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Chapter 4

INTERNATIONAL EXPANSION OF CHINESE MULTINATIONALS: THE NEW CHALLENGE OF GLOBALIZATION

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ABSTRACT

Over the last few years, a new generation of Chinese multinationals has set out to conquer global markets, featuring major international acquisitions that were unthinkable until very recently. This work seeks to analyze the nature of this emerging phenomenon, illustrating the reasons behind the international expansion of Chinese multinationals, the factors that facilitate and hinder this process, the entry modes that they use and the strategic implications for Western companies of their sudden arrival on the new world stage.

INTRODUCTION

Around 200 years ago, Napoleon referred to China as a slumbering giant that was better to let lie because, when awakened, it would shake the world. In fact, some economic historians argue that we are not witnessing the birth of a new economic power but rather its rebirth. The Chinese call their own country *Zhong Guo*, which means "the central land" or "the middle kingdom", and, in fact, this is not the first time that China can be found among the ranks of the leading world powers. Over the course of its thousands of years of history, it has lived through several periods of great splendor and development. Under the hegemony of the Western Han dynasty, between the third century BC and the first century AD, China opened up major trading routes—in particular, the Silk Road—which was the main commercial artery between Asia and Europe for hundreds of years. Later, during the Ming

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dynasty from the fourteenth to the seventeenth century, China experienced a new period of growth that elevated it to the status of the world's leading seafaring power.

Following the fall of Imperial China in 1911, there were several years of instability which saw a Japanese invasion and a civil war and ended with the declaration of the People's Republic of China by Mao Zedong in 1949. His rule was marked by major social and political upheavals until Deng Xiaoping came to power in 1978. That year formed a watershed—a before and after in the recent history of China—with the implementation of profound structural reforms and a process of opening up known as the "open door policy". All of this translated into a period of growth and development that has continued to the present day.

China's cost advantages and its status as the world's most populous country with around 1,300 million inhabitants have caused it to be dubbed "the world's factory" or "the biggest potential market in the world". Over the last 30 years, this Asian giant has experienced one of the most rapid and spectacular economic transformations of modern history, with growth rates of over 10% a year. Everything we hear about China these days is accompanied by figures in the millions. It is currently the third global economy in terms of product value (beaten only by the US and Japan), the second largest exporter (after Germany), the third largest importer (after the US and Germany), the third largest recipient of foreign investment (and the greatest among the developing economies), the second largest consumer of energy (after the US), the biggest online market (with some 298 million Internet users) and the biggest mobile phone market (with some 500 million users). It is also the leading producer of cotton, steel, white goods, pork, textiles and footwear.

Traditionally, this production has been associated with low costs, but many Chinese companies are now specializing in products and technologies that are increasingly sophisticated and innovative. Haier is the world leader in the manufacture of refrigerators, Huawei produces broadband Internet access equipment that is more advanced than that produced by some Western countries, BYD is the world's biggest manufacturer of nickel-cadmium batteries and holds a quarter of the global market for mobile phone batteries, Johnson Electric is the world's leading producer of small electrical motors, the Pearl River Piano Group is the greatest global producer of pianos and China International Marine Containers ships 50% of international transport containers.

These names are probably not overly familiar to Western ears, but they represent a new generation of Chinese multinationals that have set out to conquer global markets. It is not surprising that some of them have featured massive international operations that were unthinkable until very recently.

The prestigious Fortune Global 500 ranking published annually by *Fortune* magazine, which lists the world's top 500 corporations in terms of revenue, also provides data that enables the magnitude of this phenomenon to be calibrated. In 2009 (*Fortune*, 2009), 37 Chinese companies were featured on this list (as opposed to 29 in 2008 and just 24 in 2007). This makes China the fifth country in the world in terms of the number of Fortune Global 500 companies (after the US, Japan, France and Germany). China's list is headed by two oil companies (Sinopec, ranked 9th, and CNPC, ranked 13th), followed by State Grid, at number 15.

Furthermore, Sinopec is the biggest company in Asia. On the other hand, Beijing (home to 26 companies) is the third city in the world with the most Fortune 500 firms, behind Tokyo and Paris. Also, CNPC and State Grid are the second and third companies in terms of the

number of employees (with over 1.6 million and 1.5 million, respectively), beaten only by the US firm Wal-Mart (over 2 million).

Another example is the November 2007 floating on the stock exchange of oil and gas giant PetroChina, a state-owned enterprise (SOE) founded in 1999 with assets and facilities originating from the restructuring of CNPC. Upon its debut on the Shanghai Stock Exchange, it tripled its value to reach a figure of around one billion dollars, overtaking that of US oil company Exxon Mobil and thus becoming the biggest company in the world by market capitalization.

