

Go Overseas via Direct Investment:
Internationalization Strategy of Chinese Corporations
in a Comparative Prism

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ABSTRACT

China's success in attracting the inflow of foreign direct investment (FDI) has been well documented. Less known is the initial success of China's "going out" strategy, which encourages domestic enterprises to participate in international capital market and to directly invest overseas. This paper assesses the aggregate dynamics of China's outward FDI and compares it with that of South Korea and Japan. The paper traces the strategic shift of Chinese overseas investment in a comparative prism and presents case studies of two Chinese multinationals, which are distinguished by their innovative strategies of internationalization in general and direct investment overseas in particular. The paper also discusses the strategic implications of emerging Chinese multinationals for their Western counterpart.

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1. Introduction

China's successful story at attracting the inflow of foreign direct investment (FDI) has made headlines in both media and academic circles for years. By 2002, the total stock of FDI inflow amounted to US\$ 448 billion (UNCTAD, 2003, p. 259). In 2002, due to the decline in global merger and acquisition (M&A) volume, China surpassed the USA to become the world's biggest recipient of FDI (*The Economist*, 6 September 2003, p. 57). Recent surveys of foreign investors have consistently shown China as one of the top interesting destinations for foreign investors (AT Kearney, 2003; MIGA, 2003).

Less known is, however, the fact that in parallel with the "open-door" policy for attracting inward FDI, China has achieved initial success in implementing its "going-out strategy", which encourages domestic enterprises to play a part in international capital market and to invest overseas (Shi, 2002). At the macroeconomic level, the strategy of go-overseas via direct investment is largely in line with China's persistent trade surplus and positive saving-investment gap (Wong and Chan, 2003). At the firm level, China's enterprises have their own strong interest to implement internationalization strategy by the way of overseas investment. As a result, some Chinese brands have achieved considerable success in the global market, which include Haier (home appliances), Konka (color television), TCL (multi-electronics), Jianlibao (beverage), Tsingtao (beer), Galanz (microwave) and others (Gilmore and Dumont, 2003). Haier Group occupied almost half of the U.S. small refrigerator's market in 2002. Galanz, which produces one third of microwave ovens in the world, captured a 40% of European market in 2002 under its own brand name (Zeng and Williamson, 2003).

According to the Ministry of Commerce (MOFCOM), the successor of the former Ministry of Foreign Trade and Economic Cooperation (MOFTEC), by the end of October 2003 China had set up 7,360 "non-trade" enterprises overseas with a cumulative investment of US\$11 billion mainly in manufacturing and natural resources sectors. According to the data of UNCTAD (2003), which include trade-related capital movement and is based on balance of payment (BoP) accounting, China has emerged as one of the largest sources of outward direct investment among developing economies. By 2002 China's outward FDI stock amounted to US\$36 billion, accounted for 4.18 percent of the total outward FDI stock of the developing world (118 countries, including the newly industrialized economies), and ranked number 6 next to Hong Kong (US\$370 billion), Singapore (US\$71 billion), Taiwan (US\$60 billion), Brazil (US\$53 billion) and South Korea (US\$44 billion).

In comparison with the feature of outward FDI from developed economies, which has been regarded as having comparative advantages in technology, management and marketing, the feature of China's outward FDI is to a large extent similar to that of the third world's multinationals, which is not characterized by technological advantage but advantages in cost and flexibility (Lall, 1983). However, if paying attention to the specific internationalization process of Chinese multinationals, one would find that they are quite different from their Third-World's peers. Chinese multinationals typically establish joint ventures with Western multinationals within China before their overseas investment and they often used equity joint-venture and M&A as the ways to directly acquire advanced production, technology and managerial skill overseas (Zhang and van den Bulcke, 1996a; Wong and Chan, 2003).

Notwithstanding the increasing importance, there has been a lack of research attention on China's outward FDI in general and internationalization strategies of Chinese companies in particular. In sharp contrast to the huge body of literature on FDI inflow to China, there have been few academic publications on China's overseas direct investment. The latter literature is emerging recently and typically provides introductory analyses of Chinese government policy and the regulatory framework regarding outward investment, and/or a preliminary assessment of development trends, regional patterns, and investment motivations. Some researches focused on a certain region or country, such as Southeast Asia (Wu and Sia, 2002), Hong Kong (Sung, 1996; Tseng, 1996; Chan, 1995), Australia (Wall, 1997), or Russia (Wu and Chen, 2001). On the basis of data sources, this literature can be grouped into MOFTEC data-based research (Wu and Sia, 2002; Wu and Chen, 2001; Teseng, 1996), BoP accounting data-based research (Mizra, 2000; Cai, 1999; Sicular, 1998),¹ case studies (Mcdermott and Huang, 1996; Wu, 1993), and questionnaire surveys (Wang, 2002; Zhang and van den Bulcke, 1996a). Research on comparison between China's outward FDI and that of other economies has been largely missing. This paper intends to fill this important niche.

Two well-acknowledged reasons for the lack of systematic analysis and comparison are the scarcity of industrial distribution data in different recipient regions and the difficulty to have direct reconciliation between the two major sources of statistical data. In this paper we argue that a partial consolidation between the project-centered data and the BoP accounting-based data is possible if one understands that the MOFTEC data is always associated with the administrative function of the Ministry on the approval and monitoring of overseas projects. Moreover, if our major attention is on the dynamics of internationalization strategies, we can acknowledge the systematic discrepancies on absolute value at the aggregate level between these two data sources and then focus on the distributional patterns (shares) and their shifts (change rates), which are relatively free from systematic discrepancies at the aggregate level.

Based on our data consolidation, this paper assesses the progress and performance of China's outward FDI in the light of a comparison with the cases of South Korea and Japan. It analyzes the evolving process of internationalization strategies of Chinese enterprises and investigates socio-economic and institutional forces driving the process. It examines to what extent the Chinese experience has followed the development path of Korea and Japan and to what extent the Chinese development has been different from the experience of Korea and Japan. To highlight the rapid rising of enterprises-led overseas investments, we present two illustrative case studies, which show the impressive dynamics of Chinese multinational's internationalization strategies despite the constraints of weak domestic institutional development.

