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THE ROLE OF CONTEXT IN THE GLOBALIZATION OF CHINESE FIRMS

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Abstract

This paper argues that it is crucial to take account of both home and host country contexts in order adequately to understand their implications for Chinese enterprises investing into foreign countries. This calls for an analysis that is sensitive to *both* home and host country contexts, and that takes into account how the institutions and political systems in those contexts establish institutional and resource capital needs for the overseas-investing firm. We discuss and illustrate three different conjunctions of Chinese and host country characteristics, and the firm-level learning and adaptation required in the light of the relevant capitals likely to be available to Chinese firms. The analysis draws upon insights from resource-based, institutional and political perspectives. While it is developed with specific reference to China, we also suggest that this form of analysis can be applied more generally to the implementation of outward foreign direct investment from any country.

Keywords: Adaptation, China, Context, Firm, Government, Home country, Host country, Institutional capital, OFDI, Resource capital

THE ROLE OF CONTEXT IN THE GLOBALIZATION OF CHINESE FIRMS

The rapid expansion of outward foreign direct investment [OFDI] from China has been a new and significant development in international business during the past decade. The rise in China's OFDI was particularly marked after 2005 as its 'go global' strategy was consolidated and government restrictions were progressively eased to ensure political support for OFDI (Salidjanova, 2011). It expanded from an annual flow of under US\$100 million in the 1980s to approximately US\$10 billion by 2005, surging to US\$84 billion by 2012 (UNCTAD, 2013). Even in 2010, when global OFDI levels fell dramatically as a result of the financial crisis, Chinese non-financial OFDI recorded a year-on-year increase of 25.9%. It represented 5.1% of global OFDI flows placing the country as the 5th largest provider of OFDI in the world (MOFCOM, 2011; Peoples' Bank of China, 2011; The Heritage Foundation, 2012). By 2012 Chinese OFDI stock had reached an estimated US\$509 billion (UNCTAD, 2013).

The marked increase in China's OFDI has understandably attracted growing attention among both academics and politicians. It raises a number of important theoretical and policy issues. To date, more attention has been given to the motives behind Chinese OFDI than to how it is negotiated and implemented in different host country contexts (e.g. Buckley et al., 2007). China has been seen to qualify, even challenge, the conventional analysis that the internationalization of firms is motivated by opportunities to capitalize on ownership, location and internalization (OLI) advantages. It has been asked whether we need an alternative analysis that is better suited to emerging economies in which firms may not possess such advantages (Child & Rodrigues, 2005; Dunning, 2006; Mathews, 2006; Narula, 2006; Rugman, 2009; Ramamurti and Singh, 2009; Boston Consulting Group, 2011; Marinov and Marinova, 2011).

One reason why China can be regarded as a different case concerns the suspicion that the motives for its overseas investment are informed by a political agenda. The heavy state guidance of much Chinese OFDI suggests that it is an orchestrated arm of the country's foreign policy, motivated by the country's strategic interests (Zhang, Zhou & Ebbers, 2010; Luo, Xue & Hun, 2010). The assumption that this is the case has led to opposition to Chinese acquisitions in Australia and the United States (Scott, 2009; Hanemann & Rosen, 2011) and to debate over the motives for, and impact of, Chinese investment in sub-Saharan Africa (Van Dijk, 2009; Brautigam, 2010). In this way, the motives for Chinese OFDI connect to both its home and host country contexts.

It is the contention of, and justification for, this paper that it is crucial to take account of both home and host country contexts in order adequately to understand their implications for Chinese enterprises investing into foreign countries. The extent to which the internationalization of Chinese firms has been assisted by support from their home context, as well as their capacity to adjust to conditions in their host contexts deserves closer attention than they have received so far. It is our aim to propose a framework that develops this analysis and also to indicate how it can enhance our understanding of the advantages and disadvantages attending Chinese OFDI as well as the contingent adjustments that foreign investing Chinese firms may have to make. We believe that such a framework could have wider relevance, especially for OFDI from other emerging economies characterized by strong government intervention.

There are several requirements to meet this aim and these give rise to the sections that follow. The first requirement is for a more refined conceptualization of 'context' than has generally been employed in international business analysis. The key aspects of home and host country contexts relevant to internationalization need to be identified. For a more adequate

understanding of context, a socio-political perspective has to be added to the economic one prevailing in the literature. This perspective would help highlight the significance of institutional and political aspects of country context. It would assist our appreciation of the contrasting characteristics of business systems in different contexts. For example, much western-informed international business literature differentiates between business and government, or the firm and the country levels of analysis. This distinction is far less tenable in a context such as China, soon to become the world's largest economy. The active involvement of the Chinese state in firm internationalization policy, and its associated support can extend to bilateral agreements on host country conditions for Chinese firms of a kind that would be alien to western countries. Such agreements can stabilize host country environments, and offer incoming firms exemptions from employment and tax regulations and other privileges.

Having incorporated the institutional and political dimensions of country context, a second requirement is that account be taken of both home and host country contexts *together*, giving attention to the implications of different conjunctions of the two that are created by variations in host country conditions. Most existing literature on internationalization fails to consider the combined implications of home and host country contexts. It is the conjunction of home and host country-specific advantages and disadvantages (CSAs and CSDs) that define the conditions under which firms internationalize (Rugman and Li, 2007). These conditions determine the human and other resources that are available in their domestic and host contexts as well as the institutional capital available to the firms.