The growing importance of China on the world stage has spawned a proliferation of empirical studies in prestigious international publications in recent years. However, most of these have focused on business and management of companies in China, in particular of Sino-Western joint ventures (JVs) established in the country (Quer, Claver and Rienda, 2007). Given the emerging nature of Chinese multinationals in the international arena, much less is known about them to date.

With the aim of filling this gap, the objective of our work is to analyze the phenomenon of the international expansion of Chinese multinationals, seeking to answer the following questions: In which sectors and in which geographical locations are they expanding? What are the underlying motives for their decisions to become international? What factors are driving the process and what obstacles must be faced? What entry modes are they using? Are the traditional approaches that have enabled an explanation of the international expansion of companies from other countries applicable here? And what are the strategic implications for Western companies?

TARGET SECTORS AND COUNTRIES OF CHINESE MULTINATIONALS

It was only a few years ago that Chinese companies first started to make foreign direct investments (FDIs) of any major significance. Although those with the greatest media coverage have been the acquisition of the PC division of IBM by Lenovo, or the European forays of TCL, TPV and Nanjing Automotive, the greatest FDI by a Chinese company so far has been the 7.5 billion dollars paid by Sinopec for the acquisition of Geneva-based Addax Petroleum Corp. Table 1 below summarizes the principal investments made by Chinese multinationals to date.

According to official figures published by the Ministry of Commerce (MOFCOM), China´s outward FDI net flows in 2008 reached 55.91 billion dollars, of which 41.86 billion corresponded to non-financial FDIs and 14.05 billion to financial FDIs, essentially within the banking and insurance sectors (MOFCOM, 2009). By the end of 2008, China's accumulated outward FDI stock had risen to 183.97 billion dollars. Up until the end of 2008, it is estimated that nearly 8,500 Chinese companies had carried out around 12,000 FDI operations in 174 countries around the globe. Table 2 gives an overview of the evolution of China´s outward FDI since 1982.

Table 1. Main FDIs of Chinese multinationals

Chinese company	Target company	Type of investment	Year
TCL	Schneider Electronics (Germany), TV manufacturer	Acquisition	2002
TCL	Mobile division of Alcatel (France)	Joint venture (majority control)	2004
TCL	TV and DVD subsidiary of Thomson (France)	Joint venture (majority control)	2004
Lenovo	PC division of IBM (USA)	Acquisition	2004
TPV	PC monitor and TV flat screen division of Philips (Holland)	Acquisition	2004
Shanghai Automotive Industry Corporation (SAIC)	Ssangyong Motor (South Korea), automobile manufacturer	Partial acquisition (majority control, 51%)	2004
Nanjing Automotive	MG Rover (UK), automobile manufacturer	Acquisition	2005
China National Petroleum Corporation (CNPC)	PetroKazakhstan (Canada), oil	Acquisition	2005
China National Offshore Oil Corporation (CNOOC)	Oil facilities of South Atlantic Petroleum (Nigeria)	Partial acquisition (45%)	2006
Sinopec	Udmurtneft (Russia), oil	Acquisition	2006
CITIC Group	Kazakhstan oil assets of Nations Energy (Canada)	Acquisition	2006
China Minsheng Banking Corporation	UCBH (EE.UU.), banking	Partial acquisition (9.9%)	2007
China Development Bank	Barclays (UK), banking	Partial acquisition (3.1%)	2007
Industrial and Commercial Bank of China (ICBC)	Standard Bank (South Africa), banking	Partial acquisition (20%)	2007
Bank of China	La Compagnie Financiere Edmond de Rothschild (Francia), banking	Partial acquisition (20%)	2008
China Oilfield Services	Awilco Offshore (Norway), oil	Acquisition	2008
Petrochina	Singapore Petroleum (Singapore), oil	Partial acquisition (45%)	2009
Sinopec	Addax Petroleum Corp. (Switzerland), oil	Acquisition	2009

Source: Various reports and publications

As shown in Table 3, the sectors in which FDI flows have increased the most over the last three years have been leasing and business services, finance, and wholesale and retailing (MOFCOM, 2009). Up until the end of 2008, four sectors had accumulated around 78% of the Chinese outward FDI stock: leasing and business services (29.7%), finance (19.9%), wholesale and retail trade (16.2%), and mining (12.4%).

In terms of the geographical distribution of Chinese FDI, Table 4 shows the FDI flows and the accumulated stock by regions over the 2006–2008 period, while Table 5 gives the ranking of the top 10 host countries in order of accumulated stock up to the end of 2008 (MOFCOM, 2009).

