Journal of Business Strategy

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The authors wish to acknowledge the research assistance provided by Jennifer Jokl, Liyang Liu and Aniruddh Fatehpuria of Rollins College.

Zou chu qu: Chinese firms going global

The rise of China on the global stage in recent decades is an important chapter in contemporary world economic history. Since the reform era began in 1978, with its large population base, low-cost labor and abundant capitals from foreign direct investments (FDIs), China has essentially functioned as the world's low-cost manufacturer; however, this export-driven model cannot be sustained forever, as further growth in trade is rather limited, and wages in China have also begun to rise. In anticipation of its World Trade Organization membership concessions, the Chinese government in 1999 launched its "*Zou Chu Qu* – going global" strategy, a major policy initiative that has since had a profound impact on not only the growth of the Chinese companies but also the world economic development.

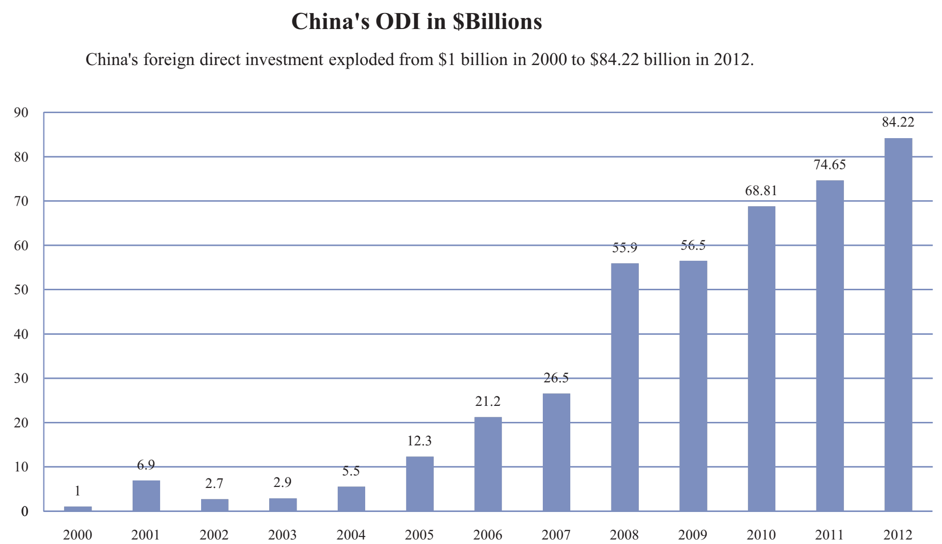
Just as every multinational has been busy formulating its own strategy for China, Chinese firms are also trying to figure out how to better integrate into the global economy. In developing their business expansion plans, they typically align with the nation's strategic priority. This is especially the case for Chinese state-owned enterprises (SOEs), which have been playing a dominant role in the current globalization drive. What is their decision-making process? What are their rationales and the key motivation factors for going global? What are their preferred modes of entry and location choices? This research presents the findings of a survey conducted by the China Center at Rollins College in collaboration with Kedge Business School and China Executive Leadership Academy at Pudong (CELAP). Conducted in 2011-2012, the objective of this study is to gain a better understanding of the outward direct investments (ODI) by Chinese SOEs under the government's "going global" strategy; more specifically, it aims to understand where and why SOEs are investing.

Overview of the Chinese ODI

China has is ranked among the top recipient countries of the world's FDI. However, not too many people realize that with 84 billion dollars of ODI in 2012 and another 84 billion from Hong Kong SAR, China is already the third largest investment economy in the world, only after the USA (329 billion) and Japan (123 billion), and ahead of the UK, Germany and Canada (UNCTAD, 2013). The Economist Intelligence Unit (2013) even predicts that by 2017 China will become a net investor in the world. Figure 1 demonstrates the remarkable rise of Chinese outward FDI since the beginning of this century when the "going global" strategy was first launched.

While much attention has been focused on the large FDI China received, the tremendous growth of its manufacturing sector and its global trade outreach, it is only in recent years that international business scholars begin to study the Chinese ODI (e.g. Alon *et al.*, 2012).

Figure 1 China's ODI (2000-2012)



Source: PRC Ministry of Commerce, and the UNCTAD *World Investment Report 2013*

Despite the new development from emerging economies such as China, the mainstream theory on FDI is based largely on the foreign investment practices made by firms from the developed countries. In outlining his eclectic paradigm, Dunning (2001) identifies ownership, location and internationalization (OLI) advantages that motivate firms to go global. In terms of location choice, he further lists three primary factors for firms seeking outward FDI:

1. foreign-market-seeking ODI;
2. efficiency-seeking ODI; and
3. resource-seeking ODI (Dunning, 1977, 1993).

As China is known for its low-cost manufacturing, efficiency-seeking ODI has largely been disregarded as a primary motivation factor for most Chinese firms. According to Buckley *et al.* (2007), foreign-market seeking ODI is typically taken by companies for trade supporting reasons: accessing distribution networks and enhancing exports to other large and growing markets; while resource-seeking ODI is mostly launched by firms to secure the supply of raw materials and energy sources, and to acquire strategic assets such as R&D capabilities, established brand names, technical and managerial expertise.

Although it has been argued that China does not require a specific model that would differ significantly from the mainstream theories (Peng, 2005), studying Chinese ODI will likely provide us a better understanding on the globalization process of emerging multinational enterprises (MNE) from developing economies. While some scholars examine the macroeconomic determinants (Wei and Alon, 2010), others focus on firm-specific factors that influence Chinese overseas investment (Wu *et al.*, 2012). As China is being transformed from a planned economy to a market economy, the country has also grown swiftly to become the most populous consumer market in the world. Instead of globalizing based on prior competitive advantage, Child and Rodrigues (2005) point out that Chinese firms internationalize to address competitive disadvantages in domestic markets. In other words, the highly competitive nature of the Chinese domestic market is a major force that drives many Chinese companies to adopt the globalization strategy. This argument has

> **"Studying Chinese ODI will likely provide us a better understanding on the globalization process of emerging multinational enterprises (MNE) from developing economies."**

since been supported by other international business scholars, as summarized by He and Lyles (2008, p. 487):

> Today, fierce competition and declining domestic revenues, combined with government encouragement and financial support, are pushing Chinese firms to globalize to establish local sales and distribution networks in host countries, support exports and open up new markets, secure raw materials and acquire technology and global brands.

In terms of ownership structure of outward FDI, China progressively lifted its previous ban on private firm-led FDI (Buckley *et al.*, 2007). The share of private firms is growing, as they accounted for 9.5 per cent of China's ODI in 2012, compared with less than 4 per cent two years before (*Economist*, 2013). Despite the growing activities from private enterprises, the simple fact is that the SOEs have been the dominant force in the current globalization drive. When studying the Chinese ODI, the role of Chinese government and the impact of its major policy initiative must be examined closely.