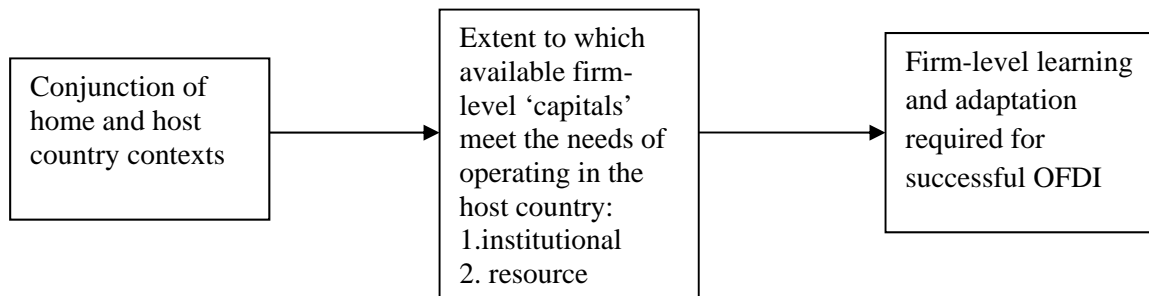
A third requirement therefore is to apply an essentially resource-based view of the firm to identify the resource capital and institutional capital required for successful OFDI and whether these can be supplied from the home or host country context. Resource capital in the context of internationalization refers to the value-enhancing assets and competencies that a

firm requires for successful operation in a foreign host country. It includes the staffing of its foreign operations and the practices it follows in them. Institutional capital refers to the ability to accommodate to and/or manage relations with domestic and foreign institutions in ways that also enhance international performance (Oliver, 1997). Our use of the term ‘capital’ will be with reference to these two concepts.

The motives for OFDI are relevant to this issue, particularly whether internationalization is motivated primarily by asset-seeking or by opportunities for asset-exploitation in customer-driven markets. If the former, as with OFDI into primary industries, the resource capital required will be primarily that for achieving ‘exploitation’ - operating existing technologies and managing local labor (March, 1991). If the latter, then the ability to ‘explore’ may be required, including acquiring an understanding of local markets and possibly innovating to suit local expectations. Competence in managing global value-chains may also be necessary. The general question that arises is whether the resource and institutional capitals to support OFDI by Chinese firms are available from domestic sources or have to be secured from the host country. Again, this means that account needs to be taken of both home and host country contexts.

The nub of our argument, in short, is that the globalization of Chinese firms calls for an analysis that is sensitive to *both* home and host country contexts, and that takes into account how the institutions and political systems in those contexts establish requirements for institutional and resource capital on the part of the overseas-investing firm. It is therefore necessary to consider the implications for successful Chinese OFDI of *different conjunctions of home and host country* characteristics. A basic representation of this argument is given in Figure 1. It draws upon insights from resource-based, institutional and political perspectives. While we now develop the argument with specific reference to China, we also suggest that it can be applied more generally to the implementation of OFDI from any country.

Figure 1. Basic representation of the argument



Country context – China and OFDI host countries

There is considerable variation in the geographical destinations of Chinese OFDI as well as in its industry distribution. It is widely dispersed and truly globalized: in 2011 there were Chinese foreign investments in 178 countries or territories, including Hong Kong and Macau (MOFCOM, 2012). By far the largest stock of OFDI has officially gone to Hong Kong, but a substantial amount of that is suspected to be ‘round-tripping’. If we exclude Hong Kong, Macau and tax havens, the stock of Chinese OFDI was, as of 2012, distributed primarily among the following host locations: Australia, Singapore, Canada, the Central Asian republics, European Union, Russia, Nigeria, Iran, Brazil and the USA. Sub-Saharan Africa accounted for a relatively small but fast growing stock of Chinese OFDI. While some high profile Chinese overseas investments have attracted media attention, the typical pattern is of investments of less than US\$10 million. Acquisition of local companies is the most common vehicle for Chinese OFDI (Luo & Tung, 2007; Li, 2007; MOFCOM, 2012). Although China’s OFDI stock is heavily weighted towards developed countries, it is also growing in certain emerging economies, which are rich in natural resources and which in some cases like Brazil and South Africa also offer sizable domestic markets.

China's OFDI stock is spread across many industries. The largest portion is in business services mainly helping to promote the export of Chinese goods. The energy sector accounts for the next largest portion, followed by the extractive, transportation and manufacturing sectors (MOFCOM, 2011, The Heritage Foundation, 2012). Different sectors require different types and levels of skill and managerial expertise, the limited availability of which in some host countries can present an adaptation problem for Chinese investing firms. The combination of host country context and industry is therefore likely to be of considerable operational relevance.

