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China Goes Global: Provenance, Projection, Performance and Policy

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Manuscript ID	IJoEM-01-2017-0006
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ABSTRACT

Purpose

This paper examines the Provenance, Projection, Performance and Policy concerning Chinese outward foreign direct investment and speculates on the existence of "China's international strategy".

Findings

There is evidence of successful coordination of Chinese OFDI, but also context, conflict and independent decision making (in Chinese firms) play a role in the determination of the direction, control and outcomes of the outward FDI.

Implications

There is great scope for further research on Chinese OFDI, particularly as the lack of data prevents definitive conclusions, particularly on the outcomes and performance of the investments.

Originality

The paper presents an original synoptic view of a key elements in the globalisation of the world economy and in the projection of Chinese economic power.

Keywords

Foreign Direct Investment, Chinese outward foreign direct investment, Chinse multinationals, globalisation, Chinese economy.

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4 **China Goes Global: Provenance, Projection, Performance and Policy**
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8 Introduction
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12 This paper examines Chinese outward foreign direct investment (COFDI) in terms of its provenance,
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14 projection, performance and policy. The provenance of COFDI emerges from the special institutions
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16 of China including the government, structure of the Chinese economy and in particular the market
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18 imperfections to which Chinese multinational enterprise (MNEs) are responding. The section on
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20 projection examines technological catch-up and the modes of internationalisation that Chinese MNEs
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22 have undertaken, their geographical and sectoral spread. Particular attention is paid here to the role of
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24 offshore tax havens, push factors from China and the role of capital flight. The performance of
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26 COFDI and Chinese MNEs is perhaps the most under-researched element of 'China Goes Global' and
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28 this issue is examined from a number of viewpoints. Finally, the critical role of policy is analysed,
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30 looking not only at the role of the central government, but also Provincial and lower tier levels of
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32 policy. Host country policy also may be important – and its negative aspects are beginning to have an
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34 impact on COFDI.
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38 PROVENANCE
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42 The Institutional Setting for Chinese ODI
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46 Institutional factors are likely to be an important influence on any country's aggregate ODI flow as at
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48 least part of the direction and nature of that ODI will be determined by source nation factors
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50 (Buckley/Casson 1976). However, institutional factors are dynamic and government policy changes
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52 over time. This section shows the influence of the Chinese institutional framework on Chinese ODI.
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54 Since the late 1970s the Chinese government has determined to a considerable degree the legal,
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56 regulatory and financial framework of ODI, either directly, by administrative fiat (via the approval
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process and foreign exchange controls), or indirectly, using economic policy implementation and other measures (Buckley/Clegg/Cross/Voss/Rhodes/Zheng 2008). Moreover, as the ultimate owner of state-owned enterprises (SOEs) (which dominated Chinese ODI prior to 2003), the government (at various levels) has effectively been the key operational decision-taker in the majority of formally approved investment projects. However, policy has often been ambivalent and inconsistent, with national and sub-national government at various times supporting, pushing and constraining Chinese ODI (Buckley/Clegg/Cross/Voss/Rhodes/Zheng 2008). Key stages in the evolution of China's official FDI approval process and some concomitant changes to the character of Chinese ODI are presented in Table 1.

Insert Table 1 around here

Even before the introduction of China's 'Open Door' policy reforms in 1978, numerous small-scale investments by Chinese SOEs could be found in major trading hubs around the world, mostly in service sectors such as international trade, transportation and financial services. After 1979, and in hand with the 'Open Door' policies, the Chinese government cautiously sought to encourage ODI as a means to better integrate the country into the global economy and to improve access to domestically scarce raw materials (Zhang 2003). The government promoted international trade by permitting, and later encouraging, export-oriented FDI by state-owned import and export corporations. However, in the 1980s and 1990s tight centralised control of outward FDI was reimposed amid concerns that it was detrimental to national development. Outward direct investment was seen as a substitute for domestic investment (Sauvant 2005). It was also feared that control of state property held overseas might be lost because of both the cost of supervising international projects at a distance and the inexperience of Chinese firms at competing internationally (Zhan 1995, Ding 2000). However, a few selected SOEs, like China International Trust and Investment Corporation (CITIC) and Shougang, were granted the freedom to expand abroad as 'experimental' MNEs (Zhang 2003).

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In the late 1980s and 1990s, it is generally acknowledged that Chinese firms internationalised mainly in pursuit of certain national and provincial economic goals and policy objectives, in particular: (i) to support the export function of state-owned manufacturers; (ii) to help stabilize the supply of domestically-scarce natural resources; and (iii) to acquire information and learning about operating abroad for the benefit of other domestic enterprises (Lu 2002, Ye 1992, Zhan 1995, UNCTAD 2006, Sauvant 2005). State-owned enterprises also undertook FDI to meet aspects of the government's political agenda, not least in establishing and strengthening diplomatic relations with other developing countries through the building of economic links. For these reasons, research has generally stressed the importance of state engagement in the business affairs of Chinese firms, either through direct ownership of productive assets or indirectly, through various kinds of regulatory control and intervention (Sauvant 2005). From the late 1990s onwards, however, Chinese firms are increasingly portrayed in the literature as internationalising in order to achieve other objectives, in particular (i) to improve access to foreign proprietary technology, immobile strategic assets and capabilities; (ii) to exploit new markets for products and services; and (iii) to enhance overall firm competitiveness through the diversification of business activities (e.g. Taylor 2002, Child/Rodrigues 2005, Pei/Wang 2001, Deng 2003, Deng 2004, Zhang 2003, Zhang 2005, Warner/Hong/Xu 2004, Sauvant, 2005, Beebe 2006). Ostensibly, these motivations are attributable as much to market forces, industry dynamics and discretionary, autonomous, managerial decision-taking as to government intervention and fiat. As UNCTAD (2006) comments, state-ownership does not necessarily invoke state-directed international strategy. At the same time, however, there remains a presumption held by some that the Chinese authorities continue to exert considerable influence over the investment activities of Chinese MNEs (e.g. Deng 2004, Deutsche Bank Research 2006). In this somewhat paradoxical milieu, it is interesting to investigate the extent to which engagement and disengagement of various levels of government has influenced the internationalisation decisions of Chinese firms (Voss, 2007).