The rest of the paper is organized as follows. Section 2 assesses the aggregate dynamics of China's outward FDI and compares it with the cases of South Korea and Japan. Section 3 traces the strategic shift of Chinese overseas investment in a prism of international comparison. Case studies of two Chinese multinationals, which are distinguished by their innovative strategies of international capital market participation and overseas direct investment, are presented in Section 4. Section 5 concludes the paper by highlighting strategic implications of emerging Chinese multinationals for their Western counterparts.

¹ Both the UNCTAD and IMF data on China's outward FDI are based on the balance of payment (BoP) statistics published by the People's Bank of China – the central bank of China.

2. Aggregate dynamics of China's outward FDI

As mentioned before China has not yet had systematic and comprehensive statistics of its outward FDI, which could be comparable in quality and coverage to the corresponding statistics of Japan Statistics Bureau and Export-Import Bank of Korea. To assess the aggregate dynamics of China's outward FDI, the best available figures are the BoP accounting-based data as reported in UNCTAD's *World Investment Report*. BoP accounting is relatively consistent over time and across countries in terms of methodology. The resultant capital flow data have a much broader coverage than that of MOFTEC, which, although having kept a detailed record of "non-trade" capital movement, exclude several key sources of financial capital movement, and report, only at rare occasions, the trade-related capital flows to the media.

The usual complaints against China's BoP accounting are its unusually large figures on the item of "errors and omissions", which reached an outflow peak of US\$22 billion in 1997 (IMF: *Balance of Payments Statistics Yearbook*). We argue that the "errors and omissions" figure cannot be solely assigned as "hidden" capital outflow or capital flight. A large portion of it could be attributed to the mis-invoicing (transfer pricing) of intra-firm transactions cross the border between the mainland and Hong Kong. As revealed in Gunter (2003), from 1992 to 1998, the errors caused by mis-invoicing of the mainland's trade transactions was almost exactly offset by opposite errors in the mis-invoicing of Hong Kong's trade transaction. A moderate portion of the figure could be attributed to repatriated profits from foreign enterprises which are not recorded in the BoP statistics as outflow. Another moderate proportion would correspond to real statistical discrepancies. The remaining part might be assigned as hidden capital flight, but a large proportion of such capital flight often flows back to China and become "new FDI" after "round tripping" (Tseng and Zebregs, 2002).

Based on the above understanding, it is reasonable to assume that the extent of under-estimating in the BoP accounting data of China's outward FDI is limited. It justifies our comparative assessment based on UNCTAD's data in this section.

Table 1. The ranking of outward FDI stock in developing economies, 1985 & 2002

1985				2002			
Rank	Region/ Country ^a	Stock (USD million)	Share (%)	Rank	Region/ Country ^b	Stock (USD million)	Share (%)
1	Brazil	40,496	(51.80)	1	Hong Kong	370,296	(43.59)
2	South Africa	8,963	(11.47)	2	Singapore	71,336	(8.40)
3	Argentina	5,945	(7.60)	3	Taiwan	59,553	(7.01)
4	Singapore	4,387	(5.61)	4	Brazil	53,227	(6.27)
5	Mexico	3,957	(5.06)	5	South Korea	43,500	(5.12)
6	Hong Kong	2,944	(3.77)	6	China	35,538	(4.18)
7	Panama	2,204	(2.82)	7	South Africa	28,755	(3.39)
8	Bermuda	1,691	(2.16)	8	Virgin Islands	23,722	(2.79)
9	Malaysia	1,374	(1.76)	9	Malaysia	20,194	(2.38)
10	Kuwait	930	(1.19)	10	Cayman Islands	20,026	(2.36)
26	China	131	(0.17)				
	Other Developing Economies	5,154	(6.59)		Other Developing Economies	123,317	(14.52)
	Total Developing Economies	78,176	(100)		Total Developing Economies	849,464	(100)

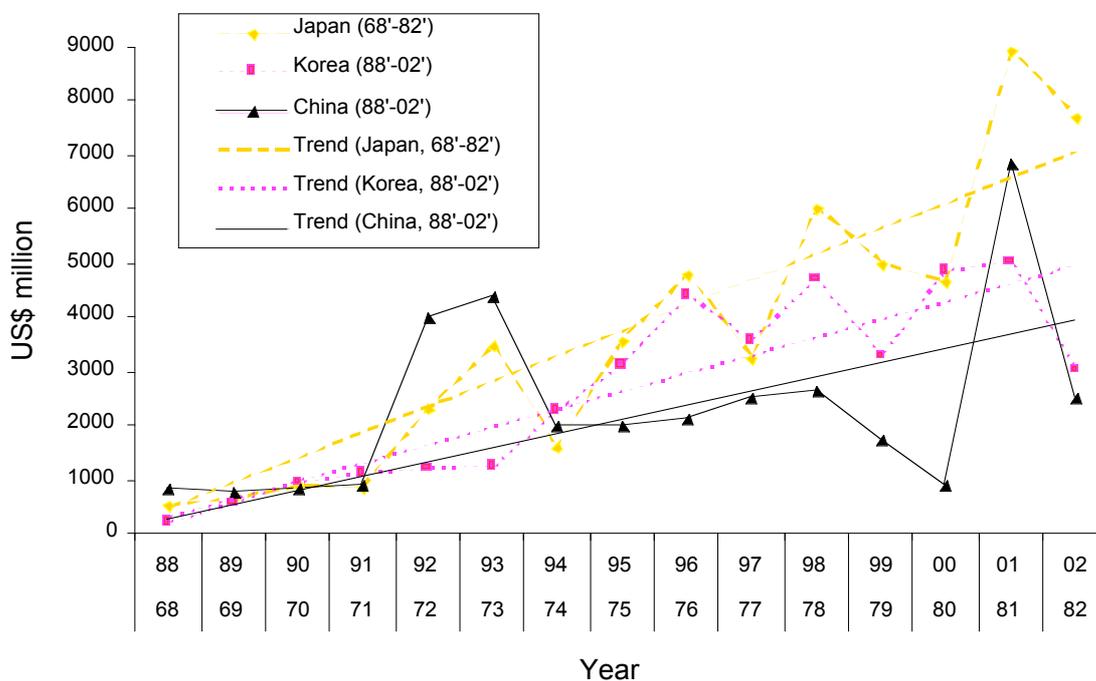
Source: UNCTAD (2003), *World Investment Report 2003*, Annex table B.4., pp. 262-265.