Most of the country's OFDI has been made by state-owned enterprises [SOEs] which remain a major component of China's "centrally managed capitalism" (Lin, 2010) or "network capitalism" (Boisot & Child, 1996). Foreign investment by Chinese SOEs is accompanied by heavy government involvement intended to ensure that foreign investments in so-called 'strategic' industries will be aligned to the country's long-term development policies (Salidjanova, 2012). The proportion of OFDI made by SOEs stands officially at 68 percent of the total, though the definition of an SOE is not always precise and the exact proportion of OFDI made by non-state enterprises is not known. The Chinese government's 'going-out' strategy has been directed primarily at SOEs, and provides for simplified approval processes, tax relief, favorable exchange rates, low-interest loans, subsidized insurance for expatriates, and advice on host country conditions (Luo et al., 2010). The ownership status of Chinese overseas-investing firms is significant because it is associated with a different level of support and protection from the home government. The relevance of home context for Chinese OFDI is therefore conditional on the ownership of the internationalizing firm. In addition to the specific supports for Chinese OFDI, government-to-government agreements can stabilize operating conditions for Chinese firms in a risky foreign

environment through inter-state bilateral economic agreements or aid arrangements. Again these benefits are more likely to be made available to SOEs.

The variation in the destinations of Chinese OFDI and its spread across different sectors and categories of firm ownership thus needs to be taken into account because it has potential implications for the host country conditions that Chinese firms experience, for the extent of support they are likely to receive from their home government, for the challenges they are likely to face in their foreign operations, and for the competencies required to meet such challenges. In particular, the wide range of host countries for China's OFDI brings different contextual conditions into play.

The analysis of context

This leads onto the question how to analyze country context in a way that is theoretically relevant for OFDI. The point of departure for developing analytical sensitivity to 'context' is how to conceptualize it. Context is defined in common parlance as 'the circumstances that form the setting for an action, event, statement, or idea, and in terms of which it can be fully understood' (Oxford Online Dictionary). The danger is that such a broad concept can mean all things to all people, especially if they approach the subject through the lenses of different disciplines. It is suggested here that two aspects of country context are particularly relevant for OFDI: the political stability of the country and its institutional maturity.

Political instability, especially in host countries, has often been regarded as harmful to OFDI insofar as it introduces additional uncertainty and risk (e.g. Lucas, 1990). While 'political stability' is a concept that we frequently employ in everyday discourse, its precise definition and measurement is not so straightforward (Ake, 1975). Ake suggests that political

instability can be assessed as the proportion of actors in a political population who violate the existing system of political exchange. The World Bank bases its assessments of 'political stability and absence of violence' on perceptions of the likelihood that the government will be destabilized or overthrown by unconstitutional or violent means, including domestic violence and terrorism (World Bank, 2011). The Economist Intelligence Unit's 'Political Instability Index' is based on four factors that have been found to predict social and political unrest (EIU, 2009). These are the level of development; extreme cases of economic or political discrimination against minorities; the presence of neighbourhoods that have suffered violent conflicts; and 'intermediate regimes' (those that are neither consolidated democracies nor autocratic regimes combined with the existence in these regimes of intense factionalism in domestic politics). The last criterion recalls the fact that political stability does not necessarily equate with the degree of democracy prevailing in a country. Indeed, comparative evidence suggests that stable autocratic regimes pose no more threat in terms of expropriating foreign investment in their countries than do democracies that are relatively unstable (Li, 2009). For present purposes a country's political stability can be said to be greater if its governance system enjoys popular legitimacy, if changes in government are orderly, and if the policies of different governments exhibit substantial continuity.

Institutional maturity refers to a situation in which a country's institutions, such as its legal system and regulatory authorities, function in a transparent manner, adhering to clear rules that are applied in a universalistic manner to all citizens. While mature institutions are subject to legislated change, they are protected from behind-the-scenes political interference. Another indication of institutional maturity is that institutional agencies function efficiently and without undue bureaucratic obfuscation. The World Bank's annual country ranking of 'Ease of Doing Business' in terms of ten indicators provides an indirect assessment of institutional maturity (World Bank, 2012). The indicators cover matters such as ease of

starting a new business, registering a business, obtaining credit, enforcing contracts, protecting investment, paying taxes and closing a business. The World Bank assessment indicates that from the point of view of business, the developed economies of the Organisation for Economic Co-operation and Development are institutionally the most mature, while those of Sub-Saharan Africa and South Asia are the least.

While they may impact on each other, political stability and institutional maturity are not the same phenomena. They may tend in the long term to go together in a complementary manner, so that political stability gives scope for more adequate institutional arrangements to be enacted while institutional maturity can help stabilize political governance by encouraging inclusiveness and non-discrimination. This is because the interaction of the two phenomena largely accord with the positive relation between the codification and diffusion of information (Boisot, 1986). Institutional maturity is normally manifest in a high level of codification of the rules of public and social behavior which facilitates their wide and universally-based application through a society (high diffusion). The high diffusion of social rules should help secure a broadly-based legitimacy for political power and hence increase political stability. However, even if political stability and institutional maturity are complementary in the long term (which is one of the justifications advanced for democracy), there are situations in which they do not go together. Thus, mature institutions can, at least for some time, maintain an orderly business environment in a country that is experiencing political instability in terms of a frequent turnover of governments, examples being the French Fourth Republic and more recently Belgium. Equally, if political stability is based on the presence of an autocratic regime, this may inhibit maturity in the country's institutions. For this reason, it is appropriate to treat the two features separately. This gives rise to the four combinations shown in Figure 2, which offers a comparative framework.