Chinese SOEs

The globalization of Chinese companies has been heavily influenced by institutional factors (Child and Rodrigues, 2005; Ren *et al.*, 2012). From its early position of controlling and limiting ODI, the Chinese government in recent years has played a more active role in sponsoring and providing support for firms to go global, and this shift toward institutional entrepreneurship has already had a major impact on the internationalization of Chinese firms, especially the SOEs. According to Warner *et al.* (2004, p. 340):

> [. . .] the State's sponsorship and funding support are a key factor that may make possible the frequent acquisition initiated by the PRC-based enterprises as a normal mode of entering and penetrating a host economy.

While many governments around the world have developed various laws and regulations to promote inward FDI, the Chinese government has gone a step further by playing the role of facilitator in the globalization of its leading companies. Notable among measures taken by Chinese government to further implement its "going global" policy was a plan in 2002 to create between 30 and 50 "national champions" from the most promising or strategic SOEs (Accenture, 2005). Although state-owned, they are not government-run, and such large firms typically enjoy a range of benefits from the government, including information-sharing networks, domestic tax breaks, cheap land and low-interest funding from state-owned banks (*Economist*, 2005).

Compared with MNEs from the developed countries, Chinese companies often have fewer political constraints in terms of investment destinations. A research report by Accenture (2005) notes China's global political and economic aspirations are an important factor driving expansion abroad, and its outward investment has a dual purpose of building China's political capital and influence around the world. With strong encouragement from the government, in recent years, Chinese SOEs have begun to aggressively build their presence overseas, acquire natural resources, technological skills and know-how, bring their operations in line with international standards and develop new markets and global brands. However, even among Chinese SOEs, there are differences between those controlled by the central government and firms belonging to various provincial and local entities. While a few central enterprises grab most of the spotlight, a large majority of Chinese SOEs are in fact regional companies that do not receive special treatment from the central government, and their ODI decisions are primarily driven by commercial factors.

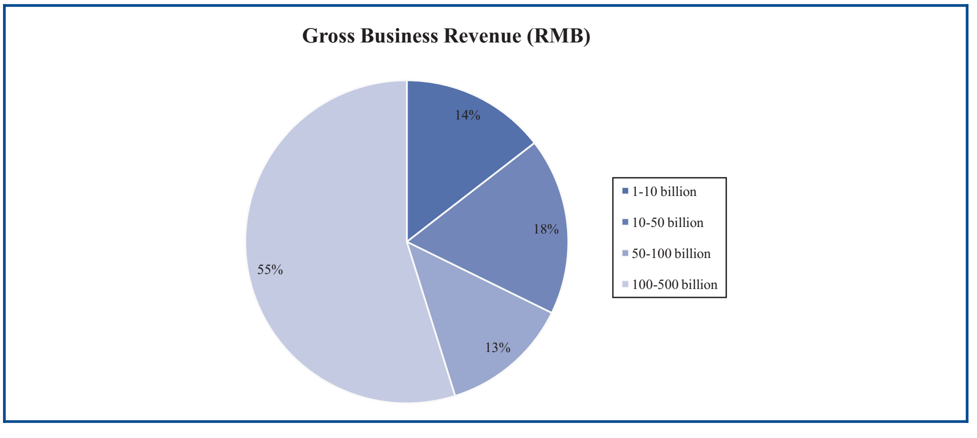
The growth of Chinese SOEs has been a contentious issue. Due to lack of transparency, most people from the West lack a comprehensive understanding of the nature and scope of SOEs. Compared with private firms, SOEs certainly have an ownership advantage largely due to the capital market imperfections in emerging economies (Buckley *et al.*, 2007). Nevertheless, they also face an extra liability of foreignness in their globalization process. Although Chinese SOEs enjoy strong government support to internationalize, they are often perceived negatively overseas, especially in the host countries whose political systems are vastly different from China's. In fact, a recent report indicates that Chinese private enterprises are now finding it easier to go overseas than SOEs (Moody *et al.*, 2013).

The globalization of Chinese SOEs is a complex subject. What is the view of Chinese firms on this matter? How do they perceive the international market nowadays? How do they make decisions, and what are their plans for future global expansion? In the following sections, we present our research findings from the "global champions in waiting" (Lunding, 2006).

Chinese SOEs participated in the study

Since the survey was conducted in Chinese, back-translation was adopted to safeguard the reliability of research data collected. After the original English questionnaire was first translated into Chinese, it was translated back into English by an independent professional translation agency, and then the Chinese questionnaire was revised to ensure accuracy. In our initial survey conducted in 2011, top managers from large SOEs were invited to answer the questionnaire during their executive training program at the *CELAP, and we were able to gather valid* data from 38 Chinese companies. Repeating the same study in 2012, we also collect usable information from 25 additional firms, thus bringing our total sample size to 63 SOEs. Ten companies chose to not to identify themselves in the study. All participating companies are members of the China Council for the Promotion of International Trade (CCPIT). Among them, about 14 per cent of the companies have annual revenue of less than RMB 10 billion (around USD1.67 billion), 55 per cent are over RMB 100 billion (around USD16.7 billion) and another 31 per cent are somewhere in-between (Figure 2). This composition reflects the nature of the CCPIT membership, as large SOEs are more likely to be integrated into the CCPIT for its support in entering international markets.

Figure 2 Chinese SOEs by company size



We believe those companies are a reasonable representative of emerging Chinese SOEs, as the composition of the sample fairly reflects the structure of Chinese industries, ranging from agriculture, airlines, aerospace and automotive to chemicals, construction, energy, finance, insurance, manufacturing, mining, shipping, technology and telecommunication. The companies are representative of a wide range of major and minor industrial sectors, and this diversity maintains a balanced sample of ODI intention from different industries (Figures 3 and 4).

