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A review of institutional influences on the rise of made-in-China multinationals

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Abstract

Purpose – This paper aims to re-examine the role of institutions in the rise of made-in-China multinationals. Specifically, the paper seeks to understand how changes in the global environment, especially global financial crisis, have solidified the Chinese government's role in pushing and encouraging Chinese firms to engage in outbound foreign direct investment (OFDI) activities.

Design/methodology/approach – This is a conceptual paper. The analysis is based on a large number of publicly available sources, including research papers, government documents, and reports. The paper strives to triangulate the validity of the data with multiple sources.

Findings – The study finds that while the role of the state in China has been evolving since the start of the economic reforms in 1978, by no means has it been lessened. Instead, the state has asserted its role specifically to grow Chinese multinationals in size and in number, by leveraging the financial resources accumulated over the last 30 years, by taking advantage of the cheap assets made available globally by the recent financial crisis and by institutionalizing its "Go Global" strategy.

Research limitations/implications – The study implies that the role of the state will be further solidified through China's national goal of enhancing competitiveness via knowledge acquisition through OFDI and simultaneously, multinationals' OFDI initiatives and strategies will be reinforced by the state's economic policies and goals while their commercial interests will take on an increasing importance in the global marketplace and their behavior will co-evolve with and be reshaped by local, national, and international environments. The paper suggests that future studies employ co-evolutionary theory to investigate the role of state-owned enterprises (especially the functions of their CEOs) as well as non-state actors in shaping the institutional framework in China. Future studies should verify some of the ideas with empirical data and strive to triangulate different data sources to increase data quality.

Practical implications – The study also provides implications to Chinese policy makers on how to balance the government's role as conductor, enabler, protector, and constrainer while allowing Chinese multinationals to integrate into the global market for the benefit of both China and the world economy.

Originality/value – This study represents an original contribution to this topic. The research contributes to the study of globalization of Chinese enterprises by exploring the renewed dynamic relationship between the state and the firm after the 2008 global financial crisis.

Keywords Institutional theory, Financial crises, Globalization, Chinese multinational firms, Coevolution, Foreign direct investment (FDI)

Paper type Conceptual paper

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This work is dedicated to Professor Clyde Stoltenberg, who was a life-long educator, mentor and friend to many young men and women, including the first author in this paper.

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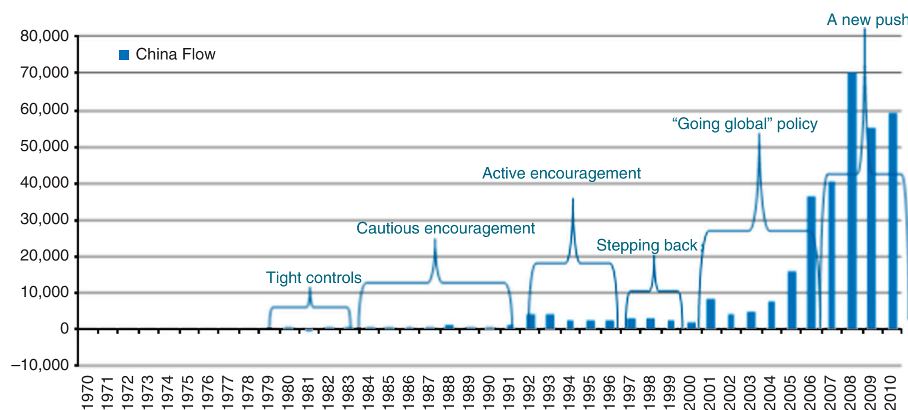
Introduction

China, as the world's second largest economy after the USA, has recently become a major source of outbound foreign direct investment (OFDI) in the world. Chinese OFDI remained largely insignificant until 2005 when Lenovo made its landmark acquisition of IBM's PC division for US$1.75 billion. China's OFDI flow in 2010 amounted to more than $60 billion (see Figure 1). By 2011, more than 17,000 Chinese companies had invested abroad, reaching virtually every country in the world, while OFDI stock reached US$424.78 billion, making China the13th largest investor in the world. The average annual growth rate for China OFDI was 44.6 percent in 2002-2011 (MOFCOM, PRC, 2012). The rapid rise of Chinese OFDI has seen Haier become the world's leading producer of refrigerators and Lenovo the world's leading producer of PCs.

In spite of the phenomenal growth of Chinese OFDI and the presence of China multinationals in every corner of the world, limited understanding of the nature of Chinese OFDI coupled with recent actions by the US government (such as US President Obama's blocking of Chinese invested firm Ralls Corp from owning wind farms in the State of Oregon on September 28, 2012, and the US Congress House Intelligence Committee's report on October 8, 2012 warning US firms against dealing with Huawei and ZTE, citing national security concerns due to their state ownership and "the special characteristics of China") once again brought to the forefront the debate on the role of the state in China and its impact on the rise of Chinese multinationals.

Scholars have summarized the following unique features of Chinese OFDI: first, Chinese multinational firms enjoy the kind of government support not often found in the west; second, large state-owned firms comprise the key investors among all those expanding globally; third, Chinese firms invest abroad with lightning speed, primarily through acquisitions; fourth, Chinese firms invest in a large spectrum of industries, ranging from natural resources to high technology sectors, and fifth, most Chinese firms are going global without first possessing advanced technologies and know-how (Peng, 2012; Yang *et al.*, 2009).