Figure 2. Countries categorized according to their political stability and institutional maturity

		Institutional Maturity	
		High	Low
Political Stability	High	A <i>United States, Canada, North and West European countries, Australia, New Zealand</i>	B <i>China, Central Asia republics, South Africa</i>
	Low	C <i>French Fourth Republic, Belgium</i>	D <i>Sub-Saharan Africa</i>

Adapted from Rodrigues (2010)

An analysis informed by the identification of political stability and institutional maturity offers a potentially useful tool for understanding the nature and significance for Chinese foreign-investing firms of contrasts between home and host country contexts. Country differences are realities that such firms have to address. Sometimes they create risk for OFDI; other times they lead to entry barriers. Thus political instability and institutional immaturity in host countries tend to present high levels of risk, although many may be receptive to inward FDI. By contrast, some politically stable and institutionally mature countries may erect barriers to Chinese OFDI driven by domestic political pressures arising through highly developed systems for expressing local interests. The extent and nature of the inter-country difference also carries implications for the competencies and knowledge required to meet the challenges that arise. If these competencies are available to firms, the

impact of country-specific factors may be moderated by firm-specific ones (Marinova, Child & Marinov, 2012).

As the home context for OFDI, we would classify China into category B of Figure 2. This classification is more contentious for political stability than it is for institutional maturity. China scored only 24 out of a possible 100 for the year 2010 on the World Bank's 'political stability and absence of violence' index. This suggests that China is a country that has low political stability. Certainly, tensions remain between reformers and conservatives within the ruling communist party, and the authorities continue to fear social unrest. On the other hand, despite the turmoil of 1989, China has enjoyed a long period of political continuity since the mid-1970s, and it has also achieved a peaceful mode of leadership succession (Harding, 2011). Although the regime depends on pervasive control by the Communist Party, this mode of governance does not transgress traditional Confucian values and it has in the past two decades enjoyed substantial popular acceptance.

China ranked 91 out of 185 on the World Bank's 2012 'Ease of Doing Business' assessment which denotes limited institutional maturity. The country's institutional immaturity arises partly from the continuing tendency for the application of institutional rules to be subject to political criteria and active interference by government and party officials. It also reflects a shortage of professional personnel to implement laws and regulations.

This home country environment has important implications for the globalization of Chinese firms. Government policies are supportive of OFDI, and can be relied upon so long as the foreign investment projects accord with national strategic priorities which privilege certain industries and host countries. If OFDI projects meet government criteria, assistance is made available to firms in the form of low-cost finance, diplomatic support overseas, and (where required) business services from other Chinese firms operating the foreign territory

(Luo, Xue & Han, 2010). These are potentially significant CSAs especially in host country environments that lack intermediate markets and other resources and/or which are politically unstable. In other environments such as the United States, the close association of large SOEs with the Chinese government has furnished a political excuse to deny Chinese firms opportunities for market entry through the acquisition of local companies. In the latter case, China as the home country creates CSDs for globalizing firms. The high transaction costs that domestic institutions create for Chinese firms has also been argued to be a CSD that motivates such firms to move or expand to foreign environments (Witt & Lewin, 2007).

Our argument is that it is the combinations of home and host country contexts that are particularly consequential for Chinese OFDI and we can now examine such combinations in terms of the categories identified in Figure 2. Category C in the figure is a rare combination, arguably illustrated by the unusual linguistically fractured case of Belgium, and it will therefore not be addressed further. We start with the United States, which clearly falls into category A of the figure, as a host country context for Chinese OFDI. Other host countries falling into the same category include Australia, Canada and the north European members of the EU.

When the host country for Chinese firms is in category A, its home context can be disadvantageous for several reasons. First, China as the home base of investing firms generates opposition on grounds of its lack of transparency and suspected state manipulation which host-country opponents of the investment claim constitute violations of their country's institutional norms. Another pretext for opposition in the USA to Chinese OFDI lies in China's own diminishing openness to inward foreign investment and its new framework for subjecting inward investment to national security screening (Hanemann, 2011). Moreover, the openness of the political system in the United States makes it easier for opposition to be

mobilized and more difficult for confidential inter-governmental understandings facilitating foreign investment to be reached. For example, Huawei has been trying to expand in the US since 2008 and has been thwarted repeatedly as US lawmakers raised opposition about security risks from the Chinese company. In early 2011, Huawei withdrew its purchase of California-based 3Leaf Systems patents, in compliance with a recommendation by the US Committee on Foreign Investment. Prior to this, Huawei failed in bids to acquire other companies including the 3Com Corp in 2008 and 2Wire and Motorola's wireless business in 2010. Political opponents of Huawei's planned acquisitions of American firms claim that the company has close ties with the Chinese military, receives financial support from the Chinese government, and poses a threat to national security. In October 2012, the US House Intelligence Committee urged that American companies should not do business with Huawei, and a smaller Chinese telecoms equipment company ZTE, and that these companies should not be permitted to acquire or merge with American firms on the grounds that their links to the Chinese government pose a national security risk (US House of Representatives, 2012).

Another obstacle facing Chinese firms seeking to invest in category A host contexts is that, by and large, Chinese executives are not familiar with how to act in a highly sophisticated market and mature institutional system. The modes of lobbying and public relations that are institutionally accepted in such countries (Barley, 2010), contrast markedly with those operating in China.