Analysis of the ODI by Chinese SOEs

Our research indicates that a great majority of the respondent companies have already had some involvement in the international markets (Figure 5). However, only 4 per cent of the companies state that more than half of their sales revenue came from overseas business activities such as exports, offshore manufacturing and sales. This indicates that Chinese SOEs are still at the beginning stage of globalization, as overseas revenue only counts for a minor portion of their total operating income. In terms of timing, although the earliest

Figure 3 Chinese SOEs by major industries

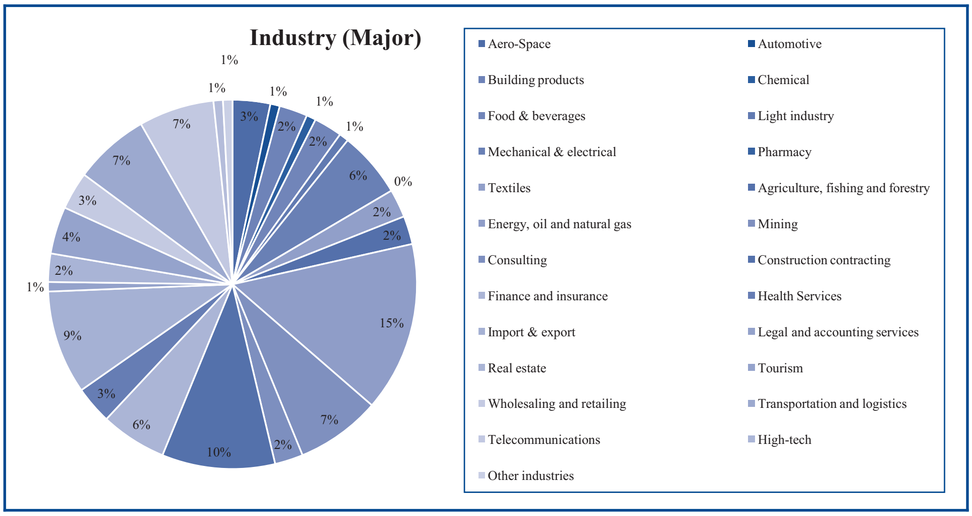


Figure 4 Chinese SOEs by minor industries

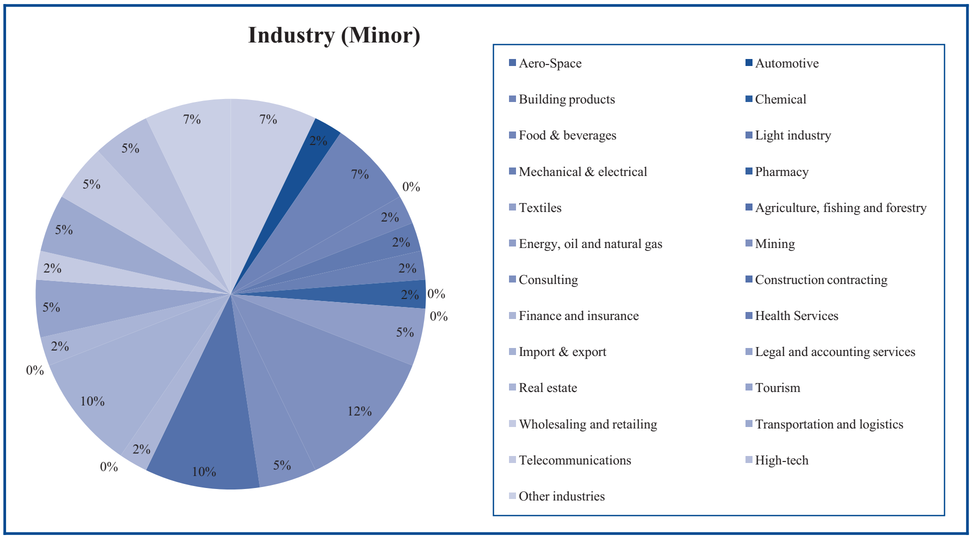
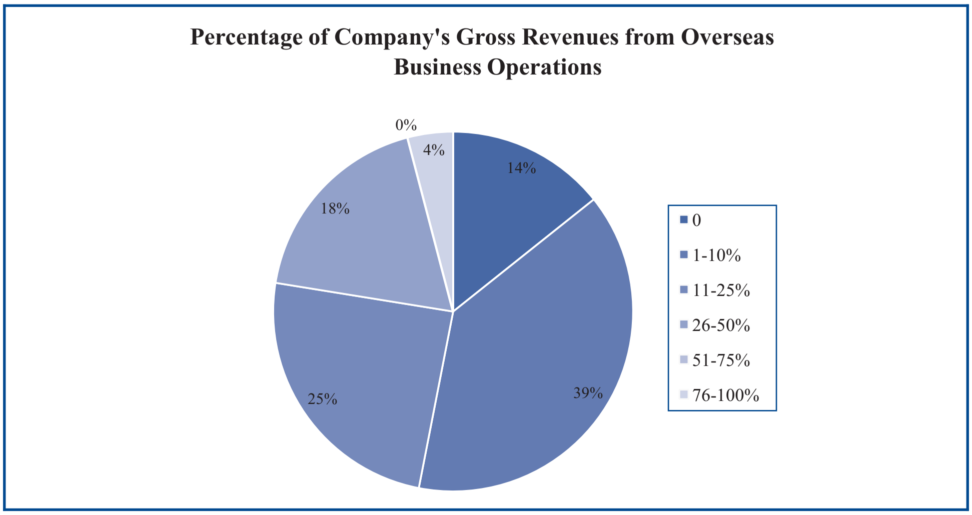


Figure 5 Current involvement in overseas business operations



report of foreign investment project was before 1990, more than 50 per cent of the existing ODI projects occurred after the Chinese government launched the “going global” strategy (Figure 6).

Looking forward, Chinese SOEs seem to be very ambitious about their foreign investment plans, as virtually no respondent companies intend to stay at the same level in terms of ODI over the next five years, and only 13 per cent of companies are planning to do so in the short term. While less than 3 per cent may decrease their foreign investment activities, 44 per cent of the Chinese SOEs that participated in the study intend to substantially increase their ODI over the next five years, and another 35 per cent plan to do so in the immediate future (Figure 7). Further, larger Chinese companies are more likely to start or increase ODI in the near future than their smaller counterparts.

