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Chinese multinationals and public policy

Alan M. Rugman (Corresponding Author)

Professor of International Business

Henley Business School, International Business and Strategy

University of Reading

Henley on Thames, Oxon, RG9 3AU, England

Quyen T.K. Nguyen (Ph.D)

Lecturer of International Business and Strategy

Henley Business School, International Business and Strategy

University of Reading

Whiteknights Campus, Reading RG6 6AH, England

E-mail: t.k.q.nguyen@henley.ac.uk

Ziyi Wei (Ph.D)

Lecturer in Chinese Studies

School of East Asia Studies

University of Sheffield

6-8 Shearwood Road, Sheffield S10 2TD

E-mail: z.wei@sheffield.ac.uk

Structured Abstract

Purpose – The purpose of this paper is to examine the interaction between large Chinese firms as they internationalize and their home and host governments.

Design/methodology/approach – The approach taken is that of an analysis of relevant literature and the application of a popular theoretical framework by Rugman and Verbeke to the case of Chinese firms as they expand abroad.

Findings – First, the paper adapts a well-known business-government framework to analyse emerging economy issues, all in a Chinese context. Then the paper relates this analysis to the existing literature on the international expansion process of Chinese firms. The paper finds that in their attempt to seek strategic assets, Chinese multinational enterprises (MNEs) face conflicts with host countries and Western firms in which host government support for international competitiveness can be used as quasi protectionist defense mechanisms. Using the public policy and MNE framework, the paper examines several recent disputes and finds that Chinese MNEs have complementary goals with the Chinese state, but they have conflicting goals with Western governments.

Originality/value – These findings have important academic research, managerial, and public policy implications.

Keywords Protectionism, Chinese firms, Complementary goals with home country, Conflicting goals with Western host countries, Public policy-MNE framework

Paper type Viewpoint

Article Classification: Viewpoint

Introduction

Chinese multinational enterprises (MNEs) heading abroad are often impeded due to conflicts with the political and economic objectives of host governments. For instance, in an attempt to seek strategic assets, Chinese MNEs face conflicts with host countries and Western firms in which issues of international competitiveness can be used as quasi protectionist defense mechanisms. Although acknowledging such conflicting goals with host country regulations, there is very limited discussion on Chinese outward foreign direct investment (FDI) from the perspective of public policy. Thus, the objective of this paper is to explore this neglected aspect of the international business (IB) literature. Both formal and informal government regulations can explain the activities of Chinese MNEs. We carefully integrate IB theory applicable to Chinese firms with public policies affecting institutions in the home and host countries.

This paper makes a substantial contribution to the Chinese MNE literature. Our framework suggests that Chinese firms have made aggressive international expansion thanks to Chinese government support; however, this could be a double-edged sword. On the one hand, it could be helpful for firms having complementary goals with the Chinese state. On the other hand, it could be harmful for others having conflicting goals with Western governments. We find that internalization theory (Rugman and Verbeke, 1992, 2001; Verbeke, 2009) and the MNE and public policy framework (Rugman and Verbeke, 1998) are useful in explaining the strategy and performance of Chinese firms and their international expansion.

The MNE and public policy

Using internalization theory and the resource-based view of the firm, Rugman and Verbeke (1998) advance an explicit “strategic” perspective for MNEs interacting with governments. They develop a matrix that examines the interaction between MNE parent, MNE subsidiary and home and host government goals. This provides insights into the managerial aspects of the firm-level strategy process of “recombinations” between firm and country level factors (how the firm obtains core competencies and dynamic capabilities) that need to be integrated into the MNE-government literature. This framework has not yet been applied to emerging economy MNEs and their interaction with host Western governments, so we apply it here to analyze Chinese MNEs.

Rugman and Verbeke (1998) carefully differentiate the policies of home and host governments, and how the institutional structures of both public policy and MNEs are relevant to the current IB literature. This framework reflects the issue of consistency between

MNE goals and government goals in both home and host countries. There are four main possibilities in this area as shown in Figure 1.

Insert Figure 1 here

In quadrant 1 of Figure 1 interactions of MNEs and both home and host governments are driven by goal conflict. This reflects the tensions between the micro-efficiency-driven behavior of MNEs and the macro-efficiency or distributional objectives of governments. The opposite situation arises in quadrant 4; here the goals of MNEs and both home and host governments are complementary. In quadrant 2 there is consistency between MNE and home country goals, but conflicts with host country goals. The reverse applies in quadrant 3.