In view of these issues thrown up by the combination of China (category B) and the United States (category A) as respectively home and host contexts for Chinese OFDI, Karl Sauvart (2011) of the Vale Columbia Center on Sustainable International Investment has identified the requirements for such OFDI to be more acceptable in the USA and other category A countries. First, China must develop and enforce greater standards of transparency

both for its SOE sector and for privately-owned businesses. The issue here is that China's regulations and legal frameworks are not at present compatible with the desire of Chinese multinationals to operating in the United States and other OECD economies. In Sauvant's words, 'the country must develop and enforce greater standards of transparency both for its SOE sector, but also for privately owned businesses. Doing so would help answer questions which range from what sort of influence the Communist Party has on procurement policy and technology transfer, to more easily addressed questions over whether accounting standards are being held to international standards'.

Second, executives in Chinese firms have to become more cognizant of the cultural expectations that prevail in such host environments. Thus, 'Chinese firms need to internalize the subjective standards that come with operating in a foreign culture...how you do business, how you get permission to do certain things. Chinese executives need to understand how you behave in a highly sophisticated market with established institutional systems like those in the US'. Third, Chinese investors need to be educated on how to navigate the corridors of power in Washington. This would help them assess realistically whether proposed Chinese OFDI projects in the USA will be politically acceptable.

Host countries located in category B of Figure 2 are like China characterized by a relatively high level of political stability combined with relatively low institutional maturity. Economic relations in such countries are highly embedded in the political system and are informed by political objectives. Government intervention in business is high and not transparent. While laws and regulations have been enacted that may formally conform to high international standards, their local interpretation and implementation is often opaque and subject to behind-the-scenes arrangements.

When the host country for Chinese OFDI is located in category B of Figure 2, its home context (China) is advantageous because of the similarity in the two countries' political and institutional systems. This reduces the learning that Chinese firms require to build institutional capital in those countries, especially in terms of how to relate to less democratic governments. In addition, understandings are often reached between the Chinese and host governments, sometimes backed by substantial Chinese monetary aid, which lead to local institutional regulations being 'accommodated' to the requirements of Chinese investing firms. The understandings are reached with relatively stable and centralized regimes and as a result they can be relied upon over the time-period of the investment.

Kazakhstan provides an example of the benefits to Chinese OFDI of the similarity of many features as between the home and host context. Chinese OFDI to that country has grown rapidly since 2000 – totaling some US\$13billion by 2012 (Tengri News, 2012). While the oil and mineral resources of Kazakhstan provide a material incentive for Chinese investment, the country's political and institutional context also assists its implementation. Kazakhstan has had the same political regime since its independence in December 1991 which denotes high stability. The country's institutions continue to be less than fully mature in terms of their transparency and universalism, although its periodic elections have over time have moved closer to international standards, and its World Bank rankings in terms of ease of doing business have steadily improved.

O'Neill (2009) has described the significance for Chinese OFDI of this relatively favorable host country political and institutional context as follows:

'Chinese government policies, both financial incentives for Chinese firms as well as loans for the Kazakh government, push state owned enterprises (SOEs) to invest there...these policies provide protection for Chinese SOEs given the weak rule of law

and high corruption in Kazakhstan...Chinese foreign aid constrains Kazakh leaders from acting against the interests of Chinese firms...foreign aid buys the support of the Kazakh leadership for Chinese investments by creating a win-win status quo for both governments. The Chinese government secures access to much needed resources and potential profits for Chinese state owned firms. The Kazakh government receives financial resources from China that leaders can use to provide public goods for the people of Kazakhstan or private goods for key members of the government and their families and supporters. These resources are especially welcome at present given the economic downturn stemming from the global financial crisis.'

Most sub-Saharan African countries fall into category D of Figure 2. Countries in this category are characterized by economic relations that are deeply embedded in political relations and are often shaped by personal or factional (sometimes tribal) objectives. Their political regimes are in many cases fragile and unstable. Decisions on business-related matters are frequently made through personal and secret channels, often subject to corruption. Their institutional systems are immature with limited transparency and official accountability.

In a host country context of this nature, Chinese firms may be able to benefit from understandings they and/or their government makes with local politicians. In reaching such understandings, they may be prepared to overlook local governance practices at which investors from western countries would probably balk or be prohibited by their host country laws from participating in. The Chinese embassy, specifically its economic section, is typically the most important contact for Chinese investors. In Zambia for example, 'investors get advice on investment options and crucial support to establish contacts with Zambian

authorities and the Zambian elite. The Embassy is the extended arm of the Chinese political leadership and it is directly involved in investment negotiations' (Bastholm & Kragelund 2009: 126). However, while Chinese investors may reach accommodations with category D host countries more easily than those from some other countries, the institutional capital that is built up can fall foul of political instability and thus prove short-term and vulnerable. As Zheng Chao, commercial counsellor at the department of outward investment and economic cooperation at the Ministry of Commerce admitted, the prospects for Chinese OFDI in Africa are 'not as good as expected', because of political instability (*China Daily*, June 5, 2011).

