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What drives Chinese firms to invest globally?

*An analysis of outward foreign direct investments from China with
a special focus on the case of Lenovo Group Limited*

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Én, Somosi Dávid Áron teljes felelősségem tudatában kijelentem, hogy a jelen szakdolgozatban szereplő minden szövegrész, ábra és táblázat – az előírt szabályoknak megfelelően hivatkozott részek kivételével – eredeti és kizárólag a saját munkám eredménye, más dokumentumra vagy közreműködőre nem támaszkodik.

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1. Introduction

Some big countries such as China or India have gone through enormous changes in the last three decades. Their global emergence has been particularly spectacular in recent years. Due to their massive economic growth, influence of these economies is unavoidable nowadays.

These countries are often labelled as emerging economies or emerging markets (EMs). “EMs are defined as low-income, rapid growth economies that have experienced in the past years radical institutional changes, such as increased openness and liberalization” (Hoskisson *et al.*, 2000 cited by Stucchi, 2013, p. 14). This group of countries includes Middle and South America, Africa, and countries of the Association of Southeast Asian Nations (ASEAN). On the other hand, advanced markets are represented by North America, Western Europe, Australia, New Zealand and Japan as well as the so-called Newly Industrialized Economies (i.e. Hong Kong, Singapore, Korea and Taiwan) and Israel (Stucchi, 2013, p. 14). The remaining countries are considered emerging and developing.

There are several factors and characteristics that EMs share such as the less functioning institutional contexts compared to advanced markets, infrastructural voids, high rate of corruption, low GDP/capita and costs level, and low market efficiency, however, rapid growth in population and urbanization. Control of the government in several sectors in the past also characterized these countries and it still plays a major role (Stucchi, 2013).

Parallel to the rise of EMs, firms from these countries have also started to expand internationally resulting new players on the global scene. They are often called emerging multinational enterprises (EMNEs) in the literature. The emergence of these firms is substantial and particularly interesting since the international business (IB) literature has traditionally been dominated by theories that roots back to the Western economies, thus their applicability to the case of EM firms might be questionable.

The rise of EMNEs in the information technology (IT) sector also draw attention of recent literature and had media coverage as well. This field is especially interesting, important, and relatively new in IB. The common section of a growing and rapidly changing industry and a group of economies with similar attributes raises relevant and

current research questions. Motives and incentives of foreign direct investments by IT firms from EMs require further researches in order to have a better understanding.

In the present thesis, I focus on the development of outward foreign direct investment of Chinese firms with a special focus on IT firms. My basic research question is what drives FDI by Chinese firms especially in the field of IT?

In chapter 2, I give an overview of the relevant IB literature. I go through the most important theories and models and also focus on recent developments that try to process the phenomenon of EMs and EMNEs. I summarize the key models and approaches that can be useful if we want to have a deeper understanding of EMNEs in bigger perspective. Structured overview and synthesis of the literature can help to see and comprehend the way these firms become international and expand further in general as well as the drivers and motives that play significant role in this process.

In chapter 3, I summarize the key trends of the global outward FDI focusing on the role EMs and China. I also highlight how the roles of EMNEs have changed in recent years.

In chapter 4, outward FDI of Chinese firms is examined in order to identify the most frequent factors and patterns that drive international expansion through FDI.

Innovational background and development of China is described *in chapter 5* in order to have a wider perspective about the relevant macro level conditions of IT firms there. In this chapter, I will introduce some cases in India in order to compare China's state to the other most important EM in the field of the IT sector.

Finally, *chapter 6* introduces a case study of the Lenovo Group Limited as a relevant example of the research question. In my view, recent developments and the acquisitions of Motorola Mobility in the beginning of 2014 makes Lenovo an interesting and important firm to better understand and also to have a practical example of the patterns and drivers examined in the chapters before.

In this thesis regarding chapter 3 and chapter 4, I partly rely on one of my previous papers (Somosi, 2012) that participated in the Students' Scientific Conference (TDK) at the Corvinus University of Budapest in 2012 and at the National Students' Scientific Conference (OTDK) organized in Veszprém in 2013.

2. An overview of some relevant literature and theories on outward foreign direct investment

2.1 Traditional theories and models

In general, firm internationalization occurs when a firm diversifies its activity geographically and thus operates cross-border. Corporate strategy that is related to internationalization is considered international strategy (Czakó, 2010). Internationalization is a complex process containing more elements. Motivators of internationalization and type of product, location selection, schedule, ownership structure on foreign markets can be examined accordingly (Incze, 2007). Factors determining decisions related to internationalization of firms have been examined by the literature since the 1960s and there has been an important and ongoing development of international business studies since that decade. The related literature has identified several different research fields ever since (e.g. location selection costs, cultural factors, competitive strategies) (Buckley & Casson, 1998).

One of the most important academic journals that cover research on international business is the Journal of International Business Studies (JIBS) an official publication of the Academy of International Business that was established in 1970. Significance of this journal in business and management studies is demonstrated by the fact that it has been represented in the top publications in the field of both strategic management and international business¹.

The basis of today's IB roots back to the 1970s decade. This was a time when theories and models were established that have been helping to understand the phenomenon of international firms, their development and the process of internationalization. The most important and determining works include the internationalization theory (Buckley & Casson, 1976) and its further development, the so-called OLI model (also known as the Eclectic paradigm) (Dunning, 1980), and the Uppsala model (Johanson & Vahlne, 1977).

¹ According to the Google Scholar ranking that measures productivity and impact of published academic works, JIBS was ranked number 1 and 7 in the categories of international business and strategic management respectively in July 2013 based on the previous five years figures (Google Scholar, 2013a, 2013b).

2.1.1 The OLI model

One of the most widely accepted and tested frameworks in the field of foreign direct investment studies is the so-called *OLI model* also known as the *eclectic paradigm* by the British economist, John H. Dunning (1980). The abbreviation of OLI stands for ownership, location, and internationalization that refer to the main groups of competitive advantage in case of outward foreign direct investment (FDI). *Ownership advantages* mainly refer to intangible resources that a firm can easily transfer to its foreign markets (e.g. brand, technology) thus achieving higher revenue or reduced costs. *Local advantages* help firms to enter new markets in the framework and include economic advantages (e.g. lower production costs or rare natural resources), political advantages (e.g. economic policies to encourage foreign investors to settle), social, and cultural advantages (e.g. remarkable cultural similarity between the culture of internationalizing firm and that of the host country). Multinational enterprises have several different modes of entries to foreign markets (e.g. export, joint venture (JV), subsidiary). If transaction costs are too high on the market, firms internalize these activities, organizing them within its own borders on international level as well. The concept of *internalization advantages* suggests that in such cases, a firm rather produces its own product instead of giving the production license to another firm. (Dunning, 1980)

Dunning (1980) distinguished two main groups of FDI according to the motivation of investments: (1) *resource seeking investments* (in order to establish access to favorable factors of production such as important raw materials or cheap labor); (2) *market seeking investments* (in order to enter an already existing market or establish a new one). Since that two more groups were identified by Dunning, namely (3) *efficiency seeking* (FDI taking advantage of differences in traditional factor endowments in different countries), and (4) *strategic asset seeking* (FDI acquiring a new technological base, rather than exploiting an existing asset) (Franco, et al., 2008).

2.1.2 The Uppsala model

The Uppsala model is one of the most important and long-lasting models of firm internationalization originally published in 1977 by two Sweden-based professors, Jan Johansson and Jan-Erik Vahlne. This is the most cited JIBS article ever since – according to the Google Scholar it has been cited 7,002 times (Google Scholar, 2014),

while based on the JIBS database number of citation is 1,780 so far (JIBS, 2014)². The authors argue that internationalization is a characteristic of existing firms that start to gradually expand on foreign markets after successes on domestic markets. Based on their experience, firms following a kind of risk-averse strategy start internationalization by exporting than they gradually increase their influence and finally, establish own subsidiaries abroad. Its subsequent revision by the same authors pointed out that knowledge of local market is an extremely important resource in order to handle “liability of foreignness”³, however, knowledge acquisition by non-empirically ways (e.g. firm acquisition or imitation) can be also favorable. The latter is indicated by the trend that acquisition has become the most important form of internationalization in terms of monetary value nowadays (Johanson & Vahlne, 2009).

2.2 Emerging markets in international business literature

Although these theories and frameworks have been good basics ever since there is a wide range of literature dealing with these findings and IB in general. Several papers and books in the field of IB challenge or complement them. New phenomena such as the rise of emerging markets and emerging multinational enterprises draw the attention of researchers and has resulted an enhanced interest in IB. The ways EMNEs improve and internationalize follow some patterns that could have not been surely and completely explained by the original IB theories. The literature has recognized the significance of this issue as well as the opportunity to observe the phenomenon of global growth among EMNEs that can be a good basis to further enrich current theories about firms’ internationalization.

Many authors have added important new elements to the field of IB that have contributed to a better understanding of emerging markets and their internationalizing multinational enterprises. Thus an overview of these new theories and developments are necessary in order to better understand and establish an appropriate theoretical framework that can explain international strategies of EMNEs

² Google Scholar monitors a wider range of sources including journals, university studies and other publications that may get stuck on the filter of JIBS.

³ Liability of foreignness is the inherent disadvantage that foreign firms experience in host countries because of their non-native status (Johanson & Vahlne, 2009).

Based on an exhaustive and comprehensive literature review, Stucchi (2013) distinguishes historically two main phases in the development of emerging markets related IB literature. The first stream of research emerged in the 1970 and 1980s and focused on the so-called “first wave” of internationalization of EMNEs. These studies were characterized by limited range of data and some “anecdotal evidence” on the new multinational firms originating from developing countries. Obviously, it was challenging to empirically study and compare them. The second, more recent and extensive body of literature emerged in the 2000s and studied internationalization of EMNEs with a special regard to drivers, growth, host location choices, ownership structures, relational assets, and performance effects of internationalization (Stucchi, 2013, p. 16).

The beginning of the latter phase was rather exploratory with studies concentrating on the growing phenomenon of EMNEs and its interesting aspect. However, research focus has shifted to better understand how the rise of EMNEs might challenge already existing explanations since environment and characteristics of such firms have been different. On the one hand, a group of researches argued that traditional theories and models that are based on studies of mature advanced market firms are not adequate enough in this context and thus these firms should be studied using different perspectives. On the other hand, another group of researches claimed that traditional concepts are suitable for EMNEs and there is no need to develop new theories and models. What the mainstream IB literature follows now is more a third, moderate point of view that is open to extend traditional theories due to the unique conditions in emerging economies. However, it does not suggest radical abandonment of mainstream IB theories either.

Below, I introduce the so-called *strategy tripod* (Peng, et al., 2008) that can be a useful concept in order to better understand EMNEs including elements of traditional theories but also an approach that has not been widely applied in IB literature.

2.2.1 The strategy tripod

Since the deeper understanding, thorough and comprehensive explanation of international business strategy of EMNEs form a significant part of the current thesis, I highlight the most important elements in this field and emphasize some key points in

which remarkable differences can be identified between multinational enterprises from developed and emerging economies. Here, I largely rely on Peng et al. (2008) who claimed international business strategy approaches and views can be traced back to three main theories called the strategy tripod including the industry-based, resource-based, and institution-based views.

Two of the most basic questions in IB studies are the following: what drives firm strategy in IB and what determines the success and failure of firms? To answer these questions, traditionally two views of the strategy tripod are applied: the industry- and the resource-based views (Peng, et al., 2008).

Industry-based view

An industry-based view, represented by Porter (1980) argues that industry conditions determine firm strategy and performance on the long run. This was the basis of the so-called five forces framework that has become of the most well-known frameworks in management studies. It says that five forces bargaining power of suppliers, bargaining power of buyers (as parts of the supply chain), threat of new entrants, threat of substitute products or services, and rivalry among existing competitors shape industry competition (Porter, 1980, p. 4). In case of low bargaining powers of suppliers and buyers as well as low threats of new entrants and substitutes, and low industry rivalry firm performance and profitability can be higher.