There is little doubt that state control over the international activities of Chinese firms has been relaxed considerably since the late 1990s. Perhaps the most prominent and clearly articulated policy has been the introduction of the 'go global', or *zou chu qu*, policy in 1999. This was subsequently formalised in China's 10th five year plan, 2001-2006, and re-emphasised in the latest 11th five year

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plan, 2007-2010. Its objective is to encourage ODI through various means with a view to improving the international competitiveness of domestic companies and thus strengthen the national economy (Sauvant 2005; UNCTAD 2006)[i]. It is partly in response to marketization of the Chinese economy and the country's World Trade Organisation (WTO) accession commitments (Sauvant 2005), both of which have combined to heighten domestic competition, amongst other things. Accordingly, since 2001, policies towards ODI have been liberalised (mainly through the easing of investment restrictions,[ii] simplification of approval procedures and relaxation of foreign exchange controls) and with indirect, 'hands-off' economic policies increasingly substituting for direct, 'hands-on' management (see also Table 1). To illustrate, government agencies like MOFCOM and the National Development and Reform Commission (NDRC), which were previously instrumental to the formal approval process, now purport to provide mainly advisory, information and support functions to international investors. A further important aspect is the treatment of private Chinese enterprises, which were prevented from investing abroad officially (with a few notable exceptions, like the white goods manufacturer Haier) before this restriction was lifted in 2003.

In future, it seems likely therefore that the individual investment decisions of Chinese firms will be shaped more by commercial considerations and less by political ones. The partial nature of the privatisation of SOEs may also influence ODI. In the early years of privatisation SOEs were given the opportunity to invest overseas and were encouraged to do so, but they were not strictly governed as for-profit enterprises. This led to a serious agency problem. Top managers in SOEs could increase their income by positioning themselves overseas as managers of the companies' foreign operations. This perverse incentive (together with round-tripping to exploit tax incentives) induced excessive ODI and may account for some of the unique patterns of China's ODI. As institutional reform proceeds, we would expect these perverse incentives to subside. However, the picture is complex and the challenge for researchers is to disentangle the role of national and sub-national government from other determinants (such as demand conditions and competition) of the level and direction of Chinese ODI flow.

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Government support and involvement

Presently, the involvement of the Chinese government in OFDI does not remain on a macroinstitutional level, however. The provision of an "acquisition fund" and cheap loans influence the investment decision of Chinese MNEs and constitutes an invaluable source of competitive advantage (Antkiewicz & Whalley, 2006; Child and Rodrigues, 2005). Micromanagement is evident in the annual appraisals by MOFCOM and SAFE to assess the performance of overseas affiliates (MOFCOM, 2004, People's Daily, 2002). Whether, future approvals of outbound investment and expatriation of staff are granted or not is based on the outcome of this evaluation. Such types of "parental" involvement by the Chinese authorities in the decision-making of state-run and non-state-run enterprises is said to be common practice (Ring, et al., 2005; Child & Tse, 2001).

The "Go Global" policy has also impacted on China's foreign policy. Numerous high-profile state visits by China's leaders to developing countries since 2000, especially to the African continent, and the establishment of the Forum for China-Africa Cooperation to smoothen the way for Chinese companies to enter potential host countries are evidence of this development (Liu, 2001; Fernando, 2007). During state visits, China has a signed a number of wide-ranging economic cooperation agreements and, foreign aid schemes, such as an agreement on exploration rights for CNOOC in Kenya. The Africa link is further politically supported through a newly established investment fund worth up to US $5 billion designed to encourage Chinese businesses to invest in Africa (Zafar, 2007; China Daily, 2007). Another example is China's participation in the Technical Cooperation among Developing Countries and Economic Cooperation among Developing Countries programmes of the United Nationals Development Programme. One of China's explicit objectives in this cooperation is to foster the "Go Global" agenda and, in particular, to support and encourage privately owned Chinese enterprises to invest in Africa (Zhao, 2007). This this end, China has established the China African Business Chamber for private businesses and seeks to conclude double taxation treaties and bilateral investments treaties worth a number of African nations (TCDC Update, 2005, 2006). Moreover, china's official development aid is generally allocated to infrastructure projects which are often

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conditional on the receiving country awarding a Chinese company with a construction contract, as has been evident in the cases of Cambodia, Ethiopia, Laos and Sierra Leone, for example (Pheng & Jiang, 2003; Zhan, 1995; Frost, 2005; FT, 2005, 2006a, 2006b. China's official development aid strategy supplies Chinese companies with international contracts, and this helps them to establish an overseas market and set up affiliates with government-backing under low risk conditions.

