1. Introduction

This chapter is concerned with delivering the rationale for researching Chinese outward direct investment (OFDI). In so doing, vaguely understood patterns of Chinese OFDI and international strategies by Chinese firms are identified and the research objectives expressed. It is also highlighted that the role played by the Chinese government in effecting Chinese OFDI may be underplayed in current research. This chapter also provides terms and definitions used throughout the book to avoid any misinterpretations.

1.1 RATIONALE OF THE RESEARCH

Since the instigation of the ‘Open Door’ policies (gaige kaifang, 改革开放) in 1978, China has experienced three decades of considerable domestic economic and institutional reform. These reforms have been directed towards changing the domestic industrial structure and increasing the degree of integration of China’s economy and its businesses into the global economy. China is thus well known and researched as a host country for foreign direct investment (FDI) (for example, Clegg et al. 1996; Cross and Tan 2004; Branstetter and Lardy 2006; Buckley et al. 2007a). Less well understood, however, is China’s evolving role as a source country of FDI and the determinants of China’s outbound foreign direct investment (OFDI). Until 1979, OFDI from China’s autarkic economy was modest. But since then, OFDI flows have steadily increased. A first peak was reached just after Deng Xiaoping, de facto Paramount Leader of China, revived the economic liberalisation and reform process in 1992 and annual outflows jumped to USD 4.4bn (see Figure 1.1). Outflow levels remained on a relatively high level for an emerging economy and reached another peak of nearly USD 12bn in 2005 before significantly increasing to about USD 40bn and USD 43bn in 2008 and 2009, respectively (MOFCOM 2010). These developments are nurtured by repeated announcements by high-profile Chinese politicians and adjoining policy changes to create some 50 international competitive Chinese multinational enterprises (MNEs) (Sauvant 2005; Buckley et al. 2008).
The determinants of Chinese outward direct investment

Frost (2005) shows the increased significance of Chinese investment for South East Asia, listing and describing extensive Chinese investors in this region. To date, China has become one of the most important developing source countries for FDI in terms of absolute flow and stock figures (UNCTAD 2010a). UNCTAD reports that China’s OFDI stock has been valued at nearly USD 150bn by the end of 2008. This places China behind economically more advanced East Asian countries like Hong Kong (special administrative region, SAR), Singapore and Taiwan but ahead of emerging countries from South American, West Asian and European transition economies such as Finland, the Republic of Korea, or Malaysia. Although Chinese OFDI flows and stocks are generally relatively low compared to the USA or the UK, the development since the end of the 1970s nevertheless marks a significant departure from the former hostile business environment towards capitalistic forces.

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Source: UNCTAD (2010a).

Figure 1.1 Chinese OFDI stocks and flows (1980 to 2008)

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The rise of China’s OFDI stock is also evident in other areas. Chinese
firms are increasingly active in acquiring (often ailing) international firms. Not only has the number and total value of the acquisitions risen, as Figure 1.2 illustrates, but also the proliferation of the target companies. Well-publicised purchases include the takeover of IBM’s PC business (USA) by Lenovo in 2005, Nanjing Automobile’s successful bidding competition with its domestic rival Shanghai Automotive Industry Corporation (SAIC) for MG Rover (UK) in 2004/05, or Geely’s purchase of Sweden-based Volvo from Ford in 2010 (FT 2005a, 2010). Today, Chinese companies are often mentioned among the first potential buyers when a company or parts of a company are for sale. A point in case was Daimler’s divestment of Chrysler. The three Chinese auto-manufacturers, Chery, First Auto Works and SAIC, were all separately rumoured to have negotiated with Daimler to acquire the American subsidiary (FT 2007a). The serious consideration of a Chinese firm as a potential buyer of a

Note: Data for the years prior to 1987 are not reported.

Source: UNCTAD (2010a).

Figure 1.2 Chinese cross-border mergers and acquisitions (1987 to 2007)
leading automobile manufacturer exemplifies the perceived change in the quality and potential of China’s OFDI. What this example however fails to identify or to explain are the drivers behind China’s outbound surge. It also raises the question of why Chinese firms are deemed capable of acquiring and managing a large Western multinational enterprise (MNE) when their firm-specific advantages and managerial capabilities are generally questioned (for example, Nolan 2002; Shenkar 2005; Liu et al. 2008).