In the following sections, we will demonstrate that in the process of international expansion, Chinese firms receive substantial support from the Chinese state as they have complementary goals with home country policies. This is cell 2. However, in their attempt to seek strategic assets in Western economies, Chinese firms will face protectionism from Western governments as their firm-level goals are potentially in conflict with those of Western governments or are perceived to be by influential business lobbies in the host economy. This is cell 1. First we review relevant literature and relate this to the framework. Then we explore several recent disputes in more detail.

The literature on Chinese firms and government policy Emerging economies as home countries for FDI have stimulated IB scholars to study not only host country “pull” forces, but also home country “push” factors that attract and facilitate Chinese firms to actively participate in international investment and production (Wei, 2010; Wei and Alon, 2010; Luo and Wang, 2012). From an institution-based view (Peng et al., 2008), Chinese firms use international expansions as a “springboard” to take advantage of preferential policies and financial support offered by the Chinese government, as well as to overcome domestic institutional constraints (Luo and Tung, 2007). On the one hand, a home country government can be an essential ally to MNEs, which can offer various types of institutional support. These include fiscal incentives (such as tax incentives, tax deductions, and low-interest loans); insurance against political risk; assistance to the private sector in international expansion through government agencies (Commerce Council, National Business Council et al.); double taxation avoidance agreements; bilateral and regional treaties to protect investment abroad; bilateral or multilateral frameworks to liberalize investment conditions in host countries; and helping enterprises deal with a host country’s governmental or legislative institutions at the collective level (Rui and Yip, 2008; Voss et al., 2009; Luo et al., 2010). On the other hand, Chinese firms, by investing in foreign countries, can escape from domestic institutional voids, such as capital market imperfections, weak intellectual property rights (IPR) and inefficient legal frameworks, and the decentralization of the economic system, etc. (Witt and Lewin, 2007; Boisot and Meyer, 2008; Deng, 2009).

In this paper, we discuss the role of institutions in Chinese outward FDI by taking a slightly different angle and focussing on the complementary and conflicting goals of Chinese firms and home and host country governments. Host country specific advantages (CSAs) that reflect local complementary resources have received the most attention from scholars. Host CSAs include market size, strategic asset endowments, natural resource endowments, and cheap labor endowments (Buckley et al., 2007; Cheung and Qian, 2009; Kolstad and Wiig, 2012). In contrast to extant studies on Western MNEs, relatively less attention has been paid to the influence exerted by the host country institutions on emerging market MNEs. Host institutional CSAs include: the population of the overseas Chinese diaspora; policy liberalization; openness to inward FDI; and a more entrepreneurial market based business culture. These host CSAs attract Chinese firms' investments (Buckley et al., 2007; Cross et al., 2007; Cheung and Qian, 2009; Quer et al., 2012).

Moreover, Chinese firms perceive risk in a different way and, specifically, they are often attracted to natural resource development in a host country, even with a high level of political risk. This characteristic (which differs from IB conventional wisdom) is mainly due to home government support, which enables Chinese firms to invest in more risky foreign environments (Buckley et al., 2007; Quer et al., 2012). Furthermore, emerging market firms may face a lower liability of foreignness than firms from developed countries when entering host countries with institutional voids, because of the skills and experience acquired as a consequence of having similar political and institutional environments at home (Cross et al., 2007; Cuervo-Cazurra and Genc, 2008).

Complementary goals of Chinese firms with the Chinese government (cell 2)

The surge of Chinese outward FDI, as a result of the home government's adoption of its "go global" policy, aims at enhancing China's political and economic influence and developing Chinese "national champions" in the international arena. In other words, the internationalization decision of Chinese firms, to a large extent, is institutional-embedded rather than reflecting the strategy and FSAs of firms (Rugman and Li, 2007; Voss et al., 2009; Luo et al., 2010). Due to the political control and strong policies exerted by the home government, Chinese outward FDI tends to or has to be consistent with the national goals of the Chinese government (Child and Rodrigues, 2005; Kolstad and Wiig, 2012).

From a macro-economic perspective, scholars have researched the evolution of Chinese outward FDI in different phases with each phase characterized by an increase in foreign investment caused by Chinese institutional changes in administration and regulation. (Buckley et al., 2007; Cross et al. , 2007; Voss et al. , 2009; Yang et al. , 2009; Luo et al. , 2010). At a micro-economic level, the majority of China's outward FDI is undertaken by state-owned enterprises (SOEs) that are administrated by the government's ministries and agencies (Morck et al., 2008; Peng et al. , 2011). Without government permission, it was not until 2003 that private enterprises in China were formally allowed to invest abroad (Alon, 2010; Lattemann et al., 2012).

