Internationalization of China’s Private-Sector MNEs: An Analysis of the Motivations for Foreign Affiliate Formation

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China’s private-sector multinational enterprises (MNEs) are often owned and controlled via offshore holding companies in tax havens. As such, their foreign affiliates are often difficult to identify, and their activities are also not captured in official Chinese outward foreign direct investment data. To date, therefore, there has been comparatively little systematic analysis of these affiliates as they internationalize. Here we address this gap by developing a method that allows us to identify 104 privately owned Chinese MNEs owned via offshore holding companies, as well as their 227 foreign affiliates. We analyze and discuss the motivations for the formation of their foreign affiliates in light of current theory. © 2012 Wiley Periodicals, Inc.

Introduction

To date, systematic analysis of China’s private-sector multinational enterprises (MNEs) using large samples of MNEs has been quite limited. Extant research has either gravitated toward the use of a relatively small number of high-profile case studies or else tried to draw inferences from official data sources. Unfortunately, officially reported data on Chinese outward foreign direct investment (OFDI) does not usually cap-
ture the OFDI activities of many of China’s private-sector MNEs. This is because private-sector MNEs often deliberately structure OFDI via intermediate offshore holding companies. In doing so, they not only hide the ultimate investment destination from Chinese authorities, but also circumvent domestic approval requirements and possible interference and monitoring of their overseas activities. In this article, we look to further explore the subject of private-sector OFDI in China’s MNEs. In particular, we examine whether there are any particular features of China’s private-sector OFDI and whether it differs from the received wisdom on Chinese MNEs.

We first review some of the current literature on Chinese MNEs, from which we refine our research questions. Following this, we explain the method we use to identify Chinese private-sector MNEs. Our results and discussion then consider the dominant motives for the formation of foreign affiliates in our sample. We highlight, among other things, the prevalence of cautious market-seeking strategies among private-sector MNEs and the somewhat limited extent of strategic asset seeking (pursuit of brands, technologies, management know-how, and the like). We also note the importance of links forged with developed-country MNEs as drivers for the further internationalization of China’s private-sector MNEs. Efficiency-seeking motives, generally thought to be less relevant for Chinese MNEs owing to low domestic labor costs, are also in evidence.

**Background and Literature Review**

For much of the past two decades China's economic policy has looked to attract inward FDI, and until the introduction of the new Enterprise Income Tax law in 2008, MNEs investing in China were granted lower income taxes than domestic Chinese businesses. One unforeseen consequence of this policy was that it created incentives for Chinese companies to reconstitute themselves as foreign-invested enterprises and, in effect, transform themselves into MNEs. To date, following these incentive structures, many Chinese businesses have created offshore holding companies for the purposes of owning their onshore domestic Chinese subsidiaries. This process, of reconstituting domestic Chinese businesses as foreign affiliates via FDI—and moving capital offshore to bring it back onshore in a different form—is known as “round-tripping.”

Round-tripping is most commonly discussed with reference to its impact on the calculation of FDI into China. Such practices, it is argued, have led to substantial overestimates of actual inward FDI. To date, however, the impact on OFDI from China has been overlooked. Yet offshore holding companies established for the purposes of round-tripping also form very suitable vehicles for further onward FDI. We call this type of FDI “onward-journeying.” While round-tripping leads to serious overestimates of FDI into China, onward-journeying leads to serious underestimates of Chinese OFDI. This is because the foreign affiliates established by offshore holding companies are recorded as OFDI from the host country of the holding company and not China (such as the Cayman Islands, for example; see Table 1 for more details of preferred locations). The distortionary influences of offshore holding companies on the use of FDI data are not exclusive to China. The FDI data of all nations, as used as a barometer of MNE activity, to a greater or lesser extent are affected by this problem (Beugelsdijk, Hennart, Slangen, & Smeets, 2010). Owing to the aforementioned preferential taxes China has offered, however, as well as the historic coincidence of having a leading offshore financial center close at hand (Hong Kong), the practice of onward-journeying has been particularly common for Chinese MNEs. This is reflected by the large flows of officially recorded OFDI from China to the tax havens and Hong Kong, which stood at around 80% in 2009 (State Statistical Bureau [SSB], 2010).

As noted, recent legislation now harmonizes tax rates for foreign and indigenous Chinese businesses. As such, the tax incentives to move offshore have largely been removed. Despite this, however, many of China’s privately owned businesses still look to establish offshore vehicles to avail themselves of the various other benefits that they have discovered can be found there. First, establishing offshore vehicles greatly enhances opportunities to tap international capital markets for private businesses. The Cayman Islands, for example, is a popular location for incorporating Chinese holding companies. It is also one of the world’s largest financial centers (International Monetary Fund [IMF], 2009). Second, offshore legal, accounting, and financial institutions are superior to those found in China. They may provide Chinese businesses with greater security and flexibility. Third, offshore holding companies also allow Chinese businesses to bypass government regulation of their activities—including those related to FDI (Voss, Buckley, & Cross, 2010).

