Chinese Foreign Direct Investment
Looking Abroad from an Emerging Economy

By Ronald Kalafsky

Foreign direct investment (FDI) can occur when a firm either establishes operations or purchases a controlling interest in the business operations of a company in another country. Companies often engage in FDI for three straightforward reasons: to grow their sales, to expand their geographical market range, or to take advantage of the firm's own assets (e.g., brand name, technologies). If a firm is to increase its revenue, domestic sales are often not enough, and the company is required to expand into new markets. Other countries may offer better growth prospects for a firm's products or services. Beyond the physical presence needed to develop sales (such as an office or a factory), FDI can also enable companies to benefit from their internal technological advantages (such as Toyota's manufacturing processes) in new markets. In some cases, firms also conduct FDI to obtain new technologies and processes and gain the market intelligence and experience to succeed abroad.

The most obvious benefit for regions *receiving* FDI is job creation. One can see evidence of this with German, Japanese, and Korean motor vehicle assembly plants in the US, such as Mercedes in Alabama, Toyota in Kentucky, and Hyundai in Alabama. Thousands of jobs have been created from the establishment of these factories and from numerous suppliers locating (or relocating from an investing firm's country) in proximity to these plants. A related benefit includes the development of linkages with local firms, such as suppliers.[1] Honda, for example, purchases a significant percentage of the parts for its Accord (assembled in Ohio) from domestically owned suppliers. Another benefit includes potential technology transfer. Foreign firms bring new technologies and manufacturing processes that can improve domestic industries. A good example of this type of FDI was when Doosan Infracore of South Korea purchased Bobcat, the American construction equipment manufacturer, keeping manufacturing within the US. Despite concerns over foreign ownership of domestic firms (e.g., loss of American industry, lower wages), FDI in the US has resulted in the creation of thousands of jobs and relatively high-paid, advanced manufacturing positions (in industries such as machine tools and motor vehicles). It should be noted that much of this investment has occurred at a time when overall manufacturing employment has declined not only in the US but in Western Europe as well (another large recipient of FDI).

The focus of this essay is on Chinese FDI, which is a relatively new but growing segment of international investment. China has boomed economically in the past three decades, with a growth trajectory fittingly illustrated by its ascent to become the world's second-largest economy, recently surpassing Japan. Accompanying its overall economic growth has been a rise in living standards, with per capita gross domestic product rising from $341 in 1990 to more than $4,200 in 2010.[2] Given this rate of economic growth and its looming presence in the world economy, it is of little surprise that many Chinese firms are now emerging on the international stage. A recent study by Accenture, a global management consulting company, listed two Chinese companies, Haier and Lenovo, as emerging multinational firms.[3] Relatively unknown internationally twenty years ago, Haier has developed into a global leader in household appliance manufacturing, and Lenovo became one of the world's largest computer manufacturers when it purchased IBM's PC division in 2005. The emergence of these two firms as multinational corporations should come as no surprise when one considers that Samsung and LG of Korea were virtually unknown twenty-five years ago; and only fifty years ago, Sony and Honda were unfamiliar to most Western consumers.

In 1999, the Chinese government established its Go Global Policy in order to facilitate the international aspirations of domestic firms. This policy has been instrumental in encouraging companies to expand into international markets, in developing brand recognition for Chinese firms, and in seeking opportunities for its firms to act as contract manufacturers for companies located in industrialized economies. Because most Chinese firms are relative newcomers to international markets, many of their brands are unknown by potential customers in wider global markets. Acting as contract manufacturers can allow firms to develop a customer base and a wider international following by legally using a well-known firm's brand name. As the Chinese firms grow, it is hoped that they can manufacture under their own trade names and, eventually, invest abroad. Regardless of its aims, Chinese FDI has increased in recent years, going from approximately $21 billion in 2006 to $48 billion in 2009.

Keeping the international emergence of China's firms in mind, the remainder of this article takes a brief look at some of the FDI-related motivations and problems for Chinese firms, based on a 2010 survey.[4] These findings can enable classroom discussion of Chinese economic growth and international investment, particularly in terms of how it can be compared and contrasted with investment by companies from Canada, the US, Western Europe, Japan, and South Korea. Additionally, it illustrates how firms that are relatively new to international investment face many hurdles, including problems pertaining to perceptions of quality and a lack of understanding of targeted overseas markets. At the outset, it is important to note that China has been involved in the world economy for only the past few decades, since the beginning of Reform and Opening, a period of increased economic liberalization during the late 1970s and early 1980s.