The state regulates and manages Chinese outward FDI through various state-owned institutions, which include the Ministry of Commerce, Assets Supervision and Administration Commission, State Administration of Foreign Exchange and the People's Bank of China, etc. Foreign investments of both SOEs and private enterprises need to be approved by these institutions and their agencies (Voss et al., 2009; Luo et al., 2010). It has been argued that the "go global" policy has led to a steady liberalization of the outward direct approval process as well as more independent firm administrative control. Thus Chinese outward FDI has moved from being politically oriented to more commercially motivated. Government involvement in even large SOEs is diminishing, and Chinese firms need to make profits for other shareholders (Cross et al., 2007; Cheng and Stough, 2008; He and Lyles, 2008).

Due to the dominant role of SOEs and the approval regulation, there is no doubt that Chinese outward FDI is intertwined with strong political considerations. Initially motivated by promoting exports, foreign investments from China is prone to be diversified. Natural resource seeking in the energy and minerals sector aims to secure a domestic supply of natural resources to promote China's economic growth (Buckley et al., 2007, 2008). The Chinese government also supports domestic firms in developing or acquiring overseas strategic assets in advanced technology, innovation capabilities, brand reputation, and management expertise so that its national champions can compete successfully in the global landscape (Deng, 2009; Alon et al., 2011). Additionally, the Chinese government tends to use outward FDI as a platform to strengthen its relationship with other countries such as Africa and South Asia (Deng, 2004; Fornes and Butt-Philip, 2011).

Conflicting goals of Chinese firms with Western governments (cell 1)

Foreign investments from emerging markets have raised issues of discrimination imposed by host country government toward foreign acquisitions. In recent years, several attempted acquisitions made by Chinese MNEs have attracted attention and made headlines in newspapers. Indeed, it has been argued that less than half of the foreign acquisitions announced by Chinese are successfully completed (Sun et al. 2012). Table I lists several announced but uncompleted overseas acquisitions by Chinese MNEs. While the high rate of uncompleted acquisitions could be due to Chinese firms' lack of foreign experience and poor financial due diligence during the transaction, in practice it is government intervention and political issues in Western host countries that have received the most attention in the IB literature (Boisot and Meyer, 2008; He and Lyles, 2008; Peng, 2012). Chinese MNEs in particular usually bid a higher price compared to those from developed economies in most of these failed acquisitions. For instance, the price premium offered by China National Offshore Oil Corporation (CNOOC) in its bid to acquire American oil company UNOCAL was US$6 per share higher than the price offered by Chevron Corporation who was the eventual acquirer, after the Chinese bid was blocked on national security grounds by CFIUS, the US FDI review agency (Chen and Young, 2010).

Insert Table 1

It is worth mentioning that such sensitivity by host government is not entirely without reason and it is closely related to the nature of Chinese outward FDI. Compared with their counterparts from developed countries, many Chinese enterprises lack traditional FSAs in terms of proprietary technology, international brands, advanced marketing, and managerial skills; rather, their firm resources and capabilities are home country related, such as home government support, low production cost, network assets, and institutional attributes that allow Chinese firms to operate in uncertain economic and political environments (Rugman and Li, 2007; Yiu et al. , 2007). Historically concentrated on greenfield and joint ventures, Chinese firms have been aggressively buying out foreign assets around the world (Buckley et al., 2008; Deng, 2009). Furthermore, FDI outflows from China, as discussed previously, tend to be guided by the Chinese government in securing natural resources and acquiring strategic assets abroad. Obviously, these non-commercial motivations have raised national security concerns, which in turn have imposed costs and risks on the host economies (Chen and Young, 2010; Zhang et al., 2011). For instance, the political background of resource-seeking

Chinese companies has led the governments of Canada and Australia to quash the M&As bids of Rio Tinto and Noranda by the Aluminium Corporation of China Limited (CHALCO) and China Minmetals. Due to host country technological protection, Huawei Technologies has failed in its acquisitions of companies in the USA, namely 3CM, 3Leaf Systems, and Motorola wireless device.

Chinese SOEs as the dominant players in outward FDI raise additional concerns for the host country. The managers of SOEs may pursue political goals that are not necessarily aimed at long-term profit maximization for shareholders. Chinese SOEs usually lack transparent organizational structure and efficient management, in which acquired local firms may suffer financial losses. Chinese SOEs may also create unfair competition with host country companies, since their foreign activities are directly or indirectly subsidized by the Chinese government (Globerman and Shapiro, 2009). Other fears relate to the negative reputation of China due to its poor enforcement of product quality, safety measurements, and IPR (He and Lyles, 2008). Although the potential concerns arising from Chinese foreign acquisition cannot be ignored, due to the lack of empirical evidence, it remains unclear to what extent the strategic decisions of Chinese MNEs' internationalization are influenced by the Chinese government, and to what degree such concerns can justify the discriminated treatments of Chinese acquisitions.