These features point to a unique context that is not easily replicated in other parts of the world: the impact of the Chinese state on OFDI decisions. We intend to revisit the multi-faceted role of the state in Chinese firms' internationalization process: conductor, enabler, protector and constrainer (Yang and Stoltenberg, 2008). With these dynamics



Source: UNCTAD and Chinese Statistical Yearbooks, various years

Figure 1. China OFDI flow and stock (US dollars million)

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in mind, we ask the following research questions: "What explains the rapid rise of Made-in-China multinationals?" "What is the nature of the relationship between the state and Chinese multinationals, especially in the wake of the global financial crisis?"

This paper addresses these questions from an institutional perspective and explores how changes in the domestic and global environments have led to changing dynamics between the state and Chinese multinationals. We argue that while the role of the state in China has been evolving since the start of the economic reforms in 1978, its relationship with Chinese multinationals has morphed into a multi-faceted and co-evolving one. On one hand, the state has asserted its role specifically to grow Chinese multinationals in size and number, by leveraging the financial resources accumulated over the last 30 years, by taking advantage of the cheap assets made available globally by the recent financial crisis and by institutionalizing its "Go Global" strategy. Thus, we believe that the role of the state in China will be further solidified through its national goal of enhancing competitiveness via knowledge acquisition by its multinationals investing globally; simultaneously, multinationals' OFDI initiatives and strategies will be reinforced by the state's economic policies and goals. On the other hand, as the process of internationalization deepens, a greater number of made-in-China MNEs will become more integrated into the global market, behave more like any other MNEs, and are more likely to generate more feedback effects on policy-making of the Chinese government. As a result, we are likely to see co-evolution between Chinese institutions and the Chinese MNEs being reshaped by local, national, and international environments (Carney *et al.*, 2009). Our research contributes to the study of globalization of Chinese enterprises by exploring the renewed dynamic relationship between the state and the firm. We also contribute to the contextual richness of the institutional theory by examining the phenomenon of globalization of Chinese enterprises in the changing local, national and international institutional environments.

In the next section of the paper, we will discuss the historical and institutional contexts for the rise of Chinese multinationals and explore the role of the state and its changing relationship to Chinese multinationals based on first, domestic considerations in the areas of economic and innovation policies; and second, international and regional considerations resulting from the impact of two recent financial crises on the state. We move on to probe the future path of China and Chinese multinationals before reaching our conclusions.

Rise of Chinese multinationals

Evolution of the institutions and the rise of Chinese multinationals

The case of China demonstrates the profound impact of institutions on business. Chinese multinationals had sporadic and regional presence in the 1950s-1970s (see Gammeltoft *et al.*, 2010; Yang and Stoltenberg, 2008 for a more detailed discussion on the growth of Chinese multinationals prior to the economic reforms). The demarcation came after the "Go Global" policy was envisioned by Deng Xiaoping and then later developed by Jiang Zemin in 1992, when he encouraged Chinese firms to go abroad to build world-class corporations to compete successfully in the global marketplace. Since then, the growth of made-in-China multinationals has been accompanied by the development of OFDI policies. The following describes the different stages of growth of Chinese multinationals in relation to OFDI policy development.

1979-1995. The Chinese government established "Go Global" economic policies on August 13, 1979. This is the first time that China included outward foreign direct

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investment in the national economic development program, aiming at paving the way for large-scale overseas expansion activities. During this phase, the Chinese government issued permits to large state and provincial trading houses to set up overseas operations. As a result, many of the OFDI projects were set up in Southeast Asian and developing countries to facilitate exports from Chinese petrochemical and machinery companies. These firms experimented with Japan's keiretsu operations through networks of sub-contractors. While the Chinese government played a pivotal role in promoting OFDI as part of its economic and foreign policy, many of the FDI projects were poorly managed and underperformed. As Hong and Sun (2006) observe, the key decisions on overseas investments during this period, including choices of location and sector, "were mainly determined by the consideration of enhancing China's political and economic influence and expanding its international trade relationships rather than that of maximizing market profit."

After 1991, the Chinese government began to grant permits to large state-owned enterprises (SOEs) to allow these firms to directly access international markets, thus bypassing large state owned trading companies to further economic liberalization. This move contributed to competitive growth of these SOEs in international markets (Luo *et al.*, 2005). During this phase, the government's motivation to promote OFDI was associated with the desire to address natural resource constraints to further development (Hong and Sun, 2006) as well as the desire to shift mature technologies and industries to other developing countries to maximize profits by using some comparative advantages. However, at the beginning of 1993, the government undertook rigorous screening of OFDI projects due to the overheating of the economy, and the level of investment and number of projects fell over the previous years, which led to a slowdown of OFDI growth.

1996-2003. Beginning in 1996, a large group of enterprises (that were established after the 1978 economic reforms began) started to internationalize their business. Many of these firms were from the home appliances and automobile industries. This coincided with the fact that the home appliance and auto markets in China were becoming saturated around that time.

Hong and Sun (2006) suggest that what explains this increased M&A by Chinese companies is mainly the need for direct access to natural resources, increasing brand value of Chinese products, and obtaining advanced marketing and distribution networks and technologies in the shortest possible time. Such needs led to a change in the form in which Chinese companies pursued OFDI. We witness an increasing number of Chinese firms listing on developed country stock exchanges with the goal of raising equity capital directly in hard currency and establishing international image and reputation. Capital raised through IPOs has gradually allowed transnational M&A to become the main form of China's direct investment abroad and, in the process, led to further privatization of SOEs (Hong and Sun, 2006). The need for natural resources also directed the bulk of Chinese OFDI to Southeast Asia for the purpose of acquiring such resources for domestic market consumption (Rasiah *et al.*, 2010).