First and foremost, what compels Chinese firms to look internationally for investment opportunities? Figure 1 reveals that the FDI motivations for China's survey respondent firms look similar to those cited by firms from other countries when considering FDI opportunities. Investment policies (including tax breaks and infrastructure improvements) of destination countries are important, as one sees the efforts of states and provinces to attract international firms, such as the recent case of Volkswagen in Chattanooga, Tennessee. Moving beyond saturated domestic markets is also a common motivation among multinational firms, regardless of national origin, as is aiming to acquire new technologies or reduce production costs. Many Chinese firms already face domestic competitors in numerous market niches, especially in some lower-end manufactured goods such as apparel and basic household appliances. Also, profitability may be hampered by the still relatively low (albeit growing) incomes of Chinese consumers when set against those from mature industrialized economies. The fifth most-selected motivation (resources), on the other hand, is important to firms given China's rapidly expanding economy and its increasing demand for minerals. Interestingly, the Go Global Policy was selected by only 5 percent of the firms, which suggests, at least at this stage, that some Chinese firms no longer need central government leadership to invest abroad. Instead, firms are making FDI decisions on their own, based on market conditions.

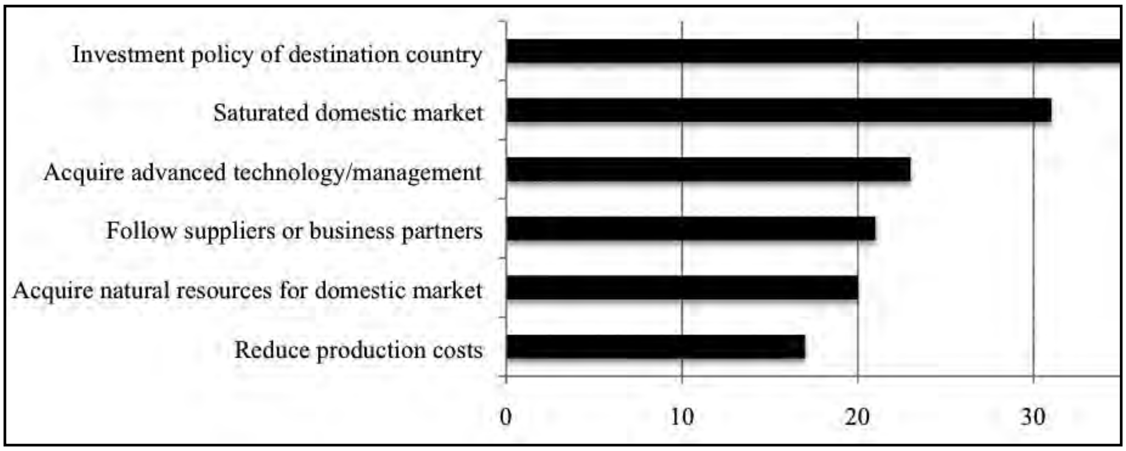

Figure 1: Future investment motivations (percentage of 1,377 firms selecting). Source: China Council for the Promotion of International Trade, 2010.

Although the potential benefits of FDI seem to be obvious, investing abroad is wrought with challenges, as domestic and international market environments vary widely in terms of consumer demands, political structure, the cultural and business environments. These challenges are magnified for firms with little international experience, including many of those from China. A question from the above-mentioned survey asked Chinese companies to rate challenges that impeded their potential international investment. Table 1 lists the top problems for Chinese firms with FDI anywhere in the world. (Figure 2 will limit its scope to North America.) The top impediment for the respondents was obtaining financing to expand their overseas investments, a problem often cited by companies from industrialized economies. Moreover, inexperienced international personnel (fourth); a lack of foreign market knowledge (sixth); and cultural barriers (seventh), such as language and differences in business relationships, are issues that confront most firms, regardless of nationality. It is often difficult for firms to support the research and personnel needed to successfully enter new markets.

Rank	Challenge
1	Financing difficulties
2	Local market does not understand Chinese brands
3	Concerns over Chinese quality and safety
4	Lack of international business talent
5	Lack of technology for new markets
6	Do not understand new market risks/laws
7	Cultural barriers
8	Negative response from host country
9	Negative response from Chinese government or people

Table 1: Top global challenges for all surveyed Chinese firms conducting FDI.
Source: China Council for the Promotion of International Trade, 2010.
Note: 1,377 valid, firm-level surveys were received.

Other issues appear to be unique to Chinese firms. A lack of local market understanding of Chinese brands (second), quality and safety fears over Chinese products (third), and an overall negative host country response (eighth), however, are unique to Chinese firms at this point. Given incidents in recent years concerning food safety (such as harmful additives in baby formula for domestic consumption and pet foods that were being exported) and other manufactured goods from China (including a recent scare involving lead-based paint in toys), these issues remain a salient problem for many firms.