This view, however, cannot explain some important IB issues. For example entry barriers can determine industry competitiveness thus researchers has focused mainly on market-based variables such as economies of scale or competitive strategy (mass or differentiating production) but they rarely have taken non-market proxies into account such as regulatory environment that can also have a great effect on entry barriers. Peng et al. (2008) mentions antidumping laws as examples which have long been key determinants of strategy and performance of emerging multinationals in developed countries. This is particularly relevant when home country firms and governments realize the threat of new, foreign entrants and thus the growing pressure of competition. An OECD study shows that the vast majority of anti-dumping practices are unfair in developed countries – they use double standards to the domestic and foreign firms. Common abuses were in the calculation of costs, unfair price comparisons and use of arbitrary exchange rates or minimum profit rates (OECD, 1996). Despite the tightening

rules favoring international trade, such protectionist policies and tools can be still found. However, another point of view has also emerged, namely security issues and fears that have become more important in recent years, e.g. Huawei, a Chinese telecommunication firm failed to bid for telecommunication network developments in the United States due to security concerns of interception and spying (Bloomberg, 2011).

A resource-based view

Meanwhile, the resource-based view says that it is firm-specific differences that drive strategy and performance. This view was largely exemplified by Barney (1991) who suggested the so-called VRIO framework that argues a firm can sustain competitive advantage if its resources are valuable, rare, in-imitable, and non-substitutable. The last element of this framework is often replaced by organizational embeddedness (VRIN). This framework translates the theory by saying that a firm can sustain its competitive advantage and thus higher performance and profitability if it has valuable resources that are neither perfectly imitable nor substitutable without great effort.

Even though resource-based view is an outstanding, often used and referred approach of strategy and IB today, again, some highly significant developments in IB cannot be explained through a resource-based view utterly. A good example is the rapid growth of Indian business process outsourcing (BPO) firms in the last three decades. The traditional argument says that due to the massive investments of Western firms in India in order to outsource some of their business processes lead to the rise of competitive Indian firms and their internationalization in this industry. This is because these firms could learn the key features of the industry and had the same access to the most important resource: talent pool. However, several studies have drawn the attention on the importance of other factors, claiming that Indian BPO or IT firms could not have grown and internationalize without the massive supporting role of the state or the particular social net and background that these firms have (D'Costa, 2009).

Institution-based view

Recent developments of emerging multinational firms suggested that these two views are not sufficient enough to explain their international business strategy. Peng et al. (2008) argues that home and host country environment also matter to a great extent especially in the case of emerging markets. They claim that industry- and resource-

based views can be criticized for heavily ignoring the formal and informal institutional explanations of international business strategies. Hence, an institution-based view is also necessary to be applied as a third leg of the strategy tripod, especially when emerging multinationals is examined. They say that the importance of institutionalism and its penetration into the IB and strategy studies has been growing since the 1990s that is in line with the rise of emerging economies and the transition of post-socialist countries indicating that understanding and explaining new phenomena on the worldwide stage requires additional approaches (Peng, et al., 2008, p. 924).

Institutions are basically the “rules of the game” that can be defined as “regulative, normative, cognitive structures and activities that provide stability and meaning to social behavior” (Scott, 1995, p. 33). In this sense, institutions can determine societal transactions in the fields of politics (e.g. corruption), law (e.g. economic liberalization), and society (e.g. ethical norms) (Peng, et al., 2008). This approach is largely relevant for determinants of home and host country environment and it has become more relevant as emerging and transition economies appeared in the early 1990s. So far the mainstream strategy and IB studies had focused on and examined countries where well-established and relatively constant institutions had functioned. However, the transition of the former Eastern bloc (including Hungary, Poland or Russia) from socialist to capitalist systems and the rise of emerging economies (such as China or India) from a relatively closed to more open market are good examples of that when the “rules of the game” are constantly changing and not completely known (Peng, et al., 2008, p. 924).

Institutions are more than simple background conditions for firms they can directly determine how firms perform. That is why its importance is also largely stressed by international comparisons and rankings such as the World Economic Forum’s Global Competitive Report (WEF, 2013) or Th (UnctadStat, 2014a)e World Bank’s Doing Business Guide (The World Bank, 2013). In case of emerging markets, research of institution-based view has become a cutting edge of strategy research in the 2000s years and it turned out to be the third leg in the strategy tripod (see Figure 1).

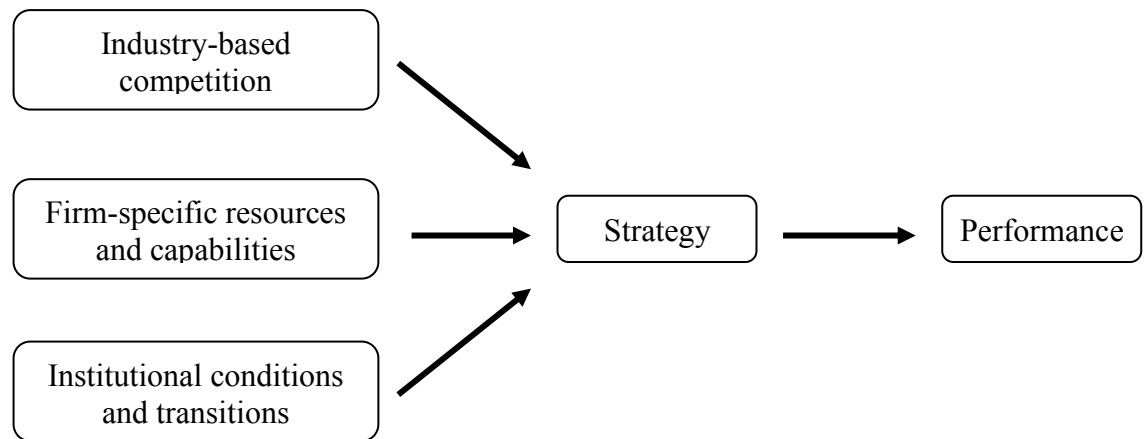


Figure 1. The Strategy Tripod.

Source: Peng, et al., 2008, p. 923

2.2.1 Institutional differences

It is clear that strong economic growth hardly can occur in countries where regulations fail to perform their tasks. Well-functioning public and private institutions are crucial in order to sustain environmental conditions that greatly determine performance of firms and individuals. This logic is widely accepted and significantly stressed in literature (WEF, 2013), however, we should not forget that these assumptions and statements root in today's Western economies and the way they function.

Despite the remarkable economic growth in China in the last three decades, the Chinese institutions are relatively underdeveloped. This poses an important question: how can China achieve such an economic performance, while retaining a less developed institutional order? Peng, et al. (2008) say that in order to answer this question an institutional-view and a deeper understanding of the Chinese norms and institutions is necessary. They highlight the role of interpersonal networks (called *guanxi* in Chinese) of managers can be an informal substitute for formal institutional support. This micro and interpersonal relationships are really good basis organization of works, alliances to grow firms and resources to help other members of the network. Accordingly, without more formal and stronger institutions, firms and individuals develop substitutes that support market coordination on a micro level and drive firm strategies and performance.

This is not only a Chinese phenomenon thus it should not be simply contributed to the Chinese culture. Numerous studies have shown similar evidencies of the rise of such

informal networks and relationships in other developing or transitional parts of the world such as Argentina, India, or Russia (Peng, et al., 2008, p. 927). As a conclusion, Peng, et al. (2008, p. 928) argues that „the broad range of these countries with different cultural traditions and transition trajectories suggests that the convergence on convergence on this network-based strategy is not likely to be driven by national culture alone but, rather, more significantly by common institutional characteristics – in particular, the lack of formal market institutions – during the transitions.”

This observation raises an interesting dilemma. On the one hand, if it is national culture that drives strategic choices, the importance of interpersonal relationships described above will survive even if formal institutions grow stronger as market reforms deepen since culture changes relatively slowly. On the other hand, if it is the state of institutional development that greatly influences strategic choices a gradually decreasing role of such interpersonal relationships and growing reliance on formal institutions can be expected. There is no exact answer to this dilemma and it will remain an interesting basis of further researches while market reforms will be probably continued in developing and transitional countries. However, evidences supporting the institution-based view is now emerging (Peng, et al., 2008).

2.2.2 Ownership and corporate governance characteristics

The phenomenon described above illustrates well that studies on emerging markets and enterprises should not be based on frameworks or approaches that were determined and shaped by the environment and conditions of Western economies. The question of firm ownerships in emerging economies also shows that different macro and micro conditions can result remarkably different structures that would be expected otherwise.

In the field of firm ownerships, researches has long been based on the assumption that ownership is dispersed and separate control functions in case of multinational enterprises. This approach can be traced back to the principal-agent conflict modelling the relationship and opposition between shareholders and managers. However, Peng, et al. (2008) points out that dispersion of ownership and separate, well-functioning control is rather an exception than the rule in the world. They say that is especially true in emerging economies where significant state and family ownerships can be seen in case of many large multinational enterprises. For example the majority of Tata Group from

India is owned by one family while China Mobile, the leading Chinese telecommunication company is wholly owned by the state (The Economist, 2011). This eliminates the principal-agent conflict, indeed it brings a principal-principal conflict between the controlling shareholders (usually a family or the state) and minority shareholders. In such a situation, development of separate control is a great challenge since the controlling shareholders (a family or the state) rarely want to share the control anybody.

As a conclusion, study of EMs and EMNEs in the international business and international strategy literature is a still developing and expanding field. Many researchers have claimed that traditional models and frameworks are not always adequate in case of EMs and EMNEs due to their different background and home country environment. Although different approaches are necessary to better understand this field, a complete change in the ways international firms are studied are not widely supported and thus not required.

3. Outward foreign direct investments from emerging economies

3.1 *Key terms and definitions*

In this chapter, I describe and analyze outward foreign direct investments (FDI) from emerging economies in the last two decades. My goal is not to give a complex analysis of outward FDI rather to have an overview and understand the role and place of outward FDI by EMNEs in the world. This can be a good basis of further examination as micro level case studies can be placed and understood in a bigger perspective.

As an official definition of FDI, I use the United Nations terminology saying that “foreign direct investment (FDI) is defined as an investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investor (FDI enterprise or affiliate enterprise or foreign affiliate).” (United Nations, 2007, p. 245). I use statistics provided by the United Nations Conference on Trade and Development (UNCTAD) (UnctadStat, 2014a). UNCTAD is “the United Nations body responsible for dealing with development issues, particularly international trade – the main driver of development” (UNCTAD, 2014a). Statistical department of UNCTAD “validates and processes a wide range of data collected from national and international sources. Most of the time series cover long periods, with some dating back to 1948, for almost all economies of the world” (UNCTAD, 2014b).

I distinguish regions and types of countries based on their level of development in my analysis in order to present and compare figures that can be assigned to emerging markets. Due to the fact that UNCTAD does not have emerging economies category in its statistical databases, I use the more traditional “developed” and “developing” economy distinction in some cases. I must highlight that there is no established convention for the definition and designation of “developed” and “developing” countries in the world. World organizations such as The World Bank or United Nations usually agree on the classifications of many countries, however, they might apply slightly different interpretations in some cases. I use the United Nations terminology in this sub

chapter, and divide countries into three major categories: developing countries, transition economies and developed economies (UnctadStat, 2014b). Table 1 below shows definitions of each category. I must note that I mention transition economies in other parts of my thesis that refer to a wider range of countries that in the UN statistics presented below. This is because several Central and Eastern European (CEE) countries such as Hungary, Poland or Romania are considered developed by the UN, however, more authors highlight that their transitions from centrally planned economy to free market have not been finished yet, thus they are also handled as transition economies. This is particularly relevant in the description of the institution-based view of IB (Peng, et al., 2008).

Development status	Description
<i>Developing economies</i>	This category includes all countries and territories in America, Africa, Asia and Oceania not included in the two categories mentioned below.
<i>Transition economies</i>	This group includes countries in transition from centrally planned to market economies including Albania, Bosnia and Herzegovina, Croatia, Georgia, Montenegro, Moldova, Serbia, TFYR of Macedonia, Turkmenistan, Ukraine, and each country in the Commonwealth of Independent States (CIS).
<i>Developed economies</i>	In common practice, Israel and Japan in Asia, Bermuda, Canada, Greenland, Saint Pierre et Miquelon, and the United States in northern America, Australia and New Zealand in Oceania, and the European Union are considered "developed" regions or areas.