**Different Influences on State-Owned and Private MNEs**

Following from the above points, it is likely that the internationalization strategies of China’s private-sector MNEs may differ from those found in state-sector businesses. This is because the internationalization strategies of emerging market (EM) MNEs are significantly shaped...
by their domestic institutional environment (Scott, 2002; United Nations Conference on Trade and Development [UNCTAD], 2006). Market imperfections, in particular, caused by state intervention, can create disequilibrium within domestic markets, as well as between domestic and foreign markets. Domestic firms with strong linkages to domestic institutions, such as state-owned businesses in the Chinese case, may use such imperfections to internationalize. They may develop monopolistic positions in domestic markets, for example, helping them to engage in OFDI (Morck, Yeung, & Zhao, 2008). These positions may also allow them to obtain subsidies for outward FDI (e.g., China’s “go global” policy) (Ning, 2009). This includes below-market credit rates available for state-owned businesses and soft loans. Indeed, it is in general argued that large Chinese SOEs can undertake relatively high-risk FDI with less concern over loan repayments (Buckley et al., 2007; Buckley, Cross, Tan, Xin, & Voss, 2008; Child & Rodrigues, 2005; Lardy, 1998; Morck et al., 2008; Yeung & Liu, 2008). This may, for example, help them acquire natural resources or strategic assets (i.e., brands and technologies).

In contrast to state-owned MNEs, the private sector may find it considerably harder to raise capital to undertake OFDI, as well as negotiating domestic regulation and intervention. To illustrate the reasons as to why private-sector MNEs go offshore and how this may affect their OFDI strategies, we consider the example of Wuxi PharmaTech, one of our sample firms. It incorporated a holding company in the Cayman Islands before going on to raise nearly $200 million in an initial public offering (IPO) on the New York Stock Exchange. As such, it has largely circumvented China’s capital markets and instead relies upon international investors. In addition to raising capital offshore, it notes in its annual report how the holding-company structure allows its management and shareholders “to take significant corporate actions without having to submit these actions for the approval of the administrative agencies in every country where we have significant operations” (Wuxi PharmaTech, 2010). Wuxi PharmaTech illustrates how Chinese MNEs that move offshore do so to address domestic capital market constraints as well as institutional and regulatory constraints. It is interesting to consider their OFDI strategies in this light.

Motivations for Foreign Affiliate Formation in China’s Private-Sector MNEs

A number of motives have been put forward as to why China’s MNEs undertake OFDI. Building from the current literature, we briefly review these.

Strategic Asset–Seeking Motivations

Mainstream international business (IB) theory has been largely drawn from the experience of MNEs originating from the triad economies. It is debated, however, whether these theories explain EM MNEs, or whether instead alternative frameworks are needed (Buckley et al., 2007; Child & Rodrigues, 2005; Lall, 1983; Mathews, 2006b; Teagarden, 2008). Recent IB literature offers a number of alternative perspectives for understanding OFDI from
developing countries, including China. The strategic asset-seeking or springboard perspective posits EM MNEs lack ownership advantages and that firm-specific “strategic assets” are actually embedded in the firms of industrialized countries (Alcácer & Chung, 2007; Deng, 2009; Teece, Pisano, & Shuen, 1997). Strategic assets refer to critical resources or capabilities, including, for example, research and development (R&D) capacity, proprietary technology, design facilities, brands and reputation, and distribution and production networks that give firms competitive advantages over others (Teece et al., 1997). EM MNEs can only access them through high-risk and aggressive takeovers of these “critical assets” from advanced MNEs in order to overcome their inherent latecomer disadvantages, such as technological backwardness, incompetent management and business practices, and home-country market and institutional constraints (Buckley et al., 2008; Deng, 2009; Dunning, 2001; Li, 2007; Luo & Tung, 2007). In addition to serving as a “springboard” to compensate for latecomers’ “competitive weaknesses,” these assets can reduce latecomers’ liability of foreignness, allowing them to compete on an equal footing with their global rivals and even “counter-attack” rivals in advanced economies (Luo & Tung, 2007). International expansion of latecomers, such as Chinese MNEs, is therefore primarily driven by their need to “catch up” through acquiring strategic assets, according to this view.

A strand of research on Chinese MNEs implies that OFDI from China has a strategic asset-seeking bias (Child & Rodrigues, 2005; Deng, 2010; Luo & Tung, 2007). Private-sector MNEs, however, do not have similar access to low-interest loans for OFDI. They also circumvent the pressures of domestic institutions by going offshore, and so are less likely to feel pressured by policymakers to undertake such investments eager to promote rapid firm-level catch-up. This raises the question of whether strategic asset seeking is also common for private-sector MNEs.

Special Ownership Advantages

A further variation on the general internalization theory of OFDI argues that firms from emerging economies like China are used to operating in volatile environments and thus develop particular ownership advantages in managing “institutional voids.” This allows them to thrive better than local firms and Western MNEs in some developing countries with similar market conditions to those found in China, such as weak market institutions and opaque regulatory regimes (Chittoor & Ray, 2007; Gubbi, Aulakh, Ray, Sarkar, & Chittoor, 2009; Luo & Tung, 2007). In contrast to this, however, some also argue that Chinese firms in general lack firm-specific advantages. Instead, it is argued, they rely heavily on country-specific advantages, such as low labor costs, to internationalize (Rugman & Li, 2007). This raises the question of whether private-sector MNEs do invest in difficult markets for doing business, markets that also are largely unattractive to Western MNEs, to exploit these touted ownership advantages.