Table 2. China's outward FDI 1982–2008 (millions of US $)

	FDI flow	FDI stock
1982–1990	495 (annual average)	4455 (by the end of 1990)
1991–2000	2331 (annual average)	27768 (by the end of 2000)
2001	6885	34654
2002	2700	22900
2003	2854.65	33222.22
2004	5497.99	44777.26
2005	12261.17	57205.62
2006	21163.96	90630.91
2007	26506.09	117910.50
2008	55907.17	183970.71

Source: UNCTAD, Foreign Direct Investment Database, http://stats.unctad.org/fdi/ [1982-2001]; MOFCOM, Statistical Bulletins of China´s Outward Foreign Direct Investment, http://english.mofcom.gov.cn/ [2002-2008].

Table 3. China's outward FDI by industry 2006–2008 (millions of US $)

Industry	FDI flow			FDI stock		
	2006	2007	2008	2006	2007	2008
Leasing & business service	4521.66	5607.34	21717.23	19463.60	30515.03	54583.03
Finance	3529.99	1667.80	14048	15605.37	16719.91	36693.88
Wholesale and retailing	1113.91	6604.18	6514.13	12955.20	20232.88	29858.66
Mining	8539.51	4062.77	5823.51	17901.62	15013.81	22868.40
Transport, warehousing & postal service	1376.39	4065.48	2655.74	7568.19	12059.04	14520.02
Manufacturing	906.61	2126.50	1766.03	7529.62	9544.25	9661.88
Other industries	1175.89	2372.02	3382.53	9607.31	13825.58	15784.84
Total	21163.96	26506.09	55907.17	90630.91	117910.50	183970.71

Source: MOFCOM (2009)

Table 4. China's outward FDI by region 2006–2008 (millions of US $)

Region	FDI flow			FDI stock		
	2006	2007	2008	2006	2007	2008
Asia	7663.25	16593.15	43547.50	47978.05	79217.93	131316.99
Latin America	8468.74	4902.41	3677.25	19694.37	24700.91	32240.15
Africa	519.86	1574.31	5490.55	2556.82	4461.83	7803.83
Europe	597.71	1540.43	875.79	2269.82	4458.54	5133.96
Oceania	126.36	770.08	1951.87	939.48	1830.40	3816
North America	258.05	1125.71	364.21	1587.02	3240.89	3659.78
Total	17633.97	26506.09	55907.17	75025.55	117910.50	183970.71

Source: MOFCOM (2009); 2006 data only include non-finance outward FDI

Table 5. China's outward FDI stock by countries up to 2008 (millions of US $)

Country	FDI stock up to 2008	Percentage over total FDI stock
1. Hong Kong	115845.28	63%
2. Cayman Islands	20327.45	11%
3. British Virgin Islands	10477.33	5.7%
4. Australia	3355.29	1.8%
5. Singapore	3334.77	1.8%
6. South Africa	3048.62	1.7%
7. US	2389.9	1.3%
8. Russia	1838.28	1%
9. Macau	1560.78	0.8%
10. Pakistan	1327.99	0.7%
Total top 10	163505.69	88.9%
Total	183970.71	100%

Source: MOFCOM (2009)

By regions, Asia accounts for both the greatest FDI flow and the greatest accumulated stock over the three years in question. Ten countries account for around 90% of the FDI stock accumulated until 2008. Hong Kong is a clear leader at the top of the ranking, with over 60% of the accumulated FDI, followed by two Latin American tax havens: the Cayman Islands and the British Virgin Islands. Investment in this kind of tax haven habitually results in reinvestments in other economies, including China itself. Following at a considerable distance are Australia, Singapore and South Africa. In short, given that 79.7% of the accumulated Chinese FDI stock is concentrated in three tax havens (Hong Kong can also be considered as such), it becomes difficult to know for certain the true geographical distribution of Chinese FDI.

In any case, it is logical that there is a greater presence of Chinese companies on the Asian markets, due to geographical proximity, closer cultural similarity and low

relative operational costs (Yin and Choi, 2005). Therefore, as Chinese multinationals develop overseas, it is to be expected that their main focus of attention will be the Asian Pacific region, thus demonstrating a geographical pattern similar to that of other multinationals around the world, whose expansion is more regional than global (Rugman and Li, 2007).