The availability of trained and disciplined local personnel in sub-Saharan Africa is often limited. For this reason, Chinese OFDI there is frequently accompanied by a heavy deployment of Chinese managers and workers. It has been estimated that there may be around one million Chinese personnel working in Africa (van Dijk 2009). Limited local job creation is one of a number of factors that have given rise to local criticism. Among others are reports of slack safety standards and the harsh treatment of African labor (for instance in Zambia), and a limited participation of African partners and of technology and knowledge transfer despite professions to the contrary (van Dijk 2009). Smaller private Chinese firms compete with local firms in sectors such as plastics goods and textiles. For their part, Chinese personnel complain of high personal security risks and arbitrary treatment by officials in countries such as Angola (Faucon & Su 2010). The latter problem has been attributed to the institutional immaturity of the country:

'According to human rights group Amnesty International, [the] law "is vague and does not enable individuals to foresee whether a particular action is unlawful. It basically means that any act which the authorities say is a crime will be a crime even if this was not stated in law at the time the act was committed' (Faucon & Su 2010: 14)

The stock of Chinese OFDI in sub-Saharan Africa remains below that invested in Asia and Europe but it is growing steadily. South Africa, Nigeria, Zambia and the Congo DR have received the largest amounts. The Chinese policy that accompanies this investment has attracted considerable attention, partly because China is seen as replacing the former colonial powers as the major influence in the region. This new ‘Beijing Consensus’ contrasts with the Washington Consensus enunciated by Ronald Regan and Margaret Thatcher (see Table 1). Under the Beijing consensus, the Chinese government plays a leading economic role. In return for not imposing conditions for the soft loans that it is prepared to offer African regimes, the Chinese authorities negotiate to pave the way for Chinese companies to have a free hand to import their own staffs and apply their own practices and technology, with little transfer of knowledge and experience taking place.

Table 1. Economic implications of Washington versus Beijing Consensus

Washington consensus	Beijing consensus
<ol style="list-style-type: none"> 1. Free markets and important role for the private sector 2. Loans but under strict conditions 3. Projects: use local companies to create employment 4. Transfer of technology, knowledge and experience (capacity building) 	<ol style="list-style-type: none"> 1. Important role for the government in the economy 2. No conditions for soft loans 3. Use Chinese companies, employment and technology 4. No transfer of knowledge and experience

Source: van Dijk, M.P. (ed.) 2009. *The New Presence of China in Africa*. Amsterdam University Press: 22.

Chinese OFDI in Africa has become a politically sensitive issue which has provoked a debate over whether the Chinese contribution to African economic development is more

effective than that from the West. Critics point to the limited creation of new local employment and the low transfer of technology as negative aspects of Chinese OFDI. The tendency for Chinese firms investing in Africa to import their own resource capital by relying on their own staff, technology and practices to a greater degree than is found, say, in category A host countries, raises the wider question of how host context is relevant for firm-level staffing and practices.

Implications of host country contexts for Chinese firms

In the case of China, some home country features are CSAs that nearly always translate into firm-specific advantages (FSAs). The provision of low-cost finance and the overcoming of intermediate-level market imperfections such as in the provision of working capital, are examples. In the area of technology and managerial expertise, whether Chinese firms have FSAs or firm-specific disadvantages (FSDs) depends largely on the host country context. We have noted that Chinese FSAs are high for OFDI into most other emerging economies, which is partly due to the CSAs on offer to those firms that invest abroad in accordance with official guidelines. These CSAs can include provisions for asset security and stable operating conditions that are negotiated between the Chinese and local governments. In other words, the Chinese authorities may be able to negotiate institutional capital for their overseas-investing firms. Other FSAs include the familiarity of Chinese executives with characteristics common to emerging countries such as high levels of political intervention and an imperfect institutional environment, and how to negotiate necessary arrangements under such conditions. In the case of many host developing countries, Chinese firms will also possess superior managerial and technical expertise compared with local human resources. This contrasts with the situation Chinese firms experience when investing into developed economies, where they have FSDs in terms of their managerial and technical quality. They

will also lack appropriate institutional capital and if they are closely identified with the Chinese government they may suffer a considerable country-level disadvantage (CSD) as well. The question therefore arises as to what these contrasts between developed and developing host country contexts imply for the institutional and resource capital required to support OFDI.

Chinese OFDI practices in developed economies

Chinese firms investing in contexts such as the United States, located in category A of Figure 2, have several FSDs with respect to institutional and resource capital. Their executives who are seconded from their home base will usually be unfamiliar with the different embedded rules, norms and thinking of institutions in the host country (Scott, 2001). Their customary ways of approaching officials, which will probably be grounded on an experience of informal relationship management based on *guanxi*, may prove to be counterproductive in a context where there is an insistence that formal procedure be strictly adhered to. Their institutional capital is therefore limited. In these circumstances, Chinese firms have to adapt to local institutions and may need to employ local managers and staff. Equally, the value of their resource capital may be limited by unfamiliarity with market expectations, managerial styles and organizational practices in the local context.

The findings from Guo's (2008) detailed case studies of three British subsidiaries of Chinese MNCs are consistent with this analysis. He found that the MNCs absorbed local marketing practices through granting a high level of autonomy to their UK subsidiaries and appointing British managers to run them. As part of the same investigation, Guo also studied three UK subsidiaries in China and found that, by contrast, they employed expatriate managers and applied British marketing practices. He concluded that the reason for this

difference in mode of adaptation lay in the conjunction of FSAs/FSDs with the characteristics of the local context. The British firms possessed FSAs in terms of advanced practices, and it was appropriate for these to be applied, with the support of suitably experienced staff, in a developing country context. Indeed, they were officially welcomed as part of China's catching-up process. By contrast, when firms like the Chinese ones with branches in the UK suffer from FSDs in terms of expertise and knowledge, those weaknesses would place them at a disadvantage in a developed country context unless they compensated for this by appointing local staff with the experience to apply appropriate practices.