Market Seeking

Although the notions of strategic asset seeking and special ownership advantages have certainly captured attention, because of their implications for extant theory, some research has also found that market seeking is an important motivation for Chinese OFDI. Such market-seeking activities typically involve less aggressive, smaller investments. Some studies provide evidence that market seeking has also been an important motive for Chinese MNEs (Buckley et al., 2007; Sutherland, 2009; Voss et al., 2010). Buckley et al. (2007), for example, show that market seeking has been an important motive for Chinese OFDI, whereas the acquisition of strategic assets was only limited in their sample (Buckley et al., 2007, p. 510). Voss et al. (2010) echo this finding using a more recent sample of firms from the Yangtze River delta. They found that sample firms invested abroad “overwhelmingly for market-seeking reasons . . . the objectives of accessing advanced technology or an established brand are barely in evidence” (Voss et al., 2010, p. 41).

Despite a focus on strategic asset seeking in some of the current literature, it is also possible private-sector MNEs adopt more conservative FDI strategies. Again, lack of access to domestic capital markets, as well as less pressure to follow national “go global” policies, may influence their strategies. Given the great export success of many Chinese companies, moreover, it would be a surprise if some foreign affiliates were not established for the purpose of better serving these markets (Sutherland, 2009).

Natural Resource

Much has been made of China’s appetite for natural resources to feed its booming economy and rapidly growing infrastructure. In general, state-owned enterprises can be said to dominate many of the natural resource sectors and have a heavy involvement in resource-related OFDI (Yao & Sutherland, 2009). Chinalco, for example, a massive state-owned metals conglomerate, was involved in an attempted $19.5 billion investment in Rio Tinto. According to official statistics, about 25% of China’s OFDI stock is natural resource-related (SSB, 2010). In general, however, private-sector businesses are less common in the natural resource sectors. This raises the question of
whether private-sector MNEs also have extensive involvement in natural resource seeking.

**Efficiency Seeking**

Comparatively little has been made of efficiency-seeking motives in Chinese MNEs. It is generally argued that the low costs found in China are likely to be such that OFDI for the purposes of efficiency seeking is likely to be limited (Buckley et al., 2007). This said, labor costs have risen substantially in recent times and this has even driven investment within China inland. Infrastructure bottlenecks have also been experienced, and power and water supplies, for example, are sometimes stretched. If efficiency-seeking motives exist for FDI, it is possible that dynamic private-sector MNEs that are more cost-conscious and that face less pressure to generate domestic employment will try to exploit them.

**Networks and Global Production Chains**

A network or linkage perspective views firms’ internationalization processes as creating new relationships in different industries, based on the observation of the rise of alliance capitalism and the proliferation of firms’ networks in the late twentieth century (Dunning, 1997; Ghauri, 1992; Johanson & Mattson, 1994). Firms from developing countries are often assumed not to possess any ownership advantages that they can exploit abroad. However, through being mature MNEs’ suppliers in the lower end of their global production network, latecomers can build up knowledge of foreign markets and enhance their capabilities to engage in OFDI at later stages. They are drawn overseas when their foreign partners internationalize. The initial production and learning capability of developing countries’ firms therefore plays a crucial role in them attracting strategic foreign partners (e.g., through inward FDI). Such alliances can lay a foundation for latecomers to “catch up” and gain the resources and knowledge needed to move up the value chain and expand globally later (“latecomer perspective”) (Luo & Tung, 2007; Mathews, 2006a; Ponce, 2007). The emphasis on networks raises the question of whether private-sector MNEs create foreign affiliates in response to the demands of their important MNE customers.

**Methodology and Data**

Official Chinese OFDI data is based on information that firms provide during their registration and approval process. As the location of their investment holding companies may be different than the final destination of investment, however, such data does not provide an accurate picture of private-sector Chinese MNE activity (Rosen & Hanemann, 2009; Sutherland & Ning, 2011). How can we find the ultimate destination of Chinese outward FDI that takes account of the use of offshore holding companies? One way around this problem is to use Chinese companies that go offshore with the specific purpose of raising capital via public listings on foreign stock markets (Sutherland & Ning, 2011). Foreign listed companies are generally subject to high levels of transparency. They are required by law, for example, to provide detailed annual reports, including financial statements. From such annual reports, it is normally possible to ascertain details of their ownership structures, as well as the number and type of their foreign affiliates and business activities. Although reporting requirements differ by country, in the stock markets we look at here, the location and activities of foreign subsidiaries are generally reported in the notes.
to the consolidated financial statements. Details of the five largest shareholders are normally also reported.

Using the annual reports of China’s privately owned listed companies is one of the few windows through which to systematically develop insights into the activities of Chinese MNEs held through offshore vehicles (Sutherland & Ning, 2011). To generate as large and broad a sample as possible, we look for Chinese companies listed on a number of non-Chinese stock markets, including those known to be popular listing locations, such as Hong Kong (the main board, excluding GEM), Singapore (main board and growth market), and New York (NYSE and NASDAQ), as well as less popular exchanges for listings, such as Frankfurt (including first quotation board), London (AIM and main board), and Toronto (excluding the TSX Venture Exchange). Our sample markets are also selected on the transparency of the reporting requirements of the listed companies (i.e., they report details of subsidiaries and major shareholders).

**How Do We Define Chinese MNEs?**

Technically speaking, all Chinese businesses that round-trip transform themselves into MNEs via the establishment of one or more foreign subsidiaries. This raises the important question of how we distinguish between genuine and nongenuine MNEs (i.e., between those that only round-trip via the use of holding companies and those that onward-journey to third countries—that is, undertake foreign investments beyond simple holding company activity). As we are interested here in Chinese MNEs that undertake productive activities in their foreign affiliates, we need to distinguish between the two. We therefore stipulate certain requirements for inclusion in our sample of private-sector MNEs.