REASONS BEHIND THE FDI OF CHINESE MULTINATIONALS

Inevitably, reflecting on this emerging phenomenon leads us to recall the experience of companies from Japan and South Korea, who expanded during the second half of the twentieth century. While the timescale of the Chinese FDI has had to necessarily differ from that of its regional counterparts, it has likewise been motivated by factors such as saturated home markets, the search for natural resources overseas and the need to withstand protectionist trade barriers (Taylor, 2002). These parallels, alongside the socio-cultural differences with regard to Western countries and the concerns that fear of the "yellow peril" awakes in these, mean that to a certain degree it could appear to be *déjà vu* (Tung, 2005).

However, the motivating factors of Chinese FDI show a series of differentiating traits (Deng, 2004). The FDI made by Chinese companies has not been motivated by the quest for efficiency through cost reduction (they have their cost advantages in China, and even relocate to the interior of the country should costs increase in the coastal areas). Furthermore, the FDIs used as export platforms, which have been the incentive for some companies in the newly industrialized countries of Southeast Asia, have not been a motivational factor for Chinese multinationals.

At first, Chinese FDI mainly sought to access natural resources. However, over recent years the motivations have broadened to embrace other objectives, some of which are common to multinationals the world over. Below, we shall examine the reasons behind these FDIs, grouping them into three blocks (Deng, 2004; Hong and Sun, 2006; Wong and Chan, 2003; Wu and Sia, 2002).

Resource Seeking

The search for resources, particularly natural resources, has been one of the traditional objectives of Chinese FDI. Until 1991, it was concentrated on Canada and Australia, extending to other countries during the 1990s with an increasing emphasis on fuel and industrial raw materials. One of the most significant examples of this strategy can be found in the purchase of Canadian oil company PetroKazakhstan by CNPC in 2005.

Market Seeking and Diversification

At first, Chinese FDI also often arose from the need to diversify markets and obtain foreign exchange. The establishment of trading subsidiaries promoted Chinese exports, since these subsidiaries were founded upon distribution channels and provided knowledge of the

market. Recently, the Chinese market has reached its limit in certain areas, causing an excess of production capacity in sectors such as textiles, bicycles, footwear and domestic appliances. Also, Chinese companies face quantitative restrictions on exports to other countries (which are even more severe than for non-Chinese companies), so productive FDI has been in many cases the solution to continue accessing those markets.

Some major SOEs have made FDIs seeking to diversify risks. This strategy has been reinforced by the trade reforms started in the 1980s, which meant that some companies lost their monopoly in China. One such example is Sinochem, a foreign-trading SOE that held a monopoly over the import and export of oil and chemical fertilizers. As a result of the reforms, Sinochem had to find new lines of business, which have transformed it into a company that is present in sectors as diverse as oil, chemicals, tourism and real estate.

Many Chinese SMEs have also sought to cultivate their comparative advantage in developing areas of Southeast Asia, Africa and Latin America. Essentially, these are small-scale, work-intensive projects of little added value, in which Chinese firms provide equipment, machinery and raw materials, through which they also contribute to increasing exports from China.

Strategic Asset Seeking

Over the past few years, some Chinese companies, rather than exploit an existing competitive advantage, have sought to gain a greater edge through the acquisition of strategic assets. On the one hand, they are looking to access advanced technology and managerial and productive know-how in developed countries, as is the case of Haier, which was one of the first Chinese companies to establish a production plant in the US. They also invest in developed markets seeking internationally recognized trademarks. Examples of this include the international operations of Lenovo (with its purchase of the PCs division of IBM) and TCL (with its acquisition of Schneider Electronics or the JVs that have enabled it to control the mobile phone business of Alcatel and the television and DVD business of Thomson).

OVERSEAS EXPANSION OF CHINESE FIRMS: DRIVING FORCES AND OBSTACLES

Facilitators of Chinese FDI: The Role of the Government

The internationalization of Chinese companies has been favored by factors such as strong governmental support, the ability to combine this support with entrepreneurial action and the obtaining of foreign capital, and the willingness of foreign companies to sell or share technology, know-how and branding (Child and Rodrigues, 2005). With regard to this last point, Chinese multinationals practice what is known as *coopetition* (competition and cooperation at the same time) with global players both at home and in the host country. These ties with rivals sit well with the *yin-yang* philosophy that is so deeply rooted in Chinese culture: the *yin* (cooperation) and the *yang* (competition) can been seen as two mutually complementary sides of the same coin (Luo and Tung, 2007).

Another outstanding factor is the personal traits of Chinese managers (Zhang and Van den Bulcke, 1996), as is the case at Haier. Its chairman Zhang Ruimin took over the management in 1984 of what was to be the seed of Haier: a refrigerator factory in Qingdao with enormous losses. Since then, his strong leadership has accelerated decision-making and has enabled Haier to expand into a large number of countries in a short space of time (Liu and Li, 2002). Entrepreneurial and managerial skills in Chinese companies have improved over recent years thanks not only to the learning derived from foreign companies set up in China but also to the development of private property, the transformation of SOEs and the encouragement of hi-tech firms (Rui and Yip, 2008).

