Business Horizons (2007) **50**, 71—81

Available online at www.sciencedirect.com

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Investing for strategic resources and its rationale: The case of outward FDI from Chinese companies

Ping Deng

John E. Simon School of Business, Maryville University of St. Louis, 13550 Conway Road, St. Louis, MO 63141, USA

KEYWORDS
Chinese MNCs;
FDI;
Resources;
Strategic needs;
Competitive advantages

Abstract As more Chinese companies become engaged in foreign direct investment (FDI), particularly in industrial countries, a crucially important issue must be addressed: what is the motivation of Chinese outward FDI, and what is its rationale? Based on a detailed analysis of both primary and secondary data sources, this article argues that when investing in advanced economies, Chinese multinational corporations (MNCs) are motivated primarily by the quest for strategic resources and capabilities, and that the underlying rationale for such asset-seeking FDI is strategic needs. The examination of this premise will hopefully prompt business practitioners to think about this important issue in new and innovative ways, thereby identifying an appropriate policy and strategic response.

1. Outward FDI from China: A closer look

As a rapidly emerging economy with great global impact, China is attracting enormous attention for very good reasons. After more than two decades of unflagging expansion, China has become a leading economic power in the world. The country has been the second largest recipient of inward foreign direct investment since 1992 and the third largest trading nation in the world since 2004, and boasted a record trade surplus of $102 billion in 2005. At the same time, China's outward FDI has grown rapidly; in fact, the country has the largest FDI outflow among emerging economies, with a cumulative investment exceeding $50 billion (www.mofcom.gov.cn; UNCTAD, 2005). Despite this fact, outward FDI from Chinese multinational corporations (MNCs) has received relatively little research attention (Child & Rodrigues, 2005), particularly from the asset-seeking perspective. As latecomers, in order to catch up with the incumbent global giants, Chinese firms face an urgent need to engage in asset-seeking FDI.

Because the motivation for foreign investment largely underlies the very nature of MNCs and their behaviors, an explicit understanding of why Chinese firms invest abroad is critical (Caves, 1996). This issue has significant implications for business practices and is necessary to propose adequate policy responses. With motivations being of such critical importance, this article focuses on the asset-seeking motivation of Chinese outward FDI and the rationale behind it. In essence, this article contends that when Chinese MNCs invest abroad, particularly in industrial countries, they are moti-

E-mail address: pdeng@maryville.edu

doi:10.1016/j.bushor.2006.07.001

vated primarily by the quest for strategic resources, the logic of which can be attributed to strategic needs. By arguing that Chinese outward FDI represents a means to acquire critically needed resources and competencies in the logic of strategic considerations, this study is of great interest to business practitioners, and will hopefully prompt them to think about this issue in new and innovative ways. For an effectively analytical result, we begin by highlighting some of the recent features of outward FDI from Chinese MNCs that are particularly relevant to the asset-seeking investment motivation.

2. Characteristics of outward FDI from Chinese firms

Over the past 26 years, China has made extraordinary strides in attracting foreign investment. Compared to this inward trend, outward FDI from China seems much less significant. Nonetheless, following rapid growth of FDI outflows in the 1990s, China became the second largest outward investor among all emerging countries by 2002; by 2004, 5,163 Chinese firms had invested a total of $44.8 billion abroad (MOFCOM, 2005). While Chinese MNCs have invested on a global basis, they have exhibited a strong investment concentration in a small number of destinations, particularly Hong Kong and the United States. For example, for the period spanning 1979—2002, approximately 62% of China's approved cumulative FDI outflows went to four top destinations: Hong Kong, the United States, Canada, and Australia (UNCTAD, 2005).

Unlike MNCs from other emerging economies, which typically invest in neighboring countries that feature levels of development similar to or lower than their own (Kumar, 1998), Chinese MNCs tend to invest more in higher income or industrial countries because of their superior investment environment, high technology, and advanced management methods. Supporting this assertion, Wang (2002) noted that, excluding Hong Kong and Macau, more than 70% of Chinese overseas subsidiaries were established in industrial countries. Moreover, Chinese firms are especially active in establishing research and development (R&D) centers, and setting up design institutes in industrial countries. According to the U.S. Bureau of Economic Analysis (BEA, 2005), as of 2002, Chinese firms had established in the United States 646 R&D centers or affiliates, 609 of which were in manufacturing and 33 of which were in chemicals. Chinese outbound FDI is characterized by two significant and distinct features: the critical role of the Chinese government and the increasing use of mergers and acquisitions (M&As) as a mode of entry. Both of these factors are extremely important to strategic asset-seeking FDI from Chinese MNCs.

As Deng (2004, p. 14) observed, "(the) Chinese government has, to a great extent, played a crucial role in shaping the structure of China's approved outward investment." Since the turn of the 21st century, the Chinese government's role seems to have evolved into a much more strategic one, giving encouragement and support for key firms to globalize within the rationales of their own needs and policies, particularly in the context of dramatic increase of foreign exchange reserves (Child & Rodrigues, 2005). Chinese policymakers have widely recognized outward investment as a necessary stage of growth for Chinese companies and as a precondition of their ability to compete in global markets (www.mofcom.gov.cn).

In October 2000, the Chinese government formally announced the "go global" strategy as part of its long-term, innovation-oriented development plan. In the context of the "go global" strategy, the government promulgated a series of regulations and circulars in order to improve their competitive positions and secure an international business presence. Additionally, China is the only Asian government which not only actively facilitates and encourages outward FDI, but also explicitly encourages investment in R&D (UNCTAD, 2005). For example, in a circular issued in October 2004, the government specifically encouraged Chinese firms to invest in overseas R&D centers that could "utilize internationally advanced technologies, managerial skills, and professionals." Such encouragement reflects the Chinese government's efforts to enhance China's innovative capability by leveraging foreign resources. Significantly, in September 2004, the China International Fair for Investment and Trade, the sole national event focusing on FDI, placed equal emphasis on attracting foreign FDI and encouraging outward FDI.

The crucial role Chinese government plays in outward FDI can largely be explained by the country's current political and economic systems. Despite the development of a market system, China remains a political economy characterized by active governmental involvement in business, both through ownership and through regulation. Chinese industries consist of state-owned enterprises (SOEs), which are owned directly by the central government or provincial or municipal governments, and non-state-owned enterprises (NSOEs), which are owned by township or village governments, and urban collective firms and private firms. Although not quite as vital to the Chinese