New Kid on the Block Learning the Rules

Karl P. Sauvant, Columbia University
FITTING IN

New kid on the block 
learning the rules

KARL P. SAUVANT

China has arrived in the 
global outward foreign-direct-
investment (FDI) market. The 
country’s outflows, which doubled 
between 2007 and 2008 to US$54 
billion, held steady during the 
Western economic and financial 
crisis—at a time when world FDI 
outflows halved. When the country’s 
outward investment flows reached 
US$68 billion in 2010, China became 
the world’s fourth-largest outward 
investor (not counting Hong Kong). 
The country’s outward FDI stock 
in 2010 stood at US$298 billion, 
invested in more than 34,000 foreign 
affiliates controlled by some 12,000 
Chinese parent companies. This is an 
impressive performance when one 
considers that, only a decade ago, 
China was a very marginal player in 
the global outward FDI market.

Because Chinese multinational 
enterprises (MNEs) are new kids on 
the block, they face various challenges. 
To begin with, they lack experience in 
establishing and managing integrated 
international production networks, 
and so they need to function on a 
steep learning curve. Meeting the 
internationalisation challenge means 
they not only have to learn how to 
enter foreign markets successfully, but 
to operate and prosper in them as well.

The principal entry mode for many 
firms looking to access international 
markets is through mergers and 
acquisitions—but achieving success 
can prove difficult. Even experienced 
enterprises frequently fail in this 
respect: Daimler Benz’s unsuccessful 
acquisition of Chrysler is a case 
in point. Being a foreigner abroad 
is another liability that Chinese 
enterprises have to overcome. This is 
particularly challenging for Chinese 
firms because the gap between the 
operating environment in China 
and that in many host countries 
(especially in developed ones, in 
which ever more non-natural resource 
foreign investment is taking place) 
is particularly wide. Finally, foreign 
firms need to be good corporate 
citizens in their host countries, which 
requires all sorts of activities—some 
of them involving corporate social 
responsibility. Chinese firms typically 
are not familiar with these challenges,

so their success is tied to retraining 
their executives and staff.

Another set of challenges relates 
to the FDI regulatory environment, 
as this environment is becoming 
less welcoming in a number of host 
countries, especially in developed 
countries. The host country challenge 
is particularly acute when it comes 
to inward mergers and acquisitions 
in sensitive industries, or when 
these involve national champions, or 
when mergers and acquisitions are 
being undertaken by state-controlled 
entities—be they state-owned 
enterprises or sovereign wealth funds.

China suffers in this respect, as 
many countries regard Chinese 
inward investment with suspicion, 
especially when it takes the form 
of mergers or acquisitions, because 
China is a communist country 
and is often considered a strategic 
competitor. In addition, most of its 
outward investment is undertaken by 
state-controlled entities (mostly state-
owned enterprises) that, rightly or 
wrongly, are seen to pursue interests 
beyond the commercial domain, and 
many believe they benefit from all 
 sorts of (financial, fiscal, competitive) 
advantages. It is difficult to gauge the 
extent to which this might be the case 
and to speculate how the situation 
differs from state-controlled entities 
and private firms headquartered in 
developed countries. But it does raise 
the question of ‘competitive neutrality’ 
in the global outward FDI market, 
an issue that is likely to garner more

... mergers and 
acquisitions conducted 
by Chinese firms are 
receiving more regulatory 
attention in a number of 
host countries, similar 
to Japanese firms in the 
1980s

EAST ASIA FORUM QUARTERLY APRIL - JUNE 2012 11
A decade ago, exports were the focus of Chinese commercial activity and the country was only a marginal player in the global outward foreign direct investment market. Now it is among the world’s largest overseas investors.

Attention in the future. The upshot is that mergers and acquisitions conducted by Chinese firms are receiving more regulatory attention in a number of host countries, similar to Japanese firms in the 1980s. This implies that Chinese firms need to be extra careful when expanding abroad in this way: they have to prepare their moves and they need to learn how to navigate the corridors of power in important capitals.

Finally, there is the home country challenge. Chinese firms are lucky in that they benefit, like their competitors headquartered in developed countries, from a regulatory framework that not only allows outward investment but encourages it. (Firms in most other emerging markets do not enjoy this advantage.) But given the relative inexperience of Chinese enterprises, the Chinese government has a particular responsibility to keep an eye on the manner in which China’s outward investment is conducted. Most notably, firms need to be reminded that, since host countries consider foreign investment a tool to advance their development, this investment needs to be sustainable. In other words, FDI needs to take place on the basis of fair-governance mechanisms (especially when it comes to contracts) and contribute as much as possible to the host country’s economic, social and environmental development. If the country’s FDI is not sustainable in this manner, it may well suffer a backlash in the years to come.

All of these challenges can be overcome, but they need decisive action and good will on the part of all concerned. In time, as with Japanese and South Korean multinationals before them, Chinese firms will cease to be the new kids on the block. They will become regular players in the global FDI market, their outward investments improving corporate competitiveness and contributing to the development of host countries.