Table 1. Definitions of countries, territories, and country groups by development status

Source: UnctadStat (2014b)

3.2 Development of the global outward FDI between 1993-2012

Total outward FDI (OFDI) stock has greatly grown since the beginning of the 1990s which was an era of ever growing international trade liberalization and also considerable growth rate in world economy (Tussie & Aggio, 2006). FDI stock in the world became 8.5 times larger between 1993 and 2012 reaching nearly 23.6 trillion

USD, that was mainly dominated by developed economies but developing ones had a growing share as well (see Figure 2). A significant drop at the outbreak of the global financial crisis of 2008 can be seen, however, FDI started to pick up again in the 2008-2012 global financial recession. This upspring was partly due to a more intense FDI activity of developing economies. In Figure 3, data of Brazil, Russia, India, and China (BRIC) are shown as one common group separated from developing economies (or transition economies in case of Russia) in order to better illustrate their growing importance in this field. However, in Table 2 their data can be found in the relevant group of economies.

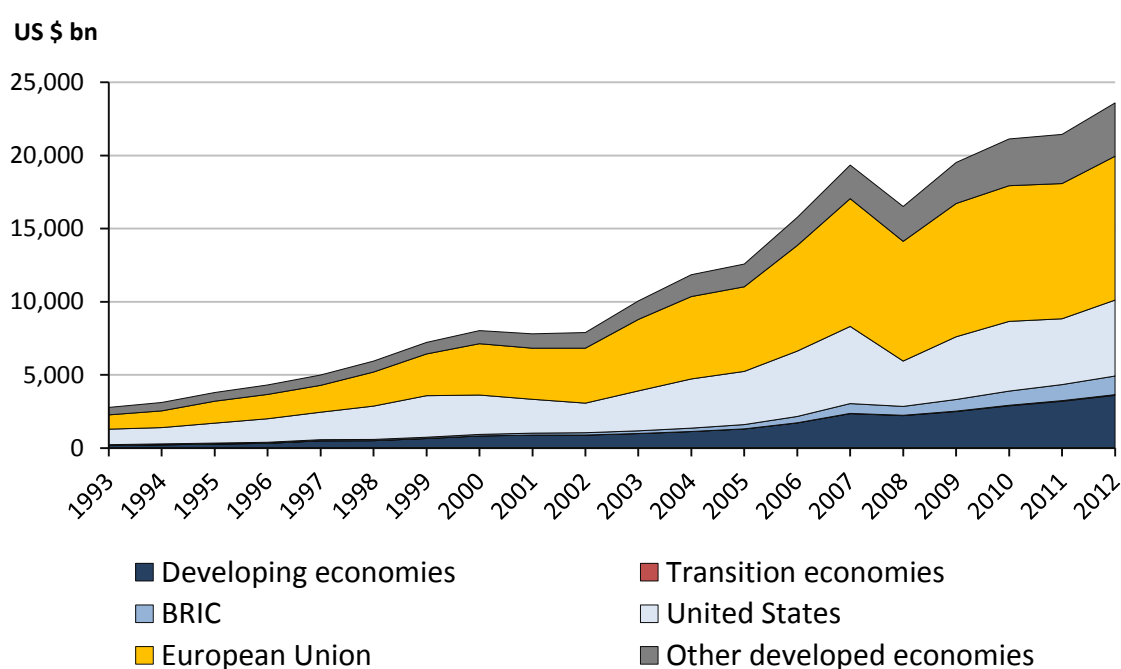


Figure 2. Global outward foreign direct investment stock, 1993-2012

Notes: Values are expressed in US \$ at current prices and current exchange rates in millions. Brazil, China, and India are excluded from the developing economies category their figures are illustrated in the BRIC category. The Russian Federation is considered a transition economy, but on this chart its figures are illustrated in the BRIC category and excluded from the Transition economies group making its size insignificantly small. *Source:* Calculated from UnctadStat (2014a)

Table 2. shows that developing and transition economies also had a higher annual growth rate than developed economies. While developed countries had nearly 92% share in total outward FDI stock, this figure has been dropped to 79% by 2012 indicating that international firms from developing countries emerged that have continuously growing outward FDI. This drop is especially remarkable in case of the United States.

Country	CAGR (1993-2002)	CAGR (2003-2012)	Share in total (1993)	Share in total (2012)
Developing economies	17.9%	17.1%	8.0%	18.9%
Transition economies	40.4%	19.2%	0.1%	2.0%
Developed economies	11.6%	8.6%	91.9%	79.1%
European Union	16.1%	8.1%	35.2%	41.7%
United States	7.4%	7.4%	38.3%	22.0%
World	12.3%	9.9%	100.0%	100.0%

Table 2. Global outward foreign direct investment stock growth and distribution, 1993-2012

Note: CAGR = compound annual growth rate in FDI stock

Source: Calculated from UnctadStat (2014a)

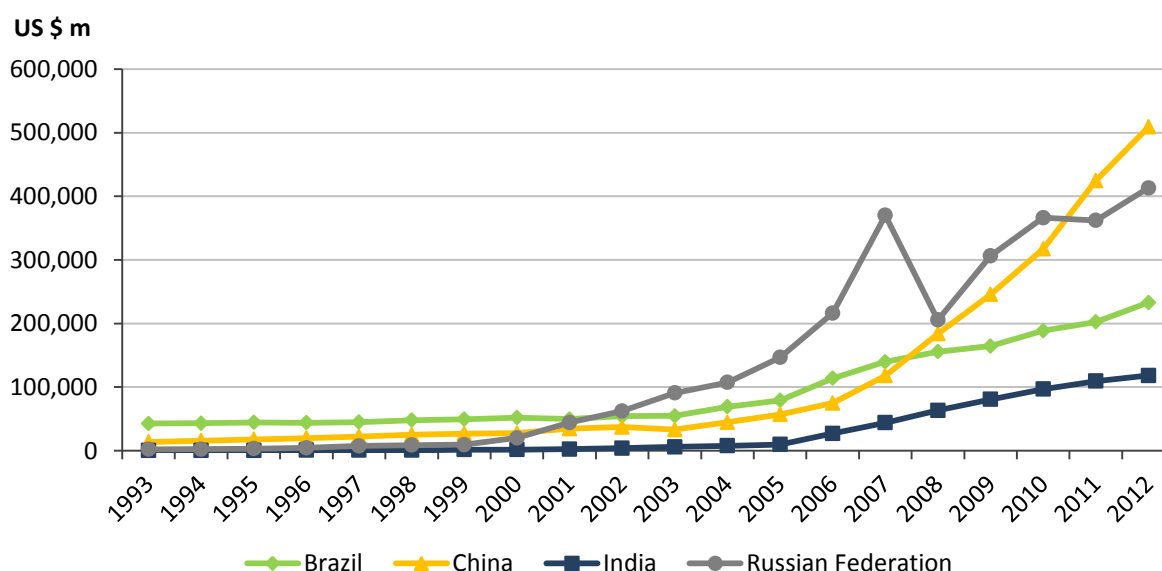


Figure 3. Outward foreign direct investment stock in BRIC countries, 1993-2012

Note: Values are expressed in US \$ at current prices and current exchange rates in millions.

Source: Calculated from UnctadStat (2014a)

Regarding BRIC economies (Brazil, Russia, India, and China) growth in outward FDI is notable. Outward FDI stock rocketed from nearly 59 billion USD to 1,273 billion USD between 1993 and 2012 (UnctadStat, 2014a). A significant change in trends can be seen in the beginning of the 2000s. This was partly due to the newly acquired membership in the World Trade Organization and thus diminishing regulation and trade barriers but massive economic growth of these economies and international growth supporting government policies also played an important role (Nicolas & Stephen, 2008). Since

that China had outstanding compound annual growth rate making it the economy with the largest outward FDI stock (509 billion USD) among BRIC and emerging economies. China is followed by the Russian Federation reaching 413 billion USD, while Brazil and India had significantly lower outward FDI stock in 2012: 233 and 118 billion USD respectively (see Figure 3).

Country	CAGR (1993-2002)	CAGR (2003-2012)
Brazil	2.7%	17.4%
China	11.7%	35.4%
India	33.9%	39.1%
Russian Federation	44.3%	18.3%
<i>Average (weighted)</i>	<i>11.6%</i>	<i>23.9%</i>

Table 3. Outward foreign direct investment stock growth rates in BRIC countries, 1993-2012

Note: CAGR = compound annual growth rate in FDI stock

Source: Calculated from UnctadStat (2014a)

3.3 Limitations in the analysis of aggregated outward FDI from China statistics

Three main limitations of the findings above must be noted: (1) role of offshore investments, (2) Hong Kong's special situation, and (3) the effect of the global financial crisis started in 2008.

Role of offshore investments. Vast majority of the Chinese OFDI is invested in countries with favorable tax conditions in order to reinvest that in China and thus realize significant tax relief. These destinations include tax havens such as Hong Kong⁴, Cayman Islands, and British Virgin Islands. These destinations accounted for 67%, 6%, and 6% of China's outward FDI respectively in 2009 (Salidjanova, 2011, p. 23). This phenomenon is largely due to government policies and regulations as China gives tax benefits and other concessions for inward FDI regardless even if the actual firm is not truly foreign (Peng, 2012). This does not necessarily mean that all of the investments in the above mentioned three countries are reinvested in China again. A

⁴ There are different views about Hong Kong's state if it is a tax haven. As it is officially part of China, it is often not represented as a separate country in international reports, though different regulations can be still applied there. It makes OECD listings of countries that do not comply with internationally agreed tax standards even more complicated and slightly controversial (Watt, et al., 2009).

large portion of it may be invested in other developing or developed countries and the intermediate step of tax havens is used in order to avoid stricter government inspections or duty to provide data.

This trend draws the attention on the importance of institution-based view in case of China's OFDI. Host country advantages has accreted a remarkable attention in IB studies, however, role of home country governments should not be neglected in many cases. State of China's OFDI is a good example of how home country government policies determine FDI trends. The role of this in an institution-based perspective is explained in details in a later chapter in which incentives of Chinese MNEs is described.

Hong Kong's special situation. Hong Kong plays an important role in case of inward and outward FDI to and from China as it is often an intermediate step for firms going to or coming from China (Peng, 2012). Hong Kong's outward FDI was 1,310 billion USD in 2012 that is 2.57 times higher than that in China (UnctadStat, 2014a). A portion of this amount is probably reinvestment in China or FDI by firms from developed countries that want to invest in China in the end but firms listed on the Hong Kong Stock Exchange also have an important role (Peng, 2012). This should not be neglected as some firms originally from mainland China (excluding the Special Administrative Regions of Hong Kong and Macau) are listed on the Hong Kong Stock Exchange, hence their outward FDI are represented in the statistics of Hong Kong.

Effect of the global financial crisis. Due to the global financial crisis lack of capital largely determined the investments of MNEs from developed countries such the United Kingdom or the United States. This resulted in reduced OFDI from these economies. However, a drop in economic growth to such an extent did not threaten China and sufficient financial capital was available. This made it possible for China to increase its share in total FDI and partly fill the gap that was resulted by the reduced FDI of MNEs from developed countries in general. Figure 3. also represents that after 2007 Chinese OFDI growth graph was steeper. However, it must be noted that regardless the effect of the global financial crisis, OFDI from China could also grow in terms of absolute values.

3.4 Conclusion of the Chinese outward FDI trend

As a conclusion, macro level statistics of outward FDI supports the assumption that FDI from China have started to rapidly expand on the global market. This does not mean at all that altogether it has achieved the same level that of the developed economies. What it means is the fact that the role of Chinese outward FDI cannot be ignored anymore as it contributes to the global FDI activity more and more and its share is becoming ever more determining if current growth rates sustain in the near future. However, these findings should be handled carefully as majority of such investments cannot be viewed as real outward FDI in every aspect. This is due to the role of offshore investments and then reinvestments in China. Moreover, the effect of the global financial crisis also overshadows this picture.

Despite the limitations of the findings described above, these statistics as well as the previous conclusion numerically supports the idea of growing significance of Chinese firms on the international scene. It also supports ideas that draw attentions on the relevance of internationalization by Chinese firms. On the following pages, I introduce, describe, and analyze the historical development of the Chinese outward FDI and also try to highlight possible limitations of this trend.