The starting year of the "Go Global" policy is ambiguous. Cai (2006) states that Premier Jiang Zemin announced the policy in 1998 while Child and Rodrigues (2005) refer to the year as being 1999. Sauvant (2005) and Zhang (2005) take 2000 as the starting point. A fourth group of researchers refers to the year 2001 in connection with the FYP (e.g. CAITEC and WDA, 2005). The most recent date is proposed by Kaartemo (2007) who refers to 2003. The discrepancies probably derive from (i) access to original sources in Chinese and (ii) reference to either the first mentioning or the public implementation of the policy.

In emerging markets financial systems are considered to be quite inefficient and their capital markets, in this neoclassical sense, also imperfect. One might, therefore, expect finance to be highly relevant to the economic geography of emerging markets. The capital markets of the People's Republic of china, for example, are generally considered not to be driven purely by market forces (and are imperfect, in this neoclassical sense) (Karreman and van der Knaap, 2012; Lai, 2011; Vlcek, 2013). And as Martine (1999, 8) points out, 'the institutional geography of the financial system is important because it can influence how money moves between locations and communities'. This is certainly true in China, where State Owned Enterprises especially 'national champion' business groups have privileged access to capital through the state banking sector at favourable rates and preferential access to capital markets owing to their embedded nature within the Communist Party system (Sutherland, 2009, Karreman and van de Knaap, 2012; Naughton, 2007). Private firms, by comparison, generally face acute challenges in securing bank loans because of state control over lending within Chinese banks and control over domestic stock markets (Shen et al., 2009; Lai, 2011). Consequently, expect for the favoured few, private firms are often crowded out of the domestic capital market (Lu and Yao,

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2009). As access to domestic capital is limited by regulation, discrimination by lenders and by the restricted range of outside funders, private firms search for alternative ways to augment their capital stock, sometimes outside of China.

New outbound policies such as the One Belt, One Road (OBOR) initiative have a neomercantilast aim – pursuing a Government inspired global strategy to strengthen and sustain domestic industry, particularly those state owned companies suffering from over capacity by combining the output with privileged access to foreign markets. The social rate of return on such projects for China is unlikely to be high, although they may have some diplomatic pay-offs.

PROJECTION

Recently, the number and scale of cross-border mergers and acquisitions (M&A) by Chinese MNEs have also started to accelerate (Sun, Peng, Ren, & Yan, 2012) – a phenomenon which has attracted controversy in political circles but little academic scrutiny (see Table 2 and Figure 1). According to UNCTAD (2014), in 2014 alone, Chinese MNEs spent over US$ 50 billion undertaking cross-border M&As. One of the issues is the rationale underlying cross-border M&As, as an increasing number of acquisitions are targeted at more advanced countries away from the home region (*Economist*, 2010); and the Chinese government's interventions still influence these firms (Luo, Xue, & Han, 2010), which results in incautious investment decisions, in particular in the apparent lack of risk analysis. *The Economist* (2010) claims that, due to its opaque nature, China's important role as a foreign investor has been interpreted as a threat to countries in the west and sub-Saharan Africa (Bond, 2006; Brautigam, 2009). As a result, some M&A deals proposed by Chinese MNEs have been stalled, e.g., Rio Tinto-Chinalco deal (BBC, 2009). In addition, Chinese MNEs are alleged to have low international business management ability and a lack of coherent overseas investment strategies (Wang, 2011). Scholars (e.g., Child & Marinova, 2014) suggest that the empirical basis of these remarks on China's M&As require much more careful analysis to investigate the motivations of Chinese cross-border M&As, along with home and host country contexts to explain the location choices made by Chinese MNEs.

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Table 2 and Figure 1 around here

Scholars have carried out a great deal of research on the motives of China's OFDI and into the applicability of traditional frameworks of analysis (Buckley et al., 2007; Cheng & Ma, 2010; Cheung & Qian, 2009; Deng, 2004; Kolstad & Wiig, 2012; Meyer, Estrin, Bhaumik, & Peng, 2009; Sun et al., 2012). However, traditional investment motives, such as market size, labour costs, and resource endowments, originally developed in a western context, provide only a partial explanation of Chinese OFDI location strategies.

It is interesting to note that developed countries in the West, e.g., US, Canada, Germany, UK, and France, are among top location choices for Chinese M&As. This is a relatively new phenomenon – an outcome of the 'Go Global' policy – which presents an intriguing case for the study of motivation of Chinese MNEs in seeking strategic assets available in these western economies, as compared to the previous strategy of investing in neighbouring countries for natural resource seeking purposes. Nicolas and Thomsen (2009) suggest that Chinese firms are investing in these European countries to seek brands and technology. These authors observed that some Chinese automobile firms have taken over small Italian firms in Turin to gain their technology and design capabilities. This is also likely to benefit the acquirer firms from the spillovers arising from the Moncalieri science and technology park in the vicinity.

The 'Go Global' policy has pushed Chinese MNEs to enhance their technological capabilities (Pei & Zheng, 2015). In 2006, Chinese firms accounted for 2.8% of total R&D projects by foreign investors in Europe – rising from virtually zero in 2001 (Nicolas & Thomsen, 2009). The latest 'Science, Technology and Industry Outlook' published by the OECD (2014) further suggests that the research

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intensity of Chinese firms has massively increased. China has edged out the European Union in terms of investment in R&D with its R&D to GDP ratio touching 2%.

