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Internationalisation of Chinese MNEs during the Global Financial Crisis: Opportunities to Catch up through Pursuing Strategic-Asset-Seeking Outward Foreign Direct Investment?

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Abstract: The rapid international expansion of Chinese companies during the global financial crisis has caught worldwide attention. This paper discusses whether they can take advantage of this crisis to improve international competitiveness through overseas strategic-assets acquisition. It argues, contrary to some theoretical perspectives, that Chinese firms' desire to 'springboard' in this way appears the exception rather than the rule. Chinese MNEs' internationalisation still appears to reflect China's expansion as a trading nation and need to overcome challenges as a result of China's imbalanced economic structure, weak "soft" managerial capabilities and overseas investment- and operation-related political issues.

Key Words: Internationalization, Foreign Market Entry, International Business Theory, Chinese Multinationals, Outward Foreign Direct Investment (OFDI)

I. Introduction

The global financial crisis ("the crisis") started in July 2007 and deepened during the autumn of 2008, rapidly leading to the most severe economic downturn the world has experienced since the last great depression nearly 80 years ago. Around the world stock markets crashed and large financial institutions collapsed. Many governments had to improvise a rescue or bailout plan and financial stimulus package in the hope of stabilising their economic system. As Michael Porter's diamond model indicates, chance events and government interventions could result in a significant reshuffle of key industry players in the global market (Porter, 1998). The current crisis, similar to the wisdom embedded in the Chinese characters for "crisis", resembles a dialectic between 'danger' and 'opportunity' for firms based in different countries.

The crisis indeed has changed the global foreign direct investment (FDI) landscape. After a period of continuous growth from 2003-2007, the world's FDI flows reached a record high of $4,125 billion in 2007, but fell to $3,555 billion in 2008. While FDI flows of developed countries kept declining, developing economies' global share of FDI flows continued to rise, surging to 16 percent in 2008. Outward FDI (OFDI) from developing countries increased from $215 billion in 2006 to $292 billion in 2008, accounting for 15% of the world's total (see table 1)(UNCTAD, 2009). Rather than danger, it seems that the crisis has created an opportunity for emerging-market MNEs (EMNES) to use international expansion as a springboard to compensate for their latecomer disadvantages via high risk and aggressive strategic asset acquisition from mature MNEs based in developed economies, where such critical assets are more abundant. In 2008, China more than doubled its OFDI of 2007 to a historic high of $52 billion. The persistent rise in OFDI from Chinese firms has surprised the world and caught wide media attention.

This paper investigates whether firms from developing countries such as China can take the opportunities arising from the crisis to catch up with global leading MNEs. It particularly examines the extent to which Chinese firms' internationalisation is through strategic-asset-seeking (SAS) OFDI that is most closely associated with firm-level catch-up. This paper first reviews current literature on the internationalisation of Chinese firms and then goes on to explain how the research question is raised. Consequently, it investigates the extent to which Chinese companies are taking advantage of the crisis, acquiring strategic assets overseas that allow them to build up the potential to move toward the frontier of global competition. Section 4 discusses the challenges and constraints for Chinese firms to undertake SAS OFDI for catching-up. Section 5 concludes the analysis and discusses the managerial implications.

II. Theoretical Perspectives on the internationalisation of Chinese Multinationals

The mainstream generic international business theories were largely developed based on the observation of MNEs originating from triad economies. It has long been debated whether they can be applied to explain the rise of EMNEs. Many suggest that amendments to the theories or an alternative framework are needed (Buckley, *et al.*, 2007; Child and Rodrigues, 2005; Lall, 1983; Mathews, 2006). Recent literature offers a number of alternative theoretical perspectives for understanding OFDI from developing countries, especially China. For example, these include:

The *ownership perspective* suggests that firms from emerging economies like China are used to operating in their own volatile environment. They have experience and developed a particular ownership advantage in managing “institutional voids”. These allow them to thrive better than local firms and Western MNEs in some developing countries with similar market conditions such as weak market institutions and opaque regulatory regimes (Khanna and. Palepu 2006, Chittoor and Ray, 2007; Gubbi, *et al.*, 2009; Luo and Tung, 2007). Chinese firms generally lack firm-specific advantage (resource based view) and have to rely heavily on country-specific advantages such as low labour costs to engage to internationalise (Rugman and Li, 2007). This is the primary reason why they could successfully enter some regional Asian and developing country markets unattractive to Western MNEs. Chinese OFDI in industrialised countries is mostly about asset-seeking rather than asset-exploiting (Nolan, 2004; Nolan, 2005; Sutherland 2009).

The *springboard* or *strategic-asset seeking perspective* posits that firm-specific “strategic assets” (e.g. R&D capacity, proprietary technology, design facilities, brands and reputation, local distribution and production networks) are embedded in the firms of industrialized countries (Alcácer and Chung, 2007; Deng, 2004; Deng, 2009; Teece, *et al.*, 1997). Emerging market MNEs can only access them by high-risk and aggressive takeovers of these “critical assets” from advanced MNEs in order to overcome their inherent ‘latecomer disadvantages’ such as technological backwardness, incompetent management and business practices, and home-country market and institutional constraints (Buckley, *et al.*, 2008; Deng, 2009; Dunning, 2001; Li, 2007; Luo and Tung, 2007). In addition to serving as a ‘springboard’ to compensate for latecomers' “competitive weaknesses”, these assets can reduce latecomers' liability of foreignness, allowing them to compete on an equal footing with their global rivals and even ”counter-attack” these rivals in their major foothold markets in advanced economies (Luo and Tung, 2007). International expansion of latecomers such as Chinese MNEs is therefore primarily driven by their need to “catch-up” through acquiring strategic assets.

The *strategic-intent perspective* was developed based on Hamel and Prahalad’s early study on the dramatic rise of the Japanese MNEs. “Strategic-intent” is these firms’ “ambitious and compelling dream” to win, sustained although their resources and capabilities are not yet sufficient for global competition (Hamel, *et al.*, 1989; Hamel and Prahalad, 2005). Rui and Yip argue that Chinese firms, similar to Japanese MNEs in their earlier development stages, have developed “strategic-intent”, which motivates them to invest abroad strategically and reflects in their cross-border M&As. Their long-term strategic objective, such as transforming from domestic players to global leaders, could be considered highly unrealistic in the Western sense with regards to their resources and capabilities. However, ‘strategic-intent’ is an active and rational management process which can motivate the entire firm to concentrate on winning and thus lay the groundwork for their quest for global leadership in the near future (Rui and Yip, 2008).