First, the listing vehicle must be incorporated outside of China. Our research shows that the vast majority (if not all companies) that are established by Chinese nationals and listed overseas are held via offshore listing vehicles. State-owned companies that list outside of China, by contrast, most typically incorporate within China. Private companies, by contrast, typically have listing vehicles incorporated in places such as the Cayman Islands (NYSE and Hong Kong, in particular) or Bermuda (Singapore). As we are particularly interested in onward-journey OFDI in private businesses, we therefore exclude Chinese incorporated listing vehicles.

Second, we then apply certain ownership criteria. Specifically, we look for all listing vehicles in which Chinese nationals are recorded as being the largest shareholders. We use biographical information from the annual reports to do so. If the combined shareholdings of all reported Chinese nationals exceed 20% of the ordinary shares of the listing vehicle (either directly or indirectly—that is, beneficially through other offshore companies), we consider these companies as “Chinese.” We use a 20% ownership threshold, as this is often used in the corporate governance literature and is considered sufficient to lock in control of a listed corporation (López, Laporta & Shleifer, 1999). This threshold, moreover, is also used by UNCTAD as sufficient to lock in control of a foreign subsidiary of an MNE (i.e., this threshold is also used to define MNE affiliates) (UNCTAD, 2010). Typically, as it happens, the largest shareholders in our sample firms usually own considerably more than the 20% threshold. These owners, as it happens, are usually also the founders and often well-known entrepreneurs in their own right, with numerous entrepreneurial accolades (i.e., “outstanding entrepreneur,” listings in China’s Hurun Rich List, etc.). The ownership criterion we apply identifies companies that have their origins within the Chinese market. Typically, they are fast-growing, dynamic companies that have expanded domestically and were also originally incorporated in China (before setting up offshore special purpose vehicles). Companies originally from Singapore or Hong Kong, which are those most easily confused, are excluded using these sample criteria.

**Identifying Onward-Journey OFDI**

As noted, we are not so much interested in whether the sample firms technically meet the criteria for being classi-
fied as MNEs (i.e., control at least the overseas subsidiary, be it an investment holding company or not) but rather whether they undertake actual activities in overseas markets. As a final step, therefore, we use the most recently available annual reports (typically 2009 or 2010) of companies meeting the first two criteria listed above to obtain and record details of all foreign (i.e., non-PRC) subsidiaries that are not recorded as “investment holding companies.” We use official sites of the respective exchanges to identify the most recent annual reports. Importantly, we also record their reported business activities (i.e., “foreign sales and marketing,” “manufacturing,” and so on). These are reported in the notes to the consolidated company accounts, including details also of the countries in which they are established and the size of investment. We therefore use the officially reported business activity of the foreign subsidiary as a guide to the actual activity being undertaken.

To illustrate the process by way of an example, consider Longcheer Holdings. It designs and manufactures mobile phones. It is listed in Singapore. According to its 2010 annual report, it is incorporated in Bermuda. The largest shareholder (and cofounder of the group) is Dr. Du Junhong (21.31% of ordinary shares) (Longcheer, 2010, p. 98). He is also the chairman and executive director and a Chinese national. He graduated from Zhejiang University (Longcheer, 2010, p. 14). Longcheer has 13 subsidiaries, including four investment holding companies (based in Hong Kong, Singapore, and two in Malaysia, which also are reported to trade mobile handsets), seven Chinese (PRC) subsidiaries, as well as a subsidiary in India (which is reported to design mobile handsets) and a subsidiary in Hong Kong (which manufactures and sells mobile handset printed circuits). According to our sample criteria, this business therefore has four genuine overseas subsidiaries (i.e., companies that perform a function other than investment holding). This includes two in Malaysia (trading, as well as holding companies), one in Hong Kong (manufacturing and sales), and one in India (design).

All of these foreign subsidiaries are owned by the listing vehicle incorporated in Bermuda, which is owned by Du Junhong. Thus, while for all intents and purposes Longcheer is a Chinese MNE, any outward investment it undertakes will originate from Bermuda. For the purposes of official FDI data collection, only the injection of Chinese assets to the offshore vehicle is likely to be recorded.

**Final Sample Size**

In total, we find 301 Chinese companies listed on these markets that meet the ownership and listing vehicle criteria. Technically, all of these businesses can be considered Chinese MNEs, as they have foreign subsidiaries, albeit in some cases ones that may exclusively be investment holding companies. Of these 301, however, we found 104 had undertaken further “onward-journey” OFDI (Table 1). This is to say they had a foreign subsidiary incorporated outside of China that was engaged in some activity excluding investment holding (i.e., Longcheer’s design of handsets in India). Table 2 provides a further breakdown of the recorded activities of the foreign affiliates in more detail.

