlan's Pansonic vs. Panasonic).

Third, some MCTNCs are well articulated into global production networks in different industries and sectors. When global firms first internationalized into China, these firms were chosen as their preferred suppliers. Over time, production in China may be reorganized and rationalized on a regional or global basis. As these lead global firms have begun to reconfigure their global production networks in favour of newly emerging economies in Asia and elsewhere, their existing suppliers in China tend to follow suit and establish new production facilities in those newly emerged host countries such as Indonesia and Vietnam. This OFDI phenomenon is not necessarily one of lowering factor costs. Instead, it reflects the market-defense strategy of MCTNCs that are well plugged into global production networks (see Yang, 2005).

On the other hand, the large number of Chinese SOEs in the resource extraction industries points to the critical role of *access to resources and production factors* as the second most common driver of OFDI from China. Unlike many NIEs where business and labour costs are escalating rapidly and their domestic firms in labour-intensive industries venture into other

developing countries in order to gain direct access to lower factor costs, large SOEs from mainland China are much less driven by lower business and labour costs. Instead, many of them belong to resource extraction sectors such as minerals, oil and gas, and agricultural products (see Table 2). As they have already controlled a large share of these industries in China, these resource-seeking TNCs tend to go abroad to develop direct access to similar or related resources at lower costs. Recent examples include CNOOC's failed takeover of Unocal in the US in 2005, CNPC's successful purchase of Canada's PetroKazakhstan in 2005 (see also APF Canada, 2005; 2006; Antkiewicz and Whalley, 2006; Woo and Zhang, 2006), and Chinese SOE investments in Africa (UNCTAD, 2007b: Chapter III; Campbell, 2008). During a visit to Argentina in November 2004, President Hu Jintao signed a US$19.7 billion investment deal of which US$5 billion was earmarked for oil exploration (*The Straits Times*, 1 July 2005, p.8). As China's national consumption of key natural resources and commodities continues to increase, this strategic imperative driver will remain highly important to understanding the nature and strategy of China's OFDI in the near future (see also Wang, 2002; Deng, 2004; 2007; Battat and Aykut, 2005; Pamlin and Long, 2007).

The above two common drivers –market access and resource-seeking – point to the very high likelihood that MCTNCs will invest in other developing countries in Asia due to geographical proximity or other regions due to China's evolving geopolitical role in international politics. This greater significance of geographical or political proximity in driving OFDI from China is sometimes linked to the relative lack of firm-specific competitive advantages among some MCTNCs in the global marketplace. In other words, they tend to invest in nearby markets at similar stages of development because they have the highest chance of business success or in further markets in order to benefit from China's burgeoning economic diplomacy. For example, both APF Canada's (2005; 2006) surveys of Chinese firms found that Asia remains the top target of future OFDI expansion among most respondents.

Buckley et al.'s (2007) study found that OFDI from China between 1984 and 2001 tended to be associated with high levels of political risks in, and cultural proximity to, host countries throughout. Between 1984 and 1991, host market size and geographical proximity were major determinants, whereas host natural resources endowments were the main determinant for the period between 1992 and 2001.

This proximity driver can be further elaborated in relation to personal and national factors. At the personal level, some entrepreneurs and managers from China are familiar with other Asian developing countries (e.g. Vietnam and North Korea) or have experience in working in some of them (e.g. Hong Kong and Singapore). Some of them have developed strong inter-personal ties; others may have extended family links due to immigration for the past two centuries. Even in the absence of these social and cultural ties, mainland Chinese entrepreneurs and managers would have traveled to neighbouring for tourism and work reasons. Their relatively higher familiarity with other developing countries in Asia makes a huge difference in their cognitive repertoires and, subsequently, FDI decision-making processes.

At the national level, FDI in other nearby developing countries makes sense to many mainland Chinese entrepreneurs and managers. Potential host developing countries in Asia may have relatively lower factor costs, untapped markets, and stringent regulations (main obstacle to entice FDI by developed country TNCs). Successful mainland Chinese entrepreneurs and managers tend to develop strong competencies in navigating complex webs of patron-client relationships and personal and institutional favours in such relatively opaque and difficult business environments as China. Buckley et al., (2007: 510) therefore note that mainland "Chinese foreign investors seem not to perceive risk in the same way as industrialised country firms". Indeed, many large SOEs-turned-MCTNCs occupy monopolistic positions in China's huge domestic market in which predatory corporate

behaviours are often observed and tolerated. As noted in the earlier section, China's post-Mao economic reform and different configurations of central-local politics have enabled many of these SOEs to exercise their monopolistic power without due concern with business risks and failures. They have indeed become "too big" to fail and "too powerful" to be questioned. Pei (2006) goes even further in arguing that China's lack of democratic reforms has led to pervasive corruption and a breakdown in political accountability among its upper echelons. Furthermore, their easy access to state finance and political machinery means that the voices and concerns of these elite SOEs can be effectively translated into direct state policies and foreign diplomatic initiatives. Unlike TNCs from developed countries with open and competitive business environments, these MCTNCs are able to solve more effectively similar problems and obstacles in other developing countries characterized by relatively opaque and difficult business environments (see also Buckley et al., 2007). Geographical proximity and institutional similarity are intertwined to become a formidable advantage for these MCTNCs.

Apart from the above three common drivers, there is an additional driver of economic diplomacy that may be highly relevant to the analysis of OFDI from China. Partly due to China's socialist legacy and historical development, many MCTNCs tend to be state-owned TNCs that are often directed to venture abroad as part of the state's economic diplomacy. In some cases, OFDI by these state-owned MCTNCs represents a form of development assistance and regional solidarity. This applies particularly to infrastructural projects and resource extraction industries often in other developing economies. Most Chinese OFDI activities in Africa, for example, are believed to be following government leads rather than being economically strong projects. At the Beijing Summit of the China-Africa Cooperation Forum in November 2006, President Hu Jintao announced the establishment of a China-Africa development fund totaling US$5 billion to encourage Chinese companies to invest in Africa (UNCTAD, 2007b: 62; see also Campbell, 2008). This diplomatic nature of OFDI,

however, is not entirely unique to China. The Japanese invested heavily in Northeast and Southeast Asia throughout the 1960s and the 1970s as part of its "flying geese" diplomatic drive (Hatch and Yamamura, 1996). Since the early 1990s, the Singapore government has enticed many of its government-linked companies to develop industrial parks and invest in commercial activity in mainland China (Yeung, 2000; 2004b). This economic diplomacy is meant to strengthen bilateral relations and to develop Singapore's "external wing". At around the same time in the 1990s, the Taiwanese government explicitly promoted FDI in Southeast Asia in order to avoid excessive dependence on mainland China (X Chen, 1996; TJ Chen, 1998; Chen and Ku, 2004). It also steered Taiwanese FDI to selective African states in order to secure their support for Taiwan in the global community. In a tit-for-tat manner, recent overtures by MCTNCs in Africa reflect pretty much the same diplomatic drive – power and influence among allies.