The *network or linkage perspective* views firms’ internationalisation processes as creating new relationships in different industries other than internalisation, based on the observation of the rise of alliance capitalism and the proliferation of firms’ networks in the late twentieth century (Dunning, 1997; Ghauri, 1992; Johanson and Mattson, 1994). Firms from developing countries are assumed not to posses any ownership advantages they can exploit abroad. However, through being mature MNEs’ suppliers in the lower end of their global production network, latecomers can build up knowledge of foreign markets and enhance their capabilities to engage in OFDI at later stages. They can be drawn to go overseas when their foreign partners increase their degree of international integration between different national networks. The initial production and learning capability of developing countries' firms therefore plays a crucial role for them to attract strategic foreign partners (e.g. through inward FDI). Such alliances can lay a foundation for latecomers to "catch up" and gain the resources and knowledge needed to move up the value chain and expand globally later ("latecomer perspective")(Luo and Tung, 2007; Mathews, 2006; Poncet, 2007). Chinese firms have shown such well-developed capacities and already leapfrogged some stages in internationalisation. Overseas Chinese ethnic networks also facilitate the growth of Chinese OFDI. This confirms the social and cultural aspects of the network theories in understanding internationalisation of Chinese firms (Buckley, *et al.*, 2008; Cheng and Ma, 2007)

The *institutional perspective* contends that firms' internationalisation strategies can be significantly shaped by developing countries' institutional environment (Scott, 2002; UNCTAD, 2006). There are two different scenarios for Chinese firms to engage in OFDI. Market imperfections caused by state interventions can create disequilibrium within domestic markets and between domestic and foreign markets. Domestic firms with strong linkages to domestic institutions can transfer such imperfections into ownership advantages to develop a monopolistic position in domestic market and engage in OFDI. The market imperfections may originate from the high levels of state support (e.g. China's "go global" policy), which allows firms to obtain subsidies, and below-market credit rates available for SOEs, soft loans, or low-cost internal capital markets within Chinese big group companies resulting from the inefficient banking system and other underdeveloped market institutions. Large Chinese SOEs can undertake relatively high risk investments with less concern over loan repayments (Buckley, *et al.*, 2008; Buckley, *et al.*, 2007; Li, 2007; Lardy, 1998; Morck, *et al.*, 2008; Yeung and Liu, 2008). Conversely, Chinese firms might want to move abroad so as to avoid high transaction costs incurred by operating exclusively in the unfavourable institutional environment at home ("market exit" or "institutional arbitrage" internationalisation strategy). Examples include regional protectionism that could prevent firms from achieving scale economies, highly bureaucratic and inefficient FDI approval processes and interventions to achieve state national objectives, and poor enforcement of laws and protection for property rights that limits firms' access to advanced technologies. (Boisot and Meyer, 2008; Luo and Tung, 2007; Khanna and. Palepu 2006; Child and Rodrigues, 2005).

The common aspect of these theoretical frameworks is that the surge of Chinese OFDI is related to the development of firm-level capabilities, which allow Chinese firms eventually compete on an equal footing with developed market rival MNEs. Chinese firms may conduct mixed types of OFDI activities, but their primary objective is to leverage knowledge and resources abroad for long-term strategic development and therefore is still about the catching-up of latecomers (Luo and Tung, 2007). However, several questions related to the current literature warrant further analysis. As Morck et al noted, China's OFDI is still quite minimal in an international comparative context and especially when taking account of 'round tripping'. They hypothesise the recent growth of China's OFDI may be driven by nothing more than empire building encouraged through poor corporate governance which, ultimately, is politically driven (Morck, *et al.*, 2008). Similarly, Rugman and Li pointed out that Chinese MNEs are more likely to continue exploring their low cost country-specific advantages, as the general development trend shows most MNEs only go abroad to acquire knowledge and technology to a small extent (Rugman and Li 2008). It seems that China's surge in OFDI related to firm-level catch-up strategies is very limited.

Moreover, the previous literature and theories were developed based on the observation of firms' internationalisation strategies during a period when the world's economy was growing relatively rapidly. They did not significantly take into account two important variables developed outside the control of firms, namely the government and chance events, which could simultaneously become very active during the financial crisis.[1] Chance events may create "discontinuities" that significantly reshape global industrial structures, nullifying long established advantages of industrial leaders and creating opportunities for latecomer firms to achieve competitive advantages. Similarly, government interventions can either positively or negatively affect firms' competitive environment that leads to shifts in competitive position (Porter, 1998).

It is therefore important for this paper to look at how chance events and government interventions during the crisis have changed OFDI strategies of firms of developing countries such as China. As the 'springboard' perspective suggests, the SAS OFDI type of foreign investment is most closely associated with swiftly building firm-level capabilities to compete with leading MNEs. This paper particularly looks at whether Chinese firms are primarily driven by their need to "catch-up" through internationalisation and whether they can do so by taking advantage of the current crisis.

Method:

As Child and Rodrigues suggested, the 'sheer scale of China's internationalization warrants analysis of its forms and motives' (Child and Rodrigues, 2005, p. 382). The approach to addressing the research question therefore is to first look into the origin of OFDI by sector and its geographical destination and to compare their changes before and during the crisis by reference to time series data. As noted, SAS OFDI is generally considered to exclude trade related OFDI and resource seeking OFDI (Luo and Tung 2007). Most case studies consider manufacturing firms and in excluding important sectors, such as mining, it can be argued, at least in the Chinese case, that most such OFDI must originate from manufacturing. It might further be expected, moreover, that SAS OFDI would be destined for the more advanced markets, where strategic assets (e.g. technology) are more available. There are great difficulties in fully understanding the overall picture of, or extent to which Chinese MNEs are engaging in SAS. MOFCOM's data collection was not made using surveys, but based on information firms provided during their registration or approval processes. Stop-over locations, instead of final destinations, are often recorded (Rosen and Hanemann, 2009). A closer look at the commercial M&A database might reveal whether they are SAS types. An impression given in the previous literature is that SAS OFDIs from China are quite considerable, partly because of the focus on a few specific high profile case studies. Morck et al's (2008) findings suggest they have been important, but do not cast much light on the particular type of OFDI firms may be engaging in, instead indicating a blanket expansion across all state monopolies. The paper also discusses the key players in leading China's OFDI by exploring the ownership types of firms. Thus the approach does not warrant formal statistical testing, but instead seeks to elucidate the trends in OFDI to shed further light on the research question.