During this stage, the government's key efforts focused on building banking, foreign exchange programs, evaluation systems and other infrastructures to facilitate international expansion of Chinese firms. New regulations including "Rules on Foreign Exchange Administration of the People's Republic of China," the "Circular on Relevant Issues Regarding Perfecting Foreign Exchange Administration Relating to Capital Account," and the "Circular on Relevant Issues Concerning Return of Guaranty for Profit of Overseas Investment Being Transferred to China," were put in place.

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2004-present. This stage has seen acceleration of overseas expansion activities by way of mergers and acquisitions, such as Lenovo acquiring IBM's PC business in December 2004. This acceleration followed upon China's 2001 accession to the WTO (Kwan, 2006). The more intense domestic competition resulting from more foreign entrants coming into the Chinese market led to a rapid rise in the demand for raw materials. Soaring commodity prices since 2005 have driven the rapidly growing Chinese economy to aggressively seek supplies from Central Asia and Africa (Rasiah *et al.*, 2010). The Chinese government tasked Chinese SOEs to secure natural resources overseas in order to sustain domestic economic growth, and these SOEs tend to go alone and enter foreign markets through M&As (Gammeltoft *et al.*, 2010).

The Chinese Government turned the 2008 global financial crisis into a good opportunity for Chinese companies to acquire valuable, but cheap foreign assets and provided continued financial support for such initiatives (Zhengquan Ribao, 2009; Xue, 2008). As part of this effort, in December 2008, China's banking regulators lifted restrictions to allow Chinese commercial banks to help finance M&As of Chinese companies both at home and abroad (Rasiah *et al.*, 2010; Yang, 2009).

Meanwhile, China's State Administration of Foreign Exchange issued new regulations in October 2005 in its "Notice on Issues Relating to the Administration of Foreign Exchange in Fundraising and Reversed Investment Activities of Domestic Residents Conducted via Offshore Special Purpose Vehicles [Notice 75]." Foo (2006) observes that while prior regulation had created hurdles for Chinese firms seeking to restructure their domestic businesses under an offshore holding company as a prelude to overseas fundraising, Notice 75 established a consistent foreign exchange registration system to facilitate offshore restructurings.

Regulation of M&As within China has also continued to evolve, with the 2003 M&A Rules being replaced by the 2006 M&A Rules. The 2006 M&A Rules expressly allow (for the first time) the use of a foreign publicly listed company's shares as consideration for the exchange of Chinese equity securities in connection with an M&A transaction (Hsia *et al.*, 2006). Concurrently, the Ministry of Finance issued a series of new and revised Accounting Standards for Business Enterprises which largely reflect the approaches and principles of the International Financial Reporting Standards, and the China Securities Regulatory Commission has been promoting since April 2005 a share liquidity reform program under which listed companies are being restructured to convert almost all non-tradable legal person shares into freely tradable A shares within two years (Hsia *et al.*, 2006). These developments are likely the reflection of continued Chinese government policy moving business enterprise decision-making toward economically motivated goals and policies rather than pursuit of state-imposed mandates.

Since 2009, there has been growing political support for transnational corporations and a new push for liberalization for "Go global" in the wake of the global financial crisis, which depreciated many assets to unprecedented low prices on the global market. This is seen by a number of new government policies and regulations including MOFCOM's administrative measures on regulation of outbound investment, SAFE's regulations of foreign exchange administration for domestic enterprises' overseas direct investments as well as notice on the administration of cross-border loans by domestic enterprises, which essentially turned on green lights for those Chinese firms desiring to go global[1] (see Table I).

Year	China's OFDI policy
1979-1983	Tight controls
1984-1991	Cautious encouragement
1992-1995	Active encouragement
1996-1999	Stepping back
2000-2006	Formulation and implementation of the "going global" policy Notice on issues relating to the Administration of Foreign Exchange in Fundraising and Reversed Investment Activities of Domestic Residents Conducted via Offshore Special Purpose Vehicles (Notice 75)
2007-present	Growing political support for transnational corporations and a new push for liberalization.
May 1, 2009	Ministry of Commerce (MOFCOM) Administrative measures on regulation of outbound investment Effective
May 2009	State Administration of Foreign Exchange (SAFE) Draft regulations of foreign exchange administration for domestic enterprises' overseas direct investments Draft rules published for comment
August 1, 2009	State Administration of Foreign Exchange (SAFE) Notice on the administration of cross-border loans by domestic enterprises Effective

Sources: UNCTAD, Safe documents, MOFCOM documents, various years; Buckley *et al.* (2007); Yang and Stoltenberg (2008)

Table I. Evolution of China's OFDI policies

The changing patterns of Chinese OFDI

As seen above, Chinese firms' internationalization process has taken place within the unique Chinese institutional framework of the last 30 years (see Table I). The ownership of made-in-China MNEs has been a topic in public media. Gammeltoft and Tarmidi (2010) suggest that most large Chinese companies are owned by either central or local government and this applies equally to most of those going global. From the official list of China's 40 largest multinational enterprises as measured by FDI stock, only four of them are not state owned. This could have impacted the speed and manner in which Chinese firms internationalize.

For many years, Chinese firms have chosen to invest in developing economies that enable firms to minimize costs of their operations and allow them to take advantage of their small-scale manufacturing capability built in the last 30 years. In recent years, Chinese firms have shifted FDI to OECD countries because of new government policies, a new profit maximizing initiative, and the absence of competitive advantages in the domestic market. For instance, Milelli *et al.* (2010) observe that Chinese firms favored the European markets because of their home country constraints.