Notes: ^a Total 62 countries involved in outward FDI. ^b Total 141 countries involved in outward FDI.

Following the UNCTAD's *World Investment Report*, it is clear that China is rapidly emerging as an important player in the world capital market. Among developing countries China has become one of the top FDI exporters. China's share in the total outward FDI stock originating from developing countries has risen dramatically from 0.2 per cent in 1985 to 4.18 per cent in 2002. The stock of China's outward FDI reached about US\$36 billion by the end of 2002, which put the rank of China into the top six among 118 countries.

By comparing the development dynamics of aggregate outward FDI levels across China, Korea and Japan, it can be found that the trends of the outward FDI flows from the first two countries had been quite similar during the same period of 1988-2002 and to a great extent the Chinese and Korean trends resemble what happened in Japan 20 years ago, although the flow from China showed a higher variation and the corresponding trend was less steep (Figure 1). The time lag between the Chinese and Japanese trends may not come as a surprise, whereas the simultaneous similarity between the Chinese and Korean trend is worth further discussing. If without the devastating disruption of the Asian financial crisis in 1997 and 1998, the growth trend of the outflow from South Korea would be much stronger than what we now see from Figure 1. This in turn suggests that South Korea would be in a more advanced stage than China was in terms of direct capital exporting, a difference more in line with the investment-development path theory of Dunning (1998). Nevertheless, the Asian crisis had almost flattened the growth trend of South Korean outward FDI since 1997, making the cases of these two countries much closer to each other.

Figure 1. Total Outward FDI Flows from China, South Korea and Japan

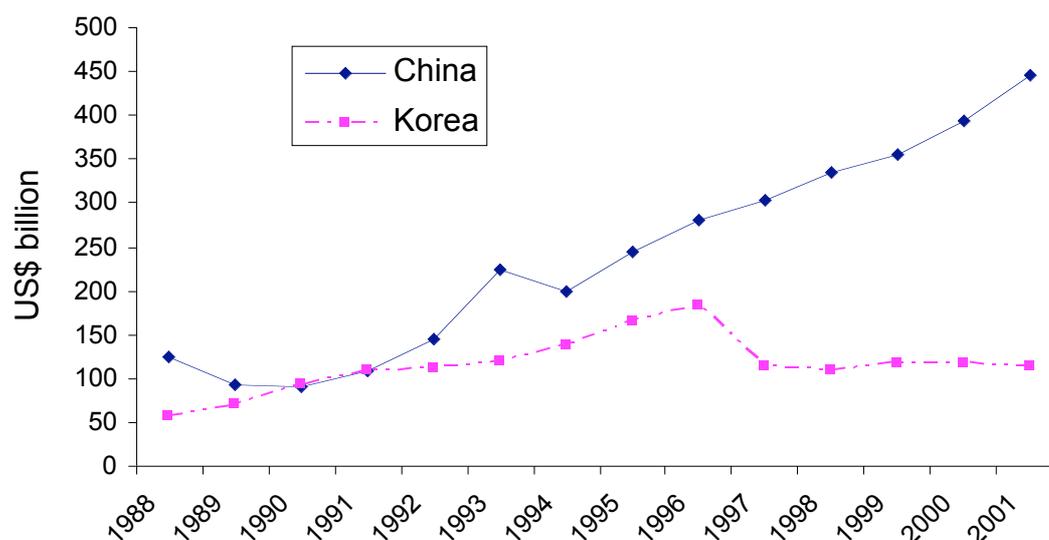


Source: IMF (various years), International Financial Statistics. Overseas Direct Investment Data Base in Export-Import Bank of Korea (<http://www.koreaexim.go.kr>). Japan Statistics Bureau (various years), Japan Statistical Yearbook.

Figure 2 further shows the devastating impact of Asian financial crisis on South Korean domestic fixed capital formation. Before 1997, China and Korea shared a sur-

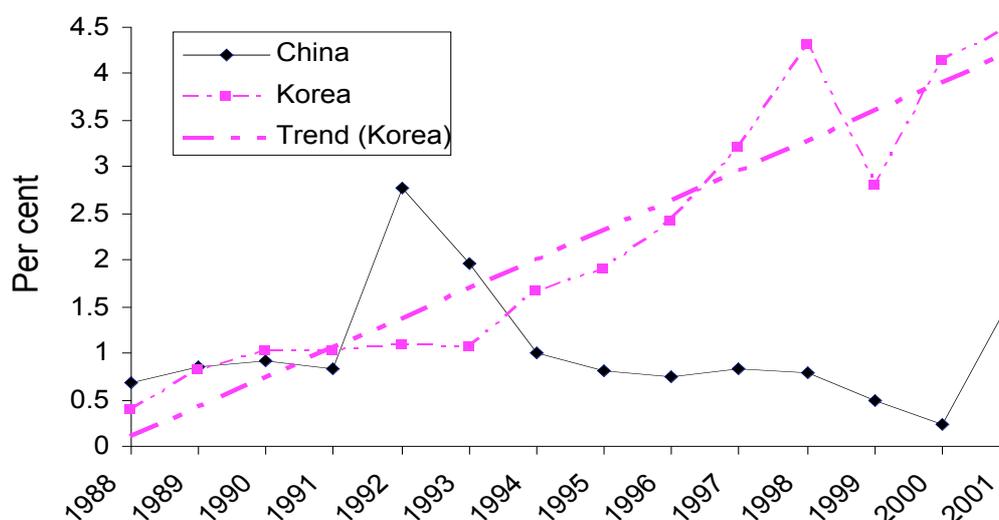
prising similarity in both magnitude and growth trend of domestic fixed capital formation. The crisis cut the scale of Korean domestic fixed capital formation by one third in 1997 and had flattened the corresponding growth rate since then. In contrast, the strong growth trend in China had been maintained. As a reflection of this diversity in both the scale and trend, the ratio of China's outward FDI to its domestic fixed capital formation did not show a growth trend due to the fact that the strong growth in domestic fixed capital formation had out-paced the growth of outward FDI flow. Whereas the growth trend of the Korean ratio became even stronger than that of the scale of the outward FDI flow, following the collapse of domestic fixed capital formation (Figure 3).