To sum up this section on the main drivers and motives of OFDI from China, it is quite clear that some of the most important drivers in existing economic theories are not quite applicable to the internationalization of MCTNCs. Despite the (over)celebrated cases of Haier, Huawei, Lenovo, and TCL (Liu and Li, 2002; Zeng and Williamson, 2003; Deng, 2004; 2007; 2008; Khanna and Palepu, 2006; Li, 2007; Liu, 2007; Wu, 2007; Simmons, 2008), very few MCTNCs venture abroad because of efficiency-seeking reasons, access to technology, and expanding regional and global networks – drivers commonly applicable to the globalization of TNCs from developed countries and FDI destined for developed countries. Instead, most MCTNCs invest in other developing countries because of access to lower factor costs and resources, existing and new markets, geographical or institutional proximity, entrepreneurial drives, and economic diplomacy. These are important differences between China's OFDI and other forms of FDI because of their significant bearings on the internationalization strategies of MCTNCs, their entry modes, and competitive performance –

key issues to be tackled in the next three subsections.

**Unique Features of Internationalization Strategies of Mainland Chinese Firms**

In general, it should be noted that with the exception of the largest and most prominent ones (e.g. Table 2), MCTNCs do not necessarily have well defined corporate strategy when they venture abroad. This relative deficiency is clearly related to the infancy or growth trajectories of many smaller MCTNCs. Some of them emerge in haphazard ways in different localities in China, whereas others grow out of former state-controlled enterprises. There is thus a great deal of idiosyncrasy in their strategic management (see Li, 2007, Alon et al., 2008). Still, we can identify several unique features of their internationalization strategies. *Sectoral specialization and high volume business* is a common strategy adopted by many MCTNCs in their internationalization into other markets. This strategy is applicable to both manufacturing and non-manufacturing MCTNCs when specialization takes place in different segments of the production chains. For manufacturing firms, sectoral specialization refers to focusing on certain core manufacturing capabilities to achieve scale economies and cost advantages. These scale benefits are best exploited in host countries endowed with lower factor costs – an important driver of China's OFDI. MCTNCs tend to focus on cost reduction through engaging in high volume, high productivity manufacturing of standardized products (Sun et al., 2008). Deng (2004: 12) found that Chinese OFDI in developing countries tends to be "characterized by relatively small-scale projects, labor-intensive production techniques, and the production of undifferentiated and low-value-added goods".

Often, these manufacturers serve as suppliers to original equipment manfuacturers (OEMs) who are major customers from the Triad regions. These MCTNCs are often described as "dependent intermediators" that tend to depend on major customers in developed countries for technology and expertise. Over time, these MCTNCs begin to acquire, absorb, and develop technology and expertise to compete against their OEM customers. This strategy is

known as “leapfrogging” that allows many MCTNCs to move beyond OEM production to original design and product development through transnational operations in other markets in Asia and elsewhere (Buckley et al., 2002; Child and Rodrigues, 2005; Guthrie, 2005; Tang et al., 2008; Zhou, 2008). When pursued successfully, these MCTNCs can develop competitive advantages based on their lower costs and competitive pricing in international markets that in turn originate from their lower labour costs in the home/host countries and inexpensive managerial and technical personnel transferred to their foreign affiliates in other developing countries. Successful examples are Huawei (Child and Rodrigues, 2005; Deng, 2007; Simmons, 2008) and Haier (Liu and Li, 2002; Khanna and Palepu, 2006; Deng, 2007; 2008; Li, 2007; Wu, 2007). For non-manufacturing Chinese firms (e.g. retail, distribution, and property development firms), sectoral specialization often means continuous expansion of the corporate group to establish a significant presence in different host markets. These MCTNCs tend to specialize in the provision of relatively standardized and lower value consumer and other services. Market access becomes a key concern to these Chinese service firms. In this regard, transnational operations have become a means through which these Chinese conglomerates consolidate their competitive position in particular business fields and to extend their value-added activities in different production chains.

*Product and geographic diversification* is another important strategy for Chinese firms to emerge as TNCs for at least two reasons. First, many Chinese firms, particularly SOEs, gain their initial wealth and capital through monopolistic rights and special grants offered by the central and/or local governments. They have subsequently become cash-rich and need to reduce their risks because of over-reliance on return to investments in these protected sectors and/or markets. Diversification into other business fields offers attractive alternatives to hedge their risks. However, as these other business fields in China may be populated by other Chinese firms with special rights, foreign ventures become a preferred strategy for risk

diversification (e.g. Sinochem and China Resources; see Deng, 2004). As alluded in endnote 6, these Chinese firms are more likely to engage in round-tripping FDI via such financial centres as Hong Kong. Second, diversification into different business activities is most preferred by MCTNCs because of their diverse networks involving personal and business relationships. When an entrepreneur or a manager from China is approached by a friend or business associate from another industry in another country for equity investment, an agreement may be struck to promote friendship and relationship, even though there may be no direct complementarities between their businesses. As a result, the diversification of MCTNCs into different business fields is often determined by social relationships, not by strategic necessity (see Yang, 2005). This strategic behaviour, while common among smaller MCTNCs emerging from TVEs and private entities in China, can also be found even in some large SOEs.

Furthermore, an internationalization strategy based on *inter-personal relationship and management* is often pursued by MCTNCs in order to exercise stricter control and intra-group coordination among foreign affiliates. One explanation is that many Chinese firms are still relatively inexperienced in internationalization. Host countries may also have difficult and highly regulated operating environments. Internalization of management and control therefore provides a better safety net for these firms to protect their firm-specific advantages and to maximize their benefits from network relationships with other firms abroad. Typically, a Chinese firm prefers centralization through personal or state ownership and centrifugal control. The ownership structure often develops into very intricate intra-group shareholding structure that in turn reflects the shareholder's desire to keep the whole group under control with minimum own investment and maximum mobilization of external resources. Similar to the case of Thai TNCs (see Pananond, 2007) and ethnic Chinese TNCs from Southeast Asia (see Yeung, 1999b; 2004), this heavy reliance on centralized ownership and control in

internationalization is endemic even among the largest and most powerful MCTNCs identified above. Apart from state-controlled MCTNCs, a vast majority of privately owned MCTNCs are highly personalized business conglomerates. Unlike their counterparts from developed countries, shareholder involvement represents a strategic move to ensure the successful internationalization of these MCTNCs into other host countries.