During the global economic crisis, when many assets in western countries became far more affordable, many Chinese firms expanded their international business through mergers and acquisitions and leveraged their low cost position to gain a foothold in the developed countries. This new investment behavior was enabled by the timely relaxation of foreign exchange restrictions by SAFE in May 2009 and further facilitated by SAFE's new policies on loans to Chinese firms investing abroad in August 2009.

The state not only actively facilitates and encourages OFDI, but also encourages investment specifically in R&D in developed countries to enhance China's innovative capability (UNCTAD, 2005). In October 2004, the National Development and

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Restructuring Committee and Export-Import Bank of China issued a circular to promote overseas investment via M&As to enhance the global competitiveness of Chinese firms and to accelerate their expansion into western markets (Deng, 2009).

In a study conducted on over 100 publicly listed Chinese MNEs investing overseas from 2001 to 2009, over 30 percent of them made investment in developed countries (Yang *et al.*, 2011). The specialized nature of companies and industries in the US allows China to diversify its business at a relatively low cost *vis-à-vis* developing its own technology. This trend is seen in a database developed at University of San Francisco's Globalization of Chinese Business Facility where we observe that the number of Chinese firms investing in OECD countries is larger than that in non-OECD countries between 2009 and 2010, as compared with the period of 2002-2008 (see Figure 2).

On the other hand, the changing pattern of Chinese OFDI is not merely a result of Chinese government policies. The rising cost of labor, shortage of unskilled migrant workers (which were in abundant supply before the 2008 global financial crisis), and the increasing competition from foreign companies have not only become a sharp knife on the throat of many less competitive Chinese firms, but also have eroded handsome profit margins many more successful Chinese firms once enjoyed. These firms view OFDI as an avenue to get out of their predicament, to migrate up the value curve, and establish global brands in order to consolidate their competitive position at home. To some of these Chinese firms, the matter is "to be, or not to be."

Rasiah *et al.* (2010) summarize the reasons for the accelerated promotion of Chinese OFDI as follows first, China's huge foreign reserves have created high inflationary pressures on the RMB (which could lead to social unrest) that could be channeled through OFDI; second, high economic growth rates, particularly accelerated industrialization since the WTO accession, have fueled the need for, and resulted in shortage of, energy and raw materials, making access to such resources a necessity; third, trade disputes and non-tariff barriers to trade have remained major obstacles for China's export-oriented industries; hence, OFDI is a vehicle to circumvent trade

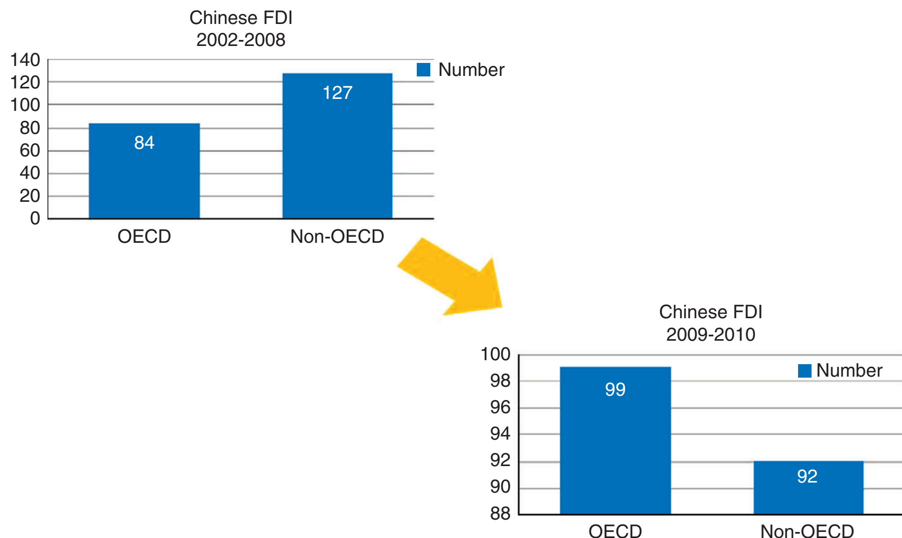

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Figure 2.
Number of Chinese firms investing in OECD and non-OECD countries

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barriers; fourth, competition from foreign companies brought by the WTO has heightened the need to create "national champions" and "global brands" in order for Chinese firms to compete successfully with their counterparts domestically and internationally.

The role of the state in China

The role of institutions and China's evolving economic growth model

China's economic reforms since 1980 have evolved and produced a shifting institutional framework. While North suggests that "the agent of change is the individual entrepreneur responding to the incentives embodied in the institutional framework" (North, 1990), in China the state itself is also a player and it determines the movement of the OFDI path (Goldstein and Pusterla, 2010). Government units tend to continue to hold significant ownership interests in enterprises even after their shareholding reforms (Deng *et al.*, 2010). The state, however, cannot operate SOEs by itself and delegates their control to the firms' managers (Lin *et al.*, 1998).