III. "Opportunities" in the crisis: To what extent are Chinese firms engaging in strategic-asset-seeking OFDI for internationalization?

Since the beginning of China's 'open-door' policy in the late 1970s, OFDI has been seen by Chinese leaders as a means to integrate China into the world economy. Although a small number of outward investments were made for political motives, an interventionist regulatory regime was imposed to restrict OFDI in favour of domestic capital formation in heavy industries in order to achieve industrialisation and to ration hard foreign currencies. The development logic of Chinese leaders was that a well-guided inward FDI strategy would stimulate the growth of indigenous production capability ("learning-by-doing") and in turn achieve export "going-out". The second step was to encourage the national champion business groups to "go global" to improve their global competitiveness, and thus strengthen the national economy. In doing so, firms can more directly access technologies that foreign investors are reluctant to bring in, explore human and financial resources and obtain the material and energy resources that the country is lacking; These development thoughts are similar to the network and stages internationalisation theories, detailing how Chinese firms move from 'asset exploitation' to, eventually, 'strategic-asset-seeking' (Ning, 2009b; Sutherland, 2009). After the "go global" policy was formalised in China's tenth five-year-plan (2001-2006), state control over firms' foreign investment became considerably relaxed. The central government gradually eased and decentralised the approval procedures. A set of supportive measures was also launched.[2]

During the crisis, the latest regulatory framework further eased approval procedures and empowered the provincial-level Ministry of Commerce (MOFCOM) to approve OFDI of less than $100 million in May 2009. Complimentary to these rules, the State Administration of Foreign Exchange (SAFE) eased capital control and approval procedures, permitting firms to access foreign exchange easily and to diversify their funding sources for OFDI (e.g. from their own foreign exchange reserves and retained overseas profits).[3] Domestic enterprises, subject to approval, can now provide loans and security for financing to their overseas subsidiaries or affiliated joint stock companies.[4] Since 2008, domestic commercial banks have been also allowed to lend for firms' overseas acquisitions.[5] Other capital-raising opportunities for international expansion include US dollar bond issues and possible direct investment from China Investment Corporation (CIC) and SAFE. Both institutions are considering diversifying their overseas portfolio by funding Chinese firms' cross-border M&A and treat such investment as an alternative to holding US treasuries and foreign stocks.[6]

Capital-raising opportunities have also been boosted by the monetary stimulus policy, which has lead to a surge in bank lending since late 2008. To counter the downturn effects of the crisis, China not only launched an infrastructure-centred "4 trillion RMB" fiscal plan, but also an aggressive fiscal policy.[7] The lending quotas of both domestic and foreign banks were raised. While national banks were subject to a 5 percent increase, local banks were to have a 10 percent increase. Since early 2008, the government has also cut down the benchmark interest rates several times to a historical low level of 2.25 percent and lowered credit rates to 5.31 percent (Chinadaily 2009). As a result, Chinese banks lent a record 7.37 trillion Yuan in the first half of 2009, exceeding the whole year target of 5 trillion Yuan (Reuters 2009). The US dollar depreciation during the crisis also led to RMB appreciation. It seems market distortion and institutional factors, as suggested by previous literature from market and institutional perspectives, would positively motivate Chinese companies to snap up more financially distressed foreign firms on the cheap.

The questions are how significant Chinese OFDI is, and whether they are the SAS type, which allows enterprises to build up international competitiveness. The aggregate data seems to suggest that Chinese MNEs' SAS OFDI has been rather limited. Instead, firms' global expansion still appears, as the network perspective explained, to be closely linked to exploring and building network to support China's expansion as a trading nation with a natural resource deficit.

Global Significance of Chinese OFDI: Despite its impressive growth rate, China's OFDI is still small and has not yet reached truly commercially and geo-economically significant levels. China's OFDI took off during the 2000s as a result of the "go global" policy. Having averaged only about $2.3 billon USD in the period of 1990-1999, China's OFDI reached a record of 12.3 billion in 2005. When the crisis started in 2007, China's annual OFDI growth rate declined from 72% (21.2 billion USD) in 2006 to 6.19% (22.5 billion USD) in 2007, but reached 132% (52.2 billion USD) in 2008 while the world FDI outflows fell by 13.5% (UNCTAD, 2009). In the second quarter of 2009, China's OFDI is worth 8.7 billion USD (12.4 billion USD stock), increased 37% compared to the same period last year and 182% over the first quarter (MOFTEC, 2009). Although China's OFDI outflows and stocks doubled, they seem to be comparatively small, only representing 2.8 and 0.91 percent of the world's total and 1/7th in flows and 1/14th in stocks of the developing countries. China's FDI outflows are close to Russia, but stocks are less than Russia and Brazil, about 1/6rd in flows and 1/10th in stock of the UK, 1/8th in flows and 1/20th in stocks of the US. However, there is no denying China's potential to soon become the major actors in the world FDI market, given its size and world's largest foreign reserves (1.95 trillion USD in 2009).

Sectoral composition of OFDI activities: Much of China's OFDI appears to be more geared towards greasing the wheels of its international trading empire, rather than acquiring critical assets which would allow them to 'springboard' leading MNES and improve international competitiveness. Three sectors continued to dominate both China's OFDI stock and outflows from 2003 to 2008. During the crisis, outflows of 'leasing and business services' rose significantly from about 26% in 2006 to 52% of the total non-financial outflows by 2009, taking the largest share and accounting for 37% of China's OFDI stock. The 'wholesale and retail trade' sectors represented 20% of all OFDI stock and 16 % of the outflows, and the 'transportation, storage and post' sectors took a 10% and 6% share respectively. In total, these sectors accounted for 74% and 67% of China's OFDI stock and flows in 2008. All these sectors are typically of high importance in supporting China's export and import activities. The remaining OFDI stock and flows were divided between natural resources (mining 14% outflows and 16% stocks) and manufacturing industries (a declining 4% outflows and 7% stocks). Mining and natural resources are of central importance to continuously support China's trade expansion together with her energy and resources-intensive heavy industries as well as their upstream sectors, of which their domestic demands have been boosted by China's 4 trillion stimulus plan (see also discussion)(see Table 2).