Figure 6 Timing of current ODI by Chinese SOEs

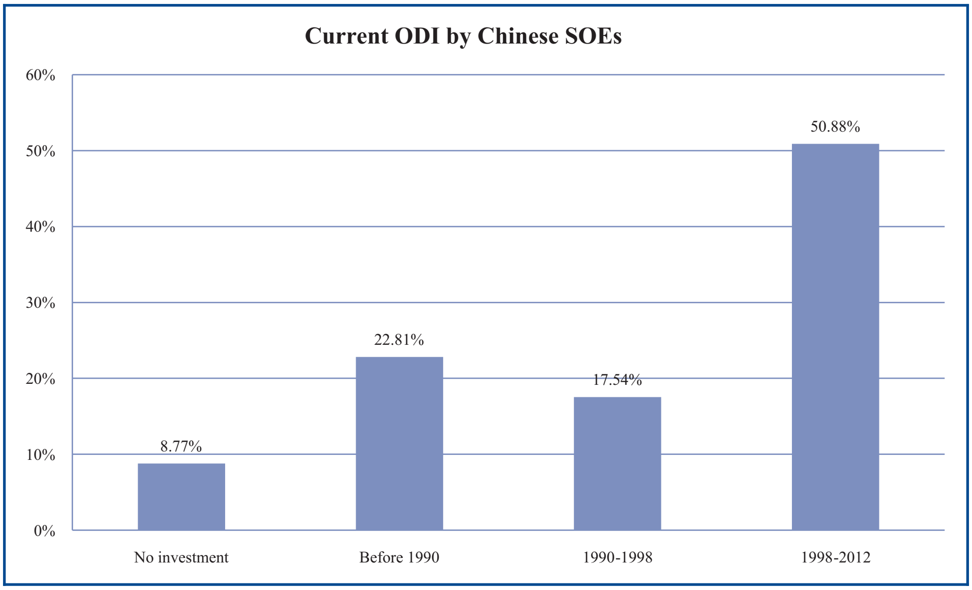
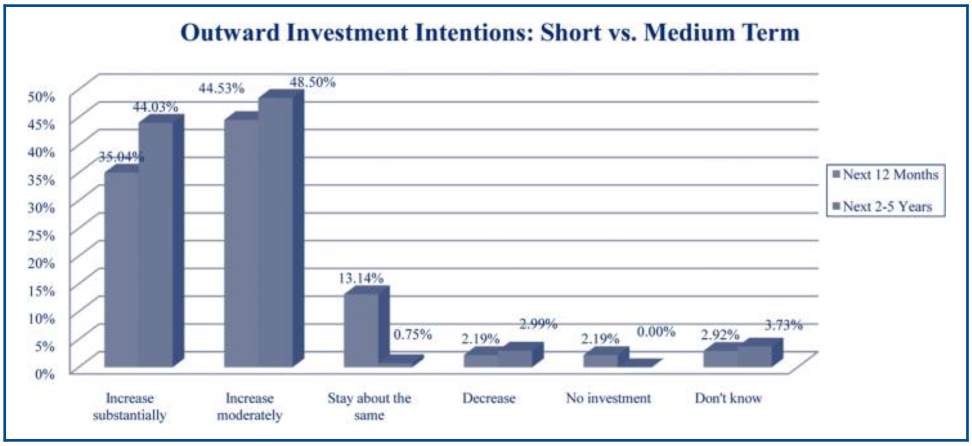


Figure 7 Future ODI intentions of Chinese SOEs



Key drivers of ODI for Chinese SOEs

According to our study, resource extraction, trading (including import/export) and technical services are the top three business activities in which Chinese ODI has flowed to date (Figure 8). Looking forward, Chinese SOEs participating in the survey indicate resource extraction, trading, other manufacturing and technical services are the top four business activities that have the strongest attractions for their ODI in the near future, as more than a quarter of companies specify that resource extraction is the main planned overseas investment for them (Figure 9). This result is consistent with other research findings (e.g. Trinh *et al.*, 2006), and it is not at all surprising to see the desire to secure the energy and resources needed to sustain economic growth as a significant driver of Chinese SOEs' globalization strategy. In fact, KPMG (2013) reports that a majority of China's overseas investments so far have been in the resources sector.

Entrepreneurial insight is critically important for any business ventures, even more so for SOEs, as they often have to overcome the added burden of government bureaucracies and the extra liability of foreignness. The vision of business leaders will likely determine the direction of their overseas investment operations, and one of the greatest barriers to the globalization efforts of Chinese companies is the lack of top

Figure 8 Field of overseas business activity by Chinese SOEs

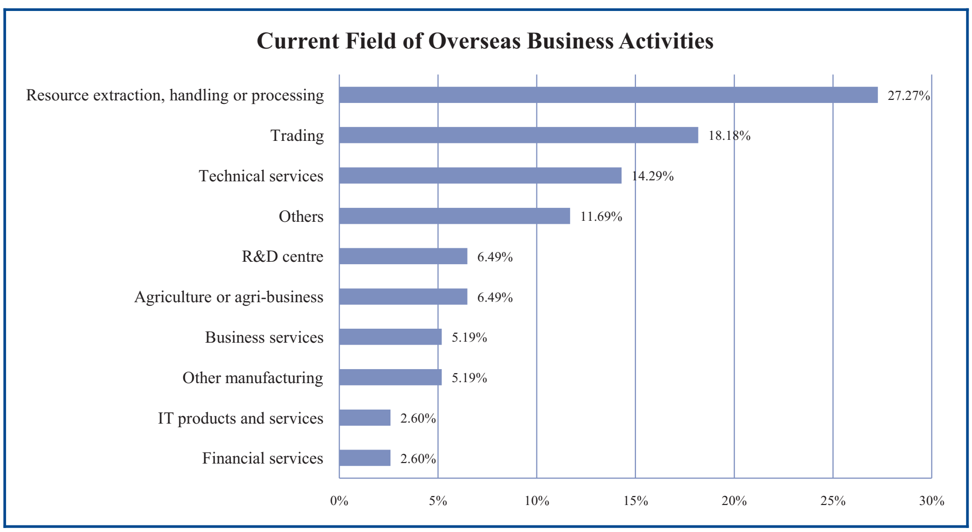
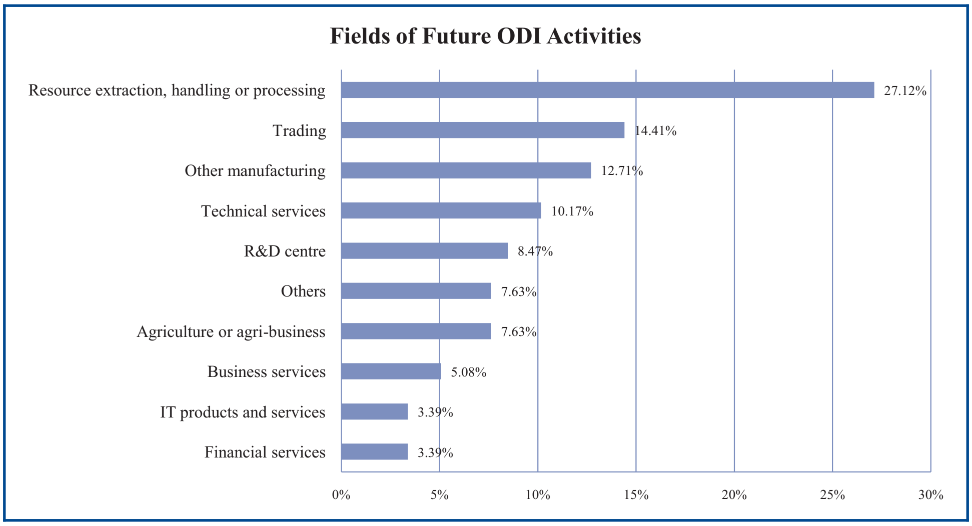


Figure 9 Fields of future ODI activities by Chinese SOEs



employees with the right knowledge and skills (Dietz *et al.*, 2008). According to our study, ODI by Chinese companies is driven primarily by the business strategies of enterprise leaders (Figure 10). On a scale of 1 (weakest) to 5 (strongest), business strategies was ranked highest, 4.55, among all motivations for current ODI.