3.5 Growing importance of EMNEs among the largest firms

3.5.1 Comparison of the largest MNEs in developed and developing economies based on the level of internationalization

Table 4 gives an overview of the largest 100 transnational companies (TNCs) worldwide (dominated by developed countries) and from developing and transition economies (i.e. EMNEs). Internationalization is reflected by three main proxies of firms, namely assets, sales, and employment allocation. In 2011, largest TNCs worldwide had significantly higher rate of internationalization with minimum 60% share of foreign assets, sales and employment. Meanwhile, the same figures of the 100 largest TNCs from developing and transition economies remained below 50% (but growing) showing that their internationalization is still lagging behind. However, we must not that on the one hand, the largest TNCs from developing and transition economies are usually from the emerging markets with huge domestic market, on the

other hand, many of the great transnational companies in the developed countries have a small domestic market and thus make their own operation and sales international from the very beginning.

	100 largest TNCs worldwide			100 largest TNCs from developing and transition economies		
	2010	2011	Change	2010	2011	Change
Assets (\$ bn)						
Foreign	7,285	7,634	4.8%	1,104	1,321	0.0%
Domestic	4,654	4,897	5.2%	3,207	3,561	11.0%
<i>Total</i>	<i>11,939</i>	<i>12,531</i>	<i>5.0%</i>	<i>4,311</i>	<i>4,882</i>	<i>13.2%</i>
Foreign as % of total	61%	61%	-0.1	26%	27%	1.4
Sales (\$ bn)						
Foreign	4,883	5,783	18.4%	1,220	1,650	35.2%
Domestic	2,841	3,045	7.2%	1,699	1,831	7.8%
<i>Total</i>	<i>7,724</i>	<i>8,828</i>	<i>14.3%</i>	<i>2,919</i>	<i>3,481</i>	<i>19.3%</i>
Foreign as % of total	63%	66%	2.3	42%	47%	5.6
Employment (000)						
Foreign	9,392	9,911	5.5%	3,561	3,979	11.7%
Domestic	6,742	6,585	-2.3%	5,483	6,218	13.4%
<i>Total</i>	<i>16,134</i>	<i>16,496</i>	<i>2.2%</i>	<i>9,044</i>	<i>10,197</i>	<i>12.7%</i>
Foreign as % of total	58%	60%	1.9	39%	39%	-0.4

Table 4. Internationalization statistics of 100 largest non-financial TNCs, worldwide and from developing and transition economies, 2010-2012

Note: Changes in “Foreign as% of total” are represented in percentage points.

Source: UNCTAD (2012, p.25)

3.5.2 Global challengers

Growing number of EMNEs on the global scene catalyzed several research and analysis that studies key characteristics of such enterprises. The motive is clear: if the number and value of these enterprises continue to rapidly increase developed economies need to be prepared and know what to expect with changing global market conditions and roles. This trend is relevant for Western incumbents, managers, regulators, and consumers as well. This logic was recognized by the Boston Consulting Group (BCG) almost a

decade ago and launched a special report on the development of outstanding EMNEs. The BCG has been publishing Global Challengers – a list of 100 fast-globalizing companies from emerging economies (the authors call them rapidly developing economies (RDEs) every second year since 2006 (The Boston Consulting Group, 2006, 2008, 2009, 2011, 2013).

The authors have been using the same methodology since 2006. Below, I summarize the methodology since understanding the model can be a good basis of also understanding what consultants and professionals in business world consider rapidly growing and internationalizing firm from emerging economies.

Monitoring is launched with more than 3,000 companies based in RDEs, which are selected on the basis of GDP, export value, and amount of FDI. The list of these economies includes both transition (e.g. the Czech Republic, Hungary, Poland, Russia) and developing countries (e.g. Brazil, China, Malaysia, Thailand). Shortlisting continues with the analysis of the largest companies in these locations based on different types of resource such as the top 500 companies in India selected by Businessworld (the leading business magazine in India). There are some strict rules applied when a company is shortlisted – a minimum of \$1 billion annual revenue, at least 10% export revenue, and truly RDE origins excluding companies that are foreign joint ventures or RDE subsidiaries of multinational corporations. This step is followed by the scoring model that is based on more criteria related to the extent of international operation including network of manufacturing facilities and R&D centers, sales network, access to capital and source of financing or intellectual property portfolio. Finally, the analytically rigorous approach generated list of companies is considered to be the actual global challengers – fast-globalizing companies that have a growing influence on the global scene. (The Boston Consulting Group, 2006, p. 8)

It must be noted that such scoring models and reports published by management consulting firms can be blamed for considerable simplification. Selection of drivers and factors have professional foundation without a doubt, however, corporate managers and clients – who often requires aggregated and simplified information – are the main target groups of these studies.

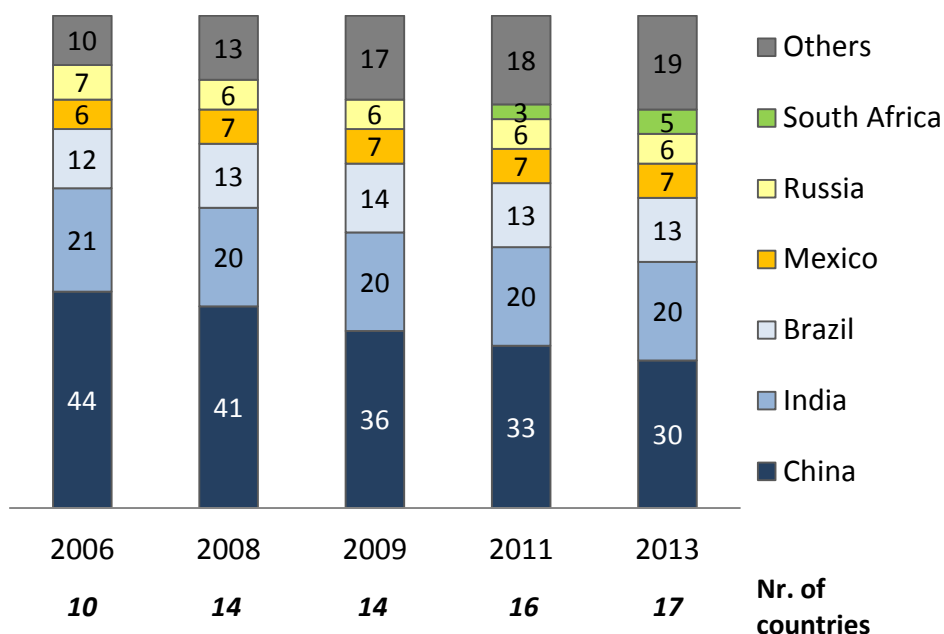


Figure 4. Number of BCG 100 global challengers by home country locations, 2006-2013

Note: Others include countries that are represented only by maximum four challengers. This category mainly includes Chile, Malaysia, Thailand and Turkey.

Source: Based on The Boston Consulting Group (2013, p. 13)

Figure 4 represents how the number of global challengers by home country locations changed since the report was launched. Chinese companies had the highest number each time, however, a continuous shrinking can be seen: 44; 41; 36; 33; and 30 out of 100 in 2006, 2008, 2009, 2011, and 2013 respectively. Meanwhile, number of home countries in the 100 list increased and in parallel share of challengers from the others category also rose. It shows a continuously growing diversification in terms of home country location indicating the trend that the group of RDEs (and by extension of emerging economies) and their internationalizing multinational enterprises are expanding on the global market. These companies cover a wide range of industries such as automotive, energy, financial services, information technology, shipping or steel production.

This trend shows that Chinese EMNEs are still dominating among the entire group of EMNEs even if their weight has declined. Hence, not only the aggregated market values and revenues but more sophisticated and complex analyses have proved the relatively developed internationalization and high influence of Chinese EMNEs. This statement can be important as it implies that future development and judgment of emerging

multinationals on the global market will be largely influenced by the presence and performance of their Chinese counterparts.

3.5.3 Largest firms by revenue and market capitalization

In general, international presence of firms from a given country is in line with outward FDI figures from the same country. This assumes that due to rising outward FDI international activity, operation or export revenue of firms also increase. Thus outward FDI data is commonly used in most researches on the internationalization of Chinese companies (Schüler-Zhou & Schüller, 2009).

EMNEs had a remarkable growth in terms of more important general indicator such as revenue, headcount, market capitalization, or foreign direct investments in the 2000s. The spectacular development is reflected by the Fortune Global 500 and the Financial Times (FT) Global 500 rankings. The former ranks the largest 500 companies based on revenue, while the latter also ranks the largest 500 based on market capitalization in the world. Looking at the results of both rankings since 2007, growth of Chinese firms is unquestionable. Number of firms headquartered in China jumped from 24 to 89 between 2007 and 2013 (see Table 5). Growth in market value is also significantly higher in case of China (CAGR: 12%) and other emerging economies during the same period. Meanwhile market value of firms from developed economies shrank or slightly increased in general (see Table 6).

	Country	Number of companies			
		2007	2010	2013	Change
1	US	162	139	132	-30
2	China	24	46	89	65
3	Japan	67	71	62	-5
4	France	38	39	31	-7
5	Germany	37	37	30	-7
6	UK	34	30	26	-8
7	Switzerland	13	15	14	1
8	the Netherlands	14	13	11	-3
9	Canada	16	11	9	-7
10	Brazil	5	7	8	3
11	Australia	8	8	8	0
12	Italy	10	11	8	-2
13	Spain	9	10	7	-1
14	Russia	4	6	7	3
15	India	6	8	7	1

Table 5. Top 15 countries based on revenues of companies headquartered there

Note: The list includes a few companies that cannot be clearly categorized as they have two headquarters with the same rank in two countries (e.g. Unilever that is co-headquartered in London, UK and Rotterdam, Netherlands or Rio Tinto in London, UK and Melbourne, Australia).

Source: Calculated from Fortune (2014)

The vast majority of Chinese firms in these rankings operate in the energy or financial services industry such as China National Petroleum or Industrial & Commercial Bank of China (FT, 2014) (Fortune, 2014) (Nicolas & Stephen, 2008). These results, however, are influenced by the effect of the global financial crisis since the value of many firms from developed countries was dropped making it easier for Chinese firms to grow. I find the Fortune Global 500 rankings more relevant and a better representation of the importance of Chinese firms as many global but large firms are not listed on stock exchanges.

3.5.4 Largest firms by market capitalization

	Country	Number of companies				Market value (\$ bn)			
		2007	2010	2013	Change	2007	2010	2013	CAGR
1	US	184	163	182	-2	10,585	8,663	11,583	2%
2	UK	41	32	31	-10	2,496	1,875	1,940	-4%
3	China	8	23	22	14	860	1,752	1,675	12%
4	Japan	49	42	34	-15	2,091	1,443	1,437	-6%
5	France	32	27	23	-9	1,754	1,229	1,062	-8%
6	Hong Kong	8	19	23	15	393	668	979	16%
7	Switzerland	12	13	12	0	878	804	976	2%
8	Germany	20	19	19	-1	1,032	825	954	-1%
9	Canada	23	27	25	2	772	886	904	3%
10	Brazil	7	12	10	3	354	764	636	10%
11	Australia	11	13	10	-1	443	644	608	5%
12	Russia	8	11	8	0	643	513	430	-6%
13	India	8	16	12	4	241	485	388	8%
14	South Korea	6	6	5	-1	233	241	335	6%
15	Sweden	9	7	10	1	299	212	328	2%

Table 6. Top 15 countries based on market values of companies headquartered there

Notes: Change is the difference in the number of companies between 2007 and 2013.

CAGR = compound annual growth rate revenue between 2007 and 2013.

Source: Calculated from Fortune (2008), Fortune (2011), Fortune (2014)

Corporations in the field of energy and financial services as well as telecommunication service providers represent Chinese multinationals the most. It is important to note that there are more Chinese firms in these lists that mainly operate on the domestic market with domestic resources and consumers. Such firms are Tencent and Baidu in the field of online media or China Life in the field of bank and insurance. As a conclusion, those Chinese firms have more important role that internationalize in order to acquire natural resources. Besides large Western energy companies such as Exxon or Shell, PetroChina or Sinopec can be also found among the leaders, however, Chinese IT or automotive companies are not included in the examined lists even though many of their Western counterparts are on the top of these lists.