It is noteworthy that China's small share of manufacturing OFDI contrasts significantly with the general OFDI patterns of MNEs from advanced economies, where manufacturing is more important. During the crisis, Chinese manufacturers cannot significantly rely on factors such as production cost and scale to survive as there is a lack of external demand from its trading partners. They need to capture a larger share of the global value chain and currently only gain about 20% of the final profit margin (Rosen and Hanemann, 2009).All figures at face value suggest that the OFDI of Chinese firms is still likely related to market-seeking OFDI activities, which are driven by China's rapid trading expansion based on country specific advantages, rather than SAS that can be used to enhance firm-level competitive capabilities for moving up the global value chain and managing the global production network.

Geographic distribution of OFDI activities: MOFTEC statistics on geographic destinations show, with the exception of Hong Kong and tax heavens, China's OFDI is quite evenly distributed in the world (see table 3). This balance arguably reflects the establishment of trade related facilities by Chinese firms in the countries with which they trade, rather than SAS. With the expansion of natural resource seeking investments, Africa's importance has increased. Asia, as China's major regional market, continues to absorb most China's OFDI (71.4 % of total stock). However, many developed regions where critical assets may be abundant still receive a minimal share of China's OFDI (about 2-3% for Europe and North America). China's huge surge in OFDI in tax heavens and Hong Kong (63 % of Asia) could be due to data distortion as discussed in the methods section. China's OFDI stock in Hong Kong was 63 % of Asia and in Latin America (17.5 %) consists of mostly the 11% of China's OFDI registered as leaving for Cayman Islands and 5.7 % going to British Virgin Islands. Some analysts suggest 60-70% of China's OFDI volume in 2008 consists of M&A deals. Some big deals will often not appear in MOFTEC's statistics as many Chinese companies use special purpose vehicles in the third countries such as Hong Kong and Singapore to execute their acquisitions, instead of home based firms. For example, Chinalco's $14 billion stake in Rio Tinto was executed through a special vehicle formed with Alcoa in Singapore (Davies, 2009; Rosen and Hanemann, 2009, Sutherland and Yao 2009). The commercial M&A database suggests that the number of deals in high-tech sectors happened more in Asia (especially Hong Kong) and increased significantly in 2006/2007, but declined in 2008 and is still small compared to raw materials, energy and industrial manufacturing (see Table 4). Another possible factor contributing to such a surge is "round-tripping", which allows Chinese firms to bring back their overseas investment in order to enjoy preferential FDI treatment (e.g. deduced tax) at home and thus further strengthen their positions back in the domestic market. It is questionable whether these investments are related to the strategic international expansion that has ‘spring-board’ effects.

IV. “Dangers” in the Crisis - Why Can Chinese Firms Not Use the Opportunities of the Crisis to Improve Firm-Specific Advantages?

The previous literature seems to mainly emphasise the determinants of Chinese OFDI, and pays less attention to how the country’s macro-economic development has shaped Chinese firms’ internationalisation strategies for catching-up at the firm level. The aggregate data seems to suggest that SAS OFDI has been rather limited. The reasons include.

Impacts of China’s imbalanced economic structure during the crisis: Even if the crisis has created many windows of opportunity for acquiring under-priced strategic assets, the majority of Chinese firms are still more likely to continue their current market- and natural-resource seeking OFDI strategies and less likely to take this catch-up opportunity. This is due to China’s imbalanced sources of economic growth, which are highly dependent on trade surpluses (over 12% GDP/ export represent 40% of GDP) and capital investment (averaging about 40% of GDP). Net exports and investment primarily related to export capacity building in total contributed to over 60 percent of China’s economic growth in the 2000-2008 period, 20 percent more than in the 1990s (Guo and N’Diaye, 2009). While the crisis has deepened, China’s GDP growth has declined from an average of 10 percent in the last three decades to an estimated 7.2 percent in 2009 (WorldBank, 2009). China’s sharp economic slowdown during the crisis reflects its heavy dependence on trade surpluses. It is not surprising that Chinese OFDI is mainly about establishing the necessary infrastructure for China to integrate into the world trading system.

As in all economies, the growth of output is the sum of domestic consumption, investment, government spending and net exports. The growth of household consumption (around 30-35% of GDP) always lagged behind the rapid economic growth in the 1990-2008 period. Government consumption was relatively stable at around 14% of the GDP before the crisis. Capital investment made up about half of China's GDP (2004-2008). 30 percent of Capital expenditure was ultimately concentrated in manufacturing of new capital goods for the expansion of traded sectors, while 18 and 23 percent went into infrastructure and real estate sectors respectively (IMF, 2009; Roubini, 2009). Rising investment has also been fuelled by China's increasingly high national saving rate, accounting for half of GDP in 2008 (China statistical yearbook 2009). It has become apparent that there is massive excess capacity as a result of overinvestment, mostly led by SOEs and accumulated over the last decade. China's domestic consumption is not sufficient to soak up this excess productive overcapacity, which could be exported prior to the crisis. It has become hard for China to sustain its export-led and investment driven economic growth as world demand has fallen (estimated 20% contraction in 2009) (Bergsten, *et al.*, 2008; Pettis, 2009; Roubini, 2009). To sustain economic growth, the government has since 2004 sought to rebalance sources of growth, focusing on boosting domestic consumption and promoting service-oriented and labour-intensive growth in place of capital- and energy- intensive heavy industry oriented investment, and export driven development. The effects of rebalancing policies are however still limited. (Bergsten, *et al.*, 2008)

In response to the crisis, Beijing increased government spending (committed 29% of the stimulus plan) and adopted an expansionary fiscal and monetary policy. While the infrastructure-centred "RMB 4 trillion" fiscal stimulus plan focused on improving structural factors by implementing tax cuts, improving the social safety net, and providing subsidies to low income and the unemployed population, the monetary stimulus has led to a surge in bank lending (see section III). However, the stimulus plan could have little effect on rebalancing China's growth model. Consumption and job creation are less likely to increase in the short term because structural constraints (e.g. an underdeveloped safety net, education, health care, and a credit system for consumer finance) cannot be improved overnight. Corporate profits and earnings are still high and not distributed (Morck, *et al.*, 2008; Roubini, 2009). Although profitability in the heavy industries has fallen significantly, it has also fallen in the labour-intensive light and machinery industries during the crisis.[8]