This undoubtedly increases the clout of the CEOs of the major SOEs. Such clout from these CEOs could influence the formal institutions in a way that would be unfamiliar to the CEOs from the western countries, just as Frazier (2010) suggests that multiple competing interests within the Chinese political system are emerging to pursue and protect their own power and resources, which could erode the coherence of China's economic goals and the central government's coordination need to achieve these goals. The intertwined and interlocking networks (guanxi)[2] within the Chinese polity could easily produce a co-evolutionary institutional environment (Carney *et al.*, 2009), where firms may gradually move to the center-stage along with other actors such as non-profit organizations and professional associations to fill the "space." Kennedy (2008) summarizes such a co-evolution as "[…] no one label – civil society, corporatism, or any other – adequately reflects the nature of government-business relations in China. […] The existence of rival norms and interests in China and different levels of influence over public policy ensures the continuation of a complex struggle to define China's economic system and the role of associations in it" (p. 173).

Gradual piecemeal privatization of China's SOEs has moved them toward practices consistent with evolving comparative advantage. As firms' stakeholders embrace more market system-type efficiencies, they may open themselves to even more profound changes, producing a continuing feedback effect between the firms' evolution and the institutional environment in which they function. The reforms have had the impact of introducing "one by one new institutional elements into the existing framework, thus changing the dynamic of the institutional matrix" (Liu, 1997). To understand the OFDI process, it is necessary to go beyond the written rules and regulations to assess the policy and institutional factors that provide the context for OFDI. These factors include both inward-looking domestic considerations and developments driven by international and regional issues.

Domestic considerations

Markets, the state and Chinese firm growth strategy. The main goal of the Chinese state's reforms has been to achieve social stability through economic growth. Their impact on the relationship between the state and enterprise has been to create some space between firm management and bureaucratic state control. The amount of that space varies by sector and the firm's relationship to perceived national security interests and resource needs for innovation to achieve higher value-added competitiveness in global markets.

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But even where they involve essential technologies, market mechanisms have acquired at least some independent significance as SOEs have had to compete with market-based firms both inside and, as they globalize, outside of China. In this evolving institutional setting, Chinese enterprises occupy a complex and unique space in which "they have to adapt their strategy to a new environment and improve their capabilities before participating effectively in global economic integration" (Jin, 2009).

In this context, commentators have identified three strategies for growth by Chinese enterprises:

(1) In view of low levels of firm concentration in many business sectors, Chinese enterprises must "carry out *integration* strategies in order to create economies of scale, enlarge the scope of their activities, and achieve a better control of key elements of the value chain."

(2) Firms need to redeploy their assets, capabilities and resources to achieve diversification "around their core business or capabilities in order to improve their management efficiency, technology, sales and clientele [...] with a greater emphasis on related products or services."

(3) Chinese firms need to embrace a strategy of globalization through "increased integration and interaction with the world economy in terms of production factors, capital, technology and human resources, as well as in terms of business functions such as R&D, supply, production and marketing" (Jin, 2009).

The goals of these three growth strategies are "to protect and expand export markets, ensure the availability of essential resources, acquire advanced technology and management skills, and export increased overseas opportunities" (Zhang, 2009).

The plan by China's grid giant to more than quadruple overseas assets constitutes an example combining all of these strategies and goals. The State Grid Corp. of China, with current overseas assets of $8 billion, plans to expand that total to $30 to $50 billion by 2020. Already China's dominant power grid distributor, the company seeks to further diversify away from the domestic market by establishing presence in the Philippines, Brazil, Portugal and other countries; to achieve such global expansion, it has set up offices in nine countries in the Americas, Europe and Africa. Overseas assets, which yield higher returns than domestic operations, are targeted to account for at least one tenth of State Grid's total assets by 2020. In addition, State Grid seeks to pursue innovation by joining a renewable energy investment consortium aimed at expanding the use of renewable energy in Europe and North Africa; that project's planned delivery would be almost enough energy to power the whole of Germany for two years (Reuters, 2012).

Innovation policy. To increase its competitiveness in global markets, China is relying more and more on innovation policy. Like other aspects of Chinese society impacted by the last 30 years of reforms, "the Chinese Innovation System has evolved over time, aiming at different priorities and implemented through various programs and regulations" (Larcon and Wang, 2009). The priority for Chinese firms is to learn from other countries' technology and experience (Li, 2009a). While such learning focuses on foreign direct investment into China early in the reforms (Li, 2009b), more recently OFDI policy is assuming greater importance for developing top-quality enterprises through various forms of cooperation with foreign companies, including acquisition of foreign assets in China and abroad (Li, 2009a).

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In addition, China is putting more resources into R&D and improving its regulatory framework for intellectual property (IP). Chinese R&D intensity (R&D expenditure as a percentage of GDP) more than doubled during the decade from 1995 to 2005, from 0.6 to 1.34 percent. R&D intensity is still greater in Japan (3.12 percent), the USA (2.776 percent), and the EU (1.93 percent) in absolute terms, but China is catching up very rapidly (Larcon and Wang, 2009). Concurrently, China has been devoting substantial resources to upgrading its IP laws and institutions. However, China's domestic governance limitations (fragmented central government authority and disjunctions between central government intent and local government implementation and enforcement) "have ensured that social values more often than not trump formal objectives, including enforcement of the IP regime" (Suttmeier and Yao, 2011).