The Chinese government's policy direction on OFDI seems to have influenced Chinese MNEs' location choices and motivations of internationalisation (Quer et al., 2012; Richet, 2013; Yang et al., 2009). As discussed above, Chinese FDI follows the government's catalogue which directs where and how FDI should be made. This directive is often driven by the political and strategic objectives of the Chinese government, e.g., its need to fuel the manufacturing base at home (Globerman & Shapiro, 2009). Consequently, countries with large endowments of natural resources were preferred location choices of Chinese enterprises (Ramasamy et al., 2012). Investments by the 'big three' state owned enterprises, namely CNPC, CNOOC, and Sinopec, into African countries, in the 1990s, illustrate this argument (Cheung et al., 2012; Yao & Wang, 2013).

Since the launch of the 'Go Global' policy, in 2002, Chinese OFDI policy has liberalized the sectors where FDI can be made by Chinese MNEs. There seems to be a thrust on strengthening of the technological and market competitiveness of Chinese MNEs. In October 2004, the National Development and Reform Commission (NDRC) and the China Export-Import Bank jointly issued a 'Policy Notice on the State's Encouragements of Key Foreign Investment Projects by Credit Support' to supplement the 'Go Global' policy. According to the joint notice, special financial assistance is available for supporting investments for: firstly, setting up overseas research and development centres which may utilize internationally advanced technologies, management experiences and professional talents; and secondly, cross-border M&As which can improve the international competitiveness of Chinese enterprises, and accelerate the exploration of international markets. Moreover, in 2009, the Ministry of Commerce and the Ministry of Science and Technology jointly issued 'Opinions on Encouraging Technology Export' which encourages foreign collaborations and cross-border M&As by Chinese enterprises engaged in the development of technology.

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Consequent to these policy changes, in the post 2002 period, the motivation of cross-border M&As undertaken by Chinese MNEs seems to be changing. Deng (2009) observes that an increasing number of Chinese firms are investing in developed economies by aggressive M&A, and contends that government support is an important determinant. Chinese MNEs use M&As in advanced countries as a springboard for acquiring strategic assets (Luo & Tung, 2007); for instance, machinery in Germany, designs in Italy and automobiles in the UK (Nicolas & Thomsen, 2009). UNCTAD (2005) further points out that the Chinese government actively encourages OFDI in overseas R&D centres as a result of which China has emerged as the largest foreign investor in R&D projects in Europe.

Prior research on the context of Chinese MNEs confirms that Chinese MNEs are less risk averse than their western counterparts (Li & Liang, 2012; Kolastad & Wigg, 2012; Quer et al., 2012). The difference in their attitude towards political risk is attributable to number of factors. First, Chinese MNEs (especially SOEs) have fewer financial constraints on OFDI and the imperfect domestic capital market creates a specific financial advantage (Voss *et al*. 2008). In the context of Chinese MNEs, special institutions at home, such as the government's direction and financial support, may lead to unconventional location choices by Chinese MNEs. Large and rapidly growing domestic markets give them enough cash to invest abroad, and some Chinese SOEs often have access to cheap state finance. For instance, the China Development Bank and the China Export and Import Bank are committed to provide the best possible service to help Chinese firms to invest overseas (Buckley et al., 2007; Dohse et al., 2012; Economist, 2010; Rui & Yip, 2008). Such privileges reduce the commercial or financial risks of OFDI, mitigate institutional distance and subsidize less profitable technology. Secondly, Chinese investors are attracted towards risky environments when strong bilateral political relations exist between China and the host country as this may reduce potential risk (Amighini *et al*. 2012). Third, Chinese investors are attracted to the short term economic rents that arise in risky host countries. Moreover, Chinese MNEs' also exhibit indifference towards the institutional conditions in host countries because of their experience of operating at home and in other developing countries with poor governance structures (Buckley et al., 2007; Quer et al., 2012).

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COFDI in Tax Havens

Chinese OFDI has been significantly directed to, and through, tax havens. This makes the final destination of this investment difficult to assess. Often such investment constitutes 'round-tripping' where the final investment destination is China – other provinces, other industries, often other ownership from its starting point. It may also be intended to raise capital outside China, through 'capital augmentation' thus the drive for offshore incorporation and FDI flows is driven not only by domestic capital market imperfections and the needs of Chinese EMNEs to augment their existing capital structure, but also by access to a more favourable institutional environment (Buckley, Sutherland, Voss and El-Gohari 2014). Internalisation theory accounts for the impact of imperfect markets and also draws attention to these broader institutional misalignments, including how businesses exploit multi-country presence (Dicken, 2003). These may drive what has been referred to as 'institutional arbitrage' (Boisot and Meyer, 2008; Kedia and Mukherjee, 2009), in which MNEs use tax havens to internalise institutional and market differences between countries, with the strategic intent of guaranteeing their long term economic viability. As such, firm-level financing and institutional arbitrage decisions may become an important determinant of where Chinese MNEs invest.

PERFORMANCE

The area where research on COFDI is weakest is the area of performance, particularly post acquisition performance. Partly this is a result of the recency of COFDI which does not allow for long runs of performance data. Partly there are methodological problems in assessing performance and partly there is deliberate obscuration and lack of transparency in Chinese multinationals muddying the waters of performance assessment.