Firms continue to respond to this price signal to make investments. The sharp increase in credit, as a result of the expansionary monetary policy, continues to be poured into capital intensive sectors mostly dominated SOEs, instead of labour intensive industries in which most SMEs are struggling due to the sharp fall in exports. The share of investment into energy consuming heavy industrial activities kept rising at a growth rate of 30 percent per year over the 2004-2008 period and will likely continue to grow and will remain higher than service sectors in the following years (IMF, 2009; Roubini, 2009; Xu, 2009). These imply unchanged rising demands for production inputs of energy and materials. Given the capital-intensive nature of China's growth, the stimulus plan and the constraints on the growth of labour-intensive SMEs, it could be hard to absorb the oversupplied labour force.[9] Precautionary savings are likely to rise further and be directed to heavy industry related investment. Consumption growth may remain too slow to compensate for a fall in exports.

China's current economic development suggests that its sources of economic growth are unlikely to be balanced in the short term. The current crisis and the state's policy response are unlikely to change China's export and investment-driven economic development path. Despite the effects of the global economic downturn, the World Bank and the IMF predicted that China's share of exports in the world trade would increase from 9.3 percent in 2008 to around 12 percent by 2014 (Guo and N'Diaye, 2009). China is also predicted to overtake the EU and significantly close its gap with the US in terms of the share of the world's total energy consumption in 2010 (EIA, 2009). China's demand for raw materials, energy and an external surplus will be resumed, rapidly expanding while global growth comes back to trend. Chinese firms' OFDI strategies may continuously reflect this imbalanced economic structure, remaining focused on market- and resource-seeking activities for trade related production and for overall domestic economic growth. Unlike the "springboard" perspective suggests, firms' desire to "springboard" by acquiring strategic assets *at an aggregated level* could be the exception rather than the rule.

Weak "soft" capabilities to engage in strategic asset-seeking OFDI: Although Chinese firms may have the financial capability and backing from the state to engage in SAS OFDI, they might be put off by their weak "soft capability" to realise the true benefits from their acquisitions. The lack of "decoding" capability might significantly delay post-acquisition "springboard" benefits such as knowledge transfer and skill learning. Chinese companies, as latecomer firms, may not always hold an equal technological/knowledge base as mature MNEs or their purchased foreign firms. Neither could they identify or recognise whether the assets they acquired from the mature MNEs have strategic value before acquisitions, nor absorb fully the potential value of the acquired firm-specific strategic assets. They could fall into a trap of "blind" global expansion. The "springboard" strategy might not always help Chinese firms, as they optimistically expected, to develop synergies or anything close to dynamic capabilities (sustainable technology development and knowledge creation).

Without these they would be less able to keep pace with the dynamic development of the world industries and safeguard the value of the acquired ‘strategic assets’ (Ning, 2009a; Nolan, 2001).[10] Indeed, no firms could purely rely on constant external acquisitions for knowledge development. For example, no matter how much progress Chinese firms like Lenovo can make to vertically expand product ranges, they still have to comply with industrial standards set by industrial leaders, and incorporate their core components, such as “Intel Inside” and “Designed for Microsoft Windows”. When new innovations such as pocket PCs become available, they have to pay heftily again to take over these newer standardized manufacturing activities shed from the leaders (Ning, 2009a).

Secondly, Chinese firms might not be put off by ‘psychic distances’ to invest abroad. Overseas investments, however, require not just strategic-intent or risk-taking entrepreneurship, but careful strategic planning, competent global strategy execution and sufficient managerial capability. Although lacking experience in these areas, Chinese firms could outsource or consult foreign management and investment professionals as, for example, with Sichuan Tengzhong’s purchase of GM’s Hummer brand (Rosen and Hanemann, 2009). However, much post-acquisition daily operation and management cannot be outsourced. These might require Chinese firms to develop a sound knowledge of different host countries’ markets, regulatory standards (e.g. safety and quality standards, tax and accounting rules), legal, political and social environment as well as competent global managerial and execution knowledge to coordinate geographically dispersed operations. They would also need to integrate home and host country business activities, to reconcile national and corporate level cultural differences (e.g. management practises on multicultural and ethnical workforce and expatriates), and maintain positive public relations and effective communication with foreign consumers (e.g. brand awareness and reputation). Unlike previous studies predicted, the post-acquisition integration of several high profile firms backfired. For example, integration failed between TCL and RCA Thomson, the steel giant Baosteel and its acquired Brazilian iron ore suppliers, Shanghai Automotive and its purchase of Korea's now-bankrupted Ssangyong Motors, and the jury is still out on Lenovo's acquisition of IBM's PC business and Geely's purchase of Volvo. These failures are typically because 'strategic assets' (objective knowledge) can be purchased, whereas 'experiential' knowledge is tacit and can only be secured through experience - "learning by doing" (Barkema and Vermeulen, 1998; Luo and Tung, 2007). The springboard internationalisation strategy often leapfrogs such learning and knowledge accumulation processes. Indeed, East Asian 'tigers' paid a high price for their lack of international knowledge and experience during their initial global expansion in the 1980s. They eventually adopted gradual internationalisation and conservative acquisition strategies (Chang, 1995; Li, 1994).

Thirdly, contrary to Rui and Yip's strategic-intent perspective findings, which are based on a case study of three Chinese large firms (two now failed), a number of recent surveys show that Chinese executives' future development strategies still primarily target the domestic market and exports. For example, CCPIT's survey shows only a small percentage of Chinese companies consider direct investment as the top priority for servicing high margin markets in developed countries.[11] A similar result was confirmed in the interviews conducted by the Peterson Institute for International Economics. Chinese business elites recognise the long-term need to internationalise as the strategic-intent perspective aruges, but they value the risks related to global expansion to be too high compared to the short-term profit opportunities readily and safely available in the domestic markets (APFC and CCPIT, 2009; Boyd and Cavey, 2005; Rosen and Hanemann, 2009). The surveys also reveal that 54% of the sample responded that they will reduce their foreign investment due to the crisis. As argued above, lacking “soft capabilities” to deal with post-springboard acquisitions, Chinese MNEs might be unable to fully realise the springboard benefits and find it simpler to engage in natural-resource seeking OFDI to support their production targeted for short-term domestic profit opportunities.