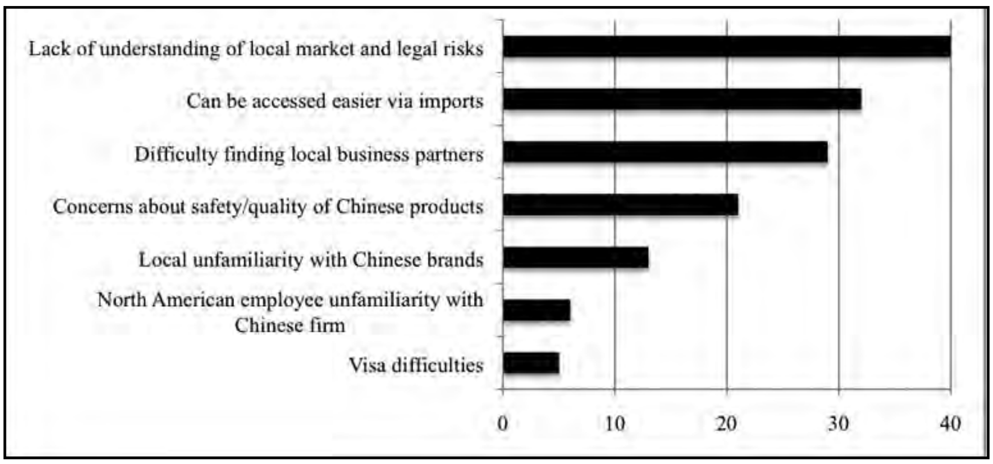

Figure 2: Impediments to investment in North America (percentage of 1,377 firms selecting).
Source: China Council for the Promotion of International Trade, 2010.

To engage students and to demonstrate the relevance of Chinese FDI to their lives, it is worth examining the problems that these firms face when specifically looking to invest in North America (Figure 2). Interestingly, almost any company looking to invest internationally, not just Chinese firms in North America, cites the highest-ranked problem as understanding the local market environment and legal risks, as well as the third-ranking problem, which addresses concerns over finding local business partners. Understanding the demands of a new market and its legal risks are difficult, consuming both money and time. Although most consultants would suggest first partnering with a local firm, this again is difficult with firms that have little international experience. Essentially, how does a firm locate a business partner that it can trust? The second-ranked issue, the foreign market that can be accessed more easily through imports, is somewhat unique to the case of China, given the huge number of imports flowing into North America. And again, the fourth- and fifth-ranked concerns center on perceptions of safety, quality, and brand unfamiliarity—problems that hamper many Chinese firms worldwide, including North America. Brand recognition is an issue that the Go Global Policy aims to resolve, yet quality and safety are valid concerns that may hamper Chinese overseas market expansion.

A competitive problem that was not listed on the North American set of challenges, but that is nonetheless a valid concern, is negative perceptions of North Americans toward Chinese investment. This encompasses worries from policymakers and the public in recipient countries over firms from a major strategic rival (like China) taking control of key domestic assets. An example of this was seen in 2005 when CNOOC, a large Chinese oil company, attempted to purchase Unocal of the United States, a move that raised national security alarms in policy circles about a Chinese firm having access to important resources. This apprehension eventually led to the bid's withdrawal rather than CNOOC attempting to obtain federal government approval.

The unease over foreign investment, however, is not limited solely to Chinese firms, as shown by the failed 2010 bid by an Australian firm for Saskatchewan's Potash Corporation, which raised similar concerns about foreign investors having control over Canada's key natural resources and over one of its major firms. An important point to mention is that during the 1980s, similar concerns were raised over Japanese investment in the US when British FDI in this country was much larger.[5] So while the nations conducting FDI may change, concerns over investment have not.

This article has taken a brief look at the topic of FDI and investment-related motivations and challenges of Chinese firms to facilitate classroom discussion of geographical changes in international investment activity. Chinese FDI will continue to increase, along with its rapidly developing economy. In several respects, Chinese companies face many of the same obstacles as their international competitors, including restricted access to financing and, perhaps more importantly, a lack of knowledge about the market environment of other countries. Still, many Chinese firms differ from some global competitors as they also face lack of brand recognition and concerns over quality and safety. Admittedly, some Japanese and Korean companies faced quality issues decades ago when they entered industrialized markets, but these have been largely remedied. Continued safety concerns, however, appear to be unique to Chinese firms at this point and could be serious impediments to success in North America. Regarding motivations for FDI, Chinese motivations do largely echo those of other global firms, including a saturated domestic market and investment policies of host countries. These findings can be utilized with students as part of discussion on international investment patterns and FDI in their home states or regions. This can also lead to further dialogue on China's economic growth and its impacts, not only on the world economy but also to the students' local economies that have been or could be recipients of FDI. ■

NOTES

1. Peter Dicken, *Global Shift: Reshaping the Global Economic Map for the 21st Century*, 5th ed. (Guilford Press: New York, 2007).
2. *World Economic Outlook Database*, International Monetary Fund, accessed February 2012, http://bit.ly/mPaaDn.
3. *China Spreads Its Wings—Chinese Companies Go Global*, Accenture, 2005, accessed February 2012, http://bit.ly/HKvq3w.
4. *Survey on Current Conditions and Intention of Outbound Investment by Chinese Enterprises* (China Council of the Promotion of International Trade: Beijing, 2010).
5. Organisation for Economic Co-operation and Development, accessed February 2012, http://stats.oecd.org.

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