Besides business strategies by enterprise leaders, other key factors that drive the current overseas investments of Chinese SOEs include the overall importance of the target country as a market, business potential/expansion, governmental policy and assistance and access to natural resources (Figure 10). In terms of their decision-making process for future overseas investments, Chinese SOEs regard business potential, access to natural resources, the government "go global" policy, and the overall importance of the target country as a market as the main factors with a scale above 4.0 (Figure 11). A scale of 3 also

Figure 10 Driving forces of current ODI by Chinese SOEs

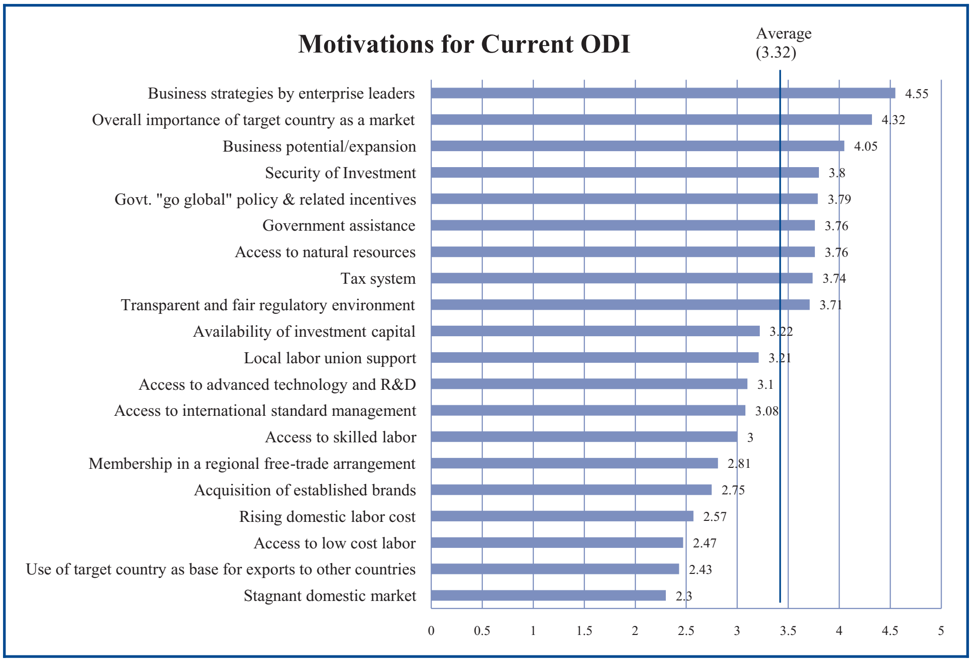
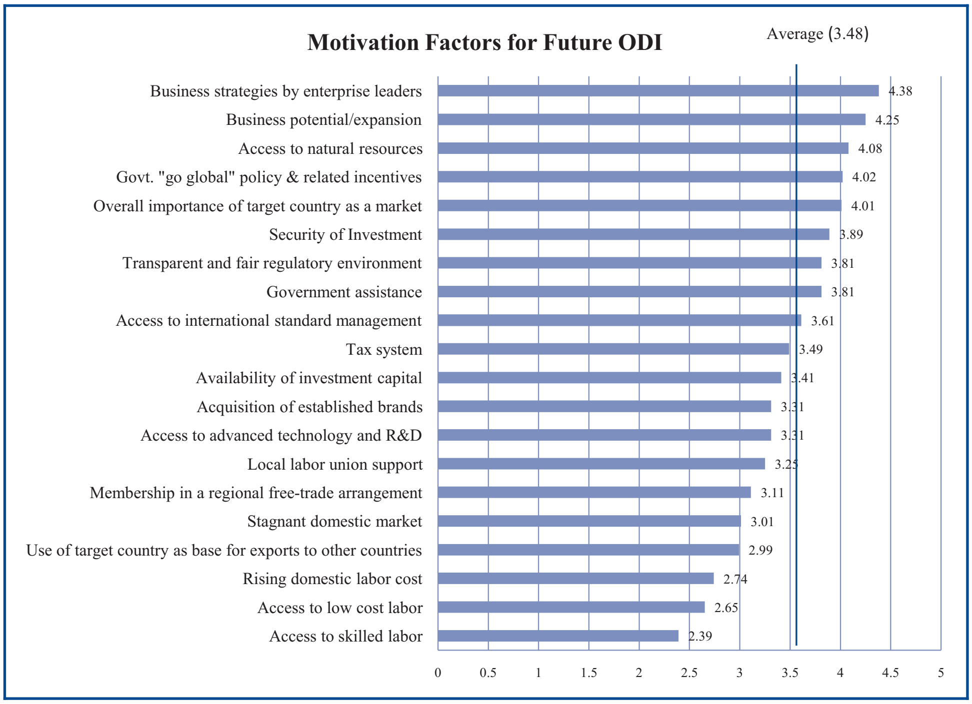


Figure 11 The key motivation factors for future ODI



influences Chinese companies' ODI decisions, but only as a secondary factor. These include: security of investment a transparent and fair regulatory environment, government assistance, access to international management standards, the tax system, availability of investment capital, brand acquisitions and access to technology and R&D. Other motivational factors include stagnant domestic markets, rising domestic labor costs, access to low-cost labor and access to skilled labor. Though still important, these factors are given less priority.

Clearly, Chinese governmental support for globalization is a strong motivation factor for SOEs to internationalize. Given their domestic cost advantage to export, the necessity to access energy and raw materials, and the need to acquire technology, brand names and management talents, it is easy to understand the main rationales for resource-seeking and market-seeking ODIs by Chinese SOEs.

Common routes of ODI by Chinese SOEs

Typical routes toward internationalization include greenfield investments, joint ventures, equity investments and mergers and acquisitions. From the latecomer's perspective, it is crucial for Chinese firms to address their competitive disadvantages through learning and/or asset acquisitions, such as leading international brands, technical knowledge and competence to manage a global enterprise. Many Chinese firms first learn about global markets through joint ventures and partnerships with MNEs from the developed countries that operate in China. When it is their turn to invest overseas, according to our study, a bigger portion of Chinese outward investment projects have been accomplished through greenfield investments, followed by joint ventures, mergers/acquisitions and equity joint ventures. As Figure 12 demonstrated, ODI projects by Chinese SOEs are split relatively evenly among the four entry types.