Chinese manufacturing MNCs, such as Haier, Huawei and Lenovo operating in developed countries (category A of Figure 2) have recruited senior Western managers to liaise with local institutions (some of which may also be prospective customers) and to introduce Western know-how and practices. They have also established R&D centers in western countries. Haier appoints local managers to run its marketing and regional subsidiaries. In the case of Huawei, it was recently announced that the 'world's second-largest network equipment maker aims to expand its footprint with more global hires' (Reuters 2011). In 2011 it hired, John Suffolk, a former chief information officer of the British government who was tasked with refining the company's cyber-security systems and reported directly to Huawei's founder and chief executive Ren Zhengfei. Lenovo, following its 2005 takeover of IBM's PC division, initially appointed an American CEO and made English the corporate language. As one commentator put it, '[Lenovo chairman] Liu wisely accepted that his Chinese colleagues were not prepared to run a global corporation by themselves, and he integrated the IBM veterans into the company's senior ranks' (Schuman, 2010). In the event, internal conflicts ensued and in 2009 the American CEO was replaced by a senior Chinese executive of long-standing in the company; other senior executives also left the company.

One has to be careful, however, not to ascribe these adjustments of personnel and practices among Chinese firms investing in developed (category A) countries just to differences in country contexts that cause the firms to lack human resource FSAs. Chinese companies investing in developed countries tend to share a number of common features, all of which mean that they need to take on human competencies additional to those they already possess. They typically invest through acquisition of a developed country company, which of itself means that they have to secure a level of managerial legitimacy and deploy managerial skills that are appropriate to maintaining the value of the acquired company. Many of the Chinese investing companies are seeking to compete in the developed markets they enter, requiring the ability to employ suitable marketing and distribution methods. For this they also require world-class technologies and the search for these is often the prime motive for their acquisitions. As Chinese firms expand globally, so they also have to attain the competence to run global businesses, manage global supply chains, compete in sophisticated markets, and run an increasingly complex organization so as to benefit from dynamic capabilities. All these factors require resources which even large Chinese firms may still lack, and they are particularly challenging for those Chinese firms investing in developed economies. It is not surprising therefore to find prominent examples where, although their top management remains Chinese, they hire foreign executives and adapt to local business norms and practices.

Chinese OFDI practices in developing economies

There is a contrasting mode of adaptation when Chinese firms operate in host environments where institutional norms are weak and local competencies are lacking. In such cases, their most important institutional capital may lie in the influence that Chinese government agencies can exert over host country governments. The ensuing understandings may permit

Chinese firms to compensate for resource deficiencies by introducing their own resource capital. As a result, they often rely on their own indigenous Chinese human resources. Thus, in sub-Saharan Africa, many Chinese firms employ their own staff, even manual workers, and appoint Chinese managers who apply Chinese work practices. Partly as a consequence of these practices, some Chinese firms isolate their personnel from local communities and transfer relatively little knowledge and practice to their African hosts. There have been complaints that Chinese firms employing local workers do not comply with local laws designed to protect the environment and labor, especially if they are private firms beyond the direct influence of the Chinese state (van Dijk, 2009). There is some debate about the exact conduct of Chinese firms in Africa — the relatively optimistic view expressed by Brautigam (2010) contrasts with some of the conclusions reached in van Dijk (2009) — and evidence is limited by Chinese secrecy on the matter. However, it seems clear that in the category D host contexts that some African countries exemplify, Chinese OFDI tends to be accompanied by far less acceptance of local practices than is the case in category A contexts. The sector again may also have some relevance to this conclusion. Many of the Chinese firms investing in category D countries are extractive or are producing low technology products using local materials. This means that they do not require the managerial and technical competencies to sell technically advanced products to sophisticated markets or to operate global supply chains. They can therefore rely more readily on their own Chinese practices.

Discussion

Figure 3 summarizes the analysis offered in this paper. In comparing three broad categories of host country for Chinese OFDI, the figure identifies levels of relevant institutional and resource capital likely to be available from domestic sources, including the firm's own

capabilities and Chinese government agencies. It suggests that host countries falling into category A of Figure 2 with high political stability (especially based on a democratic system) and mature institutions including markets, will present Chinese firms with the greatest institutional and resource challenges. Considerable learning will be required in order to relate to host institutions in ways that are regarded as legitimate, as well as to develop effective marketing practices. Moreover, the contrast between home and host political systems stands in the way of achieving inter-governmental understandings and tends to render Chinese firms with close ties to government vulnerable to accusations of threatening national security. The characteristics of these host countries turn existing Chinese country and firm-level attributes into disadvantages rather than advantages.

By contrast, when host countries have stable centrally-controlled political regimes (category B in Figure 2), there is usually more scope for Chinese governmental authorities to provide institutional capital on behalf of their firms investing in those countries. Moreover, the firms' existing institutional and resource capitals are likely to be better suited to the host environment than is the case with category A countries. Host countries falling into category D of Figure 2 present a greater risk of political uncertainty and are also generally contexts requiring the greatest importation of resource capital in the form of personnel, practices and technology. The degree and type of firm-level learning and adaptation that Chinese-investing firms require follows from these contextual situations, though it may be moderated by what the firm has already gained through previous experience and investment.