**Possible Biases in the Sample**

Our sample draws from publicly listed companies. As such, all of our sample firms have looked to raise capital. This may create certain potential biases. First, it may be argued these companies are capital-constrained, as they specifically go offshore to look for funding. While this introduces a certain bias, it also allows us to draw important inferences about the behavior of Chinese MNEs that do not have good links to domestic capital markets (i.e., more commonly those businesses with some forms of state ownership or involvement). Second, as they are listed companies, they are typically all dynamic, high-performing companies that meet the stringent investment criteria of foreign investors. Arguably, they all have good growth prospects (hence, their success in listing) and also the potential to internationalize rapidly. We would expect a higher prevalence of MNEs among these companies than in a general population of Chinese private businesses. Third, a number, though by no means all, are in newer high-tech sectors (Internet companies, solar panels, mobile phones, biotechnology, and the like). Again, the sample may not be entirely representative of China’s private sector or full population of businesses. For example, there are few companies from the natural resource sectors. Finally, our sample is by no means exhaustive. We do not search all potential stock exchanges for all Chinese companies.

**Results and Discussion**

Our interest is in ascertaining the key motives for the establishment of foreign affiliates in our sample of privately owned MNEs. To recap, a number of explanations have been put forward as to why Chinese businesses undertake FDI, including market, strategic asset, natural resource, and efficiency seeking, as well as special ownership and business network perspectives.
### TABLE 2  A Breakdown of Foreign Affiliates by Activity and Location

<table>
<thead>
<tr>
<th>Stock Market</th>
<th>Onward-Journey MNEs</th>
<th>Total Number of Subsidiaries</th>
<th>Number of Subsidiaries in Hong Kong, Singapore, and Macao</th>
<th>Number of Marketing/Sales/Trading Subsidiaries</th>
<th>Number of Manufacturing Affiliates</th>
<th>Number of Design/Research/Procurement of Technology</th>
<th>Number of Natural Resources</th>
<th>Number of Affiliates in North America, Europe, and Japan</th>
<th>Number in Emerging Markets</th>
<th>Not Specified</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>27</td>
<td>85</td>
<td>24</td>
<td>75</td>
<td>4</td>
<td>6</td>
<td>3</td>
<td>52</td>
<td>7</td>
<td>0</td>
</tr>
<tr>
<td>Toronto</td>
<td>3</td>
<td>6</td>
<td>2</td>
<td>4</td>
<td>0</td>
<td>1</td>
<td>0</td>
<td>2</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>42</td>
<td>94</td>
<td>43</td>
<td>82</td>
<td>8</td>
<td>7</td>
<td>0</td>
<td>34</td>
<td>13</td>
<td>0</td>
</tr>
<tr>
<td>Singapore</td>
<td>31</td>
<td>37</td>
<td>27</td>
<td>32</td>
<td>4</td>
<td>1</td>
<td>0</td>
<td>4</td>
<td>3</td>
<td>0</td>
</tr>
<tr>
<td>London</td>
<td>1</td>
<td>5</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>5</td>
<td>0</td>
<td>5</td>
</tr>
<tr>
<td>Frankfurt</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>104</strong></td>
<td><strong>227</strong></td>
<td><strong>97</strong></td>
<td><strong>193</strong></td>
<td><strong>16</strong></td>
<td><strong>15</strong></td>
<td><strong>3</strong></td>
<td><strong>97</strong></td>
<td><strong>25</strong></td>
<td><strong>8</strong></td>
</tr>
</tbody>
</table>

Sources: Official company annual reports.
The Prevalence of Market Seeking in China’s Privately Controlled MNEs

An outstanding feature of the foreign affiliates is the prevalence of market-seeking activities. The full sample of 104 MNEs had 227 foreign affiliates (Table 2). Of these affiliates, 193 were recorded as serving at least one of the following purposes: sales, after-sales services, marketing, procurement, or trading. Sales and trading was the most frequently cited motivation for the establishment of a foreign affiliate. By contrast, there were only 16 manufacturing-related affiliates.

A large number of the sales affiliates were established in the trading centers of Hong Kong, Singapore, or Macao (97 in total, with Hong Kong the most popular affiliate destination). Interestingly, however, the developed markets of Europe, North America, and Japan were also important hosts to sales-related affiliates. In total, there were also 97 foreign affiliates established in these developed markets, the majority for sales-related purposes. To illustrate, in the US sample of the total 85 foreign subsidiaries, 52 were in Europe, North America, or Japan (the United States 17, Canada 3, Germany 10, Italy 3, and Japan 6). Sunergy, a solar panel maker listed in the United States, is a typical example. It has a German sales subsidiary and plans to “establish a global sales network” to sell the products it manufactures in China (Sunergy, 2008). JA Solar Holding also established a US subsidiary to engage in after-sales and other related services.

Similarly, in the Hong Kong sample there were 34 sales-related affiliates in Europe, North America, or Japan. China Haisheng Juice, for example, which exports over 30% of China’s apple juice concentrate (Table 3), established a subsidiary in the United States to market and distribute its fruit juice concentrate (Haisheng, 2009). Similarly, Xinyi Glass (HK) has three subsidiaries for sales-related purposes in Canada, as well as one in Japan and one in Germany. Haitian International, which manufactures plastic injection molding machines and parts, also has sales subsidiaries in Italy and Germany (Table 3).

There are numerous examples of businesses that have successfully exported their products to Europe, North America, and Japan. On the basis of this export success, they have established foreign sales subsidiaries. There were fewer such affiliates, by contrast, established in emerging markets. In total, we identified 25 such subsidiaries in countries such as India, Russia, Mexico, Brazil, Turkey, Indonesia, Vietnam, and Cambodia. While some of these were sales-related, a small number (though a higher share than for the developed markets) were also involved in manufacturing activities (i.e., in Hungary, India, Vietnam, Indonesia, Pakistan, and Cambodia). Honghua Group, for example, a manufacturer of drilling rigs, has set up subsidiaries in Russia, India, Indonesia, and Pakistan to help manufacture and assemble as well as market and sell its rigs. BDY Electronics, for example, also manufactures in Hungary and India (Table 3).