Recent Chinese MNE disputes

Complementary goals of Chinese firms and the home country government (cell 2) Large Chinese firms receive substantial support from the Chinese government, as they are the means for the Chinese government to achieve the goal of promoting the rising political and economic power of China in the international arena (Alon et al., 2011). For example, the state-controlled nature of the three major Chinese oil and gas firms (CNPC, Sinopec, and CNOOC) presents these firms with increased latitude for risk taking, particularly when it comes to start-ups of new natural resource ventures such as FDI in smaller and unstable economies in Africa. Furthermore, privileged access to capital allows Chinese firms to shift their planning from short-term profitability targets toward long-term objectives of sale growth, thereby possibly increasing their competitiveness over time (Verbeke, 2013).

Another benefit afforded by the state-owned nature of Chinese oil corporations is that the government frequently consults the industry on policy matters. This allows Chinese firms to advocate for offshore developments which not only enhance national energy security, but also allows them to gain the experience needed to compete effectively with leading rival international oil companies. As a result, the Chinese oil industry is better able to align overseas operations and company directives with state policies as they pertain to the nation's energy security strategy. Ultimately, this creates a situation of mutual benefit for the oil and gas industry and the Chinese government (Verbeke, 2013). In terms of international political economy, Chinese MNEs are likely to be "national champions", representing the home country abroad.

Chinese firms and home country institutional conflicts (cell 1)

We suggest that there is evidence that Chinese firms can exploit China's institutions in order to acquire technological knowledge from foreign actors in China. Obviously Chinese firms are deeply rooted and embedded in the Chinese political, economic, and business systems. However, the method by which these Chinese firms sometimes acquire new technology and knowledge from external actors in China could be viewed as somewhat dubious and opportunistic due to poor intellectual property protection. Chinese firms reverse engineer technologies from Western MNEs' foreign partners investing in China and from foreign exporters when they import high-technology products. In China, the IPR are not well protected, either legally or via any local business ethics. The implications of this include the possibility of local firms obtaining and using key assets such as brands, patents and business systems (Rugman and Collinson, 2012).

For example, the US legal action against United Technologies and two of its foreign subsidiaries reveals that China has used technology provided by Western firms for its modern military attack helicopter (CAIC WZ-10 produced by one of the affiliates of aerospace and defense SOE contractor-AVIC). In June 2012, the USA charged United Technologies and two of its subsidiaries, Pratt & Whitney Canada (P&WC) and Hamilton Sundstrand, with selling to China software that provides the necessary engine codes to operate the CAIC WZ-10. While the Chinese defense ministry denied that China bought or used the software, P&WC and Hamilton Sundstrand agreed to pay more than $75 million to the US government to settle the criminal and administrative charges. As part of the settlement, P&WC pleaded guilty to two federal criminal charges of violating a US export control law for over two decades and making false statements. Federal prosecutors said that the company compromised US national security while trying to gain access to China's lucrative civilian helicopter market. The case reflects growing US concern about China's military expansion and escalating electronic espionage (Reuters, 2012). This US case has possibly closed the "back door" sales to China by the Canadian subsidiaries of US high-tech firms.

In a similar manner, a subsidiary of AVIC has acquired military technology from Russia. China violated IPR agreements when China copied and manufactured Russia's Su-27 fighter as the J-11B. In 1995, China secured a licensing contract with Russia to build 200 Su-27SKs, then cloned Russian technology in the indigenous version of the J-11B in the value of $2.5 billion for the Shenyang Aircraft Corp. In 2006, Russia canceled the contract after 95 aircraft were produced when Russia discovered that China had reverse-engineered the fighter and was secretly manufacturing an indigenous copy, the J-11B, with Chinese-made avionics and engines. There are strong suspicions that China will procure the technological know-how of the future contract to purchase the Su-35 fighter and Amur submarine from Russia and produce an indigenous version (Defense News, 2013).

In summary, Chinese firms take advantage of China's home country institutions (e.g. lack of respect for legal agreements, and poor enforcement of IPP) to acquire advanced technology and knowledge from external actors in China. They receive support from Chinese government in these attempts. Ultimately, the strategic goals of Chinese firms and the governments are compatible and complementary.