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One typical difficulty is in assessing performance is assessing the appropriate objectives. If the key motive of a Chinese foreign takeover is to transfer key assets and technology back to China, then the performance in the host country post takeover is to transfer key assets and technology back to China, then the performance in the host country post takeover is of secondary importance. This contrasts with the aim of building a global company where profitable growth might be an appropriate performance target (Buckley, Pass and Prescott 1988). The assessment of performance is also sensitive to the time frame of assessment.

Research on the performance of target firms post acquisition by emerging market multinational firms (the BRICs - Brazil, Russia, India and China) suggests that such takeovers often enhance the performance of target firms in developed countries (Buckley, Elia and Kafouros 2014). The effects can be explained by differences in the resources of the EMNE and its accumulated experience. EMNEs that are the most effective in enhancing the experience of target firms are those that have investment experience in both acquisitions and developed countries. Learning experience is vital. However EMNEs do not always acquire firms with high pre-acquisition performance and do not significantly increase the post-acquisition profitability of the acquired firm (Buckley, Elia and Kafouros 2011). However they generally increase the target firm’s productivity and sales and slow employment decline. As always in takeovers it is the combination of, and the synergy achieved between the target firm and acquirer that determines success (Buckley, Elia and Kafouros 2010). These results do not separate out Chinese acquirers, but the results are indicative.

Rugman and Li (2007) using an Ownership-Location-Internalisation (OLI) theoretical framework (Dunning 2001) argue that China’s MNEs have failed to develop firm specific advantages (FSAs) and that this means they are knowledge takers rather than knowledge creators. Their view is that Chinese MNEs are building scale economies based on China’s country-specific advantages (CSAs), cheap labour and natural resources. They go on to say that Chinese MNEs will have difficulty in sustaining their initial forays abroad and will be restricted to regional expansion rather than becoming globally competitive. This ignores the theoretical arguments of Hashai and Buckley (2014) and that EMNEs

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do not needs FSAs to be globally competitive. It also ignores the view that the "competitive advantage" of many Chinese MNEs arises from access to cheap capital, because of imperfections in the domestic capital market (Buckley et al 2007). Chinese MNEs could succeed by inputting capital into foreign firms and thus reviving them. This is clearly part of the argument behind strategic asset acquisition in COFDI where key intangible assets are purchased as part of a package deal in acquisition. The fact that Chinese firms often overpay for such assets does not diminish the explanatory power of the argument – but it clearly diminishes the performance, in terms of profitability, of the acquiring firm.

Lyles, Li and Yan (2014) argue that COFDI may be considered a form of experimental learning where Chinese MNEs are prepared to take more risky approaches. This chimes well with Buckley et al (2007) argument that risk aversion is reduced by access to plentiful, cheap capital.

A recent study of emerging market multinationals (Casanova and Miroux 2016) shows that in terms of growth, EMNEs are achieving spectacular results, but on other measures of performance, they still have a long way to go. This reflects the overall performance of Chinese multinationals have poor profitability performance. This may be because they are more focused on revenue growth than margins" (Casanova and Miroux 2016: 54) and this could be a strategic choice. Alternatively, they may not be well managed. There are exceptions to this rule – Chinese banks "have the second largest profit margins in the world and do better than banks from most developed and emerging countries (Casanova and Miroux 2016: 55). It is difficult to evaluate market capitalisation performance, given the thinness of China's domestic capital market. The international diversification of China's MNEs is low relative to Western MNEs and this is largely due to their relative newness on the global market. Casanova and Miroux (2016) find some limited evidence that Chinese firms M&As deals are conducted at a higher price for the targeted assets than their competitors. They consistently show higher price/earnings and Total Enterprise Value (total market capitalisation, preferred stock value and total debt less cash and cash equivalents)/ Revenue ratios. This price premium appears to be

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increasing over time. The picture of 'China outbound' that Casanova and Miroux (2016) conjure is of rapid growth but uncertain sustainability.

POLICY

From the host country's point of view outward FDI is not (or should not be) an objective in itself, but a means towards a given policy goal. Establishing the policy goal is an issue in itself – is it development, income growth, equity or some social objective? In rich countries, OFDI policies are often the result of policies directed to objectives often (loosely) related to OFDI – balance of payments objectives for instance. In most advanced countries OFDI has not been a major policy focus (Buckley, Clegg, Cross and Voss 2010).

As earlier sections of this piece have shown, Chinese policy on OFDI has moved from prevention to control to outright promotion, reflecting changing objectives related both to internal welfare considerations and external goals to do with increasing external influence, domestic competitive controls, "soft power" and long term global ambitions in the creation of Chinese global champions. The mix between these objectives is not always clear and they sometimes conflict. (For key stages in policy development, see Table 3.

Table 3 around here

This section examines policies towards COFDI both from within China and in the host (target) countries. The policy impacts of Chinese institutions are vital in generating, targeting, encouraging and regulating COFDI. These impacts are differential across types of foreign investor, geographically (both in origin and destination) and over time as Chinese policy evolves.

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Policy towards COFDI is not monolithic, nor does it come from only one source – Chinese investors often complain that they receive mixed policy signals. A number of (potentially rivalrous) Chinese policy institutions make up the environment for actual and potential foreign investors (see Table 3).