Fourthly, weak “soft” capabilities such as poor corporate governance can also constrain Chinese firms from internationalising and safeguard the value of their acquired strategic assets. Unlike in the Anglo-Saxon market-based corporate governance system, control- and relationship-based governance mechanisms are very common in China and other developing countries, owing to underdeveloped financial institutions and stock markets (Naughton, 2007). Such corporate structure is often perceived as opaque, unaccountable, and un-transparent by international stakeholders. It not only generates a negative corporate image, but also affects the management of foreign subsidiaries, inter-organisational control, decision making and strategy implementation for strategic acquisitions. For example, many recent regulatory and legal reforms have been unable to address the power imbalance inherent in the structures. Shareholders do not generally have the same power as the non-owners such as the firms’ communist party committee, which is often placed alongside most listed firms’ board and is chaired by its party secretary. The party committees monitor and evaluate the performance of CEOs and senior management, who are often appointed by the party and State-owned Assets Supervision and Administration Commission (SASACs). Firms’ management therefore do not normally have any personal stake in the firms, but do have incentives to maximize their career advancement through engaging in symbolic OFDI projects, at the cost of firms’ small private shareholders and long-term strategic development. (Morck, *et al.*, 2008)

State ownership and foreign political constraints on acquiring strategic assets: The crisis certainly boosts opportunities for strategic-asset acquisition abroad, but not necessarily increase the successful completion rate in the advanced economies where such assets are abundant. Previous research often overlooks OFDI-related political issues. There is an optimistic assumption shared among previous literature that international expansion along with adoption of Western business practices can be used as an effective springboard for Chinese MNEs to considerably reduce the liability of foreignness. However, the "negative country of origin" effects often appear when political tensions or investment protectionism are raised against China (Buckley, *et al.*, 2008; He and Lyles, 2008). Chinese firms may find rising protectionism and entry barriers are too high and trigger backlashes in the host countries, even though the Chinese government is on their behalf vociferously campaigning against international trade and investment protectionism. Lacking internationalisation experience, Chinese firms have often naively thought they could simply acquire assets based on market principles. Yet, they often get caught up with political controversies in advanced host countries. Failed high-profile bids include CNOOC's (China National Offshore Oil Corporation) attempt to acquire the US oil company Unocal in 2005, Huawei's joint bid with Bain Capital for 3Com in 2007. Chinalco's $13 billion investment in Rio Tinto, an Australian mining firm, Shanghai Automotive's bid for the Korean automaker Ssangyong, and the Shanghai Industrial Investment Company's Baltic Pearl master plan in St. Petersburg, Russia.

China's financial stimulus packages and "go global" policy indeed signify large scale government involvement in China's OFDI. By 2009, "centrally owned" enterprises (state-controlled business groups) contribute 81.3 % and state owned enterprises 69.9% of China's total OFDI stocks, while private sector only took about 1% of the share (Table 5). Chinese business groups are the key players of China's OFDI. They often have a complicated ownership structure, which implies the state and Communist Party have strong influence over corporate management (Morck, *et al.*, 2008; Sutherland, 2009). Policymakers in the host developed countries not only worry about the impacts of such non-commercial investors and foreign state-supported firms on their market economic systems, but also their non-commercial motivations. For example, recent policy propositions in Beijing regarding the use of China's OFDI as an alternative to US treasury holding triggered US fears and concerns. These centred on its national financial security and encouraged protectionist politicians to lobby for the expansion of the US investment review system to cover economic security regardless of national security (Milhaupt, 2009; Prasad, 2009; Rosen and Hanemann, 2009).

Indeed, many developed countries do have regulatory mechanisms in place to prevent potentially harmful investments from "negative" countries, particularly in response to the emergence of OFDI from China and the Middle East (UNCTAD, 2009). For example, the proposed acquisition of the Peninsular and Oriental Steam Navigation Company (P&O) by the state owned Dubai Ports World in 2006 and the bid of CNOOC to purchase Unocal in 2005. Under the 2007 Foreign Investment and National Security Act, the Committee on Foreign Investments in the US (CFIUS) is required to heighten scrutiny of FDI especially from sovereign wealth funds and state-owned companies in order to determine their effects on US national security. In 2008, the number of cases related to national security undergoing investigation by the CFIUS has increased from 6 in 2007 to 27. In April 2009, Germany also amended its Foreign Trade and Payment Act, which authorises the Federal Ministry of Economics and Technology to initiate reviews or prohibit any non-EU FDI with intension to acquire more than 25% voting rights shares of a German company that may threaten public security or order. (Marchick and Slaughter, 2008; UNCTAD, 2009)

Many of the legitimate measures and regulatory investment rules are neither very transparent nor clearly defined, even in developed countries and international rules (e.g. the WTO protocols). The investment review processes can often be easily politicised by domestic interest groups to discriminate against FDI. For example, China's rising strength during the crisis has caused increased US concerns both about its own global leadership and China's peer competitor status. It is now predicted that China could overtake the US economy well before the 2030 date originally forecast (Marchick and Slaughter, 2008). The US administration could easily be pushed, under the current conditions of nationwide stress in employment and declining income, to take actions against alleged Chinese commercial misbehaviour (e.g. China's currency manipulation) in order to avoid accusations by opposition party protectionist politicians and political activist media, and improve public confidence (Keidel, 2008). The changing nature of Chinese OFDI from natural resources to SAS could lead increasingly politicised investment regimes in host advanced countries to shift their national security focus from traditional issues related to critical natural resources and infrastructure, to security-relevant advanced technology and job transfers to China. These examples show that politicised investment regimes in host developed countries, where strategic assets are abundant, could possibly be one of the main constraints to a larger scale of Chinese SAS OFDI. Chinese executives' "soft capability" to understand foreign market environments and assess political risks is therefore crucial in successful SAS bids.