Figure 2. Gross Fixed Capital Formations in China and South Korea, 1988-2001



Note: All conversions are based on the average official exchange rate in the year.
Source: IMF (various years), International Financial Statistics.

Figure 3. The Ratios of Outward FDI to Domestic Gross Capital Formation in China and South Korea, 1988-2001



Note and Source: The same as in Figure 1.

Although Figure 1 alone does not suggest a difference in development stages of capital exports between China and South Korea, the combination of Figures 1-3 may suggest so. It is worth noting that while the Asian crisis cut the level of Korean domestic fixed capital formation by a large proportion, it only flattened the trend of Korean outward FDI flow. This indicates that Korean direct investment abroad is more likely associated with the strength part of Korean economy, which is much less vulnerable to domestic business/investment cycle and to shocks from international financial market. In contrast, China's direct investment overseas seems to be closely associated with the domestic business/investment cycle.

3. Shift in the Strategies of Overseas Direct Investment²

Since the late 1970s, China's outward FDI has experienced strategic shifts from the political objective-centered to the commercial interest-oriented, from the central government-dominated to local government-led and then to enterprise-led, and from resource-seeking to the trinity of resource-, market-, and technology-seeking overseas direct investment. In terms of investment mechanism and financing channel, Chinese enterprises have adopted transnational M&A as the major mechanism and used international listing as an important channel to raise capital in foreign exchange and to finance their overseas expansion.

In the earlier year of the reform (mainly, 1979-1984), only state-owned Foreign Trade Corporations under MOFTEC or under the Department of Foreign Trade and Economic Cooperation of provincial governments, and newly created Foreign Business Oriented Companies were authorized to invest overseas (Tseng, 1996; Cai, 1999). Furthermore, their overseas investment activities were strongly linked with the government's political considerations rather than commercial interests. The key decisions on overseas investments, such as choices of location and sector, were mainly determined by the consideration of enhancing China's political and economic influence and expanding China's international trade relationships rather than maximizing market profit (Wu and Chen, 2001; Wang, 2002). An illustrative example was China's heavy investment in Hong Kong's public utility and infrastructure sector, which was based on China's desire to set up political and economic power in Hong Kong (Chan, 1995; Zhang and van den Bulcke, 1996b). By the early 1985, there were only 113 non-trade Chinese enterprises overseas with an accumulated investment of about US\$ 150 million (Wu and Chen, 2001).

The significant (although gradual) decentralization of Chinese economic system since the mid-1980s brought substantial liberalization in the field of outward FDI. In the regulation of the government, all enterprises, if having sufficient capital, technical and operating know-how, and suitable foreign partner, could apply for permission to establish subsidiaries in foreign countries (Tan, 2001). Local governments took this advantage to push and help local Foreign Trade Corporations and Foreign Business Oriented Companies to establish overseas operations aiming to capital and technology acquisition and trade expansion. As a consequence, since 1987, in every year, over 100 new non-trade enterprises have been set up overseas. In the peak years of 1992 and 2002, over 300 non-trade enterprises were established overseas per annum. The average scale of these new firms' start-up investments has shown a strong increasing trend, from 1.5 million per firm

² The MOFTEC's statistics on overseas investment are classified into two main types: trade and non-trade. The category of "trade" refers to investment in service sectors including banking, commercial office, catering, travel agency, etc, whereas the "non-trade" refers to investment in industrial manufacturing and resource extraction. As we mentioned before, due to the lack of statistical track data on the "trade" category, this section will focus on the overseas investment in the "non-trade" category only.

in 1985-89 to 2.7 million per firm in 2000-02 (MOFTEC, various years). More importantly, the increasing diversity of investment agents has brought significant shift in the overall investment and business strategies. Although the agents of the central government may still put political considerations at the top, they start to give increasing weight to resource and capital acquisition. While local government agents and enterprises may initially focus on trade expansion, they become increasingly interested in reputation and brand building, and in more innovative ways of investment and financing. The analytical focus of this section is on these dynamic changes.

3.1. Dynamics on Resource- and Market-Seeking Strategies

Resource seeking, in particular natural resource-seeking, has been one of the key strategic considerations for China's overseas direct investment since the very beginning. As shown in Table 2, up to 1991 Chinese overseas investment was highly concentrated in North America and Oceania, where Canada and Australia were the two largest recipient countries, attracting US\$360 and 313 million respectively (Table 3). China's investment in these two countries includes China Metallurgical Industrial Corporation's (CMIC) investment in Channar Mine in Australia, China International Trust and Investment Corporation (CITIC) and China National Non-ferrous Metal Industrial Corporation's investment in the Portland Aluminium Smelter in Australia, China International Trust and Investment Corporation's (CITIC) investment in a sawmill in Canada, and Alberta and the China National Petroleum Corporation's (CNPC) equity in an oil extraction project in Canada (Zhan, 1995; Wang, 2002). All these Chinese corporations were directly managed by the central government.

Table 2. China's outward FDI in non-trade sector by region (US\$ million and %)

Ranking	1979-1991		1992-1996		1997-2001	
	Region	Value (%)	Region	Value (%)	Region	Value (%)
1	North America	656 (47.3)	Asia	260 (34.7)	Asia	817 (35.7)
2	Oceania	326 (23.5)	Latin America	148 (19.7)	Africa	552 (24.1)
3	Asia	203 (14.6)	Africa	122 (16.3)	Latin America	360 (15.7)
4	Europe	82 (5.9)	Oceania	71 (9.5)	North America	228 (10.0)
5	Latin America	62 (4.5)	North America	67 (8.9)	Europe	188 (8.2)
6	Africa	43 (3.1)	Europe	15 (2.0)	Middle East	72 (3.1)
7	Middle East	15 (1.1)	Middle East	7 (0.9)	Oceania	70 (3.1)
Total		1386 (100)		750 (100)		2287 (100)

Note: Data is on an approved basis.