Conflicting goals of Chinese firms with Western host country governments (cell 1)

The goals of Chinese firms may be in conflict with Western host country goals. Most of the Chinese large firms essentially act as national champions for the Chinese state. This may lead to potential restrictive regulation in host countries. In particular, the USA may seek to protect US firms in the defense and aerospace, in strategic high technology (satellites, telecoms, and information technology), scientific research, and in energy and natural resource sectors. The USA can use national security provisions to overturn the usual national treatment provisions extended to inward FDI under the WTO, NAFTA, and such bilateral investment treaties as it has agreed. Even if Chinese firms develop internal managerial capabilities, it is not at all certain that they can succeed in doing business inWestern countries. Protectionist mechanisms will be at work, especially when there are concerns of threats to US economic and national security.

For example, media reports, including one from the Wall Street Journal , say Chinese state-owned military contractor AVIC considered a bid for a contract to supply the US presidential helicopter. Yet lawmakers in the US House of Representatives have voted to bar Chinese defense firms from receiving Pentagon contracts. The amendment was passed on May 27, 2011 as part of a larger defense budget bill passed by the House in Washington. It excludes from US defense deals all companies (such as AVIC) owned by or affiliated to the

Chinese government. Congresswoman Rose DeLauro, a sponsor of the House amendment, said it would help safeguard US national security interests. “With China making significant progress in the defense and aerospace industries, including a Chinese state-controlled company considering a bid for the contract for the next presidential helicopter, it is critical that we ensure US national security is protected and that the highly skilled jobs and associated technologies in these industries are not outsourced overseas,” she said in a statement. “This amendment will help guard American interests, not only for our national security, but also the innovation, job creation and long-term economic growth” (BBC News, 2011).

Other Chinese firms labeled as security threat by US politicians include Huawei and ZTE. Chinese telecoms giant Huawei is one of the world’s biggest manufacturers of telecom networking equipment and operates in some 150 countries. The most important pillar of Huawei’s strategy is Chinese government support, which allows Huawei to increase market share in China (Gadiesh and Vestring, 2008). In October 2012, a US panel recommended that equipment or parts made by Huawei and another Chinese telecom equipment manufacturer, ZTE, should not be used by government contractors. Earlier in 2012, Huawei was barred from bidding for work on Australia’s National Broadband Network. Security concerns were the reason given for denying the company a role in the $38 billion project (BBC News, 2012).

Conclusions

In conclusion, our analysis of Chinese firms reveals several key findings. Chinese firms have developed FSAs mainly based upon recombinations with home CSAs. They take advantage of weak intellectual property protection, their control of critical complementary resources in the home country and goal alignment with the Chinese state. It is not clear when they expand internationally through foreign acquisitions, that the foreign subsidiaries of Chinese firms can develop recombination capabilities with host CSAs. These subsidiaries are stand-alone operations with insufficient integration with their parent firms. In terms of the MNE and public policy implication of Figure 1, while the goals of Chinese firms are complementary with home government goals (cell 2), their goals are conflict with Western governments (cell 1).

Finally, the goals of Chinese firms are complementary with the home country Chinese state, but conflicting with the host Western governments, especially the US concerns on the grounds of national security. The administrative heritage of large Chinese firms as SOEs and national champions might hinder their ambitions of international expansion, as Western governments will erect protectionism mechanisms to prevent of any acquisitions of strategic assets in strategic sectors.

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Figure 1: The consistency between MNE and home and host government goals

		HOST: Consistency between MNE goals and host country goals	
		Conflict	Complement
HOME: Consistency between MNE goals and home country goals	Conflict	1	3
	Complement	2	4

Sources: Rugman and Verbeke, 1998

Table 1: Selected uncompleted Chinese acquisitions

Chinese company	**Target company**	**Host country**	**Year of acquisition**
Aluminium Corporation of China Limited	Rio Tinto	Australia	2009
Bright Diary Co., Ltd.	Yoplait	France	2011
Bright Diary Co., Ltd.	General Nutrition Companies (GNC)	United States	2011
China Minmetals Corporation	Noranda	Canada	2004
China National Offshore Oil Corporation	UNOCAL	USA	2005
Haier Group	Metag	America	2005
Huawei Technologies Co., Ltd.	3CM	United States	2007
Huawei Technologies Co., Ltd.	Motorola wireless device	United States	2010
Huawei Technologies Co., Ltd.	3Leaf Systems	United States	2011
Northwest Nonferrous International Investment Company	Firstgold Corporation	United States	2009
QQ Tencent	ICQ	United States	2010
Sichuan Tengzhong Heavy Industrial Machinery Co., Ltd.	Hummer brand of GM	United States	2010