Finally, a *standalone* internationalization strategy tends to be pursued by smaller MCTNCs. As a result of their lack of professional management and control mechanisms, these Chinese firms tend to establish new ventures in other countries without explicit regard of their extent of integration into their China-based businesses. Indeed, these are the so-called "suitcase TNCs" when locally-based entrepreneurs and managers from China simply take their cash across the borders to set up new ventures and/or participate in partnership in the host countries. This guerrilla-style strategy of internationalization tends to work best when a young Chinese firm lacks managerial expertise and yet identifies a new business opportunity in another host country. It is also very effective in host countries whereby rules and regulations are opaque and changing constantly. This form of OFDI from China is systematically underestimated in the official statistics (see also Frost, 2004; Frost and Ho, 2005). As noted in UNCTAD (2007a: 60-62), "in some host countries [in Southeast Asia], such as Thailand, the Lao People's Democratic Republic and Cambodia, there seems to be some definite evidence of Chinese SME-TNC OFDI in sectors such as garments and electrical/electronic goods, often underwritten by close links between individuals in China and the host country (usually people of Chinese ethnic origin)".

In short, the above four internationalization strategies tend to be regularly deployed by MCTNCs in order to venture successfully into host countries in Asia and elsewhere. This observation, however, does not obliterate the strategic necessity of these MCTNCs to achieve cost and/or relevance in their products and services. In the political-economic contexts of

China as an emerging giant, these strategies seem to be much more relevant than the strategy of product differentiation based on technology, branding, quality, and other value propositions that is often associated with TNCs from developed countries.

**Modes of Entry and Competitive Performance**

As alluded briefly above, the internationalization of MCTNCs into other host countries in Asia and elsewhere takes a great variety of organizational forms. The choice of different modes of entry into host markets becomes an important issue in understanding the internationalization processes of MCTNCs. In general, there are many ways of organizing transnational operations, from arm's-length market transactions (i.e. exports) to fully integrated vertical hierarchies (i.e. FDI). Joint ventures and acquisitions are also common organizational modes through which Chinese firms internationalize their operations into other host countries (see also Deng, 2007; Hui and Fatt, 2008). In fact, many Chinese firms are joining hands with local enterprises and state institutions in the host countries. These joint ventures may take the form of equity investment or non-equity cooperative agreements (e.g. joint production arrangements). In APF Canada's (2005; 2006) surveys, over 60% of OFDI projects were conducted through joint ventures rather than greenfield investment or M&As.

Our study also shows that one of the most common market channels adopted by MCTNCs in Southeast Asia is the establishment of joint ventures with local firms. In Indonesia and Thailand, for example, the retail sector remains protected against complete foreign ownership. Most of the Chinese firms in Table 4 have entered into joint ventures with local Indonesian and Thai firms to market their products. In Indonesia, for example, Chinese brand manufacturers have entered into joint ventures with local Indonesian firms to provide credit and financing deals to consumers (Authors' interview, 16 July 2003). In Thailand, Haier entered into a joint venture with Distar Electric to market its products. The Thai partner was originally selling its own brand Distar TVs and had 15% of the Thai TV market. After

forming the joint venture, Distar Electric continues to market its own Distar products and yet market Haier products (*Nation*, 6 December 2002).

In more recent years, however, acquisitions are preferred by large Chinese conglomerates to gain access to foreign assets and to control their foreign subsidiaries. Boston Consulting Group (2006: 6) estimates that since 1986, MCTNCs have acquired some US$30 billion worth of assets in non-Chinese companies and nearly a third of these were done in 2004 and 2005 alone. Other cooperative strategies in internationalization, such as informal networks and strategic alliances, are also adopted by MCTNCs. These cooperative strategies are often socially embedded in ongoing personal and business relationships among entrepreneurs and managers from China. What then explains the choice of organizational modes in the internationalization of these Chinese firms? Two sets of explanations are relevant.

In their domestic *institutional contexts*, business firms in China may face positive or negative discrimination and regulatory constraints in an emerging form of socialist market system (see Boisot and Child, 1996; Child and Tse, 2001; Zhang, 2003; Breslin, 2007; Zweig and Chen, 2007). Many decide to venture beyond China in order to ride on such home-specific advantage (e.g. favourable state incentives and support) or to transcend such home-based limits to growth (e.g. monopolistic presence of large SOEs in certain sectors and state intervention in industrial policies). At a result, foreign-based affiliates are used to offset accusations of capital flight. Another component of the institutional context is the host business environment. When MCTNCs try to venture into unfamiliar markets in another region (e.g. Latin America), acquisitions are preferred because of relatively unfamiliar business environment and the tyranny of distance in developing new ventures and exercising effective management control. Acquisitions of existing operations in these host countries facilitate risk minimization, experience building, and major subsequent investments in the host region. On the other hand, the more opaque business environments in many developing

countries in general also favour joint ventures between Chinese firms and indigenous enterprises/state institutions. These Chinese firms may also team up with TNCs from developed countries that are keen to establish themselves in some booming emerging markets. Some MCTNCs may therefore promote themselves as the intermediaries between the Global South and the West.

*Firm-specific advantages* also play an important role in explaining the choice of an entry mode by Chinese firms. If a particular Chinese firm has gained sufficient firm-specific advantages in its unique domestic political-economic context (e.g. through market dominance or monopolistic protection), it may pursue a beachhead strategy for internationalization. On the one hand, many Chinese firm have established representative offices or sales offices in order to penetrate the host markets. APF Canada's (2005; 2006) surveys shows that some 47-56 percent of all OFDI cases were in the form of these representative or sales offices (see also Table 4). On the other hand, the Chinese firm may engage in joint ventures with host firms to "test the water". The foreign joint venture operation also serves as a marketing and information gathering intelligence unit to prepare the parent Chinese firm for the eventual establishment of wholly owned subsidiaries in the host countries. A Chinese firm may also prefer acquisition than other forms of transnational operations in order to gain economies of scale quickly in the host country (e.g. retail stores). Once critical mass is achieved in a particular host country, the MCTNC can exploit its business networks and other cooperative strategies to further its growth. Acquisition of existing affiliates abroad, as a form of direct investment, often enables Chinese firms to engage in transnational operations and expand into new markets and production sites. In order to sustain this process of internationalization, these Chinese firms rely on both existing competitive advantages derived from their home market (i.e. China) and new sources of advantages developed in the host countries.