Many firms prefer to retain full control of their ODI operations. In terms of ownership structure, 71 per cent of ODI projects by SOEs are wholly Chinese-owned, and 29 per cent of Chinese investment projects are predominantly Chinese-owned (Figure 13).

Figure 12 Type of ODI by Chinese SOEs

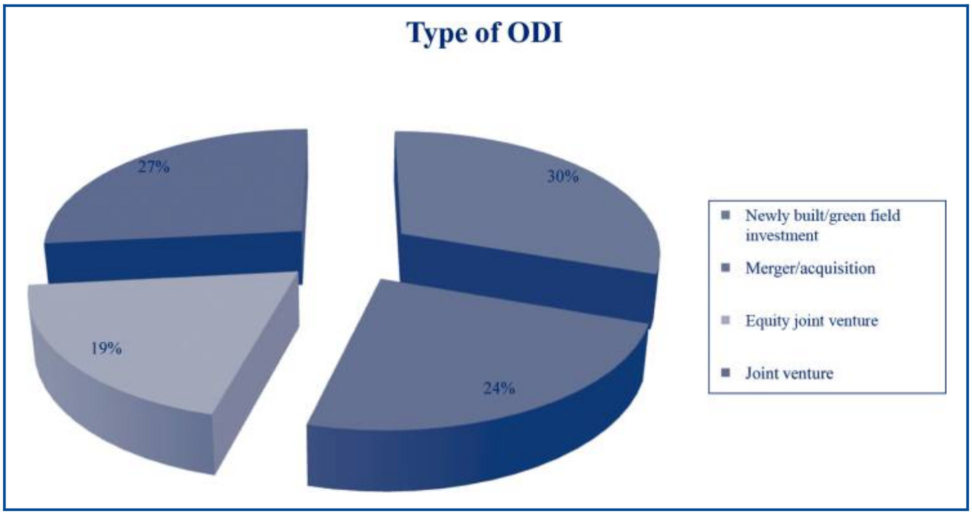
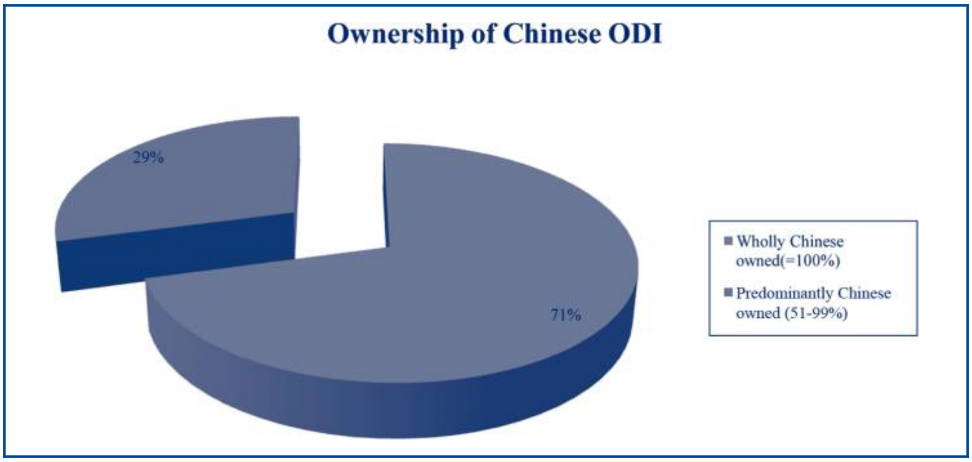


Figure 13 Ownership structure of Chinese ODI



As to the business forms, establishing a subsidiary (31 per cent) is the most common practice among the Chinese companies that currently have ODI operations, while establishing representative offices (28 per cent) is also a popular choice, followed by options such as manufacturing facilities, sourcing/distribution centers and R&D centers (Figure 14). This finding is in line with previous research (e.g. Economist Intelligence Unit, 2010) on Chinese firms at the early stage of globalization drive. For many of them an incremental expansion is the preferred route that begins with small representative offices to test the waters.

With regard to possible future modes of entry, the two most popular choices are new direct or greenfield investments (39 per cent), and acquiring or merging with existing companies in the hosting countries (39 per cent), followed by expanding or upgrading existing facilities overseas (16 per cent) Only about 6 per cent of companies are uncertain about their future ODI plans (Figure 15).

Location preference for ODI by Chinese SOEs

Our study indicates that Asia is the destination of the largest proportion of China's existing ODI, followed by Africa, Europe, Latin America, North America and Oceana

Figure 14 Form of business of Chinese ODI

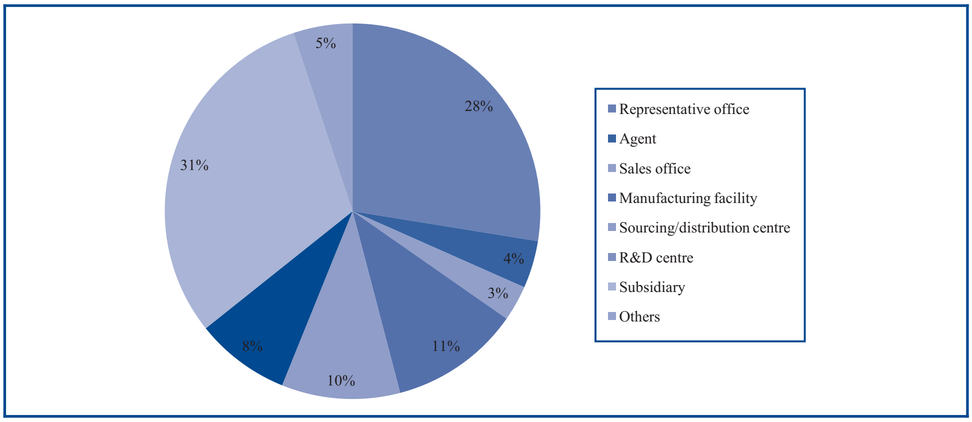
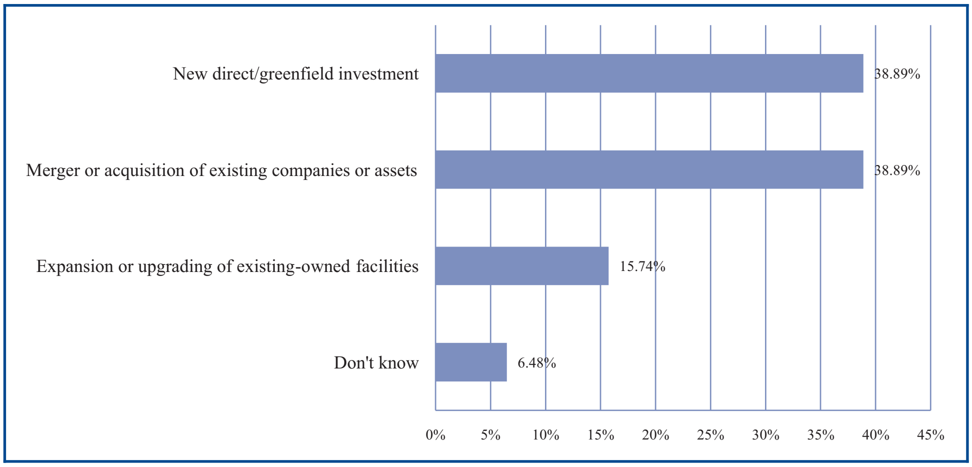