V. Conclusion and Managerial relevance

The global financial crisis, as the institutional or imperfect market perspectives show, certainly creates opportunities for Chinese firms to acquire financially distressed foreign companies and their under-priced assets in the advanced economies, where strategic assets are abundant. The Chinese government is also actively promoting OFDI by easing regulatory procedures and providing financial backup. The exaggerated impression given by media coverage is that China is buying up the world. It was also promoted by the *ex-post* observation bias of some academic work largely derived from the springboard and strategic-intent perspectives, that internationalisation of Chinese MNEs is increasingly related to the SAS type, closely related to the development of firm-level capabilities that allow latecomer MNEs to catch up with leaders. Case studies, without exception, tend to dwell on the few but exceptional cases in which well-known Western firms have been acquired by Chinese firms.

At an aggregate level, the evidence presented here suggests caution in subscribing to these views. Moreover, chance events and government interventions, as Michael Porter’s diamond theory identified, do not always significantly reshuffle the positions of industrial players or create opportunities for latecomers to catch up. These theoretical perspectives might need to take into account factors, such as the home country’s economic conditions, firm specific capabilities and political issues overseas, which still pose challenges and constraints for latecomer firms to ‘springboard’ extensively through SAS OFDI. The majority of Chinese firms’ OFDI activities are, as the network perspective views, still closely tied to the expansion of the nation’s trade and production, and based on country-specific advantages such as low costs, rather than firm-specific advantages in knowledge and systems integration. This situation is unlikely to change dramatically in the short term.

Indeed, Chinese policymakers and business executives might be able to gain some insights from the Japanese experience, to which the boom of Chinese MNEs' OFDI bears a remarkable resemblance. Throughout the 1980s, Japanese MNEs were troubled by a number of issues: trade imbalance and rising protectionism, controversies over exchange rates and intellectual property rights, national security concerns over Japanese firms' acquisitions of US and European high-tech companies, politicized debates over the possible threat posed by Japan's state-led capitalism to the Western neo-liberal form, a public perception of "buying up America and the world", cultural misperceptions, incompetent management practices, and foreign employment disputes (Milhaupt 2009; Ning, 2008). Nowadays, there is virtually no political or media controversy concerning Japanese MNEs and they are generally welcome in host developed countries. Indeed, Japan had made considerable efforts to help firms overcome foreign obstacles. At the government level, Japan initiated a series of negotiations with the US to solve its "structural problems" that had led to the trade and payments imbalance. It also gained foreign political supporters to lobby for the host governments to emphasize mutual interests and benefits for the countries, and Japan's contributions to their bilateral relations as opposed to political, cultural or national security concerns. This helped calm protectionist sentiment in the host countries. Japanese public and private organizations also actively promoted understanding of Japanese business and bilateral economic relations in the host countries through organizing conferences and events for government organizations, media, business leaders and academics. At the firm level, Japanese MNEs often tried to maintain the existing business structures of acquired firms in order to reduce the concerns and fears of local communities. They also made considerable efforts to campaign for corporate social responsibility through charity work. This actually helps firms reduce 'the liability of foreignness', integrate in to local communities, and build positive public relations (Milhaupt 2009).

While perhaps drawing lessons from the Japanese experience, Chinese MNEs still need to overcome a number of firm-specific challenges in order to take advantage of the opportunities arising from the crisis. These might include:

- Overcoming domestic structural constraints and adapting to the host country's environments based on long-term strategic planning to engage in SAS OFDI and gradual internationalization approach

- Resisting the temptation to embark on politically symbolic OFDI projects, where acquired sensitive firms can exacerbate negative public reactions in the host countries

- Developing the firm-specific "soft capability" and knowledge to effectively identify overseas strategic assets, and to respond to local conditions flexibly and improve corporate governance practices and ownership structure

- Rather than targeting profitability alone, devoting attention to corporate social responsibility, which Chinese MNEs have traditionally neglected, so as to better integrate into the local communities.

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[1] Another example is the September 11 attacks

[2] free information services, abolished foreign exchange requirements and provided easily obtained bank loans, tax breaks

[3] On 13 July 2009, SAFE promulgated the Provisions of Administration of Foreign Exchange in respect to Overseas Direct Investment by Domestic Entities

[4] SAFE further issued the Notice on the Relevant Issues concerning the Foreign Exchange Administration of Overseas Loans Granted by Domestic Enterprises

[5] On 9 December, 2008, the China Banking Regulatory Commission promulgated The Guidelines for the Risk Management of Merger and Acquisition Loans Granted by Commercial Banks.

[6] An announcement by the deputy director of SAFE in Feb 2009

[7] China's 2008 stimulus plan targeted on housing, rural infrastructure, transportation, health and education,

environment, environment, environment, industries (9 industries, steel, car, ship-building, electronics and telecommunication, non-ferrous metals, petrochemicals, textiles, light industries), disaster rebuilding, rising incomes, taxes (VAT), and finance (loans for SMEs).

[8] Profit margins of heavy and energy intensive industries on an earnings-before tax basis has been surpassed by those in the light industries since 2002, around 2% higher on average (Freeman et al., 2008).

[9] In 2009, official data shows there are 20 million migrant workers (the actual number may well be above 40 million) who lost their jobs. In addition, one in six graduates (6 million in total) did not find employment.

[10] See Ning L. 2009 global business revolution/ e.g. When East Asian ICT latecomers competed in the international market, their foreign incumbents were relatively stable, focusing on manufacturing activities. EAT companies could target the same activities and gain market share by providing lower-cost substitutes. when China entered the world ICT industry, the core meaning of global competition had changed. With international political relaxation, and trade barriers and transportation costs continuously falling, the world economy has entered a globalization era, which features more integrated national economies, a rapid outward shift of technological frontiers, enhanced GPNs and an explosion of global M&A.

[11] Member firms of the China Council for the Promotion of International Trade, which are involving in international business and have annual income over RMB 1 million. 46% (1,104) of the sample responded the survey in December 2008.