3.5.5 Other aspects

As a conclusion, that global role of Chinese MNE has incredibly jumped in the last couple of years based on revenue and market capitalization figures. However, there are other aspects that must be taken into consideration to have a more sophisticated image. Hence, I also use brand value rankings to analyze international role of Chinese firms. The BrandZ Top 100 ranking by a market research firm, Millward Brown and the Global 500 rankings by a brand and intangible asset valuation firm, Brand Finance lists the most valuable brands globally (Millward Brown, 2013) (Brandirectory, 2014). They have differences in their methodology, however, the essence of both rankings is the estimation of future revenue attributable to a brand.

After reviewing these rankings, there are two major findings: (1) IT firms have an overwhelming global role; (2) Chinese firms have significantly worse overall performance in this field than that in the previous rankings (see Table 7 and Table 8). It is important to note that leaders in these tables are also top performers in the Fortune and FT Global 500 lists meaning they are among the top companies based on revenue and market capitalizations as well. In general, what it means is that Chinese firms are still not among the global leaders in one of the most innovative industries that is already a major driver of economic growth.

Rank	Category	Brand	Brand value (\$ m)	Country
1	Technology	Apple	185,071	US
2	Technology	Google	113,669	US
3	Technology	IBM	112,536	US
4	Fast Food	McDonald's	90,256	US
5	Soft Drinks	Coca-Cola	78,415	US
6	Telecoms	AT&T	75,507	US
7	Technology	Microsoft	69,814	US
8	Tobacco	Marlboro	69,383	US
9	Credit Card	Visa	56,060	US
10	Telecoms	China Mobile	55,368	China

Table 7. The 10 most valuable brands according to Millward Brown's ranking, 2013
Source: Millward Brown (2013)

Rank	Category	Brand	Brand value (\$ m)	Country
1	Technology	Apple	104,680	US
2	Diversified	Samsung Group	78,752	South Korea
3	Technology	Google	68,620	US
4	Technology	Microsoft	62,783	US
5	Telecoms	Verizon	53,466	US
6	Diversified	GE	52,533	US
7	Technology	AT&T	45,410	US
8	Retail	Amazon.com	45,147	US
9	Retail	Walmart	44,779	US
10	Technology	IBM	41,514	US

Table 8. The 10 most valuable brand according to Brandirectory's ranking, 2014

Source: Brandirectory (2014)

In the next chapter, I examine the underlying factors that drive and determine the outward FDI of Chinese firms. First, I find it important to give an overview how this trend emerged in the last three decades and what major roles the government had.

4. Outward FDI of Chinese firms

4.1 *Stages of internationalization*

Outward FDI from emerging economies had a spectacular rise in the last decade, however, internationalization of EMNEs dates back as early as the 1970s. Internationally expanding firms usually operated with mature technologies and their competitive advantages were based on low management and manufacturing cost in these years. Given their origin, other emerging markets were favorable targets of expansion – the vast majority of their FDI was invested in these markets. EMNEs oriented towards developed economies were rare (Stucchi, 2013).

At present, the third wave of these enterprises can be seen that includes significantly higher rate of outward FDI and more sophisticated organizational forms. Many of today's internationalizing EMNEs have become global players with global workflows and international division of labor. This phenomenon was largely catalyzed by the favorable changes in both host and home country environments. Especially, the newly acquired memberships in the World Trade Organization in the 1990s and 2000s boosted these developments. (Gammeltoft, et al., 2010)

In case of China, Nicolas & Stephen (2008, p. 8) distinguish five different phases in the development of outward FDI. Their distinction and the phases are basically linked to the prevailing government policies and strategies since the late 1970s as it was the main driver of internationalization.

1. *Stage one (1979-1983): restricted outward FDI.* Only state-owned trading companies were allowed to invest overseas with the State Council approval. During this era, investment activities were largely linked to the government's political considerations.
2. *Stage two (1984-1992): gradual opening with standardization of approval procedures.* A wider range of enterprises (including non-state firms as well) was allowed to conduct business overseas but they still had to pass a serious approval process.

3. *Stage three (1993-1998): greater scrutiny of outward FDI.* Due to excess of investments, speculations on the Hong Kong real estate and stock markets, and financial Far-East financial crisis.
4. *Stage four (1999-2002): early phase of the “go global” strategy.* Prior to China’s entry into the WTO, Chinese firms were encouraged to invest overseas that would support China’s export growth. This was backed up by newly introduced financial supports, tax rebates, and simplified financial motivators.
5. *Stage five (2002-present): consolidation of the ‘go global’ strategy.* The goal of the economic policy became that to support Chinese firms to be recognized on the global market with the rise of world class companies and brands. In this last phase, greater autonomy for Chinese firms and their investment decisions is also emphasized.

Besides these five stages, it is important to note that a new, sixth stage has been evolving for the last three years. In 2011, the Congress of the People’s Republic of China approved the 12th Five Year Plan which emphasizes the shift of China towards more innovative industries. This means that the Chinese regime wants innovative, knowledge intensive and high value added industries to improve and have a greater contribution to the economy besides the outsourced production activities that are still determining nowadays. The Congress identified seven industries (new energy, energy conservation and environmental protection, biotechnology, new materials, new IT, high-end equipment manufacturing, and clean energy vehicles) that can be key sectors to drive this strategy (KPMG, 2011, p. 2). This strategic plan can be linked to the phase stage five (consolidation of the ‘go global’ strategy), however, there is a notable novelty, namely innovation has been awarded a top priority besides the simply important international role. The 12th Five Year Plan aimed to increase spending on research and development (R&D) to 2.2% of GDP (KPMG, 2011, p. 3). (This ratio was 1.84 in 2011 (The World Bank, 2014b)).

4.2 Macro level factors that supports outward FDI of Chinese firms

China undoubtedly has an increasing role in role in the world economy. Based on purchasing power parity (PPP) China had the second largest GDP in the world in 2012 (The World Bank, 2014). China’s importance has become enormous in the world trade

during the last two decades. Based on a review of international literature and my assumption, development of technology industry and innovation capabilities in China and India are determined by three factors that are also highly linked to each other: (1) *state support*; (2) *growth of foreign direct investments*; and (3) *the remarkable embourgeoisment*.

4.2.1 Role of the state support

China's government played crucial roles in the development of the countries. Their central planning was the basis of economic development for many years and it is still highly determining. Although these markets have not been real market economies some features and characteristics of the governments reflect the way of coordinated market economies (CME) (Hall & Soskice, 2001). Some basic ideas in CME such as the non-industry based coordination, non-market sources, and long term growth plans have important roles in China and India as well.

4.2.2 Growth of foreign direct investment

According to Gadish, et al. (2007), due to the change and reforms in economic policy in China since 1978 MNC from the developed countries started to invest in the country. As economic policy became more open, an increasing number of firms relocated their production to China due to the favorable costs. Inward FDI had a great role in the rise of China. Numerous electronic and IT firm invested in the country that also meant a notable technology transfer. More and more local suppliers were involved in the supply chain in order to realize a more efficient production. Newly involved suppliers had to keep up with the competition and meet the ever growing technological expectations of investors from developed countries. In these supply chains, Chinese firms had the opportunity to learn remarkable knowledge from investors. Later more and more Chinese entrepreneur used this knowledge in order to establish their own enterprises further enhancing competition and innovation pressure (Sun, et al., 2007). Hence, inward FDI had a spillover effect indirectly helping the development of Chinese firms.

4.2.3 Remarkable middle class growth

During the first two decades of growing FDI in China there was a bipolar market involving a small but growing premium market and a vast low-income market. While

the previous market segment could afford products from the developed countries the latter could purchase only the low-quality mass products by the domestic producers.

However, due to large scale of foreign direct investments and state supported developments, the Chinese middle class has appeared and been continuously growing since the 1990s. This market segment meant a large demand for so-called “good-enough” goods which were more high quality than the ones for the low-income segment but more affordable than the premium products. Many domestic manufacturers such as Haier, ZTE, Lenovo, seized this opportunity and started to produce goods that satisfied the demand of this middle segment. Later, based on their strengths and experience they could go on international markets and they have become global players (Gadiesh, et al., 2007). Hence, initial development and growth of such firms are due to the growing middle-class that had expectations for quality but it was not a target market for MNEs from developed countries as it did not represent a strong purchasing power.

4.3 Incentives of Chinese MNEs development

One of the most interesting question about the internationalization of Chinese firms is that why do they invest and expand abroad if they have a domestic market with more than 1.3 billion capita? Incentives largely depend on industry, target markets, and ownership structure. In many cases, building political influence plays also an important role (Accenture, 2005), however, regarding incentives, vast majority of outward FDI of Chinese firms can be categorized in four major groups. I summarize them below based on Gugler & Boie (2008, pp. 16-19).

- 1. Market-seeking FDI.** This is the most common type for EMNEs. Market seeking in nearby foreign markets was a key motive for Chinese FDI in the 1980s and 1990s but Chinese firms gradually moved away towards the securing of raw material even in more risky markets in the 2000s. In some industries, especially in electronic appliance manufacturing, growing competitive pressure from MNEs in the domestic Chinese market, excess capacity, and sliding profit margins were also key reasons to search for new markets abroad.
- 2. Efficiency-seeking FDI.** There are few examples of growing role of efficiency-seeking FDI from China, however, most researches agree that this motivation do not play a prime role due to the low production costs in China.

3. **Resource-seeking FDI.** China's ever growing economy needs more and more natural resources that despite the large geographical extent of the country, are not available sufficiently. Such resources are petroleum, natural gas or several non-ferrous metals. Target markets of these expansions are mainly other Asian countries and Africa (Nicolas & Stephen, 2008). This is not driven by regional proximity, but simply by the availability of assets. Due to the strategic importance of securing supplies of such resources for the home economy, a large portion of Chinese MNEs in this field are state-owned
4. **Strategic asset-seeking FDI.** Strategic asset-seeking is regarded the second most important motive for Chinese MNEs. This is often related to the acquisition of knowledge and information on international operation management techniques and intangible assets such as foreign technologies or brands. Consequently destinations of such investments are developed economies. However, such investments are often related to market-seeking and efficiency-seeking motives as well because EMNEs seeking created assets must first master the capabilities to absorb them.

According to the Accenture (2005, p. 2-5) incentives can be categorized more sophisticated, it distinguishes the following four basic reasons.

1. **The macroeconomic imperative.** It claims that opportunities through only export strategy are limited and market entry to new and more developed countries can support growth and offshoring, outsourcing certain activities to more favorable places.
2. **Building political influence.** Cooperation on international political forums and multinational negotiations can be helped by the expansion of Chinese firms and benefits they can bring.
3. **Competitive flexibility.** The domestic market is becoming ever more mature and saturated thus new resources and capabilities including R&D or brand are needed to be acquired abroad.
4. **A strategy to fuel growth.** Secure supply of natural resources is inevitable in order to sustain future development and growth.

As a conclusion, it can be seen that location related advantages are strong motives (e.g. access to new markets). However, Chinese firms rather have deficiencies in the field of ownership related advantages (e.g. less reputed brand, underdeveloped technology) that can make internationalization process more difficult.

In 2010, 10% of the entire Chinese outward FDI (6.8 billion US dollars) came to Europe. There has been a notable growth in the last couple of years, however, this figure is significantly lower than that of developed countries (US, Japan) (Zhigang, et al., 2011, p. 1). Here, it must be noted that this 10% represents a heavily distorted picture. As written in the previous chapter, top three destinations of the outward FDI from China (amounted to 79% of the total amount in 2009) was tax havens or Hong Kong that is probably heavily influenced by government incentives and advantages of reinvestments. Taking this fact into consideration, Europe's share is probably significantly higher. Milelli, et al. (2010) have empirically tested and proved some key features of Chinese and Indian expansions in Europe. The following four major conclusions are included in their study:

1. Appearance of Chinese and Indian firms in Europe can be traced back to home country incentives, namely government pressure.
2. The most popular FDI destinations are large European countries due to their market size and already existing trade relations with China or India.
3. Access to new markets and intangible assets is a more attractive aspect than access to resources.
4. Distribution of investment by sectors reflects the competitive advantages of home countries.