Source: MOFTEC, various years, *Almanac of China's Foreign Economic Relations and Trade*.

Table 3. China's outward FDI in non-trade sector by country (US\$ million)

Ranking	1979-1991		1992-1996		1997-2001	
	Country	Value	Country	Value	Country	Value
1	Canada	360	Peru	120	Hong Kong	261
2	Australia	313	Hong Kong	113	USA	207
3	USA	295	USA	57	Thailand	127
4	Hong Kong	99	Russia	47	Mexico	126
5	Russia	49	New Zealand	41	Zambia	124
6	Thailand	38	S. Africa	38	Cambodia	101
7	Chile	21	Macao	28	Brazil	81
8	Macao	16	Thailand	28	Peru	79
9	Brazil	11	Cambodia	19	S. Africa	73
10	Malaysia	10	Indonesia	18	Viet Nam	56

Note: Data is on an approved basis.

Source: MOFTEC, various years, *Almanac of China's Foreign Economic Relations and Trade*.

During the 1990s, the natural resource-seeking outward FDI continued its expansion, with an increasing emphasis on fuel and general raw materials. This is a natural consequence of China's high economic growth, which led to significant increase in demand for fuel and industrial raw materials. For example, Peru became the largest recipient of China's outward FDI in 1992-1996, receiving US\$120 million (Table 3). It can be mainly attributed to the Capital Iron & Steel's (Shougang Corporation) acquisition of Hierro Peru Mining Ltd in November 1992 (Wu and Chen, 2001). In Indonesia China National Off-shore Oil Corporation (CNOOC) recently became the largest foreign oil producer after its take-over for US\$585 million of Repsol Indonesia in 2002. Baosteel, China's biggest steel maker, is now negotiating the largest overseas manufacturing investment ever by a Chinese company to take a controlling stake, worth US\$1.5 billion, in a US\$8 billion steel plant in Brazil (*The Economist*, 6 September 2003, p. 57).

Parallel to the resource-seeking investment, Chinese enterprises have urged to obtain access to advanced foreign technologies and managerial know-how so that in the next few stages they can establish themselves in international markets. Because of this strategic desire, the U.S. has been the most attractive country for China's technology-seeking investment. In 1979-1991, the U.S. was the third largest recipient of China's overseas investment next to Canada and Australia, attracting 21.3 per cent of total China's non-trade outward FDI. In 1997-2001, the U.S. became the second largest receiver of China's overseas investment next to Hong Kong, attracting US\$207 million direct investment from China (Table 3).

In terms of the regional distribution of China's outward FDI, while having had a similar pattern with that of South Korea and Japan in the 1980s and being more concentrated in the developed countries (Ministry of Finance Japan; Export-Import Banks of Korea), a significant shift has happened since the early 1990s. As shown in Tables 2 and 3, China has increasingly cultivated its strong comparative advantages in Asia (mainly Southeast Asia), Africa, and Latin America. Between 1992 and 2001, Asia was the number one destination of China's outward FDI, accounting for over 35% of the total. More particularly, China's direct investment in Southeast Asia has considerably increased, amounting to more than 52 per cent of the total in Asia during 1997-2001. Many Chinese manufacturing firms set up their production base there with the aim to expand their market share in the host countries and to reduce production cost. A more significant distinction from the pattern of Korean and Japanese overseas investment is that Africa had risen to the second largest recipient of Chinese overseas investment in 1997-2001, taking 24.1 per cent of the total. China's investment in Africa began in the 1960s, when China initiated many aid projects and cooperated with several African countries to conduct infrastructure construction. While such political projects had become a history in the early 1980s, Chinese companies started to cultivate their comparative advantages in African in the late 1980s and had successfully expanded their manufacturing bases in the 1990s and onwards. Chinese companies take the successful experience of China's township and village enterprises in rural China to cultivate niche markets in Africa, in a way to provide appropriate products highly compatible with local demand and purchasing power. Such a market-entry and expansion strategy is consistent with the suggestions raised by the product-life cycle theory (Vernon, 1966; Wells, 1983) and investment-development path theory (Dunning, 1988).

Although there is a lack of time series data on the sectoral distribution of China's outward FDI, MOFTEC did occasionally report its survey results. According to its latest survey on the sectoral distribution up to June 2001 (*International Business Daily*, 7 September 2001), manufacturing and natural resource-seeking outward FDI accounted for 50 and

43 per cent of the total in the non-trade category, respectively. This structure bears a strong resemblance to that of Korea in the 1980s and is to a less extent similar to that of Japan in the 1960s and 1970s (Export-Import Bank of Korea; Sheridan, 1995). Interestingly, this similarity carries a clear-cut time lag that roughly matches the difference in development stages of these three economies in general and their outward FDI in particular.

3.2. Dynamics on Financing and Investment Strategies

Since the mid-1990s, increasing number of Chinese companies have taken a listing on developed overseas stock exchanges as an important way to directly raise equity capital in hard currency and to establish international image and reputation. From the listing of Qingdao Beer on the Hong Kong Stock Exchange (HKSE) on 15 July 1993 to the listing of China Life Insurance on New York Stock Exchange and HKSE on 17 and 18 December 2003 respectively, 93 Chinese companies had listed on developed overseas stock exchanges. In addition, there have been 73 “red chip” companies listed in Hong Kong, which are registered as Hong Kong companies but controlled by the mainland interests. The total capital raised was over US\$100 billion. The top three companies in terms of fund raising are China Mobile (red-chip share) with about US\$14 billion, China Unicom (red-chips share) with US\$5.6 billion and SinoPec (H share) with US\$3.4 billion (Chow, 2003; Fok, 2003).