In any case, the real driving force behind the process has been the Chinese government. FDI was first permitted in 1979, but it remained prohibited for private companies until 2003. During that initial period, the internationalization of Chinese companies was tightly controlled by the government (Buckley et al., 2007). The setting up of overseas operations by Chinese firms then became one of the official policies for opening up the economy (Hong and Sun, 2006), with the leading role being played by SOEs, which were seen as instruments through which to achieve national objectives (Zhang and Van den Bulcke, 1996).

The year 2001 brought a major boost with China's entry into the World Trade Organization (WTO) and, in particular, with the announcement by the then president Jiang Zemin of the "go out" policy. This initiative sought to promote the international competitiveness of Chinese companies by reducing obstacles to FDI. In the years to come, it is expected that the government will continue to provide incentives for the process. In fact, both the current president, Hu Jintao, and the prime minister, Wen Jiabao, believe that the formation of major multinationals will help China to become an economic superpower.

Restrictions and Obstacles for Chinese Multinationals

Obviously, the emerging rise of Chinese multinationals is not without problems. As late entrants to international trade with less experience in globalization, they are likely to be at a disadvantage compared to their Asian and Western counterparts. In particular, the main problems and challenges they must face are the following (Luo and Tung, 2007; Wu, 2007):

- Due to their limited experience in mergers and acquisitions, they have yet to demonstrate whether they have the skills required to face post-acquisition difficulties (for example, reconciling cultural differences).
- They lack international experience (in particular, specific market knowledge, which is tacit in nature and is only acquired through *learning by doing*).
- They need to improve their product and process innovation (since it is difficult to survive long term trusting only to acquisitions for knowledge development).
- The state ownership of many of them makes them vulnerable to political risk in countries where the assets they seek are considered strategic.
- The less developed status of the home stock markets and the lack of transparency derived from their state ties mean their corporate governance is generally weaker.

Some Chinese multinationals are trying to overcome these obstacles in various ways. Haier attempts to overcome its technological disadvantages by establishing R&D centers in developed countries and alliances with Western multinationals (Liu and Li, 2002). Lenovo, with its integration with IBM, appeals to the principles of candor, respect and compromise to join employees from two different cultural backgrounds (Liu, 2007).

Likewise, Chinese companies like Huawei or Haier who are facing strong domestic competition, have less governmental protection and place emphasis on R&D, managerial skills and brand image are better candidates for international success than SOEs that operate in protected industries and have been slower when it comes to accepting the realities of a market driven by efficiency (Rugman and Li, 2007).

FOREIGN MARKET ENTRY STRATEGIES OF CHINESE COMPANIES

Relying on their advantages and seeking to overcome obstacles, Chinese companies have mainly employed three entry strategies in their internationalization process (Child and Rodrigues, 2005).

The first of these is the original equipment manufacture through JVs or licenses. It is an inward method of internationalization: in other words it happens within China itself. It consists of associating with a foreign multinational to obtain modern practices that help to strengthen international competitiveness with a view to eventual outward internationalization. Examples of this strategy can be found at Chinese companies such as Galanz (currently the world's leading microwave producer), which was originally producing microwaves for many different international brands, or Huawei (one of the world's leading suppliers of broadband Internet access equipment), which initially established several JVs with foreign companies. This also reflects a characteristic trait of some mature industries, in which the centre of competition leans towards production costs and quality control, meaning that the assembling company can end up becoming the "boss", which happened for example with the entry of TCL in Thomson (Morck, Yeung and Zhao, 2008).

The second entry mode is acquisition. This has been chosen by large state-owned materials processing companies, which have made major acquisitions to ensure the supply of raw materials. This mode has also been selected by Chinese companies outside of the primary sector, with the aim of accumulating market strength (accessing technology, ensuring R&D skills or acquiring international branding). Acquisition provides a quick route to these benefits. Some of the abovementioned acquisitions, such as Lenovo's acquisition of the PCs division of IBM, are illustrative of this strategy.

From a strategic intent perspective, international acquisitions are used by Chinese multinationals for various reasons (Rui and Yip, 2008):

- To acquire strategic assets and thus compensate for their competitive disadvantages.
- To leverage their competitive advantages, such as low labor costs (initially in production and subsequently in engineering and other support activities) or low financing costs (deriving from state ownership or government support).