Importance of new markets and intangible assets is also highlighted by other authors. The European Union Chamber of Commerce in China in cooperation with KPMG and Roland Berger Strategy Consultants published a study that involved findings based on 73 interviews with senior managers of Chinese multinationals operating in Europe in late 2012 (Robinson, et al., 2013). 85% of respondents in this study indicated market acquisition as a main incentive and strategic reason of the European operation. 'Providing goods or services for the Chinese market' and 'use of local intellectual and

R&D resources' were the second and third most frequent answers with 47% and 34% respond rate respectively (Robinson, et al., 2013, p. 13).

4.4 Mergers and acquisitions by Chinese firms

In case of Chinese firms, the most frequent international market entry mode is acquisition and joint venture (JV) establishment which are the forms of FDI (Nicolas & Stephen, 2008). This contradicts the Uppsala model that says a gradual internationalization is common in which product export and then local sales network development are the first rational steps of international market entry. This contradiction can be explained by the different conditions of Chinese firms from that in the developed economies. Below, I describe the main reasons for acquisitions and JV based on Accenture (2005), Grant (2008) and Nicolas & Stephen (2008).

4.4.1 Time as common resource

When a firm develops products, services or it enters a new market it can decide whether it develops the necessary resources organically, acquires them, or develop/acquire them in cooperation with other market players (e.g. in a strategic alliance). Organic developments are rather risk-averse but time-consuming processes, while acquisitions are quicker but also more risky. This means that time frame necessary to achieve goals is a basic distinctive factor between the two kinds of strategy. Time has an important role in case of Chinese firms. Firms from developed countries or even the four Asian Tigers (Hong Kong, South Korea, Singapore, and Taiwan) had more years to develop and become competitive on the global scene in the last few decades. This time is not available for Chinese firms now if they want become globally competitive quick (Accenture, 2005).

This can be explained by the effect of globalization: nowadays, there are more competitors that have well-established positions on the global market than 30 years ago. This means that development of resources and capabilities that are necessary to compete in a given industry would take too much time (Chang & Park, 2012). Thus, when a Chinese firm acquires a foreign firm it often "acquires time" at the same time. For instance, the acquisition a well-established global brand saves the time that would be necessary to develop a Chinese brand with the same level of reputation.

This is also emphasized by Peng (2012) arguing that one of the two main reasons for acquisitions is the urgency for fast market entry, especially in the areas of natural resources. (The other one is to acquire existing world-class brands.)

According to Xu Lihua, Chief Executive Officer (CEO) of Ningbo Bird, a major Chinese mobile phone manufacturer, this trend is supported by the culture of Chinese firms as they have been forced to be quick and flexible. Chinese firms could not compete with large firms from developed economies in the fields of brand, reputation, or technology, however, they could seize the opportunity of the fast growing market due to their rapid response capability and local market knowledge (Chang & Park, 2012).

On the following page, I highlight the most frequent resources and capabilities that have been the main reasons for international acquisitions by Chinese firms. My categorization is largely relied on Söderman, et al. (2008).

Capacity. In several cases, capacity acquisition is the reason for international acquisitions. The main question in such cases is why Chinese firms should build new and expensive capacities if they can acquire already existing ones

Sales channels and networks. Development of well-functioning sales channels and finding the right partner are also time-consuming and costly process. However, not only exact sales and customer relations but knowledge and experience in sales management can also be acquired in such cases.

Research and development (R&D) resources. This factor has paradox characteristics. In China, number of technical graduates whose salary level is significantly lower has been growing in recent years. There are several R&D centers in major Chinese cities established and operated by both foreign and Chinese firms. However, R&D infrastructure in developed countries is often more advanced and the human capital is more valuable (e.g. number of patents and technological achievements are higher, or English proficiency is more widespread) (von Zedtwitz, 2005).

Brand. Chinese brands usually do not have high reputation in developed countries, however, international expansion can be largely catalyzed by the acquisition of well-known brands. This is significantly important in the field of business to consumer (B2C) products and services.

Management. Remarkable management supply shortage is expected in China in the upcoming years (Nicolas & Stephen, 2008). Moreover, “Chinese MNEs lack English-speaking, internationally savvy managers comfortable interacting with local managers, employees, and politicians in host countries” (Peng, 2012, p. 99). Besides, managers of firms from developed countries often highlights the perception that Chinese employees still have disadvantages in managing complex problems comparing to their European or American peers. This can be explained by the fact that the abstract business thinking and organizational capabilities that could make it possible to solve complex challenges. This means that imitating a product or service is a simple task for a Chinese firm but imitation of the entire corporate system is much more complicated that can also result competitive disadvantages (Chang & Park, 2012). Demand for professional management resources is understandable in case of firms internationalizing with such conditions.

4.4.2 Global M&A figures

Total value of cross-border M&As rose from nearly 200 billion USD in 2003 to 308 billion in 2012 (pre-crisis average level between 2005 and 2007 peaked at 703 billion), while total number of projects expanded from approximately 3,000 to 5,400 during the same period⁵ (UNCTAD, 2013, p. 24). Weight of M&As initiated by firms from developing countries also increased. Figure 5 illustrates the total value of cross-border M&As of net purchases (see Figure 5 note for detailed explanation of this metric) that reflects the shrinking share of developed countries, although they still dominate this field. For instance, China’s share as percentage of total value was only 1.9 in 2006 but it reached 12% by 2012. This soaring figure highlights the rapidly growing significance of China in M&A deals, however, changing FDI policies of firms in developed countries in recent years have largely contributed to this figure. A rising trend of international divestment (selling assets) and reshoring (transfer of an outsourced business operation back to its country of origin) by these firms can be seen in the last few years that results less moderate growth in FDI and accordingly in M&As from developed countries. (UNCTAD, 2013).

⁵ This means that average value of cross-border M&As shrank by nearly 15% from 66.7 million to 57.0 million between 2003 and 2012.

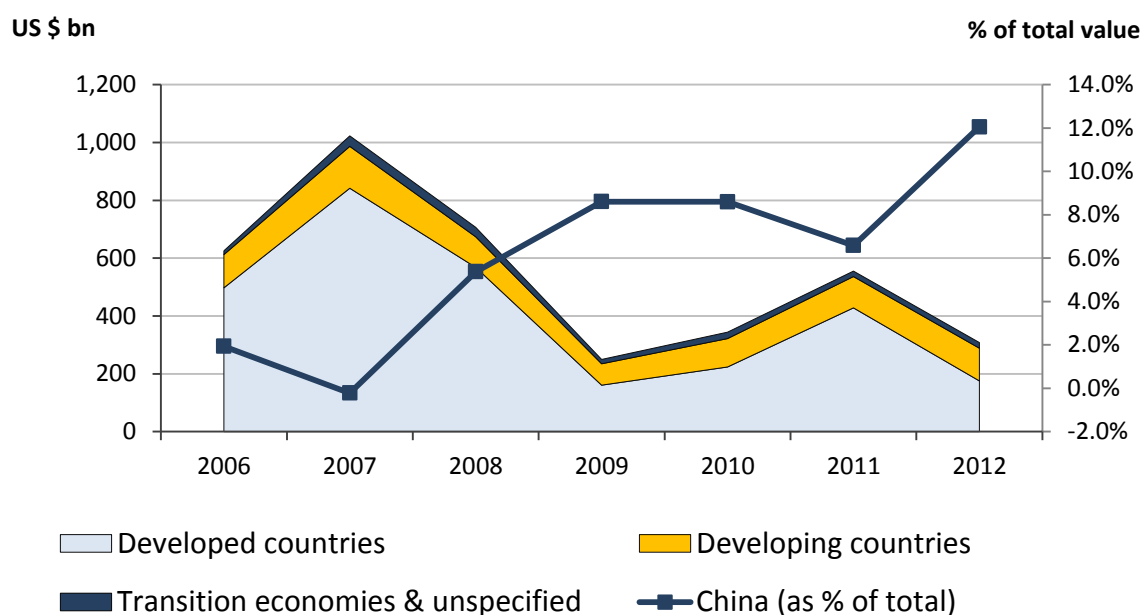


Figure 5. Value of cross-border M&As of net purchases, 2006-2012

Notes: Net cross-border M&A purchases by a home economy is calculated as follows: Purchases of companies abroad by home-based TNC⁶ (-) Sales of foreign affiliates of home-based TNCs. The data cover only those deals that involved an acquisition of an equity stake of more than 10 per cent.

Source: Calculated from (UNCTAD, 2013, pp. 221-223)

The majority of M&A purchases by firms from developing and transition economies took place in other developing and transition economies (nearly 120 in 2012 against 70 in developed economies) (UNCTAD, 2013, p. 24).

Weight of state-owned enterprises in total cross-border M&As has been slowly increasing lead by developing country firms in pursuit of strategic assets. Since 2009, the value of greenfield projects has been declining significantly relative to the value of M&As (UNCTAD, 2013, p. 12).

An important portion of outward FDI by Chinese firms is realized through mergers and acquisitions (M&A). Possible drivers of this mode of entry to another market or motives of important resources acquisitions of have been clarified in the previous chapter. However, there is an interesting and important feature of this cross-border M&A series and bids by firms from developing countries that must be noted and studied by Hope, et al. (2010). They tested whether companies in developing countries versus those in developed countries tend to bid more for assets in the developed world. In their study, a

⁶ TNC: Transnational company

large sample of cross-border M&A transactions including 3,806 bids for targets in developed countries (of which 8% was from developing countries) from 1990 to 2007 was used. They found that the bid premiums⁷ from developing countries tend to be higher and deals accompanied by national pride considerations also increases bid premiums. The authors also noted that they did not find evidence that bids of firms from developing countries are higher for targets in also developing countries meaning that bids from developing countries are not always higher (Hope, et al., 2010).

It can be also possible that frequent state ownership in firms from developing countries also play a significant role in higher bid premiums. Sellers might be more likely to push up sell price as they know that the acquirer company has a massive state support. This is less likely to happen in developed countries where states have minor role in M&A deals.

As a conclusion, this finding also suggests that different features of EMNE internationalization have to be taken into account meaning that we should not rely only on traditional views but apply wider scope of views. In the case described above, institution-based view is again an important approach as reasons of bid premiums can be linked to conditions that developed due to different institutions from that developed countries have such as frequent and high state ownership or support.

⁷ Bid premium is the additional amount an acquirer has to offer above the pre-bid share price in order to succeed in a take-over offer (London South East, 2014).

5. Is there a shift in emerging markets towards an innovation-driven economy?

5.1 The rise of information technology as a concentration of innovation

There is a vast amount of studies by economists and political scientists that focus on the main drivers and basic characteristics of economic growth and development. Many of them try to explain the long-term shifts in the economy and the reasons behind these long processes. In historical perspectives it is widely accepted that different innovations and technological developments in the previous centuries were the most important drivers of economic growth.

According to Kondratieff's work from the 1920s, these developments and economic growths follow a pattern each time creating long waves of the world economy. These so-called Kondratiev waves arise from the concentration of innovations with significant impact that launch technological revolutions which determine the economy afterwards. Kondratieff says these waves repeat approximately every fifty years and involve four main sections: improvement; prosperity; recession; and depression (Šmihula, 2009).

Korotayev and Tsirel (2010) empirically analyzed the presence of Kondratiev waves in the world gross domestic product (GDP) dynamics. Based on statistics for the 1870-2007 period, their results supported the theory detecting 52-53 years of waves in the world GDP dynamics. Kondratieff's theory motivated more scholars including Schumpeter (1939), Mensch (1979) or Freeman (1987) to develop actual "cluster-of-innovation" version of the Kondratiev waves theory (Šmihula, 2009). Five basic waves have been identified so far arguing that the current, fifth one is dominated by the information technology (IT) since the mid-1980s (Korotayev & Tsirel, 2010).

The highly influential role of IT in the world economy – especially in developed countries – is widely accepted: it is, without question, one of today's key sectors. The fact that IT has a core role in every industry or at least it supports them is also unquestionable. This is reflected by many macro level indicators such as the value of international trade of IT products and services, the global revenue, the market values or

the brand values in the industry. I assume that market values as indicator for instance are good proxies of the current importance of an industry in the global economy. As both market and brand value reflects the ability of firm to generate future cash flow in general and simplified we can say the higher these values are the more determining role these firms have (Cherewyk, 2011) (Brandirectory, 2014). Looking at the Financial Times Global 500 ranking it is clear that the presence of IT companies in the top 100 firms has become much more determining (FT, 2014). Moreover, their brand values are the most striking. Four out of the top five brands in the world are technology brands (Brandirectory, 2014) (Millward Brown, 2013).