China's innovation policy is now articulated in a 15-year medium- to long-term plan for scientific and technological development (MLP) that sets patent and technical standards objectives for IP creation and commercialization by the year 2020. The National Intellectual Property Strategy announced in 2008 and the ten-year National Patent Development Strategy announced in 2010 further emphasize the importance of IP for the goals of the MLP, which seeks to both introduce advanced technologies from abroad and develop focused R&D programs to assimilate and improve on those technologies. Against this backdrop, Suttmeier and Yao (2011) conclude that "while it is fair to continue to characterize China as a Communist-controlled developmental state, one should recognize that the role of the state is becoming increasingly contested by Chinese and foreign stakeholders in China's technological development, and the interactions of state initiatives and market forces involving non-state actors are producing a complex, sui generis political economy that defies easy categorization. […] Thus, in considering whether China's IP transition is moving toward harmonization with the international system or diverging from it, the evidence is mixed."

International and regional considerations

Financial crises and their impact on the role of the state in China. 1997-1998 Asian financial crisis. The Asian financial crisis provided China with an opportunity to participate in new multilateral institutions and bilateral free trade agreements to build a market driven, China-centered regionalism. China now has ten free trade agreements with 31 countries; the China-Association of Southeast Asian Nations FTA is the most prominent (Yong, 2011). This regional institutional integration has facilitated growth of Chinese OFDI in Southeast Asia, making the region a preferred location for many Chinese multinationals. For example, Haier uses the region as a training base for managers; Haier managers sent to the North American market have first been trained at lower cost in the Philippines (Yang and Stoltenberg, 2008).

China's FTAs have many dimensions. On one hand, "China's FTA activism reflects considerations about enhancing China's influence in the Asia-Pacific region, capturing the economic gains of FTA participation, and minimizing the trade and investment diversion resulting from the competitive dynamics of regional trade liberalization." But the move toward expanded FTAs "is also consistent with the desire to create alternative bargaining forums over trade issues that could help to stabilize expectations as well as the need to use FTAs to control the pace of trade liberalization so as to accommodate protectionist pressure emanating from domestic interest groups" (Zeng, 2010). From the outside, we might assume that Chinese leadership in regional economic cooperation is driven by a coherent strategy; however, there are in fact domestic constraints arising from several sources: first, continued fragmentation and

difficulty in creating policy coherence; second, the need for top leadership intervention at the same time that regional trade issues are relatively low on the agenda of the top leadership; and third, the relatively weak authority of Chinese negotiators (Pearson, 2010).

2008-2009 Global financial crisis. The most recent global financial crisis has caused China to take a closer look at the costs and benefits of an increased role in the global economy. Most fundamentally, decreased export demand has resulted in a shift from the familiar export-led growth model to a more domestic demand-driven economy, supported by a government stimulus package of four trillion RMB ($626 billion) over three years (Yong, 2011). The government also renewed focus on state businesses to fuel growth. World Bank data showed that the proportion of industrial production by companies controlled by the Chinese state vs the private sector edged up in 2009, reversing a trend in the other direction (Wines, 2010). These developments had important institutional ramifications at least for the short term; it remains to be seen whether the outcome of the shift will be positive for the longer term.

From the perspective of labor unrest, for example, commentators have observed differences between the outbreak of labor unrest in the spring and summer of 2010 vs more recent events. The earlier unrest "was widely attributed to China's growing wealth gap and to the frustrations of young, urbanized and more digitally wired workers" whose complaints arose from being more conscious of their rights and less willing to tolerate the conditions endured by their parents. More recent unrest "is thought to be directly linked to the sluggish state of the global economy, particularly the ongoing crisis in Europe, which accounts for just over one-fifth of all Chinese exports" (Richburg, 2011). While the central government could respond to the earlier unrest by simply ordering minimum wage increases, "with inflation now running around six percent, many workers complain that their still-modest wages are being wiped out by higher costs. And factory bosses say the higher wages have virtually wiped out their profit margins when coupled with the appreciation of the Chinese currency […] and the collapse of orders from Europe" (Richburg, 2011). The central government doesn't have the same remedies at its disposal now that it had in 2010.

The impact of international and regional organizations on institutional evolution in China. The most recent global economic crisis has provided China with an opportunity to join other developing countries in pressing for more balance in international institutions in an ongoing effort to rectify the disproportionate influence of developed countries in the international economic governance system (Yong, 2011). In the early days of the crisis, China played a leading role in the emergence of the G-20 as the primary forum for considering changes to the global monetary and financial regulatory regime (Frazier, 2010). It has also been much more assertive in shaping the agenda for trade liberalization in the WTO's Doha Round. It is interesting to note that China's shift to a "role as a shaper in international regimes coincides with internal debates […] over a new growth model and with pluralization of decision making in foreign policy" (Richburg, 2011).

One wonders whether greater international participation will increase pressure for more domestic institutional change or whether domestic policy changes will have a greater impact on China's international participation. It is certain that international organizations will continue to attempt to impact China's behavior to achieve broader global goals. For example, the IMF "pressure[d] Beijing to quicken the pace of its economic reforms and adopt a more market-oriented approach to banking and finance" (Barboza, 2011). The WTO's rulings against China in several recent cases could well

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impact the organizational practices of the affected firms and industries. China's relationship to international organizations seems to function as a two-way street, both expanding its role and level of participation in global decision making but at the same time opening its internal processes to greater external scrutiny. The Fall 2012 decennial transition to new leadership resulting from the Communist Party's 18th Congress will have a big impact on which way the scale is tilting.

The future path of China and Chinese multinationals. The 12th five-year plan. The 12th Five-Year Plan approved by the National People's Congress in March 2011 emphasizes higher quality and more inclusive growth and articulates some important goals: first, developing western China; second, energy efficiency and environmental protection; third, reducing reliance on exports and increasing domestic consumption; fourth, improving citizens' lives; and fifth, developing seven priority industries:

(1) new energy;

(2) energy conservation and environmental protection;

(3) biotechnology;

(4) new materials;

(5) new IT;

(6) high-end equipment manufacturing; and

(7) clean energy vehicles.