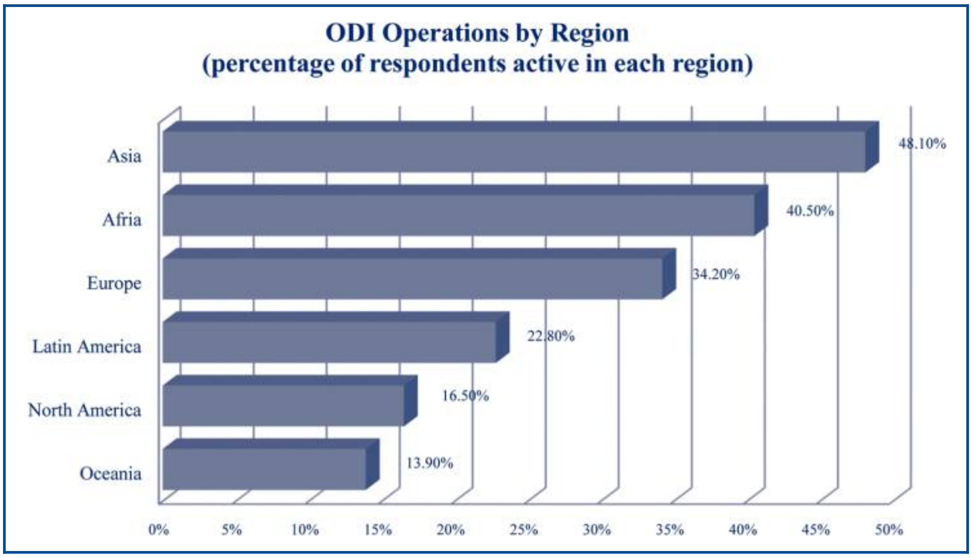
Figure 15 Form of future ODI by Chinese SOEs



(Figure 16). Asia remains the top destination for overseas investment by Chinese companies because it is close to home and many countries share similar cultural values influenced by the Confucian philosophy. The Chinese have a cultural preference for transacting in less codified regimes of network capitalism rather than in the codified formality and impersonality of markets (Bosot and Child, 1996). The Chinese business culture of *guanxi*, the basic dynamic in personalized networks of influence, certainly has an impact on the location choice made by Chinese SOEs for their ODI activities. However, to gain a comprehensive understanding of the heavy focus on Asia, as Lunding (2006) rightfully points out, the role of "round-tripping" investment should also be taken into consideration.

Because of their rich natural resources and vast market potentials, Africa and Latin American have been attractive destinations for Chinese ODI since the launch of the "going global" policy initiative, while Europe is also viewed very positively by Chinese companies for its large consumer market, advanced technologies, established brand names and more friendly environment toward Chinese business compared with that of the USA (Hanemann, 2013). Although a majority of ODI from Chinese firms has gone to developing countries, there is no set course and in recent years more investment activities by Chinese companies are beginning to take place in the developed countries. As those Chinese firms are pursuing their long-term globally oriented strategies, the attraction of large developed-country markets may more than offset any problem of psychic distance.

Figure 16 Current ODI operations by region



This is certainly the case concerning the USA, regarded by many Chinese firms as the foremost and toughest location choice for overseas investment. According to our study, about 29 per cent of the respondent Chinese SOEs currently have investment projects in the USA, and 62 per cent of the respondents are considering the possibility of investing to the USA (Figure 17). The most important attraction of the USA for Chinese ODI is that doing business in the USA has greater expansion opportunities than in other developed countries (Figure 18). In addition, the likelihood of investing in the USA does not change depending on company size (Figure 19). However, according to our research, larger companies do consistently give a significantly higher mark to the top five factors affecting decisions about FDI in the USA than do their smaller counterparts.

Conclusion

The growing Chinese ODI around the world is viewed with both fervor and fear. Due to lack of communication, many people do not have an accurate understanding of the globalization of Chinese economic power. Whereas some view the rise of China as a

Figure 17 ODI Perception of the USA by Chinese SOEs

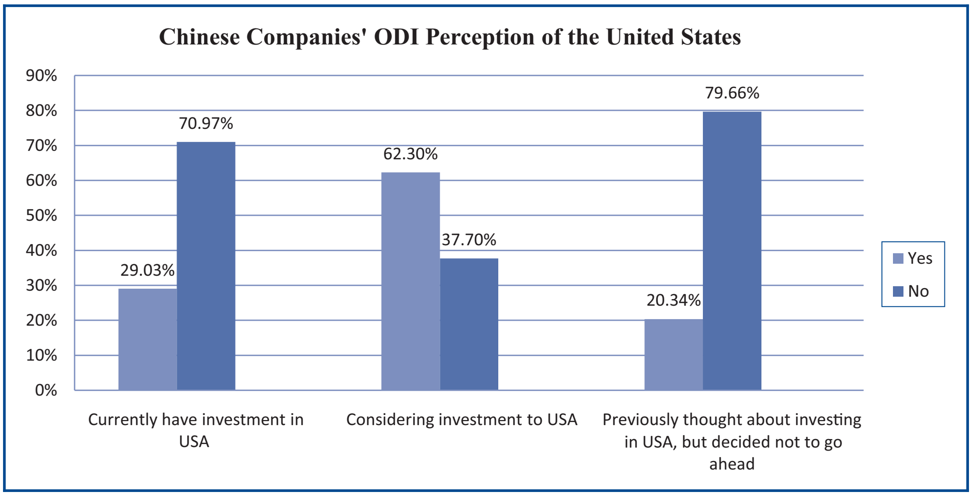
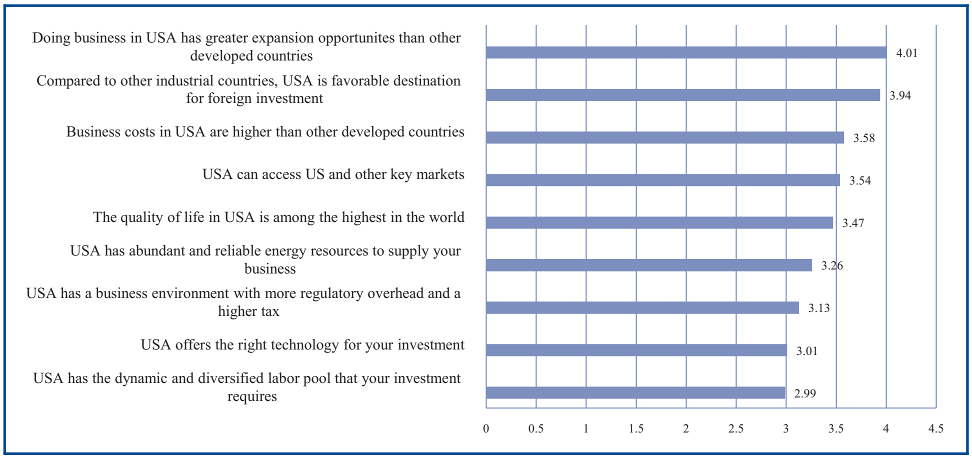