Table 4. The top 10 Chinese industrial companies listed on Hong Kong Stock Exchange (H-share listing, by market capitalization, and up to 5 November 2003)

Rank	Company	Principal Activities	Listing Date	Market Capitalization (HK\$ million)
1	PetroChina Co. Ltd.	Exploration and production of crude oil and natural gas.	7 Apr, 2000	50,110
2	SinoPec Co. Ltd.	Exploration and production of crude oil and natural gas.	19 Oct, 2000	43,210
3	China Telecom Co. Ltd.	Fixed line telecommunications	15 Nov, 2002	20,069
4	Huaneng Power International	Construction and operation of Coal-fueled power plants	21 Jan, 1998	18,714
5	Aluminum Corporation of China	Production and distribution of Aluminum	12 Dec, 2001	11,608
6	Sinotrans Ltd.	Freight forwarding, express services, shipping services	13 Feb, 2003	7,150
7	Zhejiang Expressway Co. Ltd.	Construction, and operation of High grade roads.	15 May, 1997	7,133
8	Beijing Datang Power Generation Co. Ltd.	Acquire and operate existing and new coal-fueled power plants	21 Mar, 1997	6,975
9	China Shipping Development Co. Ltd.	The shipment of oil and cargoes.	11 Nov, 1994	6,674
10	Yanzhou Coal Ming Co. Ltd.	Underground coal mining	1 Apr, 1998	6,375

Source: Hong Kong Exchanges and Clearing Limited (<http://www.hkex.com.hk>)

Table 4 presents the top ten Chinese industrial companies listed on Hong Kong Stock Exchange (H-share listing) in terms of market capitalization. They all have been the leading player of China’s overseas investment, and six of the ten are mainly natural resource-based and state-controlled enterprises. By listing on developed capital markets, these companies have also increasingly adapted themselves to international standards in the areas of corporate governance, accounting and auditing, strategic management, and business conduct.

The most striking shift in investment strategy is that transnational M&A has gradually become the main form of China's direct investment abroad. Table 5 reports the rising of M&A form in Chinese overseas expansion. It shows that within 12 years, the value of cross-border M&A purchased by Chinese companies increased from US\$60 million in 1990 to 1.04 billion in 2002, a 17-fold increase. In sharp contrast to the remarkable decrease of M&A purchases by Japan, South Korea, and Taiwan since the mid-1990s, by 2002 China has risen to the fourth largest player next to Japan (US\$8.66 billion), Hong Kong (US\$5.06 billion), and Singapore (US\$2.94 billion) in Asia. The major reasons for the increasing use of M&A by Chinese companies include getting direct access to natural resources, overcoming the low brand value of the company's products, and quickly obtaining advanced marketing and distribution networks and R&D operations.

Table 6 reports the leading M&A acquired by Chinese companies in 2002 and early 2003. It shows that China's four major oil companies represent a large share of cross-border M&A deals. China National Offshore Oil Corporation (CNOOC) was the top acquirer out of the four major oil companies. Its acquisitions in 2002 include Spanish interests-controlled Repsol YPE's five oilfields in Indonesia for US\$585 million, a 12.5% interest in BP's Tangguh LNG project in Indonesia for US\$275 million, and a 5.56% interest in NorthWest Shelf Venture's oilfields in Australia for US\$320 million. The other three oil companies also made large acquisition, including CNPC's 30% interest in two oilfields in Azerbaijan for USD 52 million, SinoPec's acquisition of oilfield in Algeria for USD 394 million, PetroChina's acquisition of six oilfields from US interests-controlled Devon Energy in Indonesia for USD 216 million.

Table 5. Cross-border M&A by country of purchaser in Asia, 1990-2002 (US\$ million)

	1990	1995	2000	2001	2002
China	60	249	470	452	1,047
Japan	14,048	3,943	20,858	16,131	8,661
Hong Kong	1,198	2,299	5,768	3,012	5,062
India	-	29	910	2,195	270
Indonesia	49	163	1,445	-	197
South Korea	33	1,392	1,712	175	98
Malaysia	144	1,122	761	1,375	930
Singapore	438	892	8,847	16,516	2,946
Taiwan	1,385	122	1,138	161	74
Thailand	18	144	5	699	87

Note: The data cover the deals involving the acquisition of an equity stake of more than 10%.

Source: UNCTAD, *World Investment Report 2003*, Annex table B.8, pp. 293-295.

Beyond the energy sector, other Chinese companies have been also increasingly using cross-border M&A as a key strategy to enhance their competitiveness in international market. The most impressive increase of using cross-border M&A has emerged in the high-tech industry sector. These M&As include BOE Technology's acquisition of Korean Hydis, the Hynix Semiconductor's TFT-LCD division, for US\$380 million, China Netcom's acquisition of Hong Kong-based Asia Global Crossing Ltd for US\$270 million, and earlier cases of China Electronic Corporation's acquisition of Netherlands-based Philips Electronics' mobile handset division and Huali Group's acquisition of US-based Philips' CDMA R&D department in 2001. Some companies use M&A as a trial to establish their images in international market under the brand name of the acquired companies, such as TCL's acquisition of Germany's Schneider for Euro 8.2 million in September 2002.

Table 6. Major cross-border M&A by Chinese companies, 2002M1-2003M2 (US\$ million)

	Acquirer	Target	Industry	Value
2002M1	China National Offshore Oil Corp. (CNOOC)	Spanish Repsol-YPE's five oil fields (equity stake), Indonesia	Energy	585
2002M1	China National Petroleum Corp. (CNPC)	30% interest in two oilfields, Azerbaijan	Energy	52
2002M1	China Petrochemical Corp. (SinoPec)	Oil field assests, Algeria	Energy	394
2002M4	Petro China	Devon Energy's six oil fields in Indonesia	Energy	216
2002M5	Haixin Group	Glenoit Corp.'s sliver knit pile fabric division, US	Fabric	14
2002M6	BaoSteel Group	46% interest in Rio Tino's mining company, Australia	Steel	30
2002M9	CNOOC	12.5% interest in BP's Tangguh LNG project in Indonesia	Energy	275
2002M9	TCL	Schneider Electronics, Germany	Electronics	8.2 (€)
2002M10	CNOOC	5.56 % interest in NorthWest Shelf Venture's oil fields in Australia	Energy	320
2002M10	Shanghai Automotive Industry Corporation (SAIC)	GM-Daewoo Motor alliance (equity stake), Korea	Automobile	60
2002M11	China Netcom	Asia Global Crossing Ltd., Hong Kong	Telecoms	270
2003M2	BOE Technology	Hydis (Hynix Semiconductor's TFT-LCD division), Korea	TFT-LCD	380

Source: Global M&A Research Centre in Institute of World Economics and Politics, Chinese Academy of Social Sciences (<http://www.online-ma.com>), PriceWaterhouseCoopers' (PWC) Asia-Pacific M&A Bulletin (<http://www.pwchk.com>), and websites of these companies.