- As a strategic choice over other entry modes (by being an easier and quicker way of obtaining a complete set of new capabilities).
- To overcome institutional constraints (such as the lack of development in intellectual property rights, which discourages local R&D) or to exploit institutional advantages (such as the strong government support for FDI or the nation´s huge foreign exchange reserves and domestic savings).

The third route is the organic international expansion, which involves the greenfield establishment of subsidiaries in other countries. The aim in this case tends to be to obtain advantages of differentiation in terms of, for example, adaptation to local tastes and needs, although it also facilitates managerial control and the possibilities for global integration. Domestic appliances manufacturer Haier may be deemed one of the best examples of a Chinese company that has gone international mainly along this route.

CHINESE MULTINATIONALS AND THE EXISTING THEORETICAL BACKGROUND

Traditionally, different conceptual frameworks have been used to explain the internationalization of companies and the behavior of multinationals. Focusing on the most influential, we shall reflect on the degree to which they are applicable in the case of Chinese companies.

The Internationalization Process Model

This approach holds that many companies follow a gradual process of internationalization, the onset of which is determined by two elements (Johanson and Wiedersheim-Paul, 1975; Johanson and Vahlne, 1977, 1990): the psychic distance, which causes the company to begin its international expansion in countries it is more familiar with; and the size of the potential market, which can lead it to enter smaller markets first, which require a smaller initial commitment of resources or where there is less competition. On the basis of all this, the internationalization process can occur over a series of stages that involve successively greater commitment as experience and knowledge is gained.

In relation to this model, it has been observed that Chinese multinationals that had established JVs with Western companies within China managed to acquire not only technology but also management skills and experience that have enabled them to skip stages in their internationalization process (Warner, Hong and Xiaojun, 2004; Young, Huang and McDermott, 1996; Zhang and Van den Bulcke, 1996). This route in which stages are skipped has been taken by many multinationals from emerging markets, which tend to become international very quickly and not incrementally; as latecomers on the global scene, they need to accelerate their rate of internationalization to catch up with other companies (Luo and Tung, 2007). This is another of the reasons behind the increase in international acquisitions by Chinese companies over recent years.

Nevertheless, some indications show that a series of stages have been followed (Young et al., 1996). At times, the exporting stage (outward internationalization) tends to precede the establishment of JVs with foreign companies within China (inward internationalization), since the former provides the foreign exchange necessary to import technology. Once they have been assimilated, modified and improved, these received technological capabilities in turn stimulate more advanced methods of outward internationalization.

With regard to the psychic distance, its influence can depend on the objectives of the Chinese company: while investments that sought markets might well have been initially aimed at countries in which this distance was smaller, investments that seek know-how have been mainly aimed at developed countries in North America and Europe, which are culturally more distant (Young et al., 1996). Also, many Chinese companies do not seem to shy away from psychic distance, perhaps aided by the alliances they have made in China with multinationals from developed countries (Luo and Tung, 2007).

The Eclectic Paradigm

Another of the most widely known approaches is Dunning's Eclectic Paradigm (1981b, 1988) which focuses on FDI decisions. Its main hypothesis is that the company will commit to FDI if three conditions are simultaneously satisfied: (1) the company has a competitive advantage over companies of other nationalities (ownership advantage); (2) it is more profitable for the company to internalize this advantage through an extension of its own activities rather than externalizing it via licenses or contracts with other companies (internalization advantage); and (3) it is more profitable to exploit this advantage together with some factor linked to the host country (location advantage).

The Eclectic Paradigm is applicable to the expansion of multinationals from emerging markets towards other developing countries in search of location advantages to benefit from their unique capabilities—for example, those based on low costs (Luo and Tung, 2007). However, when applying the Eclectic Paradigm to the case of Chinese multinationals it is necessary to take into account a series of peculiarities. As stated by Mathews (2006), multinationals from the Asian Pacific—including Chinese multinationals—are newcomers on the global scene and therefore do not depend for their international expansion upon the prior possession of resources, as has been the case for many multinationals from countries from the Triad (US, Europe and Japan). Instead, these new companies use international expansion to benefit from resources that would otherwise be unavailable. This internationalization is rather different from that seeking to exploit existing resources. This poses a challenge for the Eclectic Paradigm, which is why Mathews (2006) proposes the LLL framework as a complementary alternative:

- *Linkage*. The critical starting point for these companies is that they are not focusing on their own advantages but on the resources that they will be able to access from outside of the company.
- *Leverage*. This focuses on the ways that links can be established with other companies so that the resources may be used or exploited; it is related to the degree to which the resources are accessible.