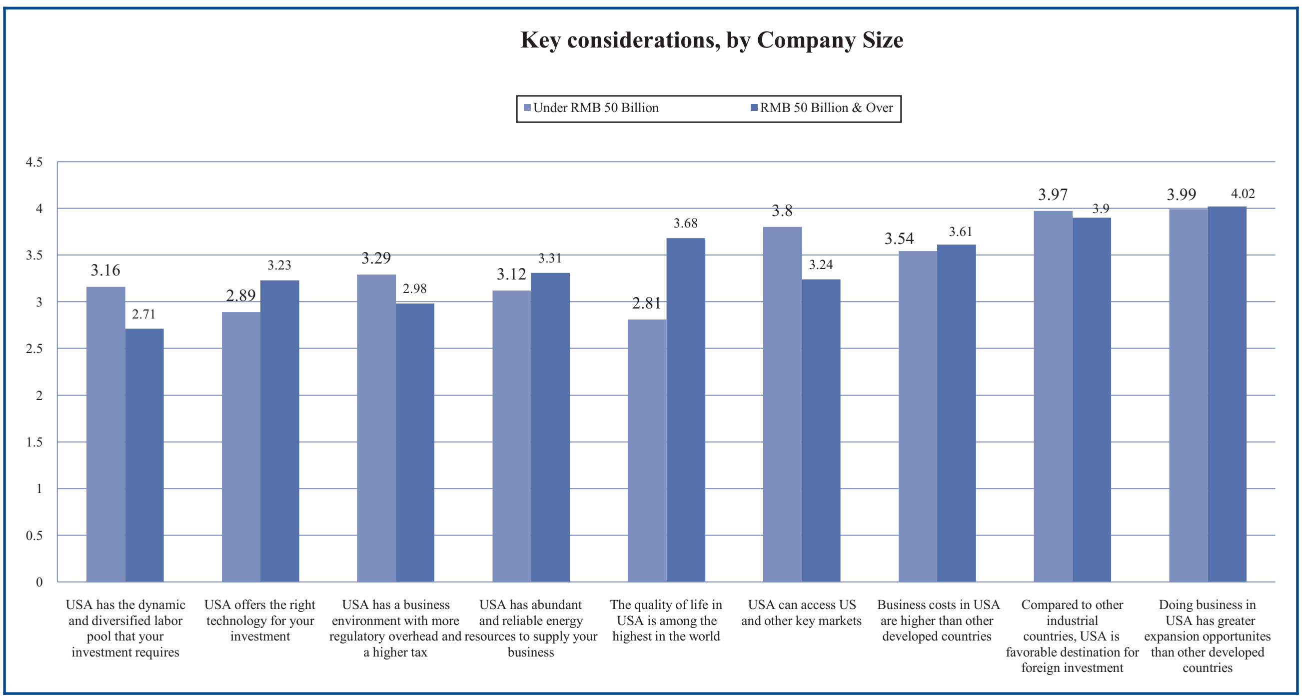
Figure 18 Key considerations on investing in the USA



contributing factor to recent hardships, others welcome Chinese business with open arms. Even within the business community, there is a misconception that Chinese companies are going to change the global business landscape overnight, and China will quickly overtake the USA economically and politically. In reality, China's ODI is still only a fraction of the world total, and it is reported that one-third of Chinese enterprises lost money on their foreign investments, and that 65 per cent of their joint-ventures failed (Tan, 2005). A reasonable approach is to view the rise of China's economic power from a business perspective. The growth of Chinese ODI will not be a zero-sum game if all sides can work together to explore opportunities for mutual economic benefits.

Dominated by SOEs since 2000, Chinese ODI is still at the early stage of development. Undoubtedly, Chinese government support for globalization is a strong motivation factor for SOEs to internationalize. However, compared to past practices, market forces in the

Figure 19 Investment intentions in the USA, by SOE size



globalization of Chinese firms have been greatly emphasized. According to a communique issued after the Third Plenary Session of the 18th Conference of Central Committee of the Communist Party, the Chinese government acknowledged the market's "decisive" role in allocating resources and strived to create fair, open and transparent market rules and improve efficiency and fairness in the allocation of resources (*Xinhua*, 2013). As a result, newly announced SOE reforms by China's state-owned Assets Supervision and Administration Commission of the State Council will include incentive mechanisms in SOEs, high degrees of marketization, improved management of state-owned assets, efficiency in business operation and corporate social responsibility. How these market-oriented measures will affect the future globalization of Chinese enterprises is yet to be seen.

Keywords:
China,
Globalization,
Chinese outward direct investment (ODI),
Foreign direct investment (FDI),
International strategy,
State-owned enterprises (SOE)

Our research indicates that Chinese companies will likely increase their overseas investment substantially in both the short and medium term. Their key business focus will include resource extraction, trading, services and manufacturing, and their preferred mode of entry will consist of greenfield investments, joint ventures, mergers and acquisitions and equity investments. While Asia has the largest share of Chinese ODIs, future investments will focus on the emerging economies in Africa and Latin America. Many Chinese SOEs intend to increase their ODI in the USA, regarded as the most important market for overseas investment. Finally, although Chinese SOEs are fairly confident about their ODI activities, they still need top entrepreneurs with the right knowledge and skills who will determine the future direction of their overseas investments.

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