2014

China Needs 'Going-in' Rules for FDI Goodwill

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Shanghai Daily
June 23, 2014

Shanghai Daily, June 23, 2014 (op. ed.)

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By Karl P. Sauvant and Victor Z. Chen | June 23, 2014, Monday | PRINT EDITION

CHINA’S rising outward foreign direct investment (OFDI) faces rising skepticism abroad. This is partly the result of the leading role of state-owned enterprises in its OFDI (and the fear that it serves non-commercial purposes), the speed with which this investment has grown, and the challenges it poses to established competitors.

Moreover, Chinese multinational enterprises (MNEs) may not always keep in mind that host countries see FDI as a tool to advance their own development and hence seek maximum benefits from it.

To assuage skeptics, avoid backlash and, ultimately, build trust, China needs to complement its relatively well-established “going-out” policy with a purposeful “going-in” strategy that guides the investments of its firms to ensure that FDI projects maximize contributions to host countries’ economic, environmental and social development.

First, a “going-in” strategy should reinforce China’s current regulatory OFDI framework. It already addresses many host country issues, including economic, environmental, corruption, and labor concerns.

However, regulations are typically couched in general language and broad principles, and do not require Chinese investors to comply with clearly defined provisions.

China should reinforce its regulatory instruments by clearly specifying penalties for the violation of any of these instruments.

Second, a “going-in” strategy should expand current efforts. The government could learn from the OECD Guidelines for MNEs.

Many Chinese firms face special scrutiny in some jurisdictions, particularly when entering markets via mergers and acquisitions (M&As).

In response, large M&As must be carefully prepared by taking into account the interests

of affected stakeholders.

Understanding how to navigate the corridors of power in host countries is important, as is coalition-building with local authorities, potential suppliers, etc.

Be it M&As or greenfield projects, in-depth knowledge of a host country's regulatory regime and business practices is required.

Liability of foreignness

To operate and prosper successfully in a host country, Chinese firms need to overcome the liability of foreignness — and, in some countries, the additional liability of being Chinese. They need to integrate into local communities, become insiders and build a positive brand.

This involves extra efforts in sourcing inputs from local firms (giving them a stake in the success of Chinese investors), hiring and training local employees, learning the local language (or at least English), respecting local customs, becoming members of local organizations, and employing corporate social responsibility (CSR) practices.

Third, the effectiveness of any "going-in" strategy requires that the government better monitor and enforce its regulations and guidance, especially for large-scale projects.

A dedicated compliance unit in the appropriate ministry could do this (assisted by China's embassies/consulates), including through on-the-ground inspections. Enforcement could involve both incentives and penalties.

On the incentive side, compliance with economic, environmental and socially sustainable FDI practices could become a prerequisite for the approval of OFDI projects and, indeed, a requirement for obtaining any of the advantages that the government makes available to outward investors.

Criminal penalties

Penalties could include fines, exclusion from doing business with the government and rescinding of the Certificate of Investment Overseas, as well as criminal penalties for,

say, corrupt practices overseas.

Such a strategy could be underpinned by two other initiatives to build trust.

One, China's government could require that a small percentage of parent firms' earnings be dedicated to foreign affiliates undertaking clearly defined CSR activities in host countries (monitored by a board-level CSR committee), creating the financial and corporate governance basis for sustainable FDI.

Two, many of China's OFDI projects are large and require extensive contractual negotiations with host countries to define the projects' economic, environmental and social dimensions.

Typically, least-developing countries' governments do not have the capacity to negotiate such contracts appropriately.

China could take the lead in establishing a global negotiations support facility that provides assistance to host countries in these situations.

China would thereby not only contribute greatly to the development of countries hosting large FDI projects, be it from Chinese or other MNEs, but also improve the stability of the contracts concluded, which is in China's interest. A "going-in" strategy by China along these lines could become a model for other home countries, whether they are developed or developing.

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