The new Five-Year Plan has significant implications for the MLP as it seeks to develop "emerging strategic industries," and some of which are intended to attain positions of global scientific and technological leadership. The Plan commits to produce more knowledge-intensive development and to create IP and standards in China, along with an expanded community of stakeholders in a strong IP regime. The strategic industries program calls for special attention to the importance of IPR in stimulating "patent alliances" among enterprises and in facilitating the transfer of IP from universities and research institutions to industry. The new policy commitments of the Plan are calculated to produce an increasingly IP-intensive pattern of industrial development in China (Suttmeier and Yao, 2011).

The new Plan's national strategic goals will require continued institutional development to address the two major weaknesses of Chinese companies in both domestic and international markets: technology and management. Chinese firms will have to better organize knowledge processes in a multinational environment by improving their understanding of many of the causal mechanisms and contextual elements in the relationship between knowledge processes and organizational factors (Foss and Pedersen, 2004). Among the issues Chinese firms will have to address are first, knowledge flows, subsidiary power and rent-seeking within MNCs (Mudambi and Navarra, 2004); second, processes of knowledge transfer in international strategic alliances (Simonin, 2004); third, how relational embeddedness between a foreign parent and international joint venture managers influences the transfer of tacit and explicit knowledge (Dhanaraj *et al.*, 2004); and fourth, the impact of headquarters control mechanisms on managing knowledge transfer in MNCs (Bjorkman *et al.*, 2004). These issues will challenge institutional processes of many Chinese firms in view of their current organization capabilities, property rights and corporate culture (Wang, 2009).

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The 18th Communist Party Congress. The November 2012 CCP Congress came at a crucial time after three decades of economic reform based on three guiding principles:

(1) replacing Marxist dogma with export-oriented economic liberalization;

(2) converting a political system that had combined ruthless dictatorship with chaotic power contests to an orderly process that selected engineers and technocrats for fixed terms; and

(3) replacing a revolutionary foreign policy with one tacitly allied with the USA.

All three of these principles have come under stress in the current environment: first, the economic model is challenged by rising labor costs and a shrinking pool of young workers; second, the political system has come under criticism for corruption and lack of transparency; and third, the foreign policy confronts a nationalistic public, an assertive military, and an intellectual elite that believes China is being constrained in its natural rise to global power and influence (Zakaria, 2012).

It is too soon to say how the new Chinese leadership will deal with these issues. The new general secretary Xi Jinping did address political and economic issues in his first speech in that capacity. On the political side, he cited corruption, being out of touch with the people, and undue emphasis on bureaucracy as problems that need to be addressed; on the economic side, he pledged to improve citizens' lives with better schooling, more stable jobs and higher incomes, more reliable social security and improved health care, housing and environment (Johnson, 2012). One tangible pronouncement made in the lead up to the Congress came with the State Council's order that all major industrial projects pass a "social risk assessment" before moving forward. This decision responded to large and increasingly violent environmental protests over the past year that forced suspension or cancellation of chemical plants, coal-fired power plants and a giant copper smelter, among others. In addition, all government agencies in China now must make public all environmental impact assessments by posting them on the internet with a description of what the government plans to do about the assessments. All these signs point toward greater emphasis on a balance between development and social factors and some greater attention to transparency. The institutional implications on made-in-China MNEs remain to be seen.

Discussions and conclusions

In 2008, we suggested that Chinese firms' OFDI was motivated by both economic and non-economic objectives, but that as China's economic reforms deepened, the relationship between the state and firm behavior began to shift, tilting toward that of co-evolution with market forces playing an ever-increasing role (Yang and Stoltenberg, 2008). This study takes a fresh look at the extent to which the financial crisis may have impacted this dynamic relationship. We examine how both domestic and international institutions were affected by the crisis, and the impact they had on the rise of made-in-China MNEs.

While the financial crisis reduced the volume of global trade and foreign investment growth for a time, the emerging economies, exemplified by the BRICS countries, have been quicker to recover and are now in the somewhat unaccustomed role of driving global economic growth through not only strengthening of domestic industries, but also by global expansion of their firms. This represents a major change in the dynamics of recent history, which saw developed economies, and especially their

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consumers, lead the global economy out of recession. While we now know that the emerging markets have not become decoupled from the global economy to the extent some had suggested (Bollen, 2008), they have become much stronger players in the global scene.

China's post-crisis domestic institutional evolution exhibits two features: SOEs' increased role in the economy in general resulted from the government's channeling resources into them, and China's enhanced competitiveness resulted from economic stimulus focused on enhancing infrastructure development. The former depicts a bi-directional interaction and co-evolutionary relationship between institutions and firms. Such interaction between the state and non-state sector and government agencies in control of resources (for instance, firms' usage of laws leading to voluminous law writing), could unleash competitive forces; this process evolves differently from that in the western capitalist countries (Nee and Opper, 2010, 2012). This latter investment is likely to assist all Chinese enterprises, not just the SOEs, in their striving for global competitiveness. Along with physical infrastructure, the other great need for Chinese multinationals is enhanced levels of knowledge as they migrate up the value chain. The emphasis of the 12th Five-Year Plan on reducing reliance on exports, increasing domestic consumption, and developing seven priority sectors points in the direction of greater focus on innovation and knowledge creation. Both IP policy and the rise of made-in-China MNEs have created a more complex interaction between state initiatives and market forces involving both SOEs and non-state actors.