In terms of numbers, sales and distribution outlets were by far the most common foreign affiliates. Market-seeking-related OFDI, therefore, is undoubtedly an important first step in the internationalization strategies of many of these private-sector MNEs. This appears to play to their strengths as low-cost export-oriented manufacturers, for which China is well renowned.

Special Ownership Advantages: Exploiting Institutional Voids?

We note there are comparatively few examples of our private-sector MNEs investing in countries with high levels of political instability and institutional vacuums, with perhaps the exceptions of investments in Russia and Pakistan. As noted, instead the more developed markets appear among the most popular destinations. It is possible, of course, that private-sector MNEs lack the necessary state backing to invest in politically unstable countries. This may be one explanation for the apparent lack of such investments. Their comparatively unfavorable access to capital via the state banking system may also be one factor driving what, at face value, appears to be quite conservative investment strategies. In this sample, there is little specific evidence to suggest an appetite for investing in hostile and difficult market environments.

Strategic Asset Seeking

The size of actual investments in sales-, distribution-, and trading-related subsidiaries is typically quite modest. Establishing foreign sales subsidiaries to collect feedback from existing customers, find new customers, and gather market intelligence is not expensive. So while sales activities are undoubtedly the most commonly reported activities, they do not constitute the largest investments in our sample MNEs. There are in fact only two large international acquisitions in the sample. At first glance, moreover, strategic asset seeking appears to be one motivation for these deals. Mindray Medical International’s (medical equipment) $209 million takeover of Datascope and Wuxi PharmaTech’s (drug testing) $163 million takeover of AppTec both involve Chinese companies taking over established US companies. Further analysis, however, suggests strategic asset seeking is only one possible motive for these acquisitions (Table 3).
First, Mindray Medical’s acquisition appears to be an interesting case of both market and strategic asset seeking (Table 3). Datascope, the acquired company, has successful and well-established direct sales channels in both the North American and European markets. In its annual reports, it notes its distribution channels are one of the primary targets and reasons for the investment. The acquisition, moreover, has only allowed Mindray to access Datascope’s brand for a limited eight-year period. This would seem to rule out the brand as its primary target. Product-wise, there is also considerable overlap between the two businesses. A further strategic asset element that does exist—namely, Datascope’s software capability (which extends functionality of the medical devices that they sell)—is therefore likely to be only one minor motivation for the acquisition. While a degree of strategic asset seeking may be important, in the form of technology, another important reason appears to be for entering the US and European market so as to further expand its sales networks (Ning, 2009; Sutherland & Ning, 2011).

Wuxi PharmaTech’s $163 million takeover of Aptec also illustrates the importance of involvement in global production networks (i.e., business networks) as well as strategic asset seeking (Sutherland & Ning, 2011). Aptec is a successful biotech company that undertakes research and development, testing, and manufacturing for bigger

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<thead>
<tr>
<th>Firm Name and Largest Shareholder</th>
<th>Business/Industry</th>
<th>Destination (and Size of Investment Where Known)</th>
<th>Reported Motivations for Affiliate Formation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alibaba (Ma Yun 80%)</td>
<td>Provision of Internet content/advertising</td>
<td>Japan, United Kingdom, and United States</td>
<td>Technology maintenance, marketing, and admin.</td>
</tr>
<tr>
<td>BYD Electronics (Wang Chuanshu, 65%)</td>
<td>Mobile phone components</td>
<td>India ($50 m) and Hungary (Euro 16.5 m)</td>
<td>To supply components for brand-name mobile phone manufacturers, such as Nokia. MNE global production networks important.</td>
</tr>
<tr>
<td>China Haisheng Juice (Gao Liang 37%)</td>
<td>Manufactures apple juice concentrate</td>
<td>United States</td>
<td>Largest Chinese exporter of juice concentrate. Undertakes marketing and distribution of fruit juice concentrate in the United States.</td>
</tr>
<tr>
<td>Haitian International (Zhang Jianming 68%)</td>
<td>Manufactures plastic injection molding machines/parts</td>
<td>Italy, Turkey, Brazil, Hong Kong, and Germany</td>
<td>Sales (all) and trading (only Hong Kong); manufacture, sales, and R&amp;D also in Germany subsidiary.</td>
</tr>
<tr>
<td>Honghua Group (Zhang Mi 50%)</td>
<td>Land rigs, related parts</td>
<td>United States, Russia, United Arab Emirates, India, Indonesia, and Pakistan</td>
<td>Sales and customer service, some assembly/ manufacture of drilling rigs and related parts in the United States.</td>
</tr>
<tr>
<td>Longcheer Group</td>
<td>Mobile handset design / manufacture</td>
<td>India</td>
<td>To improve design capability and enter Indian market.</td>
</tr>
<tr>
<td>Nine Dragons Paper (Yan Cheung 72%)</td>
<td>Paper and packaging</td>
<td>Vietnam ($30 m)</td>
<td>Manufacture of paper in lower-cost country, with access to large and fast-growing markets that may circumvent trade barriers erected against Chinese exports, therefore efficiency and market seeking.</td>
</tr>
<tr>
<td>Mindray Medical (Xu Hang et al. &gt; 20%)</td>
<td>Surgical and medical instruments</td>
<td>United States ($209 m), United Kingdom, Italy, Singapore, India, Russia, Germany, France, Netherlands, and Canada</td>
<td>Large number of sales subsidiaries. Also acquired Datascope in the United States for strategic assets and distribution channels in European and US markets.</td>
</tr>
<tr>
<td>Shenzhen International (Ma Jianrong 74%)</td>
<td>Manufacture/sale of knitwear products</td>
<td>Cambodia ($30 m)</td>
<td>Efficiency and market seeking. Labor costs considered lower and infrastructure good. Facilitates entry to Southeast Asian markets.</td>
</tr>
<tr>
<td>Texhong Textiles (Hong Tianzhu 63%)</td>
<td>Yarns and garment fabric manufacturer</td>
<td>Vietnam ($16 m)</td>
<td>Efficiency and market seeking.</td>
</tr>
<tr>
<td>Wuxi PharmaTech (Ge Li et al. &gt; 20%)</td>
<td>Pharmaceutical preparations</td>
<td>United States ($163 m)</td>
<td>Acquired a large US drug tester to expand services it could offer to large pharmaceutical MNEs.</td>
</tr>
</tbody>
</table>

