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How emerging market governments promote outward FDI: Experience from China[☆]

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ABSTRACT

Large scale outward foreign direct investment (OFDI) by emerging market enterprises has become common in today's business world. Nested within the political economy perspective, this article elucidates why and how emerging market governments enthusiastically stimulate OFDI. Drawing upon our detailed analysis of the Chinese context, we developed the logic that OFDI promotion policies set by emerging market governments are economically imperative and institutionally complementary to offsetting competitive disadvantages of emerging market enterprises in global competition. This study presents the governmental institutions that impact Chinese OFDI, discusses evolutionary changes of OFDI policies, and describes current policies and measures that stimulate Chinese companies to expand into the global market. This article concludes with theoretical and managerial discussions wherein we call for convergence between two seemingly paradoxical views – institutional escapism and governmental promotion – presently used as an institutional logic explicating international expansion of emerging market enterprises.

1. Introduction

Outward foreign direct investment (OFDI) by emerging market enterprises (EMEs) has become increasingly noteworthy and prevalent in recent years. According to WIR (2008), OFDI from emerging and developing economies reached $304 billion in 2007, the highest level ever recorded, constituting a 36.51% increase from 2006. While a small number of source economies are responsible for a large share of such OFDI, companies from an increasing number of countries are undertaking OFDI to expand into the global market. For instance, in 2005, foreign sales and foreign employment of the top 100 transnational corporations from developing economies increased by 48% and 73% respectively. These enterprises also operate in a broader range of industries than the largest multinationals from developed countries, actively participating in a large number of cross-border mergers and acquisitions. This surge has come from the rapid pace of economic development and liberal market policies implemented by home governments, along with offshore availability of market opportunities, entrepreneurial desire to hit key international markets, and strategic intent to exploit competitive advantages in cost-effective massive manufacturing (Luo & Tung, 2007; Mathews, 2002; Rui & Yip, 2008).

This surge is also due, in part, to increasingly favorable measures adopted by home governments in emerging economies. Most emerging economy governments (such as, India, China, and Brazil) now encourage local enterprises to go global (WIR, 2008). Similarly, researchers agree that institutional factors in home countries play an important part in shaping international expansion behavior and the trajectory of emerging market enterprises. However, the regulatory pillar of the home country's institutional environment, particularly specific policies enacted by home country governments, has yet to be systematically examined in the literature, giving rise to an inadequate understanding of the roles of home governments in promoting OFDI and nurturing the growth of EMEs.

Using China as our descriptive and analytical setting, this study is designed to enhance our understanding of an emerging economy government's role in promoting OFDI for researchers, policymakers, and executives. This study enriches the political economy perspective, developing the logic that governmental promotion of OFDI is a legitimate political action needed to help compensate for EMEs' competitive disadvantages and organizational deficiencies so that they can better compete against their much more experienced counterparts from advanced economies. This article

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also illuminates that an emerging economy's government, such as China, is a critical institution that should and can leverage institutional support (financial and non-financial) to EMEs in the process of global competition wherein these businesses suffer from late-mover disadvantages, shortfalls in distinctive capabilities, and liabilities of newness and foreignness. More importantly, *how* emerging economy governments spur the process of OFDI is vital because it determines the actual effectiveness of both policymaking and growth of EMEs. Finally, this article is written for international executives who need to know specific measures emerging economy governments currently adopt so that their businesses can take advantage of these measures or lobby their own governments to mimic what other country governments (like China's) do in creating a more conducive climate to launch offshore FDI.

As the world's leading emerging economy, in terms of market size and growth rate, China is an ideal country to illustrate why and how governments in emerging economies promote OFDI. China represents an appropriate lens through which we can examine the relationship between regulative institutions and OFDI. Over the past 30 years, China has evolved from a marginal player to an important source of OFDI among developing countries. Using China as the illustrative setting, we show why emerging market governments are important institutions in accentuating OFDI and stimulating the growth of EMEs, and how the Chinese government specifically promotes OFDI for the interest of national economic development as well as for the growth of individual Chinese firms.