The knowledge focus of China's development plan path puts a premium on the OFDI being undertaken by the country's multinationals. When assets of foreign firms are available at depressed prices resulting from the crisis, the opportunity to acquire them, along with the explicit and tacit knowledge embedded in them, is fully consistent with both firm and national goals. The strategic focus on innovation and knowledge creation coincides with rising costs of Chinese labor and unskilled labor shortage, which led some Chinese manufacturers of labor-intensive products or those in sectors of over-capacity, such as garments and electronics, to move production to Southeast Asia for cheaper labor and local market access (Rasiah *et al.*, 2010). This trend may continue in foreseeable future in China.

When it comes to international institutional impact, one must first recognize the tension in times of global financial stress between national interest and appeal to international institutions to tackle problems that are global in nature. The increased profile of the G20 (and China's role in it) in the wake of the financial crisis reflects the need for more harmonized responses to problems affecting all countries in a more interconnected world. At the same time, national political leaders have to balance what they know might be globally desirable and possibly in their countries' interest over the longer term with the very immediate and direct demands of their constituents, without whose support they may be forced out of office. China has been able to straddle these competing demands and opportunities since the crisis by simultaneously raising its profile in international institutions and pursuing market driven, China centered regionalism in that part of the world being looked to for driving global economic growth.

Our analysis leads us to the following conclusions: frist, China's national goal of enhancing competitiveness via knowledge acquisition and development seems a good fit for the OFDI initiatives and strategies its multinationals are now undertaking; second, while the Chinese government still acts as conductor, enabler, protector, and constrainer, its relationship with Chinese multinationals is not a simple one-way street.

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Instead, as the process of internationalization deepens, a greater number of made-in-China MNEs will have to become more integrated into the global market, behave more like any other MNEs, and are more likely to generate more feedback effects on policy-making of the Chinese government; and third, as a result, we are likely to see co-evolution between Chinese institutions and the Chinese MNEs reshaped by local, national and international environments.

Our research contributes to the study of globalization of Chinese enterprises by exploring the renewed dynamic relationship between the state and the firm after the 2008 global financial crisis. We also contribute to the contextual richness of institutional theory by examining the phenomenon of globalization of Chinese enterprises in the changing dynamic local, national and international institutional environments.

We would like to point out a caveat in our study and in the study of Chinese OFDI in general. The quality of data generated in China is often compromised as a result of varying data collection approaches, statistical methodologies and interpretations; statistics on China's OFDI suffer similar problems (Schüller and Turner, 2005; UNCTAD, 2007). A self-reporting problem occurs as MOFCOM collects data based on information furnished by firms as part of the approval process; this may skew toward either over-reporting or under-reporting subject to firms' self-interests (Rosen and Hanemann, 2012). Another data quality issue relates to the problem of round-tripping (see Hong and Sun, 2004 for more detailed discussion on this). It is suggested that such inflows may account for up to 25 percent of total inflows (UNCTAD, 2007). Chinese OFDI statistics from MOFCOM and SAFE are unable to capture such capital flight (Schüler-Zhou and Schüller, 2009). While Chinese official statistics are helpful for describing different aspects of the broader trends, we suggest that researchers build up their own database to supplement official data sources and that future studies triangulate their data with different data sources to improve data consistency and reliability.

Future studies could expand our analysis by considering the rising importance of civil organizations as actors interfacing in the space between the state and the Chinese multinational as the government continues to advocate "Harmonious Society" and how these important actors co-evolve as China increasingly asserts its international role as the world's second largest economy and soon-to-be the world's largest supply of capital (see Kennedy, 2008; Unger, 2008). We suggest that future studies employ co-evolutionary theory to investigate the role of SOEs (especially the functions of their CEOs) as well as non-state actors in shaping the institutional framework in China (see Child *et al.*, 2013; Dieleman and Sachs, 2008 for more detailed discussions on co-evolutionary theory). We hope our study will also provide implications to Chinese policy makers on how to balance the government's role as conductor, enabler, protector and constrainer while allowing Chinese multinationals to integrate into the global market for the benefit of both China and the world economy.

Notes

1. For more details the recent regulations related to Chinese OFDI, please refer to the following official Chinese documents: Regulations for the Administration of Outbound Investments, available at: www.mofcom.gov.cn/aarticle/b/bf/200903/20090306103210.html (accessed December 1, 2012); Regulations Of Foreign Exchange Administration For Domestic Enterprises' Overseas Direct Investments, available at: www.bbvaresearch.com/KETD/fbin/mult/111014_ChinaWatch_ofdi_tcm348-273161.pdf?ts = 7112011 (accessed December 1, 2012); Notice on the administration of cross- border loans by domestic enterprises, available at: www.gov.cn/zwgk/200906/09/content_1335718.htm (accessed December 1, 2012).

2. Such interlocking network could be seen in the Chairman and CEO Straszheim Global Advisors, Dr Donald Straszheim's comments: "The #1 person at Telecom retired. The #1 at Mobile went to become #1 at Telecom. The #1 at Unicom (the worst performer) went to #1 at Mobile (the best performer). The #2 at Union became #1 at Union. Consider Such bureaucratic shuffles still occur in the government […]" (Straszheim Global Advisors, November 10, 2004, available at www.siliconbeat.com/entries/20041110-China-Telecom-Mgmt-Reshuffle-2.pdf)

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