This means that the IT industry is an issue that should be studied and analyzed especially in countries where it has been recently gaining growing significance such as China or India. In this paper, I give an overview and analyze the rise of IT in these countries and the really important and related innovational capabilities. My basic findings is that these countries already have shown some major improvement in this field to complete the economic shifts toward an IT based economy is far now.

5.2 Innovation and technological development in China and India

The World Economic Forum (WEF) is one of the leading institutions measuring national competitiveness. Each year they publish the Global Competitiveness Report (GCR) that contains the competitiveness score of the vast majority of countries. For examination the WEF uses data from public sources (such as IMF databases) and the results of surveys carried out with leaders of the local businesses. The WEF uses more than 110 variables in order to determine the competitiveness results of a country. These 110 variables are divided into 12 main categories (pillars), which belong to 3 basic groups that are the followings: (1) basic requirements; (2) efficiency enhancers; and (3) innovation and business sophistication factors. These three groups are highly connected to the stages of economic development. The WEF identifies three main stages of economic development: (1) factory-driven; (2) efficiency-driven; and (3) innovation-driven. Additional two transitional stages are applied between the three stages. China is the second stage, while India is only in the first (WEF, 2013). It signs well that China has a more developed economy, however, it is far from being innovation-driven. Even though there are many high-tech related firms in the country, the national economy itself is mainly shaped by other sector with less innovative features.

5.2.1 A shift towards innovation driven economy?

Altenburg, et al. (2008) questioned whether and how China and India are progressing from production to innovation. They found this question relevant and important because China' and India's development suggests that it is possible to catch up with OECD countries and they pose threats to companies from the developed countries. By catching up they mean both the ability to compete on the basis of cost advantage and the transition from production to innovation capabilities – creating new knowledge and putting it to productive use. While China and India have already caught up to some extent regarding the first ability, they still have to significantly improve on the second one.

The authors analyzed Indian software and Chinese computes clusters and underlined the fact that these clusters are full of highly mobile entrepreneurs and engineers with strong professional and personal network. They have research and work experience in the United States but they apply their skills in their home countries now that causes 'brain circulation' instead of 'brain drain'. It is also pointed out that China's R&D expenditure has been increasing by 20% each year since 1999, and accounted for the 1.3% of the GDP in 2005. The electronics industry (electronics and communication and office equipment) accounts for the 78% of the R&D expenditure in China. In India the government invested a lot in the national innovation system but it is mainly dominated by routine services with less value added. The authors conclude that China is more economically and technologically advanced, however, India scores better in GCI reflecting a perceived superiority of its private businesses. They also stress that governments play an important role in developing the necessary skills and institutional support of R&D. Although this is in most cases still relatively simple adaptive R&D, there is a clear trend to move into more sophisticated R&D services. (Altenburg, et al., 2008)

Sun, et al. (2007) also emphasize that apart from manufacturing China has become a notable place of R&D investments as well. In one hand firms from the developed countries want to use the skilled labor, on the other hand they also want to localize some of their R&D activities next to their manufacturing sites. The fact that the number of graduates in science and engineering is keep growing and the state leadership spends large amounts of money on university developments and researches (OECD, 2012).

This means that firms in China can expect state support if skilled human resource required for their innovation intensive activities (Sun, et al., 2007).

5.2.2 China's future innovation perspective

In 2011, China accepted the 12th Five Year Plan which emphasizes the shift of China towards more innovative industries. The government wants to reduce the dependency on offshored and outsourced manufacturing activities and to increase the production of innovative and competitive products with high value added. IT was also identified as core industry in order to achieve this goal.

This plan can have an important impact on China's development. Crookers (2012) argues that innovation has already started to complement or even replace imitation that enables China to produce high-tech products that can ensure competitiveness in the long run. However, the current level of innovation is still lagging behind from the ones in the OECD countries. He also emphasizes the fact that large portion of R&D (69%) is subsidized and the basic and applied researches which have more risks are still negligible (Crookers, 2012). Values of the Global Competitiveness Index by the World Economic Forum also reflect this fact: China is still an efficiency-driven economy with moderate achievement in the innovation pillar (WEF, 2013).

The Chinese state tries to support the growing innovation with infrastructure investments such as high-tech parks, human resource developments, tax benefits after R&D activities. According to Crookes (2012) there are more factors that make this policy crucial for China. On the one hand there are external threats such as the rise of other low-cost and competitive countries (for example Vietnam) on the other hand internal factor is the dominant role of offshored and outsourced manufacturing that makes China more dependent on the economies of developed countries.

5.3 Concentration of the IT industry based on cluster developments

It is truism that the IT industry require a huge amount of innovation and strong cooperation through the value chain to develop competitive products with short product life cycle. If we want to understand and analyze the characteristics or the development of geographic areas where IT has a strong role the understanding of business networks

and clusters is crucial. I give a short overview about them in order to compare the key findings here with the geographic concentration of IT firms in China or India.

As each IT product or service involves more companies working together many key findings of network theory of firms can be applied here. Firms have constant interactions with each and other some of their key resources are available for each other that can develop differentiator capabilities. Because of these strong inter-firm relations the entire network can determine each firm's performance and result. That is also why long formal strategy development is less crucial and reliance on norms (experience, routine) is usually more important and performance can be improved by ex-post evaluation of this experiences instead of a comprehensive and planning process (Hakansson, 1989).

In reality, developed business networks often create cluster which is “geographic concentration of interconnected companies and institutions in a particular field” (Porter, 1998, p. 78). In general, Porter (1998) argues that being part of a cluster allows companies to be more productive. He highlights the followings reasons: (1) access to employees and suppliers; (2) access to specialized information; (3) complementarities; (4) access to institutions and public goods. This is the fact that embeddedness and the supporting infrastructure are the key elements of success (Cooke, 2001). Porter (1998) also argues that clusters are the phenomena of more advanced economies and their presence can be a controlling factor for middle-income countries moving toward a more developed state.

5.4 Outlook about IT clusters in emerging economies: the case of Bangalore

5.4.1 Development of the Indian IT industry

It is important to have an outlook and thus a broader base of comparisons in case of the analysis of Chinese IT clusters. Therefore I in the following short section I introduce the case of Bangalore.

The main ideas above are normative ones and in case of many geographic business concentrations one or more key features of the ideal cluster are missing. Regarding the

Chinese or Indian concentrations of IT firms we can find several issues that question the cluster being of these concentrations. D'Costa (2009) studied the Bangalore IT cluster and found evidences on that.

The rapid growth of the IT industry and the sizeable share of software exports show that the Indian IT industry is doing well. There are many factors that contributed to the rise of the Indian IT industry such as the country's emphasis on technical education, the unexpected growth in global demand for business process outsourcing in the 1980s and 1990s, state support for software exports, the success of expatriate Indian IT entrepreneurs and their extensive social networks among other professionals, the Indian economic policy reforms and FDI of multinationals in India. It is clear that the role of university education development is crucial in this improvement – the Indian IT industry could not grow without sufficient and sustainable talent supply. That is why Indian universities have significantly increased enrolment capacity and adjusted curriculum in line with market needs. This trend suggests strong relationships among different stakeholders that can create the appropriate basis of a cluster development that can contribute to rising productivity (revenue per employee), and more intense innovation activity.

5.4.2 The role of the Triple Helix Model

However, D'Costa (2009) argues that despite these trends, IT industry in Bangalore (and by extension in India) follows different pattern than that of developed countries hence, it can be considered neither a well-functioning cluster nor a competitive environment. His argument is based on the Triple Helix Model (THM) approach claiming that the Indian development does not encourage thick institutional linkages. The Triple Helix thesis says that the potential for innovation and economic development in knowledge societies largely rely on an intense hybridization of elements from educational institutions, industry infrastructure and government policies and a cluster of firms expected to emerge from the synergy of these three main groups (Triple Helix Research Group, 2014). This concept was first initiated in the 1990s by Etzkowitz (1993) and Etzkowitz and Leydesdorff (1995). According to the Triple Helix Research Group (2014), in order to generate new institutional and social forms for the production, transfer, and application of knowledge the following three main ideas have to be taken into account.

1. A more prominent role for universities in innovation is necessary.
2. A movement towards more collaborative university-industry-government relationships is needed in which innovation policy is an outcome of this cooperation instead of a prescription from the government.
3. Apart from their traditional roles each institutional party should also take the role of the other. In this case, dealing with non-traditional issues is viewed as a major potential source of innovation.

In general, this concept is valid if we look at the current improvement in developed economies. More and more universities have recently added the academic “third mission”, namely greater involvement in socio-economic development. Continuously growing capacities of universities to provide students with new ideas, skills, and entrepreneur talent has become a major asset in knowledge- and innovation-based societies. Universities have also a growing capacity to generate technology that has changed their position – instead of a traditional source of human capital and knowledge to an important source of technology generation and transfer (Triple Helix Research Group, 2014).

5.4.3 Drawback of the Bangalore IT cluster

D’Costa (2009) traces back his argument to the above mentioned theory and related observations in India. According to his research and review of surveys, most Indian firms do not collaborate extensively with other Indian firms nor do they establish strong partnership with academic or government institutions in order to perform research projects. In fact, a large part of the Indian IT sector provides only routine IT services with no real differentiation. They are not considered to be the most innovative activities and have less value added. Even though the region of Bangalore has strong educational infrastructure and many graduates with good engineering, mathematics and programming skills, trainings by employers are still dominant. Not only in Bangalore but also in the rest of India, the R&D and innovation have less important role than in China that is reflected by the number of patent applications, citation or publication or expenditures on R&D (D’Costa, 2009). Even though the Bangalore IT district is considered to be a large cluster D’Costa (2009) highlights some basic characteristics that do not support that view. Even though Bangalore has many small IT enterprises

with intense competition as barriers to entry are low, the level of corporation among firms is less significant due to low social trust in India. Moreover, there is no real input-output relation among firms and thick institutional linkages are also missing. In summary, it means that the thick institutional architecture and relationships required for an innovative cluster have not developed sufficiently in Bangalore (and by extension in India) yet.

5.4.4 Positive effects of “brain circulation” on IT cluster developments

Saxenian (2006) also studies Indian software and Chinese computer cluster in a more perspective that is more focused on the role of human capital and knowledge. Her main research question was how Chinese- and Indian-born engineers who were also socialized in the Silicon Valley are accelerating the development of the information technology industries in their home countries? (Saxenian, 2005). She argues that today, Chinese and Indian computer and software clusters have a high rate of highly mobile entrepreneurs and engineers with strong professional and personal network. These entrepreneurs and engineers have research experience in the US and learnt the role of cluster development in this sector. Now they are applying their skills in their home countries now, meanwhile maintaining their social and professional connections to the United States reversing the brain drain, and transforming it into "brain circulation" (Saxenian, 2005, p. 36).

China's government supports this process providing incentives for returnees with technological skills that is also a reason for the fact that 750 foreign-funded R&D centers were set up in China by the end of 2006 (Altenburg, et al., 2008, p. 331). Input factors such as human resource (growing enrolment and number of engineering graduates) supported this trend as well. However, Saxenian (2005) and Altenburg, et al. (2008) also argue that these clusters still lack state-of-the-art innovation compared to their Western counterparts that is well illustrated by the low level of patenting and high rate of R&D with less value added in China and India. On the other hand, availability of the appropriate human capital, economies of scale and level of internationalization can support further sustainable growth process there.

As a conclusion, shift towards an innovation driven economy is largely discussed in literature and there are different views on this issue. Clearly, China and India are not

innovation driven economies, however, slight changes have already started as most researchers noted. In the next chapter, I introduce the case of Lenovo, a Chinese IT firm that can be a good example, how this shift looks like in practice.

6. The case of Lenovo Group Limited

After a comprehensive study of outward FDI and international development of EMNEs from China, I find it important to present a case study of one of the most well-known and determining example of this field: Lenovo Group Limited (Lenovo). This company was chosen because of three major reasons. First, the growing importance of innovation-driven industries such as IT is unquestionable thus notable trends in this industry form an important field of study to better understand an industry that is a main driver of economic growth. Second, despite some limitations, there is a growing importance of the outward FDI and internationally expanding firms from China as it was proven in the previous chapters. Third, market-seeking and strategic asset-seeking are the major motives of Chinese outward FDI that also plays considerable role in the international strategy of innovation-driven companies with significant intangible assets. As a common section of these three aspects, Lenovo was selected to illustrate theories and general trends in one case.