2. Political economy view of outward FDI

2.1. The theoretic perspective

Political economists have long argued that the interaction between businesses and governments is a complex, dynamic, and interdependent process in which governments create the rules by which businesses must abide, while businesses make efforts to shape governmental policies (Boddewyn, 1988; Kofele-Kale, 1992; Moran, 1985). According to political economy theory, governments are the controllers, regulators, and adjudicators of business sectors. Government creates legislation to regulate the economy, frames the competitive environment and factor endowment, and establishes a regulatory environment in which business is conducted (Henisz, 2000; Kobrin, 1982; Rugman & Verbeke, 1998). Meanwhile, governments seek to maximize social welfare, which is contingent on efficiency, equity, and social considerations. Government policymakers are increasingly aware of the importance of mapping business responses to regulatory changes. A failure to adequately capture such responses may render those changes not only ineffective, but counterproductive (Kogut, 1991; Murtha & Lenway, 1994; Ring, Lenway, & Govekar, 1990). Furthermore, government is not exogenous to the economy. Instead, the institutional environment can be shaped by the organization since businesses can internalize government decision-makers and leverage their bargaining power as they create the capital to fund a stronger nation and bolster the nation's competitiveness (Boddewyn & Brewer, 1994; Luo, 2001; Moran, 1985). As emerging economies are more intensively engaged in global competition, enterprises in these economies become increasingly important to governments when these enterprises have a heightened role in accommodating their governments' social and economic concerns, such as steering economic growth, advancing technological infrastructure, and enhancing national competitiveness (Luo, 2001; Ramamurti, 2001; Zhang, 2003).

Corroborating our logic, we suggest that governments of emerging economies can, and should, promote OFDI. Political and economic events in the global economy, coupled with a new generation of technological advances, have spawned a new scenario for emerging market governments in which they support local firms to "go global". A home country government can be a powerful ally to EMEs, offering various institutional supports, such as (1) offering fiscal incentives (e.g., tax incentives, tax deductions, low-interest loans), (2) providing insurance against political risk, (3) assisting the private sector in international expansion through government agencies (e.g., Chamber, or Ministry, of Commerce, National Business Council, etc.), (4) signing double taxation avoidance agreements, (5) enacting bilateral and regional treaties to protect investment abroad, (6) arranging a bilateral or multilateral framework to liberalize investment conditions in host countries, and (7) helping EMEs deal with a host country's governmental or legislative institutions at the collective level, among others. EMEs are deemed to benefit from these institutional supports through reduced political risk and transaction costs along with improved financial leverages. With accumulated experience and understanding of global markets, both EMEs and their home country governments have become more familiar with the conditions under which one may contribute to the other's well-being. Emerging economy governments, in particular, have made progress in their knowledge and understanding not only of the costs, risks and benefits of OFDI, but also of the implications of being integrated into the global economy through OFDI and the actions taken by EMEs.

The political economy theory further suggests that, as businesses and governments become more interdependent, governments will be able to play a more significant role in shaping business activities and behaviors (Boddewyn, 1988; Moran, 1985). In order to foster closeness between national economies and world economies through the flow of resources, goods, services, people, technologies, information, and capital, emerging economy governments promote OFDI through which EMEs integrate their resources, products and knowledge on a global, rather than domestic, basis. When the home country's degree of openness and internationalization is higher, EMEs can benefit more from efficient flows of production factors within their globally coordinated networks. Thus, they can better arrange global value chains through vertical or horizontal integration. Through OFDI, especially as it leads to forging global strategic alliances, EMEs can improve technological, organizational, and managerial skills. When these skills are transferred back home and extended to local firms, firm-level capabilities are strengthened as a whole, thus fortifying national competitiveness.

2.2. Political economy in China

The Chinese government's decision to 'go global' certainly incorporates a political dimension and is based on appeals to national interest and the need to increase the efficiency of Chinese enterprises and the Chinese economy. China's initial response to globalization in the late 1970s was largely passive, focusing on FDI inflows rather than FDI outflows (going global). The early years of the 21st century have witnessed a growing awareness on the part of both government and Communist party leaders that globalization offers China an opportunity to project its influence and power beyond the boundaries of the Chinese nation-state. China could operate on the global stage in a far more proactive and energetic manner than had hitherto been the case (Knight, 2008). These leaders realized that China might be able to participate in globalization in novel ways that would materially facilitate China's 'rise' and fortify its influence, regionally and globally, over the structure and protocols governing international politics and the world economy. This, in effect, has ushered in a new phase in Chinese discourse on, and politics of, globalization, enabling China's economy to more effectively integrate with the international economy and improve its cooperation with other developing