The objectives of this research are to identify (i) the determinants of Chinese OFDI, (ii) the international strategies of Chinese firms and how these are influenced by (iii) domestic institutions and (iv) access to international networks. The answers to these questions may help to find explanations for the observable phenomena and rumours around, for example, the acquisition of Chrysler. In so doing, theories on FDI and on MNE investment behaviour which were developed from research focusing on industrialised country MNEs are tested for their applicability to a developing country context like the Chinese. A positive finding is generally expected (UNCTAD 2006). Thus, first, a thorough analysis of the international investment strategies of the Chinese will shed some light on the determinants of Chinese OFDI and the drivers behind international acquisitions and the potentially rising investment in South East Asia and Africa. Work by Deng (2003), Wong and Chan (2003) and others has provided a first assessment of Chinese outbound investments. Describing aggregate Chinese statistics and relying on selective case examples, this body of literature tends to assign certain strategies to particular countries. Investment in Africa occurs rather to access natural resources while access to technology is the driver for investments in industrialised countries, for example. This literature would greatly benefit from an econometric approach to analyse Chinese OFDI.

Second, companies are said to experience a sequence of stages in their internationalisation during which they increase their commitment and psychic distance to the home market. This may not hold true for Chinese firms. Official Chinese statistics presented in Chapter 3 demonstrate that early Chinese OFDI was destined to psychic distant countries in North America and Oceania. Recently this pattern has changed and Hong Kong has become the main destination for Chinese investments. It may therefore be that Chinese firms rather follow a pattern identified for international new venture. Such firms invest in locations where there is a good business opportunity readily available (Oviatt and McDougall 1994). It remains to be seen in the course of the discussion and analyses here what kind of pattern prevails for Chinese firms.

Third, to account for China’s heritage of economic planning, which is still visible in the government’s involvement today (Scott 2002), and
the continuous changes in the institutional environment since 1979, a special emphasis is placed on institutional theory. This book advances a framework which allows the testing of the extent to which institutional theory bears explanatory power for the evolvement of Chinese OFDI (cf. Buckley et al. 2011). In this respect, it is noteworthy pointing out the additional information contained in Figures 1.1 and 1.2. Chinese OFDI is generally argued to have evolved in phases as is illustrated in the figures (see, for example, Ye 1992; Wu and Chen 2001; Wong and Chan 2003). Each phase is defined by changes in the nature of Chinese OFDI mainly caused by advancements in the institutional environment and the administration and regulation concerning outbound investments. This comprises changes in the outward investment approval regime and the capability to pursue international business, among others. Capability in the Chinese context may not necessarily mean managerial capacity and technological advancement over competitors, but access to financial resources. The possibility to internalise access to abundant funding may help Chinese firms to overcome competitive weaknesses and invest abroad to pursue objective other than purely profit-maximising objectives. This is not to say that Chinese firms are not profit-maximisers. But there exists the likelihood that they invest in one country to gain access to resources which will then be exploited in a third country. The institutional realm is also of importance from another perspective. Not all Chinese firms were allowed at all times to pursue investments abroad. Liberalisation of this policy and the consequential upcoming of a different breed of firms may change the nature of the determinants of Chinese OFDI. The impact of the changes is probably best illustrated in Figure 1.2. It shows major ups and downs in the annual value of cross-border acquisitions by Chinese firms at the brink of each phase. This hints that the domestic institutional environment may affect the international investment strategies of the Chinese. Taking better account of institutions therefore seems reasonable and could help to explain the steady growth and the very positive prospect of Chinese OFDI evidenced in the official Chinese data.

Fourth, a further not fully accounted element is the influence of Overseas Chinese on the investment decision-making. A large body of research has identified that Overseas Chinese played a very important role in re-integrating China into the world economy (for example, Gao 2003; Naughton 2007) and that the Chinese government actively tries to retain strong linkages with Overseas Chinese whom have generally a strong affinity towards their ancestors home region (for example, Liu 2001). It therefore seems impertinent to include the extent to which the presence of Overseas Chinese in a host country takes a bridging role to the host market.
The reminder of the book is structured as follows. Section 1.2 presents terms and definitions used in this research. Chapter 2 firstly places Chinese OFDI into the context of global FDI flows and the distribution of MNEs, and then reviews the theories explaining FDI originating from developed countries. An overview of the research stream arguing that an emerging country’s OFDI is distinctive from a developed country’s FDI is included here as well. The chapter concludes with a framework attempting to explain patterns of Chinese OFDI. The framework is rooted in international business and economic institutional theory. The discussion of Chinese OFDI is revived in Chapter 3. This chapter is divided into three sections. The first section introduces the corporate and government actors in China. This is followed by a review of the development of Chinese OFDI with references to political and administrative changes in China. Finally, the literature on Chinese OFDI is reviewed and linked to the theories presented in Chapter 2 and the institutional environment presented in the earlier sections of Chapter 3. Chapter 4 provides an overview of the secondary data sources used for the quantitative analyses. Chapter 5 presents a quantitative approach to answer the research questions. Specifically, two models, using different sets of Chinese OFDI data and different time frames, are used to test elements of the framework of Chinese OFDI as presented in Chapter 2. Chapter 6 summarises and concludes and provides an outlook for future research on Chinese OFDI.