Source: Official company annual reports.
drug firms. It considers itself positioned to capitalize on the global trend of R&D outsourcing, as it is a “contract research organization” (Wuxi PharmaTech, 2008). These research subcontractors have grown quickly in the United States, Europe, and Japan in the 1990s to meet the needs of MNE life science companies looking to improve their R&D productivity. The outsourcing model allows independent companies to offer specialized services to a range of life science customers, competing with the more traditional vertically integrated model. Wuxi’s services assist other MNEs in reducing the time and cost of pharmaceutical and medical device R&D (Wuxi PharmaTech, 2008). It works for ten of the largest pharmaceutical companies in the world. While it is clear that the acquisition also enhances the drug testing services Wuxi can offer (i.e., a strategic asset intent), an important motivation also appears to be to position itself as a major first-tier supplier to other MNEs.

While at first sight the size and direction of these deals (aimed at US markets) appear to be related to strategic assets, closer inspection also reveals other motives. Strategic asset seeking implies acquiring critical assets that one does not already have: “to primarily enhance a firm’s critical competencies rather than to exploit existing assets” (Deng, 2009, p. 10). In the case of those firms expanding to supply global production networks, such as Wuxi, it seems likely that they are exploiting existing assets and competencies (i.e., in Wuxi’s case its recognized ability to undertake testing for large pharmaceutical companies). Similarly, in Mindray’s case, it is also leveraging the use of existing competencies in new markets, rather than simply acquiring new ones.

In total, there were 15 affiliates involved in design, R&D, or technology procurement, activities related to strategic asset seeking (Table 2). However, most of these were small investments. ChinaTechfaith, for example, has a design facility in the United States. Suntech Power Holdings (Germany, Japan, Australia [3], Germany [3], Italy, United States [3], Cyprus, Switzerland, Korea, Hong Kong) has established subsidiaries for both sales and the purposes of procuring technology. Li Ning undertakes design of athletic shoes and apparel in its US subsidiary. Alibaba, an Internet company (Hong Kong), undertakes “technology maintenance,” as well as marketing and administrative services (in the United States and the United Kingdom). Haitian International also reports undertaking R&D in Germany. Finally, Longcheer Group has established a subsidiary in India to exploit the software expertise found there in development of mobile phone handsets (Table 3).

Two of the 104 private-sector MNEs have undertaken large technology-related acquisitions. This compares with the establishment of 193 sales-related affiliates. In general, there are a far smaller number of investments that have a strategic asset-seeking focus. While strategic asset seeking may take place, it does not appear to be the major factor driving affiliate formation or acquisition in this sample of private-sector MNEs.

**Natural Resource Seeking**

As noted, few of our sample firms are found in the natural resource sectors. Some of the sample companies, however, including some listed in Canada, are involved in natural resource extraction, though primarily through operations within China. These companies, however, have not undertaken FDI for the purpose of resource seeking. Instead, several of the solar panel and module makers in the sample have attempted to secure silica supplies through establishing foreign affiliates and taking minority shares in other resource suppliers. Renesola, for example, uses a subsidiary in Malaysia to procure raw silicon for production of solar panels. Trina Solar LTD has subsidiaries in South Korea and Hong Kong for the same purpose. China Qinfa Group, one of the largest private traders and suppliers of coal in China, also has a minority investment in an Australian coal mine to help secure its supplies.

These investments are not generally large and do not compare to the types of natural resource–seeking investments made by many of China’s large state groups. Many of them, moreover, are related primarily to procurement and trade, rather than actual natural resource extraction. As such, natural resource seeking is quite limited in our sample.