In the case of a majority of China's OFDI in other developing countries in South and

Central Asia, Africa, and Latin America, MCTNCs tend to thrive on difficult and opaque business environments. Their competitive performance is embedded in the following three important advantages. *Locational advantages* are perhaps the most important determinant of the success (and failure) of Chinese firms operating in other developing countries. First, many MCTNCs tend to enjoy significant cost advantages based on their home operations and the host countries. This location-specific advantage allows MCTNCs to compete against even the most technologically sophisticated and capital-intensive TNCs from developed countries. This cost advantage becomes particularly important when it comes to developing new markets in emerging and/or poorer countries. Our interviews and local surveys show that most MCTNCs in our study (see Table 4) enjoy this cost advantage irrespective of whether they have a direct manufacturing presence in Southeast Asia.

These firms have enjoyed some extent of competitive advantage through their "guerrilla-style" sale strategies that allow them to penetrate market segments abandoned by leading South Korean and Japanese brands. In particular, Chinese products have made a significant inroad into the lower-income market segment of most categories of consumer electronics products in Southeast Asia. Our interviewees noted that most Chinese products are sold to lower-income consumers who are much more cost-conscious than brand-conscious. Even among consumers who might be more brand-conscious, Chinese products are disguised through branding practices that are locally specific. For example, Malaysian trading companies are well aware of Japan's National/Panasonic as one of the most preferred brands among local Malays. These Malaysian companies have therefore tied up with China's Chunlan to manufacture OEM products with the brand name "Pansonic" (see Table 4). Through this imitation strategy, these Malaysian companies have some success in marketing Chunlan-made products in the Malaysian market.

Second, Chinese firms enjoy a great deal of location-specific advantage through their

knowledge of home and host business environments. For a variety of reasons suggested earlier (e.g. political or personal connections), MCTNCs are often more experienced and familiar with circumstances of imperfect information or market failure in even the most difficult developing countries. This survival instinct proves to be particularly useful in the context of FDI in developing countries when formal organizational structures and management systems are less effective than centralization of information and decision-making (see also Buckley et al., 2007). Many largest MCTNCs remain highly centralized in their transnational operations, reflecting their continual belief in quick decision-making, operational flexibility, and high adaptability to the host developing country environments. These are all elements of location-specific business knowledge engendered through years or decades of operating in China's peculiar political-economic context. For example, many Chinese firms in our study (see Table 4) are well honed in marketing their products in less developed areas in China. This location-based strategy seems to work well in such fragmented markets as Indonesia and Thailand where some lesser towns and cities remain relatively less "congested" in terms of brand choice and cost options. By focusing on these underdeveloped markets, mainland Chinese products have gained some competitive advantage in their marketing efforts.

Moreover, most MCTNCs have enjoyed some competitive advantage through striking very *flexible dealership* with local distributors. This marketing advantage contrasts very sharply with Japanese and South Korean firms. According to our interviewees, Japanese electronics firms are most rigid about their dealership arrangements and incentive programs. On the other hand, Chinese brands are highly flexible in developing their relationships with local distributors. One interviewee in Thailand observed that "Chinese brand sales staffs tend to be most willing to assist as they want a foothold in the market" (Interview in Bangkok, 5 August 2003). Another interviewee in Indonesia noted that a Chinese brand manufacturer

allows each dealer to fix their own terms with the Chinese firm (Interview in Jakarta, 16 July 2003). There is no fixed price and minimum sales target stipulated by the Chinese firm to its local dealers. Each local dealer is allowed to carry other brands, whether Chinese or other brands. Such unrestricted dealership is quite attractive to start-up as well as established distributors in Southeast Asia because the entry barrier to market is rather low.

These *networking capabilities*, in turn, are both socially and economically determined. In China, entrepreneurs rely heavily on business networks to facilitate transactions and circumvent cumbersome rules and regulations. These Chinese firms often engage in political-economic alliances in order to obtain privileged access to markets and resources. When these firms internationalize their operations, such political-economic alliances will not provide a significant source of competitive advantage except that they enable these Chinese firms to build up sufficient capital and market bases in their home market, thereby enabling cross-border acquisitions and/or new venture formation. Apart from these political-economic alliances, Chinese firms also gain competitive advantage from the formation of personal and business networks. These networks have proved to be a significant source of competitive advantage when these firms compete with foreign firms in regional markets. First, informal business networks facilitate access to capital. Second, market knowledge, economic synergy, and high degrees of operational flexibility can be achieved through business networks. In our 2003/2004 study, Chunlan found it very difficult to market its own-brand products in Malaysia. But its OEM tie-up with trading companies in Malaysia to produce and market Pansonic products is much more effective in penetrating the Malay community in Malaysia. Most MCTNCs thus depend heavily on the use of local distributors to market their OEM products. For example, Haier tends to use local distributors because of their local knowledge of the market environment and business practices. Local distributors also do not suffer from barriers in languages and cultures. Finally, Chinese firms develop their competitive advantage

through strategic investments in other developing countries. These host markets provide useful "training grounds" for the firm's personnel to experience new management and marketing practices.

Since the early 1990s, *home government institutions* in China have explicitly favoured a set of industrial and business policies that promote national champions (Nolan, 2001; Breslin, 2007; see also Table 1). During the 14$^{th}$ Chinese Communist Part Congress in 1992, then President Jiang Zemin declared that "to open wider to the outside world… we should encourage [Chinese] enterprises to expand their investments abroad and their transnational operations" (Quoted in Wu, 2007: 445). Between 1991 and 1997, some 120 Chinese firms were given generous grants, incentives, and institutional support so that they could develop into global players (e.g. all SOEs in Table 2). In April 2003, the State Asset Supervision and Administration Commission (SASAC) was established with the mandate of transforming the SOEs under its control into 50 global TNCs featured in the *Fortune Global 500* (Pamlin and Long, 2007: 19-20). These forms of home state support are undoubtedly important in the global success of some of the most powerful MCTNCs listed in the *World Investment Report* (see UNCTAD, 2006), *Fortune Global 500*, and *Business Week*'s Top 200 Emerging Market Companies. Child and Rodrigues (2005: 403) thus note that major MCTNCs "are using financial strength, often supported by governmental sponsorship and financial underwriting, to secure other advantages through purchase and associated opportunities to learn" (see also Wang, 2002). Still, we should not ignore other forms of less visible support given to lesser known and smaller Chinese firms in order for them to venture abroad, particularly in nearby developing countries. UNCTAD's (2007a) recent report offers strong evidence on some Chinese government policies for promoting outward FDI and grooming global players. Many of these favourable policies have "spillover" effects on domestic Chinese firms. For example, large and successful MCTNCs may engage their domestic suppliers and business associates in

their internationalization processes. There is a kind of chain-reaction in the FDI process when smaller Chinese firms follow the lead of large MCTNCs.