4. Chinese Multinationals and Their Internationalization Strategies: Two Cases

4.1. Konka Group³

KonKa Group Company Ltd is currently China's second largest color television maker next to Chang Hong. It was established on May 21, 1980 as the first Sino-foreign joint venture electronic enterprise in Mainland China. In August 1991, Konka Group was reorganized as a Sino-Foreign Joint Stock Company. In 1992, it listed on Shenzhen Stock Exchange with an initial offer of 30 million "A" shares to domestic investors and 10 million "B" shares to overseas investors. In 2002, Konka Group had business revenue of over US\$1.2 billion. At the end of 2002, the control shareholder, the state-owned Overseas Chinese Town Group Ltd., directly held a position of 29.06 per cent and indirectly held a position of 20.25 per cent through its two whole-owned subsidiaries in Hong Kong – Overseas Chinese Town (Hong Kong) Co., Ltd. and Hong Kong China Travel Service (Group) Co. Ltd.

Konka produces a wide range of electronic appliances. The top one is color TV, earning domestic sales income of US\$719 million (4.8 million sets) and export income of US\$55 million (737,600 sets) in 2002. Konka had a market share of 13.5 per cent in China's color TV market in 2002. In 1999, the second peak year of their color TV sales next to 2000, Konka signed a technical collaboration agreement with the microelectronics group Lucent Technologies to produce cellular mobile phone handsets for the Chinese market. Within two years, mobile phone became the second most important product after

³ Unless specially mentioned, data used in this sub-section are from various annual and interim reports of Konka Group, which are available on www.konka.com.

color TV. In 2002, Konka's total sales income of mobile phones was US\$206.8 million (1.6 million sets), implying a domestic market share of 2.56 per cent. Thanks to the success in mobile phone sales, Konka further strengthened its financial position despite the price collapse of color TV in both domestic and international market in 2001 and 2002 (by more than 21 per cent in 2002 alone).

Konka's efforts in promoting its brand internationally began in late 1995, when it set up a subsidiary in Australia to market Konka color TV sets. Like many Third World's companies, in the initial stage of international expansion, Konka's overseas investments had been centered on creating marketing and distribution assets in foreign markets. In addition to the above common route, what distinguishes Konka's strategy from that of others has been Konka's innovative way of technology acquisition in the host countries.

In the TV industry, high definition television (HDTV) and digital television (DTV) were the two major technological innovations in the late 1990s, which have shown the strong potential in the TV market recently. In anticipation of substantial growth in HDTV and DTV demand, all the major manufacturers have lined up models since the very beginning. Based on the understanding that it is challenging for Konka to develop its own model of HDTV, Konka made great efforts become a member of the ATSC, the association that formulated the standard for the new age digital broadcast; and set up the US\$10 million Konka Technology Development Centre Co. Ltd in the Silicon Valley in December 1997. This centre has carried out the key development work for the new HDTV model. Konka owned 51 per cent of the development centre and the local technicians involved in the development process owned the rest (*Business-Wire*, 19 July 1999).

Konka's efforts on HDTV development were successful. In January 1999 Konka demonstrated its HDTV model on the Las Vegas Consumer Electronics Show and in June 1999 it launched the model commercially in the US. Thanks to its significant cost advantage, Konka marketed its HDTV sets at US\$3,000 each, about half the price of other available brands. This success led some observers to believe that Konka's HDTV would be able to play a leading role in the recent digital revolution that is reshaping the US television industry (*Business-Wire*, 19 July 1999; Saha, 2001).

It is worth noting that the development of HDTV has been a process involving a lot of collaborative research among leading electronics firms, the government and television broadcasting companies. As a result, the new capabilities were not really proprietary to any one single company. This feature helps Konka a lot. In the technological front, Konka seems to have narrowed the gap with the leaders in the industry significantly. While having been quite successful in the domestic market against competition from famous multinationals like Sony, Matsushita and Sharp, and being initially successful in foreign market like the US and Australia, it would still require time, efforts and substantial financial investments for Konka to build up its own brand reputation in foreign markets.

4.2. PetroChina Company⁴

PetroChina ranked number two in Fortune's 2002 list of China's top 100 companies. It was incorporated in November 1999 as a result of a comprehensive restructuring of China National Petroleum Corporation (CNPC) aiming to listing PetroChina on Hong Kong Stock Exchange (HKSE) and New York Stock Exchanges (NYSE). By the restructuring

4 Unless specially mentioned, data used in this sub-section are from the IPO Prospectus, various annual and interim reports of PetroChina Company Limited, and the company's new announcements, which are available on www.petrochina.com.cn.

CNPC transferred to PetroChina most of its assets and liabilities, interests relating to its main domestic oil and gas businesses, and a workforce of 480,000. CNPC retained its international oil business and domestic non-oil businesses. This IPO-motivated restructuring was regarded as China's most ambitious reform project before the IPO of the Bank of China (Hong Kong) in July 2001. The government intended to use PetroChina as the flagship of its state-sector reform and to lay the groundwork for other capital-starved SOEs on the international capital markets.

To meet the listing standards of HKSE and NYSE, the restructuring followed advice from China International Capital Corporation (CICC) and Goldman Sachs. Every single asset was inspected. Accounting and corporate governance systems were reorganized. In accordance with China's Company Law, the governance structure consisted of a board of directors, a supervisory board, and a senior management team in charge of business operations. The board included four committees of Auditing, Investment & Development, Examination & Remuneration, and Health, Safety & Environmental Protection. The company also committed itself to comply with the Code of Best Practice recommended by HKSE and formulated a set of policies and procedures regarding shareholders' general and extraordinary meetings.