- *Learning*. The repeated application of the two previous processes can result in the company learning to perform these operations more efficiently.

Dunning himself (2006) has responded to this proposal to reconsider the Eclectic Paradigm, offering the following reflections:

- The determining factors for Chinese FDI that seeks to exploit assets are reasonably explained by the Eclectic Paradigm, while the determining factors for FDI that seeks to augment assets fit better with the idea that, at least, some of the competitive advantages of companies "follow" rather than "lead" their internationalization.
- However, to engage in the latter kind of FDI the company must have certain unique advantages; in the case of China, these could include the ability to generate funds to acquire a foreign company and favorable access to large markets through the Chinese economic area.

In any case, each of the models presents its own respective slant: while the Eclectic Paradigm is more internal-focused, the LLL model is more external-focusing in its contrasting explanation. For this reason, and with the purpose of obtaining a more balanced view, Li (2007) proposes an integration of both.

The Investment Development Path

The Investment Development Path is a theoretical approach that proposes the existence of a systematic relationship between the level of an economy's development and its inward and outward FDI (Dunning, 1981a, 1986; Dunning and Narula, 1996). According to this focus, the economic development of a country has a positive influence both on the capacity for internationalization of domestic companies and on the location advantages it offers foreign companies. The model establishes several development phases, grouping together the less developed countries in the early stages and the more advanced or industrialized countries in the latter stages.

Two studies have tackled this model in the case of China. On the one hand, Cai (1999), analyzing the 1979–1996 period, concludes that China's position at the end of this period was in the second stage of the Investment Development Path: the inward FDI was growing due to improved location advantages and the outward FDI was emerging thanks to the improved ownership advantages of Chinese firms.

On the other hand, Liu, Buck and Shu (2005), based on figures from the 1979–2002 period, maintain that Chinese outward FDI appears to be consistent with the hypothesis of the Investment Development Path with regards to its relationship to the country's level of economic development. The increase in GDP per capita in China and the rise in the value of the investments in human capital were the two factors that most affected the growth in Chinese outward FDI.

Other Theoretical Frameworks

Beyond the abovementioned theoretical frameworks, other studies have attempted to apply some traditional concepts of internationalization to the case of Chinese firms. Thus Yiu, Lau and Bruton (2007) examine the influence on Chinese FDI of home country networks, technological capabilities and corporate entrepreneurship. Firstly, they observe that network ties in China—especially institutional network—facilitate the FDI of Chinese companies. Secondly, they found that the effects of firm technological capabilities depend on the intensity of competition within the Chinese industry; Chinese companies, particularly those heavily involved in R&D, show a greater level of internationalization when they attempt to overcome competitive disadvantages at home. Finally, corporate entrepreneurship mediates the effects of technological capabilities and home country network ties on FDI.

Meanwhile, Buckley et al. (2007) find that Chinese FDI has both a conventional and an idiosyncratic dimension. From the conventional viewpoint, Chinese FDI is positively linked to the proportion of ethnic Chinese in the host population (cultural proximity), to the size of the host market and to the liberalizing policy of the Chinese government. From an idiosyncratic viewpoint they find that, contrary to expectation, Chinese FDI is attracted rather than deterred by political risk in the host country. This can be attributed to the low cost of capital enjoyed by Chinese companies (most of which are SOEs) as a consequence of home country capital market imperfections. Also, their experience of operating in a highly regulated and controlled domestic environment may have endowed them with advantages necessary for being competitive in other emerging economies.

Therefore, while in many cases Chinese companies do not have asset advantages like technology and branding, they do have a transaction advantage: the ability to manage relationships within a complex environment like China. This gives them an edge over multinationals from developed countries when it comes to investing in markets with these institutional characteristics (Morck, Yeung and Zhao, 2008). One example of this can be found in CNPC's entry in PetroKazakhstan, which had previously been controlled in that country by a Canadian firm.

Finally, questions concerning the organization, control structure and operating policies of Chinese multinationals have also been tackled. In general, the pattern of managerial behavior shows two characteristics (Warner et al., 2004): control by the parent company at headquarters, which is stronger when the Chinese multinational is a SOE; and the legacy and philosophy of socialist China, which can lead to the formation of cultures that place emphasis on both discipline and paternalist leadership. This has been reflected in the mentality of many Chinese directors who, influenced by the tradition of the Chinese economic system in which direct control is the main means for coordinating economic activity, overvalue entry modes that involve tight control, as opposed to other alternatives such as long-term contracts. This enables them to obtain a series of private benefits such as economic gain, status, power or respect, and to strengthen Chinese national pride overseas (Morck, Yeung and Zhao, 2008).