While the above competitive advantages tend to work in favour of MCTNCs in the context of FDI into other developing countries, we should not be overoptimistic in the global success of these emerging TNCs for several reasons (see also Cai, 1999; Quan, 2001). First, while the role of the state may be beneficial in the context of regional or inter-regional cooperation, it may work against MCTNCs when they venture into more open and liberalized host economies. In some extreme cases, these MCTNCs may suffer from an image problem as they are often viewed as remnants of or surrogates for state-owned enterprises. For example, there are reports that anti-dumping laws in developed countries tend to be harsher on MCTNCs in certain industries, even though their FDI activity is located in other developing countries. In 2000, the US launched six anti-dumping cases against China involving such products as citric acid, crab meat, note-counting machines, hot rolling steel, coke, and magnesium (Deng, 2004: 12). On 13 April 2004, the US Department of Commerce released the final ruling on a dumping accusation against Chinese TV manufacturers launched in May 2003. Ten major Chinese TV manufacturers were charged a high anti-dumping tariff, ranging from 4.35 percent to 24.48 percent (http://www.chinadaily.com.cn, accessed on 9 January 2008). In 2006, the European Union decided to re-impose a 44.6 percent anti-dumping duty on imports of Chinese color TV sets first adopted in 1998 and waived under a "joint undertaking" agreement in 2002 (http://www.china.org.cn, accessed on 9 January 2008). China's fourth largest TV maker, Skyworth, faced this anti-dumping litigation in the US and the EU, even though it was headquartered in Hong Kong and listed on the Hong Kong Stock Exchange (Author's interview with Vice-Chairman in Hong Kong, 17 May 2004).

Second, the risk appetite of some MCTNCs may be excessive, a reflection of their monopolistic positions in China and their lack of professional management systems and risk

assessment mechanisms. Due to the ease of credit access and business opportunities, some well connected MCTNCs may engage in highly risky and volatile businesses abroad. Their top management members are often political appointees who are well backed by their status in the Party and yet lack sufficient international business experience. This paradox of strong political clout and weak practical experience among this emerging class of managerial elites in some of China's largest SOEs is one of the most likely reasons accounting for the rise of the "too big to fail" syndrome. With the strong political and economic backing of the central government, some of these SOEs can be reckless and predatory in their approach to international investments regardless of risk levels. In some extreme cases, international investments have served as a conduit through which well connected party cadres receive huge payoffs and kickbacks from their host country bankers, underwriters, and joint venture partners. These risky ventures, while boosting the personal ambition/pockets and ego of powerful owners and executives, may prove to be the undoing of these MCTNCs. For example, Boston Consulting Group's (2006: 6-7) study of some 500 international M&A deals involving MCTNCs found that many outright acquisitions had actually destroyed value in the acquired entities and many MCTNCs lacked managerial expertise in executing large-scale cross-border M&As (see also Antkiewicz and Whalley, 2006).

Finally, the performance and competitive outcome of MCTNCs may be marred by their mixed business concerns. Shareholder returns that drive most TNCs from developed countries may not be entirely evident among many MCTNCs. For reasons suggested earlier, other strategic concerns such as market share battles and political-economic alliances may pose as a significant distraction from shareholder concerns. This applies even to those MCTNCs listed on stock exchanges in China and the host economies (e.g. Hong Kong and Singapore). The Boston Consulting Group (2006: 17) study further notes that "Chinese companies tend to be highly entrepreneurial. Often, they are run by a small group of owner-managers who create a

strong patriarchal culture characterized by personal loyalty. They make decisions quickly without a lot of analysis. They also lack process discipline, and their management processes tend to be disorganized".

## CONCLUSION

Through a general and comprehensive analysis, this paper provides clear evidence that "globalizing China" should be reckoned with as an emerging political-economic force in the global economy. Mainland Chinese TNCs are increasingly becoming major players in selective sectors and host regions and/or economies. Our tentative conclusion is that this emerging phenomenon will only grow stronger and more intensive in the near future. A political-economy approach to this relatively recent phenomenon of "globalizing China" yields much more valid insights into its complexity, multi-dimensional nature, and differentiated power relations among different actors. Our analysis therefore has serious implications for both home and host countries. One implication relates to the changing competitiveness of both China and host countries. Different forms of China's OFDI can impact seriously on China. Developing new technology and expertise abroad, coupled with appropriate home government industrial policies, can make a significant difference to China's industrial upgrading and new competitiveness in higher value-added manufacturing activity (e.g. Haier's success in the global home appliances market). "Globalizing China" in resources and new markets can also enable China to secure crucial resource suppliers and/or market growth via an "external wing". The internationalization of many MCTNCs allows them to transcend home market constraints. A well-developed presence in foreign markets allows these MCTNCs to gain new knowledge and firm-specific competitiveness that can be brought back to their home operations.

Meanwhile, the host regions and/or economies can also benefit from the inflows of a kind of FDI that might be more appropriate to their stages of economic development. Apart from

positive employment effects, consumers in the host markets can also experience a wider variety of locally produced foreign products at competitive prices (e.g. electronics MCTNCs in Southeast Asia). Closer social and institutional affinity between China and host regions and/or economies may allow employees in these MCTNCs to experience better "demonstration effects" in terms of entrepreneurship and business skills. Furthermore, China's OFDI can improve intra-regional cooperation and competitiveness of individual developing countries that might other receive no FDI at all from developed countries. The synergy effect of this form of cooperative "South-South FDI" can be significant in regions such as Africa and Latin America. However, South-South FDI does not necessarily bring only benefits to the host developing countries. Under certain conditions (often related to poor state regulation and enforcement), it can lead to the demise of local industries, excessive exploitation of host resources, and environmental degradation – significant issues deserving closer scrutiny in future research.

Furthermore, reputation risks can be significant for both China and the host regions and/or economies. In some instances, MCTNCs at home may suffer from reputation damage when their affiliates in the host countries are convicted of bad business practices (e.g. corruption and monopolistic pricing). In other cases, successful joint ventures in the host regions and/or economies do not often engender further business cooperation in third-party countries. These MCTNCs may be seen as unfriendly and lacking in cooperative spirit. Their joint ventures in the host countries may be viewed as a partnership of convenience rather than a partnership of equals. Finally, China may suffer from a kind of nationalism backlash when the host countries are unhappy with the excessive domination of these MCTNCs in certain sectors and industries (e.g. SINOPEC's unsuccessful bid for Russia's Slavnet in December 2002, China Minmetals' foiled purchase of Canada's Noranda in early 2005, and CNOOC's failed takeover of America's Unocal in July 2005).