The backlash against Chinese OFDI

The main threat to the continued expansion of Chinese OFDI may not be in China but may come from a backlash from potential host countries. As host countries vary enormously, these pressures may differ from advanced (OECD) countries, whose concerns centre on security and loss of technological capacity and brands and developing countries whose concerns centre on loss of control of raw materials and the logistics supporting trade.

The concerns may be grouped as (1) the scale of Chinese OFDI, (2) security concerns, (3) loss of control of sensitive sectors, including culturally significant sectors (4) worries about the management and governance of Chinese MNEs.

Scale

In the UK, Chinese OFDI over the period 2005-2016 is over $40 billion. In itself, this is not remarkable but the scale interacts with concerns of lack of transparency of Chinese MNEs, the state control of much of the investment and the fact that much of it is channelled through tax havens to increase concerns.

Regulatory bodies such as CFIUS in the USA (committee on Foreign Investment in the United States) are concerned with state control and threats to national security as well as competition issues. It utilises a national list of security factors to determine if a foreign investment is in the national interest. The extraterritorial reach of US law and regulatory powers is exemplified in the recent (2016) approval by the US's security watchdog of the Chem China (China National Chemical Corporation)

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takeover of the Swiss pesticide and seed multinational, Syngenta. This approval was vital given the Swiss firm's presence in the USA. Other regulatory and anti-trust bodies share similar interests in China's purchases of existing multinational enterprises.

Security and the 'National Interest'

Concerns on security inevitably resolve into issues of the state control and state direction of China's OFDI. The supervisory role of the State Assets Supervision and Administration Commission (SASAC) gives a monolithic view of the nature of state owned companies in China and the role of the Communist Part in the governance of state assets. Unwisely, SASAC exercises its power to rotate bosses within a supposedly competitive industry – an "obscene game of round robin" according to the Economist (2016 p 10). Many private companies have strong state elements – being established by cadres from the Red Army for instance or being recently 'privatised' by deals done in tax havens. Many companies are alleged to be vehicles for the private wealth of 'children of high cadres' or 'princelings' – families of high ranking Communist party officials. In some cases this may be better described as capital flight rather than securing Chinese state control over foreign assets, particularly when the investment is in 'safe' assets such as real estate, but the lack of transparency allows both (incompatible) explanations at once.

Sensitive Sectors

COFDI reflects the structure of the Chinese economy and its strengths and weaknesses. The strengths of the Chinese economy are in large scale ventures covering energy, infrastructure and power. State ownership of these sectors enables economies of scale and thus allows projection overseas. Areas such as oil (Sinopec and China National Offshore Oil Corporation (CNOOC)), infrastructure (recently augmented by the 'One Belt, One Road' strategy), railways, transportation, docks and logistics, nuclear power and energy [AusGrid, the power supplier in Australia is a case in point] are all sensitive sectors, control of which is theoretically able to cripple a host country. Naturally foreign control is

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(and always has been) seen as problematic in the areas where China is strong. These sectors have been favoured by the Chinese state in order to build a strong, centrally controlled economy, so international projection of these key areas is bound to be politically sensitive.

China's weaknesses are in consumer goods, services and branded goods. In order to compensate for these weaknesses Chinese companies (partly private) have set out to purchase companies that can make good these deficiencies – often to introduce these branded goods more widely into China. The purchase of iconic brands in the case of the UK include Weetabix, Pizza Express, The London Taxi Company parent company, House of Frazer. These brands are culturally sensitive and foreign ownership is not well received. The recent Chinese State driven (Xi Jinping personally) initiative to upgrade Chinese football (soccer) has resulted in substantive Chinese ownership of clubs in Spain (Athletico Madrid) Italy (AC Milan, Inter Milan) and particularly England (West Bromwich Albion, Birmingham City, Wolverhampton Wanderers, Aston Villa, stakes in Manchester City and the attempted purchase of Liverpool FC). While these takeovers bring substantial capital into (sometimes fading) brands, foreign ownership is noted and often resented. Similar sensitivities concern large scale, concentrated purchases of real estate including cities like London and Vancouver, resulting in political demonstrations and resident reaction against rising house prices and often negative effects on local life when real estate is unoccupied after being purchased as a hedge or capital flight asset.

Soft Power

The concerns about Chinese OFDI are often potential rather than actual issues and they combine with host country feelings in certain areas about the exercise of Chinese soft power – influence from working with institutions in the host country. This includes a backlash against Confucius Institutes, perhaps the most successful exercise of Chinese soft power internationally.

Chinese Multinationals

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These is also a growing concern about the impact of the management of foreign assets by Chinese multinationals. The lack of transparency in governance is a key issue here. In addition the strategy of Chinese MNEs is coming under increased critical scrutiny. Some Chinese conglomerates appear to amass foreign assets and brands without a clear strategic logic. Dalian Wanda, for instance owns Sunseeker yachts, Athletico Madrid and the American cinema chain AMC amongst its large commercial property portfolio worldwide. Fosun Group owns Club Med (France), Thomas Cook (UK), Canada's Cirque Du Soleil, American St. John (clothes) and Greek jeweller Folli Follie in addition to its insurance business, including Meadowbrook Insurance Group Inc. USA, pharmaceuticals, mining and iron and steel businesses in China, real estate and Wolverhampton Wanderers FC.