6.1 *Company overview and development*

Lenovo was established under the name “Legend Group” by researchers in the Institute of Computing Technology, the Chinese Academy of Science (CAS) in 1984 (Liu, 2007). Its profile was PC manufacturing and followed the typical “good enough” path of development meaning that it targeted the growing middle-class in China with products that had acceptable quality but lower price than the international competitors from developed countries such as Dell or HP (Gadiesh, et al., 2007).

It had a successful strategy in the domestic market reaching 30% market share. During its development, Legend became publicly traded after a 1994 Hong Kong listing to raise capital. This strategy was partly supported by the CAS that is a fully state owned institution. However, the initial public offering (IPO) resulted in shrinking share of CAS and thus less weight of state ownership. In 2004, Legend decided to acquire the IBM’s personal computer (PC) business that was implemented in 2005. This was the year when the name “Lenovo” was introduced. The company managed to turn IBM’s former money-losing division into a profitable business that was mainly the result of home country advantages such as costs level and favorable manufacturing conditions. (Liu, 2007)

Liu (2007) emphasize that the decision favoring the acquisition of IBM's PC division was largely based on the motives to acquire an international and well-known brand and other important and competitive intangible assets such as patents, technology, or R&D facilities and thus have the opportunity to grow outside China. It shows that both market-seeking and strategic asset-seeking FDI was realized by this strategic decision.

Since that, Lenovo had a spectacular growth in the field of PC sales. By 2013, it became the number one global PC manufacturer based on market share (16.7% in the second quarter of 2013) overtaking HP (Mehta, 2013).

Below, I give an overview of Lenovo's main financial indicators and their developments since the acquisition of IBM's PC division in order to analyze how successful was the international strategy of the company.

6.2 Main financial results

6.2.1 Total revenue and gross profit

According to Lenovo's annual reports (Lenovo, 2013, 2011, 2009, 2007), there was a 14% compound annual growth rate in revenue between 2006 and 2013 reaching 33,873 million by the financial year (FY) of 2013⁸. Its gross profit margin slightly decreased during the same period reaching 12% in 2013 (see Figure 6). This figure is calculated as a ratio of gross profit and revenue. As gross profit is the result of revenue minus cost of sales, gross profit margin reflects how efficient operation was in a given year. In PC manufacturing it has a great importance since strong global price competition in requires manufacturers to keep their costs down in order maximize profits.

Comparison to other companies manufacturing PCs has its limitations as most of the competitors (e.g. HP, Sony or Dell) operate in other segments with different pricing and costs conditions such as software services.

⁸ Lenovo's FY ends on the 31st March.

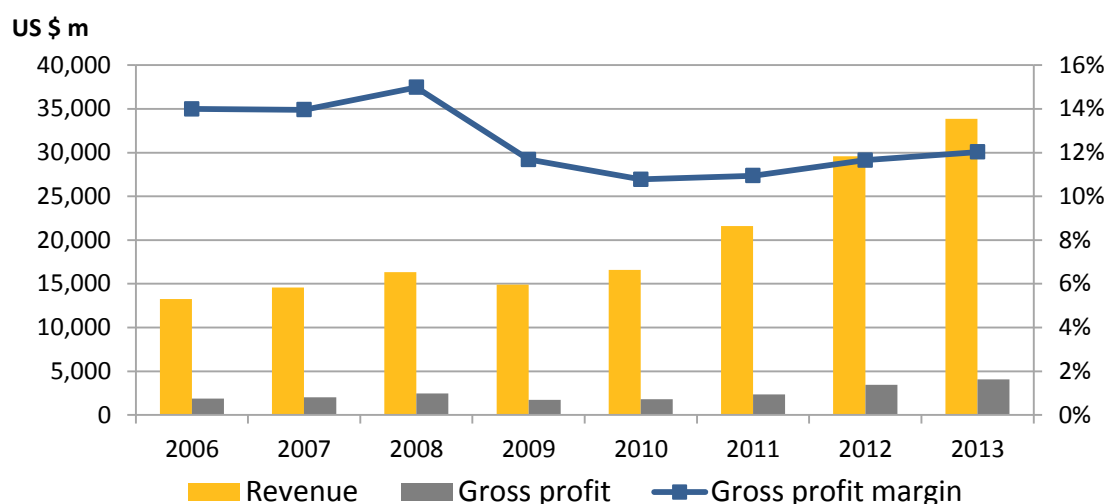


Figure 6. Lenovo's revenue, gross profit and gross profit margin figures, 2006-2013

Source: Calculated from Lenovo (2013a, p. 112)

6.2.2 Revenue by product and geographic segments

Lenovo's product strategy was heavily characterized by PC manufacturing after the acquisition focus on other IT product segments such as smartphones or tablets emerged only in recent years. It reflects some lags in this field: in 2007 Lenovo sold its "Mobile handsets" product segment and launched the similar Mobile Internet Digital Home only in 2011 when this segment had already played a significant role (Davis, 2011). In general, there were only slight changes in the main two segments: desktop computers and notebook computers (see Figure 7). However share of these two segments in total revenue started to decrease in 2011 reaching 84% in 2013.

Due to modifications in segmentation and lack of data, exact changes in revenues of geographical segments cannot be analyzed⁹. However, it can be concluded that China's share in total revenue grew between 2006 and 2012: it was 36% in 2006, while 43% in 2012 and 45% in 2013 (Lenovo, 2013, p. 5). This reflects the fact that despite the ambitious international strategy, the remarkable growth in domestic market could drive sales figures. Table 9 illustrates revenue and pre-tax income margin breakdown by geographical segments in 2012 and 2013. It shows that the largest margin and thus profitability could be realized in China with 4.6% and 4.7%, followed by North America 3.5 and 3.4% respectively.

⁹ The company significantly changed categorization of countries outside China. Between 2006 and 2009 the four main categories included "China", "Americas", "EMEA", and "Asia (excl. China)", between 2011 and 2010 "China", "Mature Markets", and "Emerging Markets (excl. China)" were the categories, while "China", "APLA", "EMEA", and "North America" have been the four geographical segments since 2012.

These ratios do not support the idea that sales in more developed countries require more pushed prices and greater amount of sales and marketing that would raise costs and thus diminish margins. However, this assumption must be handled carefully as it is based only two years data.

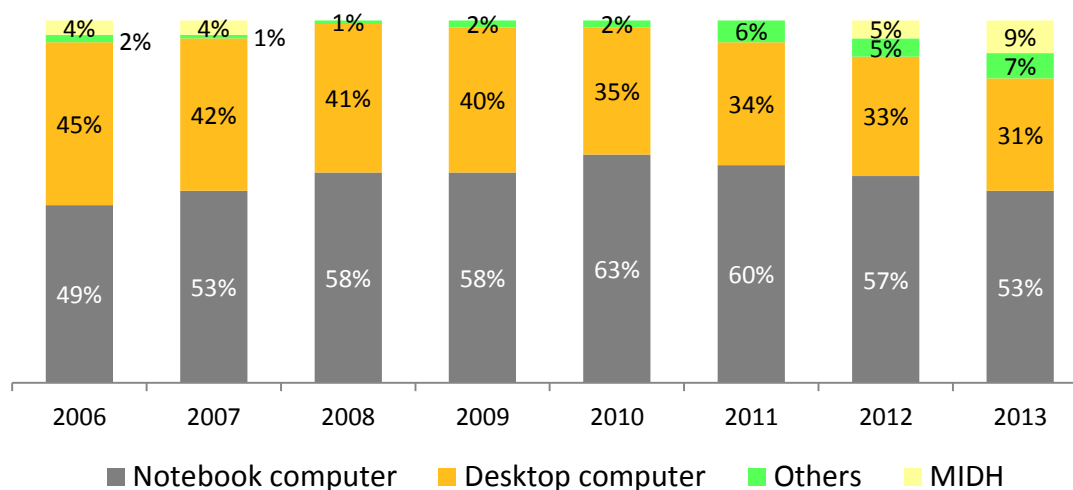


Figure 7. Lenovo's revenue by product segments, 2006-2013

Note: MIDH stands for "Mobile Internet Digital Home" including for example mobile phones and tablets. Due to changes in segmentation policy, the MIDH segment is not available between 2008 and 2011. Regarding data before 2008, MIDH is corresponded the segment of "Mobile handsets" which had a smaller scope of products.

Source: Calculated from Lenovo (2013a, p. 112)

Geographical segment	Revenue as % of total		Pre-tax income margin	
	2012	2013	2012	2013
China	42%	43%	4.6%	4.7%
APLA	21%	20%	0.0%	0.3%
EMEA	21%	22%	1.3%	1.9%
North America	15%	15%	3.5%	3.4%
Segment total	100%	100%	2.7%	3.0%

Table 9. Lenovo's revenue by geographical segments, 2012-2013

Notes: APLA stands for Asia (excluding China), Pacific, Latin America and EMEA for Europe, the Middle East, and Africa. Pre-tax income margin is the ratio of pre-tax income and revenue by segments.

Source: Calculated from Lenovo (2013a, p. 142)

6.3 The role of production and Lenovo's future outlook

As the PC segment is maturing, growing importance of mobile devices is reflected by the so-called “PC+” strategy that aims to increase non-PC sales revenue (Lenovo, 2013a). As a part of this strategy Lenovo also opened a new R&D center with a special focus on smartphone and tablet developments (Lenovo, 2013b).

Lenovo also acquired the phone manufacturer company, Motorola from Google for 2.91 billion USD in January, 2014. Lenovo's goal is to become the number three smartphone manufacturer in the world. It has been the largest acquisition by Lenovo in terms of value so far (Kastrenakes, 2014). This reflects the great importance of this segment and also the FDI policies followed by Lenovo that is similar to the one happened in the case of IBM PC division acquisition and can be explained by the resource-based view. Lenovo wants to utilize its home country advantages, namely cost efficient manufacturing with considerable level of R&D (average R&D expenses as percentage of revenue was 1.5% between 2006 and 2013 which is not a high number in this industry (Lenovo, 2013a, p. 112)) However, as a latecomer in the mobile devices segment it saves time by purchasing a well-known brand and large number of patents. It also gains new markets (mainly in developed countries) through the acquisition. Moreover, this phenomenon can be also explained by the institution-based view if we accept the fact that China's innovation capabilities and formal institutions are still lagging behind, thus it does not create an environment for Lenovo to develop the latest technology at home.

The way Lenovo develops in new product and geographical segments shows an international strategy with a focus on more mature markets. Efficient production and thus reduced costs can be supported by its follower innovation that is not only about new products but more efficient production of the already existing technologies as it was in case of IBM's PC division (Kelly, 2014).

7. Conclusions

Rise of emerging markets and emerging markets multinational enterprises have drawn the attention of international business literature and many researchers. In chapter 2 I showed that there is a wide range of literature that gives a better understanding of these EMNEs that is incredibly useful as they often have different characteristics and home country conditions. As in chapter three it was shown the global importance of Chinese MNEs and thus researches in this field is unquestionable.

Despite some limitations and drawbacks in macro level statistics, Chinese MNEs share in total outward FDI is now higher than ever and it had a rapid growth in the last decade. Chapter 4 identified the most frequent factors and patterns that drive international expansions of Chinese firms. Motives related to market-seeking, resource-seeking, and strategic asset-seeking investments proved to be the most determining based on a comprehensive literature overview and statistics analysis. Due to the changing nature of global competition and time pressure, I found that Chinese firms are more likely to acquire firms when they have outward FDI.

Relevance and importance of IT sector were also highlighted in chapter 5, however, China's macro level development in this field is still lagging behind compared to developed countries. However, the case study in chapter 6 showed that international acquisition strategy and constant market- and strategic asset-seeking strategies can be the major reasons for growing outward FDI by the Lenovo Group. It also reflects some key patterns that are probably relevant in case of other globally expanding IT firms from China.

In summary, foreign FDI by Chinese IT firms, especially the Lenovo group is driven by the demand for valuable and often intangible resources as well as new markets, however, firm strategy is also influenced by home country conditions such as state support and less developed institutional environment.

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