On the brighter side, stronger regional solidarity can develop through geopolitically inspired "South-South" FDI. If well handled, the Chinese government may gain political and other forms of legitimacy through this form of international capital flow. Host countries will have access to capital and skills badly needed for economic development. However, there is also a clear danger for both home and host countries to associate South-South FDI as political projects. There may be significant differences between running projects on the ground viz. political mandates at the top in China and the host regions and/or economies. All in all, this paper shows that China's OFDI can vary very significantly across different sectors, regions, and countries. These variations mean that some OFDI from China can be highly beneficial to China and the host regions and/or economies, whereas other FDI projects may be problematical. It is therefore necessary to appreciate this intrinsic diversity and complexity in China's OFDI before appropriate policy regimes and recommendations can be established.

## NOTES

[1] In order to avoid confusion of MCTNCs with TNCs owned and controlled by ethnic Chinese living outside China (e.g. in Hong Kong, Malaysia, Singapore, Taiwan, Thailand, and so on; see Yeung and Olds, 2000; Yeung, 2004a), we adopt the term "mainland Chinese" TNCs throughout this paper. Unless specified otherwise, the acronym "MCTNCs" will be used. For the same reason, we use "mainland Chinese" throughout the paper.

[2] The relatively recent and, in some cases, obscure activity of mainland Chinese firms in Southeast Asia does not allow for a systematic methodological approach. We therefore employed a mixed method approach. In 2003 and 2004, we interviewed senior executives from Haier in Qingdao, China (via telephone), TCL in Shenzhen, China (via telephone), Skyworth in Hong Kong (face-to-face), Chunlan in Singapore (face-to-face), and Konka in Jakarta (local consultant). We also conducted personal interviews with 15 local distributors of these Chinese firms in Malaysia, Indonesia (by local consultants), and Thailand (by local consultants). Market surveys with 150 consumers and 10 distributors each in Indonesia, Malaysia, and Thailand were also completed via local consultancy firms.

[3] There are significant differences between the Ministry of Commerce data and the UNCTAD data on OFDI from China. The Ministry of Commerce data do not include reinvested earnings, intra-company loands and non-financial and private-sector transactions. Its data therefore report lower OFDI values than those offered by the UNCTAD.

[4] In comparison to the literature on TNCs from developing economies in general that dates back to the late 1970s, this literature on outward FDI by mainland Chinese firms is relatively recent. Some of the earliest papers examine how some Chinese firms were internationalizing their operations when the phenomenon was still not in the media limelight (Gang, 1992; Wu, 1993; Tseng, 1994; 1996; Zhang, 1995; McDermott and Huang, 1996; Tseng and Mak, 1996;

Young et al., 1996; 1998; Zhang and Van Den Bulcke, 1996). Since the new millennium, researchers have begun to pay more serious attention to this emerging topic.

[5] The sample of APF Canada's (2006: footnote 3) survey was drawn from the membership of the China Council for the Promotion of International Trade (CCPIT). The CCPIT is the most important and the largest institution for the promotion of foreign trade in China. It has under it 49 local branch offices, 18 industrial branch offices, more than 600 sub-level branch offices and county-level chambers of commerce, and more than 60,000 member enterprises, covering all parts of China and all trades and industries in the country. CCPIT operates 15 representative offices in Hong Kong, the US, Canada, Britain, Germany, Australia, Italy, South Korea, Japan, Belgium, France, Mexico, Russia, the Dominican Republic and the United Arab Emirates.

[6] Xiao (2004: 11) suggests four major incentives for China's round-tripping FDI via Hong Kong: (1) taking advantages of tax and other fiscal incentives available to foreign enterprises in China; (2) seeking better property rights protection among private sector entrepreneurs from China; (3) speculating on exchange control and exchange rates because of international pressure on the revaluation of the RMB; and (4) exploiting Hong Kong's role as the best intermediation for internationally competitive financial services.

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**Table 1. Evolution of China's Policy Towards Outward Foreign Direct Investment, 1979-2007**

*STAGE ONE (1979 – 1983): Case-by-Case Approval*
Only state-owned trading corporations and provincial or municipal-based international economic and technology cooperation enterprises were permitted to invest overseas on a case-by-case basis. The State Council was the sole authority responsible for examining and approving overseas investment. OFDI was in effect prohibited unless specifically approved by the State Council, and hence there were no regulations on OFDI as such.

*STAGE TWO (1984 – 1992) Standardization of Approval Procedures*
Prohibitions against OFDI were liberalized during this period as the government allowed a wider range of enterprises to invest overseas. Non-state firms, for example, were permitted to establish subsidiaries in other countries. Prior approval was still required from the central authorities, but the approval process moved gradually from a case-by-case approach to more standardized procedures.

*STAGE THREE (1993 – 1998) Greater Scrutiny of Overseas Investment Projects*
A surge in OFDI in the previous period, encouraged both by the relaxation of rules and by an overvalued exchange rate, led to a number of debacles by Chinese entities speculating on the Hong Kong real estate and stock markets. Consequently, Beijing introduced a more rigorous process for screening and monitoring OFDI projects to ensure that these investments were for "genuinely productive purposes".

*STAGE FOUR (1999 – 2002): Overseas Investment in Processing Trade Activities*
The period straddling China's entry into the World Trade Organization was a turning point in Chinese policy towards OFDI. Recognizing the increasingly important role of Chinese enterprises in global trade and production networks, Beijing put in place new policies to encourage firms to engage in overseas activities that augmented China's export drive, also known as "processing trade" projects. The light industrial goods sector, for example textiles, machinery and electrical equipment, was encouraged to establish manufacturing facilities overseas that would use Chinese raw materials or intermediate goods. The Chinese government offered a variety of incentives including export tax rebates, foreign exchange assistance, and direct financial support.

*STAGE FIVE (2002 – Present): The "Stepping Out" Strategy*
At the Chinese Communist Party's Sixteenth Congress in 2002, the leadership announced a new strategy of encouraging Chinese companies to "Step Out" into the global economy not only through exports, but also by investing overseas. This policy shift was seen as a necessary concomitant to the successful inward investment and export policies of the 1980s and 1990s, and as part of the ongoing reform and liberalization of the Chinese economy. It also reflects a desire on the part of the Chinese government to create world class companies and brands, whereby Chinese firms are seen as more than secondary nodes in production networks that are ultimately controlled by TNCs based in industrialized countries. Recent changes in OFDI policy have focused on five areas: creating incentives for outward investment; streamlining administrative procedures, including greater transparency of rules and decentralization of authority to local levels of government; easing capital controls; providing information and guidance on investment opportunities; and reducing investment risks.

Source: Woo and Zhang (2006: 3-4).