Table 1. shares in global OFDI by selected countries 2000-2008

		00-05 Ave	**2006**		**2007**		**2008**	
		Share of global FDI	**billions US$**	**Share of global FDI**	**billions US$**	**Share of global FDI**	**billions US$**	**Share of global FDI**
World	Flow	~	1396.9	100	2146.5	100	1857.7	~
	Stock	~	12953.5	100	16226.6	100	16205.7	~
Developing economies	Flow	11.08	215.3	15.41	285.5	13.30	292.7	15.76
	Stock	12.24	1731.6	13.37	2360.8	14.55	2356.6	14.54
Transition economies	Flow	1.09	23.7	1.70	51.5	2.40	58.5	3.15
	Stock	0.93	222.8	1.72	387.1	2.39	225.4	1.39
Developed economies	Flow	87.83	1157.9	82.89	1809.5	84.30	1506.5	81.09
	Stock	86.82	10999.2	84.91	13478.8	83.07	13623.6	84.07
Brazil	Flow	0.29	28.2	2.02	7.1	0.33	20.5	1.10
	Stock	0.74	113.9	0.88	136.1	0.84	162.2	1.00
China	Flow	0.66	21.2	1.51	22.5	1.05	52.2	2.81
	Stock	0.48	73.3	0.57	95.8	0.59	147.9	0.91
EU	Flow	55.51	697.2	49.91	1192.1	55.54	837.0	45.06
	Stock	50.71	6650.1	51.34	8314.7	51.24	8086.8	49.90
Germany	Flow	4.23	127.2	9.11	179.5	8.36	156.5	8.42
	Stock	9.26	1081.3	8.35	1294.5	7.98	1450.9	8.95
India	Flow	0.24	14.3	1.03	17.3	0.81	17.7	0.95
	Stock	0.06	26.8	0.21	44.1	0.27	61.8	0.38
Japan	Flow	4.57	50.3	3.60	73.5	3.43	128.0	6.89
	Stock	4.10	449.6	3.47	542.6	3.34	680.3	4.20
	Flow	0.99	23.2	1.66	45.9	2.14	52.4	2.82
Russian Federation	Stock	0.89	216.5	1.67	370.2	2.28	202.8	1.25
United Arab Emirates	Flow	0.16	10.9	0.78	14.6	0.68	15.8	0.85
	Stock	0.05	20.4	0.16	35.0	0.22	50.8	0.31
United Kingdom	Flow	11.09	86.3	6.18	275.5	12.83	111.4	6.00
	Stock	13.21	1454.9	11.23	1841.0	11.35	1510.6	9.32
United States	Flow	18.35	224.2	16.05	378.4	17.63	311.8	16.78
	Stock	21.57	2477.3	19.12	2916.9	17.98	3162.0	19.51

Source: calculated from the UNTACD 2009

Table 2: Shares of China's OFDI by sector

	2003 Flow	2004 Flow	2005 Flow	2006 Flow	2007 Flow	2008 Flow	2008 Stock
Mining	48%	33%	14%	48%	16%	14%	16%
Manufacturing	22%	14%	19%	5%	9%	4%	7%
Construction	1%	1%	1%	0%	1%	2%	2%
Transport, Storage and Post	3%	15%	5%	8%	16%	6%	10%
Wholesale and Retail Trades	13%	15%	18%	6%	27%	16%	20%
Production and Supply of Electricity, Gas and Water	0%	0%	0%	1%	1%	3%	1%
Leasing and Business Services	10%	14%	40%	26%	23%	52%	37%
Real estates	0%	0%	1%	2%	4%	1%	3%
	96%	91%	97%	96%	96%	98%	95%

Note: some minor sectors not included
Source: MOFTEC 2003-2009

Table 3: Destination of OFDI stock by shares of national total.

	2003	2004	2005	2006	2007	2008	OFDI, stock 2008*	Stock % of total*
Total OFDI	2.9	5.5	12.3	17.6	24.8	55.9	147.3	~
Asia	1.5	3.0	4.4	7.7	15.4	43.5	131.3	71.4%
Hong Kong	1.2	2.6	3.4	6.9	13.7	38.6	115.8	62.9%
Singapore	~	0.0	~	0.1	0.4	1.6	3.4	1.8%
Africa	0.1	0.3	0.4	0.5	1.6	5.5	7.8	4.2%
Europe	0.2	0.2	0.5	0.6	1.1	0.9	5.1	2.8%
Latin America	1.0	1.8	6.5	8.5	4.9	3.7	32.2	17.5%
Virgin Islands	0.2	0.4	1.2	0.5	1.8	2.1	10.5	5.7%
Cayman Islands	0.8	1.3	5.2	7.8	2.6	1.5	20.3	11.0%
North America	0.1	0.1	0.3	0.3	1.1	0.4	3.7	2.0%
Oceania	0.0	0.1	0.2	0.1	0.8	2.0	3.8	2.1%
Australia	~	0.1	0.2	0.1	0.5	1.9	3.4	1.8%

Source: MOFTEC 2004-2009

Table 4. The quantity of China's major M&A deals by region and industry 2000-2008

	Hong Kong	Asia (ex HK)	North America	Europe	Oceania	South America	Tax Havens	Africa	2006	2007	2008	of total (regions)
Financials	52	15	5	1	0	0	4	1	17	18	16	19%
Raw materials	9	8	16	8	22	6	1	4	9	23	12	18%
Energy and power	7	16	8	7	4	4	2	4	10	13	8	13%
Industrials	14	10	9	16	2	0	0	0	6	5	9	13%
High technology	17	12	10	1	2	1	1	0	4	7	5	11%
Consumer products/ services	6	5	7	5	0	0	0	0	2	3	8	6%
Media and entertainment	14	1	4	0	1	0	2	0	4	5	3	5%
Consumer staples	7	5	2	4	0	1	0	1	1	2	3	5%
Telecommunications	8	2	4	3	0	0	0	0	0	4	0	4%
Healthcare	3	2	5	0	0	0	1	0	1	3	1	3%
Retail	6	0	1	0	1	0	0	0	0	2	3	2%
Real estate	5	1	0	1	0	0	0	0	0	3	1	2%
of total deals	36%	19%	17%	11%	8%	3%	3%	2%	14%	22%	17%	~

Sources: Thomason Financial and Rosen and Hanemann 2009

Note: cross-border direct M&A with more than 10 percent Chinese stakes.

Table 5. The shares of national OFDI stock by types of ownership

	2008	2007	2006	2005	2004
Central Enterprises	81.3	78.5	82	81.8	83.7
Local Enterprises	18.7	21.5	18	16.4	14.5
State Owned Enterprises	69.6	71	~	~	~
Limited liability companies	20.1	20.3	~	~	~
Joint stock limited companies	6.6	5.1	~	~	~
Joint stock cooperative companies	1.2	1.2	~	~	~
Collective enterprises	0.4	0.4	~	~	~
Private companies	1	1.2	~	~	~

Source: MOFTEC various years

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