Concern in major host countries about the management of Chinese multinationals includes a lack of transparency and the stripping of key assets. The diversity of M&A deals by companies such as Dalian Wanda and Fosun and the wide variety of failed deals focuses attention on the lack of transparency of much M&A activity from China. Some of the failures are due to regulatory hurdles both in China and the host countries. Increased regulation of foreign takeovers – for example in the UK by the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) concerning disclosure of ultimate control of bidders and increased vetting in the USA by the Committee on Foreign Investment (CFIUS) are believed to have deterred Chinese takeover bids. Asset stripping, in particular in transferring technology back to China is a concern. As Rob Biscof, Vice President of the German-British Chamber of Commerce said in the Financial Times (09.02.2013) "I think there's every reason to be warned. Very often the R&D goes abroad and the rest follows. It's a recipe for disaster and a slow hallowing out of our industrial base here. In Germany, concern has focused on the purchase of the robotics company Kuka and the high tech company Aixtron (the latter with suggestion of collusion between Chinese state owned firms). The Aixtron deal has been blocked by German regulatory authorities. As the scale and complexity of Chinese OFDI grows, so the management of Chinese MNEs must become much more sensitive to host country sensibilities and welfare.

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Chinese MNEs have also made unwise promises in entering host countries in order to allay fears about their operations, promising no redundancies, retention of management and extensive expansion. This is not only potentially damaging if these promises are not met, it also risks the change that Chinese firms (especially SOEs) do not meet normal commercial logic.

Summary - Backlash

Are there likely to be restrictions on COFDI by host countries? Across the board controls are unlikely in any significant host country as this requires a coalition of interests who oppose COFDI to capture the regulatory process. The benefits of inward FDI in terms of employment creation (or protection) and increased activity remain significant in depressed economic conditions. However, there are likely to be increased selective restrictions on security grounds and protection of sensitive and culturally relevant assets. There may also be protectionist policies if and when 'industrial policies' become salient in OECD countries.

Conclusion

Assembling the elements of "China's international strategy" is to put together influences at national, provincial, city (even township), company and industry levels. It is not (cannot be) fully coordinated, but the following elements are in play[iii]:-

1. Top down investment direction.
2. Bottom-up investment by companies.

   (1 and 2 are linked by SOE strategies).
3. External acquisition of technology, brand names and other strategic assets.
4. Network influences within (phalanx effects) and beyond (diaspora) China.

5. Investments in soft power both institutional (Confucius Institutes) and macro policy driven (One Belt, One Road).

The extent of successful coordination can be underestimated but it is clear that China's outward direct investment is a formidable and rapidly growing phenomenon in the global economy. The constraints in marshalling China's foreign credits (as exemplified by its foreign exchange resources) into commercial success are formidable but there are sign that its efficacy is improving and that China will post massive challenges to its national and corporate competition in coming years.

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Table 1 Key Stages in the Development of Chinese ODI Policy

Period	Description
1979-1985	*Stage One: Cautious internationalisation* With the 'open-door' policy, Chinese state-owned firms start to set up their first international operations. Only state-owned trading corporations under MOFCOM and provincial and municipal 'economic and technological cooperation enterprises' under the State Economic and Trade Commission (SETC) are allowed to invest abroad. The State Council was the only authority to examine and approve overseas investments, irrespective of investment size. The government adopted a cautious approach, favouring investment in kind (know-how and physical assets) to avoid excessive capital outflows. Prior to 1984, there were no regulations regarding ODI. Between 1984 and 1985 MOFTEC enacted two directives on the examination and approval of proposals to establish non-trading companies abroad. Only 189 projects were approved, amounting to about US$197mn.
1986-1991	*Stage Two: Government encouragement* The government liberalised restrictive policies and allowed more enterprises apply to establish foreign affiliates, provided they had sufficient capital, technical and operational know-how and a suitable joint venture partner. Standardised regulations were drafted to cover the approval process. Approval was granted to 891 projects, totalling some US$1.2bn.
1992-1998	*Stage Three: Expansion and regulation* Encouraged by domestic liberalisation, initiated by "Paramount Leader" Deng Xiaoping's journey to the South, sub-national level authorities rushed into international business activities with companies under their supervision, especially in Hong Kong to engage in real estate and stock market speculation. The Asian crisis in 1997 and the subsequent collapse of companies such as GITIC slowed down this development. Latterly, concerns about loss of control over state assets, capital flight and 'leakage' of foreign exchange saw a tightening of approval procedures and in particular a stricter and more rigorous screening and monitoring process. These measures sought to ensure that Chinese capital was invested abroad for genuinely productive purposes. The State Planning Commission and SAFE were required to examine projects valued at US$1mn or more, prior to referral to MOFTEC for final approval. Individual ODI project activity declines, despite an increase of total ODI of US$1.2bn.
1999-2001	*Stage Four: The 'go global' policy period* Contradictory policies characterised this period. Further measures to control illicit capital transfers and to regularise ODI towards genuinely productive purposes are introduced. In parallel, ODI in specific industries is actively encouraged with export tax rebates, foreign exchange assistance and direct financial support, notably in trade-related activities that promoted Chinese exports of raw materials, parts and machinery and in light industry sectors like textiles, machinery and electrical equipment. In 2001 this encouragement is formalised within the 10th five year plan which outlined the '*going global*' or '*zou chu qu*' directive. Total approved ODI rises by US$1.8bn, with an average project value of US$2.6mn.
Since 2001	*Stage Five: Post WTO period* In the outline of the latest five year plan, the 11th, the Chinese government stressed again the importance of '*zou chu qu*' for Chinese firms and the Chinese economy. Nevertheless, direct and proactive support of ODI continues to be limited, mainly to preventing illegal capital outflows and loss of control of state assets. Since 2003, privately-owned enterprises are officially allowed to apply for the approval of outbound investment projects. Heightened domestic competitive pressures, due to the

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opening of once protected industries and markets to foreign and domestic competitors, forces some Chinese firms to seek new markets abroad. Latest policy announcements indicate that the Chinese authorities are moving from a pre-investment approval procedure to a post-investment registration system. Provincial differences in implementation prevail.