**Table 2. Stock of Outward Foreign Direct Investment from China by Major Host Country/Region in 2006**

| Region | FDI Stock | Region | FDI Stock | Region | FDI Stock |
|---|---|---|---|---|---|
| **Total** | **75026** | Vietnam | 254 | Russia | 930 |
| **Asia** | **47978** | Indonesia | 226 | UK | 202 |
| Hong Kong | 42270 | Japan | 224 | **Latin America** | **19694** |
| Korea Republic | 949 | **Africa** | **2557** | British Virgin Is. | 4750 |
| Macau | 612 | Sudan | 497 | Cayman Island | 14209 |
| Singapore | 468 | Zambia | 268 | **North America** | **1587** |
| Iraq | 436 | Algeria | 247 | USA | 1238 |
| Mongolia | 315 | Nigeria | 216 | Bermuda | 208 |
| Kazakhstan | 276 | **Europe** | **2270** | **Oceania** | **940** |
| Saudi Arabia | 273 | Germany | 472 | Australia | 794 |

Source: Ministry of Commerce (2006).

**Table 3. The 10 Largest Chinese Non-Financial TNCs Ranked by Outward FDI Stock in 2006**

| No. | Name of Firm | No. | Name of Firm |
|---|---|---|---|
| 1 | China Petrochemical Corporation | 6 | China Ocean Shipping (Group) Company |
| 2 | China National Petroleum Corporation | 7 | CITIC Group |
| 3 | China National Offshore Oil Corporation | 8 | China National Cereals, Oils & Foodstuffs Corp. |
| 4 | China Resources (Holdings) Co. Ltd. | 9 | China Merchants Group |
| 5 | China Mobile Communications Corporation | 10 | Sinochem Corporation |

Source: Ministry of Commerce (2006).

**Table 4. Market Presence of Mainland Chinese Electronics Manufacturers in Southeast Asia**

| Chinese Firms | Main Products | Manufacturing | Sales Office | Local Distributors | Importance of SEA-3[1] | Control functions |
|---|---|---|---|---|---|---|
| Chunlan (Pansonic) | Air-con, fridges and washing machines | OBM and OEM in China | Singapore (holding company) | SEA-3 | Very important due to its Southeast Asia Project | Singapore |
| Haier | Air-con, fridges and washing machines | Own factories in Indonesia (1996), Malaysia (1998), the Philippines (1996) and Vietnam (2000) | Indonesia, Malaysia, Thailand and the Philippines | SEA-3 | Very important | China |
| TCL | TV | OBM/OEM in China and own factory in the Philippines (2000) and Vietnam (2000) | Indonesia, the Philippines, Singapore and Vietnam | SEA-3 | Very important | China |
| Changhong | TV and air-con | OBM and OEM in China and own factory in Indonesia (Sept 2000) | Indonesia | SEA-3 | Very important (1st plant outside China set up in SE Asia) | China |
| Konka | TV, DVD and washing machines | OBM and OEM in China and own factory in Indonesia (Cikarang) | Indonesia | SEA-3 | Very important | China |

[1] SEA-3 refers to Indonesia, Malaysia, and Thailand.
Sources: Authors' interviews, published reports, and company websites.