After five months of preparation, in April 2000 PetroChina completed a global initial public offering pursuant to which 17.58 billion shares of RMB 1.00 each, representing 13.45 billion H shares and 41.35 billion American Deposit Shares (ADSs), were issued at prices of HK\$1.28 per H share and US\$16.44 per ADS, respectively. The shares issued to the public represented 10 per cent of the total capital of the company. The remaining outstanding of 160 billion shares was state-owned and held by CNPC. Thanks to the capital-raising nature of the primary offering, the net proceeds to the Company were about RMB20 billion (US\$2.4 billion).⁵ BP plc, the world's third largest oil company, took 20 per cent of this IPO with the aim to develop a retail network and sell natural gas to power stations in China. Many Hong Kong listed companies, including Cheung Kong (Holdings) Ltd, Hutchison Whampoa Ltd, Sun Hung Kai Properties, and New World Development Company Ltd, also invested a total of US\$350 million.

The success of IPO not only brought in significant amount of net proceeds in hard currency, but also established the image of PetroChina in international capital market and strengthened its ability to conduct international acquisition. Soon after the IPO, PetroChina started to actively look for overseas investment opportunities. In April 2002, the company achieved breakthrough in international acquisition after researching and assessing more than 20 opportunities. It acquired all the share capital in Devon Energy Indonesia Ltd, a company in Indonesia controlled by US interests and engaged in exploration and production of crude oil and natural gas. To the acquisition process, Goldman Sachs acted as financial advisor and Freshfields Bruckhaus Deringer acted as legal advisor. The acquired business is a combination of producing oil fields and contracted producing gas fields with the production capacity of 17,100 barrels (oil equivalence) per day in 2002 and 22,200 barrels per day in 2003. In 2002, the acquired business contributed turnover of RMB632 million and operating profit of RMB132 million to PetroChina.

⁵ One special feature of SOE privatization in China is that share-issuing firms typically go through primary offerings instead of secondary offerings, which is the norm in almost all other countries. Under the secondary offerings the government sells existing equities and receives all of the sales proceeds and the only effect on the privatized firms comes from ownership change. In contrast, under the primary offerings, share-issuing is a capital-raising event for the firm. Share-issuing increases a firm's asset and equity accounts by an equal amount, and consequently changing the firm's ownership structure somewhat (Sun and Tong, 2003).

The strategic statement of PetroChina on international acquisition is as follows. "PetroChina will undertake international acquisitions that create value for shareholders and improve upstream portfolio returns and growth prospects. PetroChina's international expansion will be highly focused and will look to establish core areas of clustered, high quality operations with a strong reserves base and material production growth. PetroChina will focus on opportunities in basins, plays or technologies where PetroChina has specific commercial and competitive advantage." Experienced the success of the first international acquisition, the company is recently studying and preparing to take part in a tender for 10 new oil blocks in East Java offered by Indonesian government (*Business CustomWire*, 16 December 2003).

5. Conclusions and Implications

This paper has assessed the progress of China's outward FDI and compared this development with the experience of Korea and Japan. The assessment indicates that at the aggregate level, China and Korea had shared simultaneous similarity in growth trend during 1988-2002 and their trends resembled one happened in Japan during 1968-1982. By further examining the relative dynamics of outward FDI to domestic fixed capital formation, it is found that Korean direct investment abroad is more closely associated with the strength part of the economy and less correlated to the downturn of domestic fixed capital formation, whereas China's outward FDI is more closely correlated to the fluctuation of domestic fixed capital formation. This may imply that Korea would have a moderate lead ahead China in the field of direct capital exporting.

In terms of strategic orientation of China's outward FDI, while the natural resource-seeking investment has continued its expansion since the 1970s, an increasing emphasis has been placed on M&A purchase of fuel resources and general raw materials producers. In addition to the resource-seeking investment, increasing number of Chinese enterprises have used the means of cross-border M&A, joint venture and green-field investment to obtain accesses to advanced foreign technologies, managerial know-how, R&D establishments, distributional networks, and even brand names in developed economies. Chinese enterprises have also increasingly cultivated their strong comparative advantages in Southeast Asia, Africa, and Latin America. For example, increasing number of Chinese companies have established production bases in Africa to supply the local markets with cheap products highly compatible with local demands and purchasing power.

To establish international image and to raise capital in hard currency, increasing number of Chinese companies have taken a listing on developed stock exchanges as an important internationalization strategy. By 18 December 2003, 93 Chinese companies had listed on developed stock exchanges in Hong Kong, New York, London, and Singapore, and another 73 "red chip" companies, which are registered as Hong Kong companies but controlled by the mainland interests, had listed in Hong Kong. They together have raised equity capital of over US\$100 billion.

To conclude the paper, we would like to suggest two strategic implications for Western multinationals. First, the success of many Chinese companies in competitive industries like electronics and households appliances is built on their competitive advantages that can be still regarded as classic competitive paradigms: more flexible, faster response, more-customer focused and less product-focused, highly valuing the accumulation of minor innovation, and sensitive to both products and R&D niche markets. The

case of Konka is an illustrative example for the merits of such competitive paradigms. The stories of these Chinese companies share a great similarity to the stories of the Koreans about one-decade earlier and the Japanese two or more decades earlier. Moreover, as argued by Jonathan Woetzel, a Shanghai director at Mckinsey & Company Inc, "Chinese companies are more entrepreneurial, flexible and much more focused on profit than the Japanese. They change management and won't be patient. They use capital more efficiently." (*Economist*, 6 September 2003, p. 57). In this connection, the experience of Western companies in competition with Korean and Japanese companies one or two decades ago may be helpful.

Second, Chinese stories renewed the question in the west: why can a company from a developing country with limited resources and weak technological background come to our market and take away our market share? More importantly, the method used by Chinese companies to overcome technological disadvantages deserves more attention. It demonstrates that it is possible for companies from developing countries to overcome technological disadvantages by setting up R&D centers in developed countries and developing strategic alliances with Western companies for technological development. The combination of R&D acquisition abroad and cost advantage at home would bring significant competitive advantages to Chinese companies. Facing new competitors from China, the best strategy for the Western peers to maintain their lead would be to conduct R&D more intensively rather than to simply defend their technologies. It is also worth considering the trade-off of advance and retreat so that the company can focus on its sharp competitive advantage and retreat from those with declining competitive advantage.

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