Sources: Derived from Buckley, Chen, Clegg and Voss, 2016.

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Table 2 Main destinations of China's cross-border M&A(1985-2011)

Destination	No. of M&As completed		Volume of M&As completed(million US$)	
	No. of M&As	Ratio(%)	Total M&As volume	Average volume per M&As
Hong Kong	392	32.89	21914.38	55.90
US	149	12.50	15334.45	102.92
Australia	126	10.57	17134.19	135.99
Singapore	70	5.87	2140.27	30.58
Canada	65	5.45	19361.15	297.86
Japan	45	3.78	953.21	21.18
Germany	26	2.18	176.39	6.78
UK	21	1.76	7548.02	359.43
France	20	1.68	4411.89	220.59
Taiwan	18	1.51	68.00	3.78
South Korea	17	1.43	1396.04	82.12
Indonesia	15	1.26	1296.55	86.44
Netherlands	15	1.26	882.09	58.81
Malaysia	14	1.17	112.59	8.04
Italy	13	1.09	775.46	59.65
Mongolia	12	1.01	175.30	14.61
Brazil	11	0.92	12689.28	1153.57
New Zealand	9	0.76	153.00	17.00

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Source: Buckley Yu, Liu, Munjal and Tao 2016 p 429.

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Table 3 Key developments in the evolution of China's OFDI regime

	Main regulatory measures		Impact on ODFI	Political direction
Pre-1978	Closed economy and restricted International business involvement as part of the economic planning system		Virtually no OFDI	Prohibition
Phase 1 "Testing the water"	Subperiod 1	First official regulations issued by MOFCOM	Hardly any changes; OFDI by selected companies	Implementation of first national regulations; developmental state; relation-based
	Subperiod 2	Clarification and extension of regulations by MOFCOM and SAFE	Hardly any changes	Cautious liberalization steps
Phase 2 "Finding the stepping stones"	Subperiod 3	Shifting of investment approval from the State Council to MOFCOM and NDRC	OFDI takes off and subsequently contracts	Decentralization and tightening of regulation
	Subperiod 4	Instigation of the "Go Global" policy	No immediate impact of either investment flows or numbers of projects	Liberalization and increasing transparency
Phase 3 "A bridge is built"	Subperiod 5	Clarifications on investment credits, preferred host countries and local responsibilities; Subnational regulations	Sharp increase in OFDI; OFDI by state-owned and private enterprises	Decentralization and liberalization; manifestation of a rules-based administration of OFDI

Source: Derived from Buckley, Chen, Clegg and Voss 2016.

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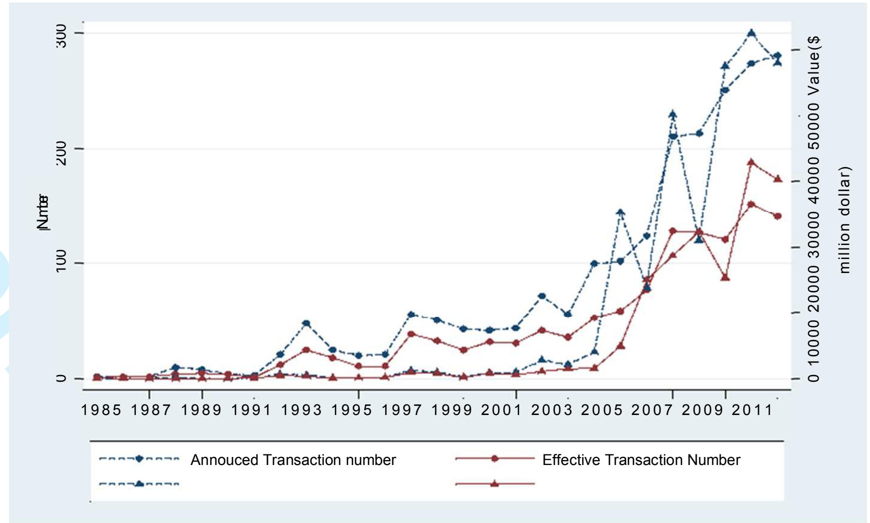
Figure 1



Source: Buckley Yu, Liu, Munjal and Tao 2016, p. 428.

Figure 1 Chinese overseas M&As 1985-2011.

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[i] Although the precise mechanisms for the promotion of Chinese ODI activity remain sketchy.

[ii] For example, the investment value ceiling has been raised to US$30mn from US$1mn for natural resources-oriented FDI and from US$1mn to US$3mn for non-resource and non-financial FDI for projects under the control of provincial authorities (Sauvant 2005).

[iii] This schema follows Simon Chadwick "Industry Economy and Success: China's great football vision and what the country is doing to win the World Cup. Business Confucius Institute Annual Lecture, University of Leeds 22.11.16.

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