A MULTILEVEL APPROACH TO UNDERSTANDING THE INSTITUTIONAL DETERMINANTS OF OUTWARD FDI FROM CHINA: A THEORETICAL EXPLORATION

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Introduction

The effects of government ownership and intervention on business has been much analyzed and debated especially for countries transitioning towards market oriented economies. Such countries struggle with the twin state priorities to bolster economic dynamism via new capitalistic initiatives to promote competitiveness while reforming to modernize its governing apparatus to preserve political control and renew ideological legitimacy. One prominent country with this dual track approach is China. Characterizations of China's emergent business system have been described variously as "centrally managed capitalism" (Lin, 2010) or "network capitalism" (Boisot, 1996) where the goals of the party state are perpetuated by control over resources and key personnel in the business and economic arenas through networks based on personal power, incentives and favors, and trust. Simultaneously, however, significant efforts to overhaul China's state owned enterprise (SOE) system through parallel decentralization and privatization programs have led to a "managerial revolution" (Walder, 2010) and the rise of a new corporate elite with greater independence from government agencies than ever before. Reforms have also reorganized the ownership of SOEs such that control over municipal and provincial SOEs have been assigned to more market-oriented local governments with a small group of about 120 national champion firms from key strategic industries made subordinate to the central government. The effects of these reforms has enabled China's market track and centrally planned tracks to co-exist with implications on Chinese outward FDI which have so far been relatively unexplored.

Drawing from several research streams including institutional and organizational theory, corporate governance, and political economy, this chapter provides a theoretical framework for exploring how decentralization of ownership and control of SOEs to different levels of government may impact outward Chinese FDI patterns. So far, much scholarly attention has focused on the outward investments of the key champion firms primarily since such deals are significant in size and involved in strategic sectors such as high technology and natural resources. Another reason for such attention has been the rapid growth in these firms' outward investment activity which have raised concern among other countries that they are explicitly aimed at achieving national economic and political objectives over the interests of shareholders. A plethora of journal articles and reports detail extensive coverage over the nature of such investments (insert strategic asset literature). Yet, surprisingly little has been studied about the outward investment initiatives of provincial, local, and municipal governments which have also substantially increased their outward investments in the recent decade since the establishment of China's Going Global policy. Only one study has examined the relationship between FDI and subnational institutions (K. Meyer and H. Nguyen, 2004) but this paper focuses primarily on inward FDI but not outward FDI. From 2004-2010, the flow of provincial non-financial outward FDI has increased dramatically from 973 million to 17.75 billion dollars (see Figure 1.1, 2010 Statistical Bulletin of China's Outward Foreign Direct Investment). This represents an 18-fold jump in total outward FDI from provincial governments and comprises over 41% of central outward FDI or about 30% of total outward FDI volume in 2010. Currently, Liu 2005 (Corporate governance in China: current Practices, Economic Effects and Institutional determinants) estimates that 61.5% of Chinese listed companies are under local government control, 15.3 percent are under central government control and 3.4 % are cooperatively controlled by different levels of government. The expanded role of provincial and local level FDI raises a number of questions which are of theoretical and empirical interest.

The goal of this paper is to provide a conceptual outline of how outward FDI orchestrated by subnational governments and authorities may differ from centrally directed FDI since existing literature on Chinese internationalization strategies covers mainly macro national level outward investment by champion SOEs which may not be generalizable to local firms. How is firm investment strategy and managerial behavior influenced by ownership structure and local institutional context? Does ownership structure play a mediating role or a main role? Does outward FDI from local government SOEs target assets in different geographical locations than central government SOEs? What are the attributes of these target firms and how might they reflect the preferences, motivations, and capabilities of local government investors? Do their preferences stem from the economic or political objectives of the local Chinese government or its institutional development? What might be the comparative advantages and disadvantages of outward investments by local enterprises compared to central SOE investments? Are they more exploitative or exploration oriented in nature? More efficiency, or market and strategic asset seeking? Are there differences in the stakeholder considerations and manner in which central government agencies and subnational government agencies represent themselves and conduct their investments? How do they differ in terms of resources (including human and capital endowments) and capabilities and what are the implications on their investment decisions? Are centrally managed and locally managed firms pursuing similar or different paths in their internationalization? The cross-border investments of provincial and local government enterprises not only have long term operational and economic impact on their targets but also on their own investment performance, risk-taking, and economic development. How are these broader set of interests reflected in their choices? Lastly, what kind of coordination process, information sharing or other consultation mechanisms exist between the central and local level governments for outward investment?

Anchored in the institutional based approach (Dunning and Lundan, 2008; North, 1990; Peng, 2003), this paper recognizes the view that “different combinations of transactions, resources and patterns of governance are possible" and firms do not "organize similar transactions in the same way." (Dunning and Lundan, 2008) This line of reasoning can be extended to elucidate how the ownership specific advantages of provincial and local government controlled firms, including the resources, knowledge and capabilities deployed at the firm level may differ from those of centrally controlled SOEs. Drawing from political economy literature, this paper will first trace the historical origins of the delineation of roles and responsibilities of local, provincial, and central governments in China with the aim to explain factors which drive priorities in the governing structure and incentives affecting how subnational and central level governments intervene in business activities under their jurisdiction. With a clearer depiction of such differences and how they shape the contours of authority at these different levels of government, the next section of this paper will explore how specific resources and capabilities may be rationalized and channeled in certain ways depending on government affiliation through policy measures to influence the organization, governance, competencies and strategic orientation of firms. Finally, the paper will present a theoretical framework for how institutions at the subnational level may influence the scope and nature of outward FDI decisions in several dimensions including corporate governance, managerial incentives and performance, risk taking, vertical integration and diversification, and resource endowments. Some testable hypotheses will be derived from this model. Since a substantial amount of inward FDI to China have already been implemented at the subnational level, local governments may also benefit from learning about the practices of foreigner investors which could influence their strategic investment orientation. Premised on the idea that local and central SOEs may possess different combinations of resources and motivations for going global, this paper also proposes that specific configurations of resources and local state support at the subnational level may serve a more appropriate role in facilitating certain types of outward FDI while central government sponsorship and resources may be better suited to other investments types. A natural implication is they may also pursue different strategies and entry modes in their internationalization paths.