Figure 3. Chinese OFDI: host country categories, capital availability and required firm-level adaptation

Category of host country for Chinese OFDI	Appropriate capital available to Chinese overseas investing firms		Firm-level learning and adaptation required
	Institutional capital	Resource capital	
Host country is politically stable and institutionally mature [Category A in Figure 2]	low	low	Need to acquire institutional capital by learning host country institutional and political rules, norms and values. Need to acquire resource capital by employing local executives and technical staff during learning period following market entry
Host country is politically stable and institutionally less mature [Category B in Figure 2]	moderate [some institutional capital provided by government to government agreements]	moderate	Some augmentation of institutional capital required involving adaptation to host country institutional and political rules, norms and values. Also some augmentation of resource capital required: Chinese personnel may have to provide training and supervision in early stages.
Host country is politically unstable and institutionally immature [Category D in Figure 2]	high [considerable institutional capital provided by government to government agreements]	high	Institutional capital supplied at governmental level. Limited need to adapt to local institutional and political rules, norms and values, though disregard for them can cause public resentment. Also political instability may require periodical renewal of institutional capital. Need to supply resource capital supplied from China – may require importation of higher-level expertise as well as labour

Whetten (2009: 31) has observed that ‘the general sentiment among authors writing on this subject [China] is that the influence of context effects is too often unrecognized or underappreciated’. Our argument is strongly context-driven and assumes that ‘context matters’. More precisely, the conjunction of political and institutional characteristics of home and host country contexts is seen to establish whether or not there is likely to be a deficit of the institutional and resource capitals that Chinese foreign-investing firms require. In order to understand both the ways in which Chinese OFDI is implemented and the conditions for its success, we have argued and illustrated that existing theorizing needs to be extended to take a fuller account of the *diversity* among relevant contexts.

However, it is not only diversity at the country level that theory-building needs to take into account. At the firm level too, the considerable diversity among Chinese overseas-investing firms is also consequential. For it means they are not all similarly placed in relation to their contexts. Diversity in the *ownership* of Chinese firms has implications for the extent to which their OFDI enjoys a CSA in the form of support from home government agencies and the control that government exercises over them. Both support and control tend to be stronger in the case of SOEs. The *industrial sector* to which the outward-investing Chinese firm belongs will be also immediately relevant for the strategic and operational resources it requires, which raises the question whether these are already available to Chinese firms or available in the host country context. If they are locally available, the economic rationale for investing via acquisition or a joint venture becomes stronger. If they are not, investment in a wholly-owned Greenfield site accompanied by the importation of the firm’s own practices and personnel tends to be more appealing.

While these firm characteristics are significant, it is now timely for the theory of FDI and globalization to broaden further beyond the heavy focus on the firm that it has displayed so

far, be this with reference to an MNC's ownership and internalization of firm-specific advantages or to the LLL policies of catch-up 'dragon multinationals' (Mathews, 2006). It is misleading to focus on firms as independent actors when in fact they operate within political and institutional domains that can both facilitate and hinder their internationalization. Although some firms may enjoy power in their environments sufficient to enable them to pursue their own preferred policies and practices (Child and Rodrigues, 2011), this is more likely in their home countries where they possess sufficient institutional and resource capital. In host country contexts, access to such capitals may be limited by political obstruction, such as protectionism and national security concerns, and by the unavailability of resources. It may be possible for financially strong firms to 'purchase' institutional capital and resources, but at a price which can include the risks of involvement in local politics and a backlash from local interests. This has sometimes been the experience of Chinese firms in Africa. In other words, locational advantages (Dunning 2000) or host country CASs (Rugman and Li, 2007) may well incur transaction costs.

This is not to deny that a firm may have acquired managerial competences and relational assets (social capital) valuable for internationalization through experiential learning and previous network-building. Rather it is to assert that the resources and practices it needs to apply to a foreign investment will depend on the relevance of that experience to the host country context, potentially mediated by political and institutional understandings (or misunderstandings) between the two countries involved.

The implication of these observations is that theorizing on Chinese OFDI, *and indeed OFDI from any national source*, needs to be developed so as to explain and predict the variety of modes of engagement of investing firms with both host country firms and institutions. It should take account of relevant political, institutional and capital (resource)

factors. These include the role of the home government in negotiating ‘rules of the game’ with host national governments and institutions. Here the fact that SOEs account for most of China’s OFDI is clearly significant, but this is not a feature wholly unique to China. In the world as a whole, SOEs, account for about 11% of global FDI flows (UNCTAD, 2012: 99). Some of the understandings negotiated by host governments particularly on behalf of enterprises they own or sponsor will be intended to enhance firm-level FSAs and ease their application within the institutional framework of the host environment. An example is the negotiation of agreements with some host governments that Chinese firms will be exempt from rules that stipulate the localization of employment.

The most important argument in this paper, and its primary contribution, is that in order to fully appreciate OFDI and its implementation, we require an analysis that is sensitive to *both* home and host country contexts, taking account of the ‘triangle’ of resource, institutional and political factors that apply in those contexts. This means that we have to draw upon insights from resource-based, institutional and political perspectives simultaneously. As we have illustrated, it is a recognition of the different combinations of home and host country characteristics that permits an adequately nuanced understanding of the challenges facing Chinese overseas-investing firms and how they are likely to cope with them. An analysis of home-host country contextual similarities and differences opens the door both to more adequate theorizing as well as to a better understanding of policy options for ensuring that foreign investment is successful.

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