**Figure 4. Global Distribution of Non-Financial Outward Foreign Direct Investment from China in 2006**

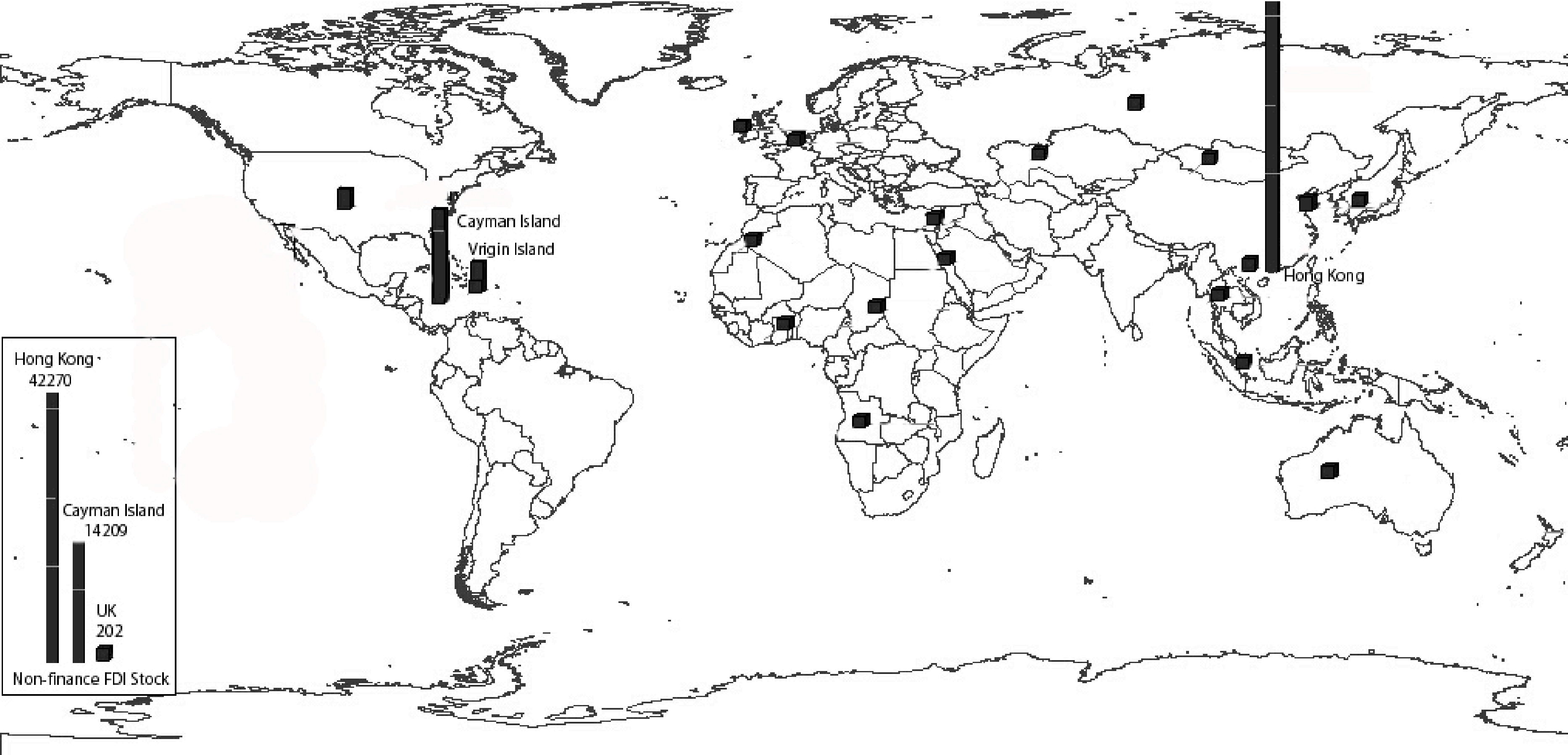
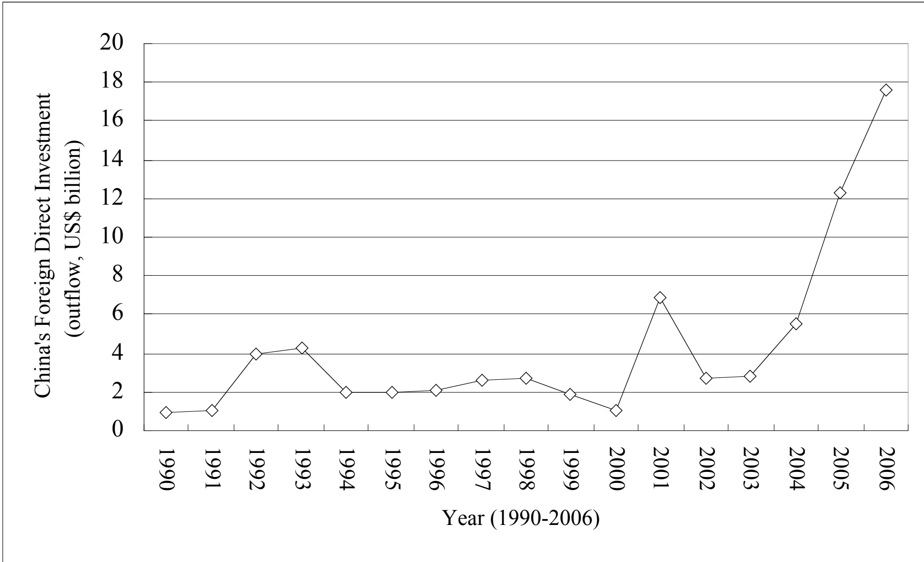
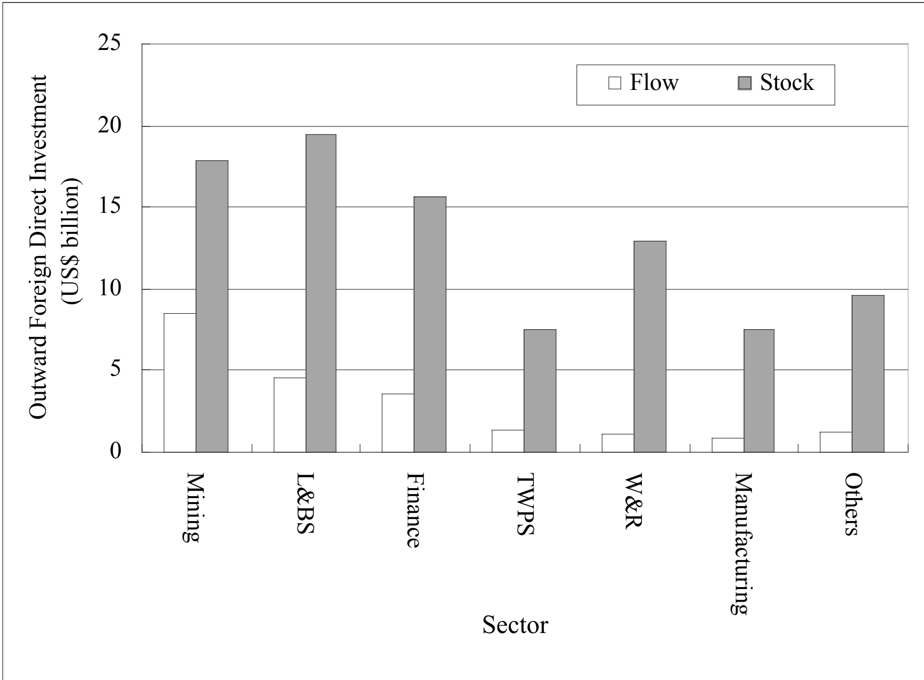


**Figure 1. Outward Foreign Direct Investment from China, 1990-2006**



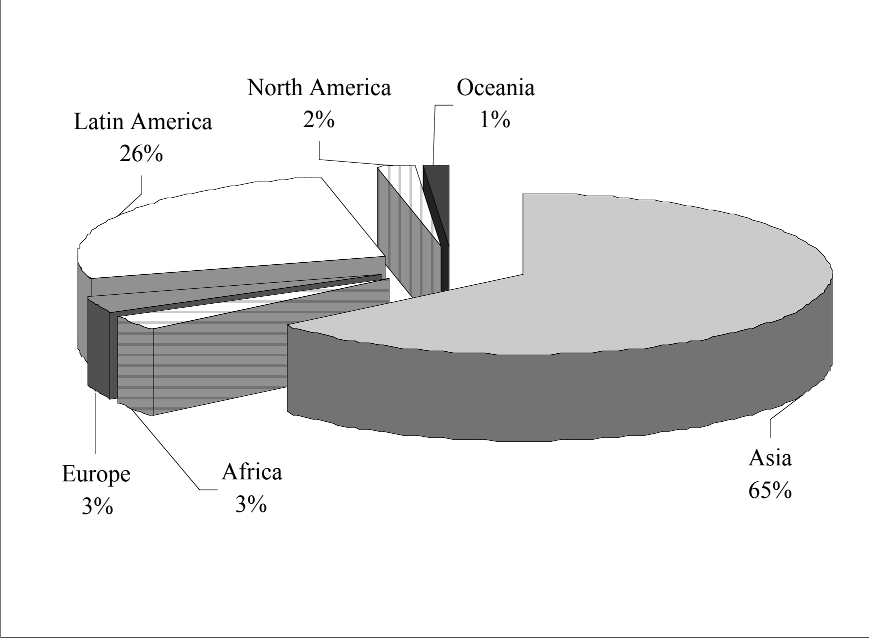

Note: These data do not include OFDI in financial services.
Source: Ministry of Commerce (2006).

**Figure 2. China's Outward Foreign Direct Investment Flow and Stock by Sector in 2006**




Note: L&BS: Leasing & business service; TWPS: Transport, warehousing & postal service; W&R: Wholesale & retailing.
Source: Ministry of Commerce (2006).

**Figure 3. Stock of Non-Financial Outward Foreign Direct Investment from China by Region in 2006**




Source: Ministry of Commerce (2006).