1.2 DEFINITIONS AND TERMINOLOGY

Before we continue, it is important to clarify the definitions and terminologies that are used in this study.

1.2.1 Foreign Direct Investment

Foreign direct investment (FDI) is a substantial, long-term relationship which an enterprise undertakes in a country foreign to its residence (UNCTAD 2009). A FDI consists of at least one of three possible investment options:

(1) equity capital, that is, the purchase of normally more than a 10 per cent of the share of an enterprise in a country other than the home country of the acquirer; the internationally recommended threshold figure for the classification FDI is in some countries higher, such as in Germany where it is 20 per cent (OECD 1996);

(2) reinvested earnings of the foreign affiliate, that is, earnings of the
affiliate which are not paid out as dividends or otherwise remitted to the parent company;
(3) intra-company loans from the parent company to the foreign affiliate (UNCTAD 2009).

The term ‘foreign direct investment’ is generally associated with investment into a foreign country which secures the control over a local operation. FDI is therefore often synonymously used for the more precise ‘inbound foreign direct investment’. Investment originating from a source or home country is called ‘outward/outbound foreign direct investment’ (OFDI) or ‘outward/outbound direct investment’ (OFDI). Both inward and outward foreign direct investment can be described in terms of flows and stocks.

1.2.1.1 Foreign direct investment flows
FDI flow is the capital provided by the investing enterprise to the foreign invested companies, or capital provided by the foreign invested company to the investing enterprise (UNCTAD 2009), in a given period of time.

1.2.1.2 Foreign direct investment stock
FDI stock is the accumulation of yearly foreign direct investment and divestment flows. Hence, the ‘FDI stock is the value of the share of the capital and reserves attributable to investing enterprises, plus the net indebtedness of affiliated to the parent enterprise’ (UNCTAD 2009: 243), normally presented as an aggregated figure for an economy.

1.2.2 Multinational Corporation and its Affiliates
A multinational enterprise (MNE) is defined as ‘an enterprise which owns and controls activities in different economies’ (Buckley and Casson 1976: 1). An affiliate is a company controlled directly or indirectly in another economy by a foreign investor. The term affiliate comprises subsidiaries which are owned by more than 50 per cent by a foreign investor, associates which are owned by 10–50 per cent by a foreign investor, and branches which are unincorporated, wholly or jointly owned by a foreign investor (OECD 2005a).

1.2.3 Country Classification
In international business theorising, in describing FDI flows, and in explaining certain firm characteristics, it is useful to distinguish between different types of host and home countries. Country-specific characteristics
differ greatly and can exert a significant influence on the outward and inward investment behaviour of MNEs.

To date, there exists no established convention among the United Nations bodies, World Bank, International Monetary Fund (IMF) and the Organisation for Economic Cooperation and Development (OECD) for the utilisation of the terms _developed_ vs _developing_ and _industrialised_ vs _emerging (transitional)_ vs _industrialising_ country. This study generally follows the United Nations Conference on Trade and Development (UNCTAD) classification of developed and developing countries as used in their online FDI/TNC database and the World Investment Report 2006. (A complete country list is available in the appendix to this book.) The terms _developed_ and _industrialised_ country are used synonymously as are the terms _developing_, _industrialising_, _emerging_ and _transitional_ country. Having said this, it should be noted that there are differences between the countries described with these terms. The terms _transitional economy_ and _emerging economy_ are typically employed to describe countries changing their economic system towards an open, market economy, and those who have (almost) reached the level of economic development of developed countries, respectively. The former is normally applied to the countries from Central and Eastern Europe, the Baltic States and China. The latter is typically associated with the so-called ‘newly industrialised countries’ (NICs) in Asia, namely Hong Kong (SAR), Singapore, South Korea and Taiwan. Although NICs are called ‘industrialised’ they are officially not classified as industrialised Asian countries but rather as emerging or developing ones (UNCTAD 2004).

A further country classification used in this study is ‘Triad economies’, comprising North America (Canada, USA), Western Europe and Japan. Finally, countries are classified depending on the membership of a country in the OECD (vs non-OECD membership countries) and in the WTO/GATT (vs non-WTO/GATT membership countries).