**Efficiency Seeking: The Role of Manufacturing Subsidiaries**

There are comparatively few examples of significant overseas manufacturing activities in the sample (16 in total; Table 2). This includes examples like Haitian International (Hong Kong), which manufactures plastic injection molding machines and parts in Germany (Table 3). Another example is China Auto Electronics Group, which has a subsidiary in the United States that owns a plant in Honduras. In the Hong Kong–listed firms, manufacturing activities are more common in the foreign affiliates, including three significant manufacturing operations located in Southeast Asia. This includes Shenzhen International, Nine Dragons Paper, and Texhong Textiles (Table 3). According to their respective annual reports, Cambodia and Vietnam were targeted by these MNEs because of their fast-growing markets and also for reasons of efficiency. By investing in these nations, a number of companies hope to circumvent export quotas and taxes,
as well as directly selling to the fast-growing Southeast Asian nations. They also hope to lower their production costs via lower-cost labor and better infrastructure, including lower-cost utilities.

The efficiency-seeking motive has not been well highlighted in analysis of Chinese MNEs to date. In general, it is argued, owing to low labor costs in China, it is likely to be minimal. However, there are three significant manufacturing subsidiaries that have a strong efficiency-seeking motive.

Business Networks

An interesting finding from our sample is the importance of relationships with other MNEs in determining the formation of foreign affiliates. A number of our sample firms have internationalized on the basis of their supply relationships with other, larger non-Chinese MNEs. We have already noted Wuxi PharmaTech’s acquisition in the US market. Other examples include VanceInfo Technologies, an IT outsourcer. It now has subsidiaries in the United States (2), Japan (1), Hong Kong (1), and Malaysia (1) to meet the demands of its clients in these markets. China Auto Electronics Group supplies wire harnesses and battery cable assemblies to assemblers in the United States (it also manufactures in Honduras). Contel Group, a supplier of electronic products and gaming peripherals, has subsidiaries in the United States and Germany. It works with large-scale retailers (such as Best Buy, Target, and Carrefour), as well as major players in gaming.

Perhaps the best example of a private-sector MNE supplying services to other successful non-Chinese MNEs is BYD Electronics. Its principal business includes the manufacturing and sale of handset components, including handset casings and keypads, and handset modules equipped with various mechanical components. It also undertakes some assembly services. It is part of the one-stop supply chain that leading mobile phone brands use. It has established subsidiaries in both Hungary and India to supply, among others, Nokia. The industry is undergoing a process of consolidation, and BYD has managed to take part in this process, as leading brand names look to outsource ever larger shares of their manufacturing activities to leading suppliers. Through the supply relationships it has developed with Nokia in China, it has managed to transform itself into a successful MNE.

China has been one of the largest recipients of inward FDI. It is perhaps unsurprising that some successful businesses have developed close relationships with these MNEs and gone on to further internationalize on the basis of these networks. To date, this motivation has received relatively limited attention. We find a number of notable examples in our sample to suggest it may be an important motivation for foreign affiliate formation in China’s private-sector MNEs.

Conclusion

To date, there have been relatively few systematic studies of the internationalization of China’s private-sector MNEs that go beyond individual case studies. This is partly, as noted, because such MNEs are hard to identify, owing in part to their frequent incorporation offshore. As a result, their FDI activities are also not captured in official Chinese data. This study attempts to address this gap by using a relatively large sample of 104 Chinese privately owned MNEs and their 227 subsidiaries to further explore the motivations for the formation of foreign affiliates.

In our sample, we did not find many headline-grabbing deals involving large acquisitions. Instead, we found most FDI was related to fairly modest market-seeking activities. Of the 227 foreign affiliates identified, 193 claimed to be involved in market-seeking activities—around 85%. A disproportionate number of such investments, furthermore, were targeted either at nearby trading hubs (such as Hong Kong) or else the larger developed markets of North America, Europe, or Japan. Contrary to empirical studies that have used official data, moreover, we did not find any particular bias in their investment patterns toward more politically unstable countries. The idea that such MNEs possess special ownership advantages allowing them to exploit unstable environments, therefore, seems unlikely to be a major motivation for their FDI. Their manufacturing activities, moreover, were in general also quite limited. This is perhaps unsurprising, as China is recognized as a low-cost manufacturing base.

There are two outstanding examples of strategic asset-seeking-related OFDI. These investments, while few in number, were large in size. So their importance should not be understated. Both involved Chinese companies acquiring US-based companies. Further inspection revealed, however, mixed motives for the acquisitions. In one case, expansion of markets was also reported as a major reason for the acquisition. In this example, moreover, manufacturing was to be continued in China, with the overseas distribution channels to be used to further exploit US and European markets. In another case, a network perspective and the desire to enter global production chains also appear as an important motivation for the investment. In both cases, the investments therefore look to build on existing ownership advantages, as well as acquiring new skills, technologies, and brand-related assets with which to build new ownership advantages.
We also found that natural resource seeking was not common in our sample MNEs. This was not entirely unexpected, as China’s private-sector MNEs are not generally found in these sectors, which are dominated by state firms. By contrast, we did find that efficiency-seeking motives were important in several of the largest foreign affiliates. Efficiency seeking has not yet been given as much attention as it may warrant, particularly for private-sector MNEs constantly seeking to reduce costs and improve their competitiveness.

Private-sector MNEs are far less likely to receive state financial support for FDI and may well be under less pressure to conform to state policies. As such, it is likely the motivation for the creation of their foreign affiliates will be different from state-sector MNEs. Further research could undertake more systematic comparisons between the two, possibly building upon the method we have advanced for understanding the internationalization of China’s private-sector MNEs.

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Note
1. “Institutional void” is defined by Khanna and Palepu (2006) as the absence of or weak market intermediaries that brings buyers and sellers together.

References