However, an organization characterized by tight central control over decision-making is hampered by the lack of information on foreign markets and by the need to depend on outside suppliers on the international markets, which constrain the ethnocentric orientation of international marketing (Walters and Zhu, 1995).

With regards to human resources policies, moving away from the conventional idea that managerial control by expatriates tends to increase with resource commitment and with more

risky entry modes, many Chinese multinationals tends to use local senior management teams in advanced countries, for example Lenovo and Haier, whose US offices are run by natives (Luo and Tung, 2007). In any case, they usually adopt an ethnocentric approach to international training and management development for both natives and expatriates (Shen and Darby, 2006).

CONCLUSION

It is appropriate to wonder at this point whether the whole of this emerging process of international expansion by Chinese multinationals is a relatively circumstantial phenomenon or whether it is something that could continue and even become more pronounced in the future. Factors that could lead us to think that over the next few years the latter will be closer to the truth (Hong and Sun, 2006; Taylor, 2002; Wu, 2007) include the following:

- The capital flows received from overseas, the huge current account surplus, the enormous foreign currency reserves and the high domestic savings rate could favor the expansion of Chinese FDI. This would also be aided by a potential revaluation of the *renminbi* or *yuan* (China's currency), which would mean greater liquidity and would make acquisitions more feasible.
- The consequences of China's entry into the WTO, the liberalization of FDI regimes worldwide and the attempt to avoid trade conflicts with the US and the EU will encourage Chinese FDI in order to maintain existing markets and to find new ones.
- Competitive pressure from foreign multinationals in China and the liberalization of the country's service sector could encourage opportunities to be sought overseas.
- Acquisitions in developed countries (with the idea of re-launching troubled firms) could help avoid job losses, which is something that could be welcomed by host governments.
- Chinese investment in countries rich in raw materials could help to revitalize sectors in decline and even increase exports from those countries.
- The Chinese government's deepening of facilitative policies would also help to boost the process.

In short, if a large number of these factors converge, the recent international acquisitions by Chinese multinationals could be merely the tip of the iceberg (Wu, 2007). Over the coming years it is likely that Chinese multinationals will continue to develop overseas, exploiting specific advantages of their home country (cheap qualified and unqualified labor). However, for their long-term success they must develop firm-specific advantages in knowledge and technology (Rugman and Li, 2007).

Among some Western managers there is the belief that high-tech businesses are immune to Chinese competition. This could be a mistaken and dangerous idea, especially when taking into account that gunpowder, paper and the compass, for example, were all invented in China. These Chinese multinationals could be "hidden dragons" that over the coming years will become the main rivals of many Western companies (Zeng and Williamson, 2003).

Western companies must be conscious of the strategic implications of this whole process (Hong and Sun, 2006). On one hand, the success of Chinese companies in industries such as electronics and domestic appliances is based on classic competitive advantages (flexibility, fast response, customer orientation and sensitivity to niche markets). Some of these advantages have already been enjoyed by Korean and Japanese firms for decades, which is why, while mindful of the differences, the history of competition with them could be useful to the West.

On the other hand, the experience of Chinese multinationals shows that the combination of R&D acquired overseas and low home costs can bring major competitive advantages. The best strategy for Western companies to maintain their lead would be to intensify their R&D instead of simply defending their technologies. It is also worth considering the trade-off of advance and retreat—in other words, focusing on those businesses in which the main competitive advantage lies and retreating from those in which this advantage is in decline. This was what Alcatel did in its alliance with TCL when it sacrificed its mobile phone business in its quest to boost its telecommunications infrastructure.

In any case, to face up to this emerging competition it is necessary to deepen our knowledge of Chinese multinationals. Several areas deserve special attention (Tung, 2005; Morck, Yeung and Zhao, 2008): the challenges faced by China when it comes to managing companies overseas (for example, the attitude of host country nationals who work for Chinese bosses, the squaring of Chinese employment policies in other places, the development of a global identity or the design of flexible operations between countries); the partner selection processes (in particular, the role of culture and the countries preferred by China in the search for partners); and how to improve their corporate governance.

All of this would help Western firms to familiarize themselves with companies that are still perceived as distant and unknown but that, if this trend continues, are destined to become leading actors on the global stage. In the same way that today when, in hindsight, we think of the leading multinationals involved in what we now know as globalization our minds turn to European multinationals (in the first half of the twentieth century), North American multinationals (after World War II) and Japanese and Korean multinationals (in the final decades of the twentieth century), perhaps within a few years this chronology will continue with the Chinese multinationals of the early twenty-first century.

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