



# The internationalization of Chinese companies

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companies

## What do official statistics tell us about Chinese outward foreign direct investment?

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### Abstract

**Purpose** – The purpose of this paper is to offer a critical perspective on China's official outward foreign direct investment (OFDI) data, commonly used in most research on the internationalization of Chinese companies. Owing to the deficiencies of China's statistical system, official OFDI data leave us with only a limited understanding of the pattern of Chinese OFDI in general and cross-border mergers and acquisitions (M&As) in particular.

**Design/methodology/approach** – Based on a theoretical discussion of the internationalization of companies, some propositions about the development pattern of Chinese M&As are derived. This study uses the Dealogic database, which covers Chinese cross-border M&As during the period from January 1999 to May 2007 in order to analyse the development trend, geographical destination, sectoral distribution, and equity participation of Chinese cross-border M&As.

**Findings** – First, the growth of China's OFDI has not been as fast as expected, while the development of cross-border M&As has been very impressive. Second, although official OFDI statistics reveal that Asia remains the most important investment destination, our M&A data analysis shows that the developed countries in the West have attracted most Chinese cross-border M&A investments. Third, in contrast to the official OFDI statistics, our findings reveal a heavy concentration of M&As in mining and manufacturing. Finally, our cross-border M&A data suggest that Chinese companies predominantly seek high-level equity participation in the acquired target companies abroad.

**Originality/value** – This paper fills a gap in the study of the development pattern of Chinese cross-border M&A investments and offers a complementary view and a better understanding of the internationalization of Chinese companies.

**Keywords** International investments, Direct investment, Acquisitions and mergers, Globalization, China

**Paper type** Conceptual paper

### 1. Introduction

The internationalization of Chinese companies is a rather new phenomenon. Owing to some spectacular mergers and acquisitions (M&As) in the fields of high technology and energy in the last few years, the investment activities of Chinese companies have attracted the attention of both Western media and politicians in charge of economic

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policy making. Chinese outward foreign direct investment (OFDI) has been analysed from various theoretical and empirical perspectives since the mid-1990s. Some of the studies have concentrated on the regulatory framework and government influence on the growth and patterns of geographical and sectoral distribution, as well as the investment motives of Chinese companies (Zhan, 1995; Wang, 2002; Taylor, 2002; Wong and Chan, 2003; Hong and Sun, 2004; Wu, 2005). Other studies have applied an international management perspective, focusing on the internationalization strategies of Chinese companies (Warner *et al.*, 2004; Child and Rodrigues, 2005; Deng, 2008; Buckley *et al.*, 2007; Rui and Yip, 2008). When categorizing this research according to the kinds of data that are examined, one finds that most works are based on official statistics, and there are only a few questionnaire surveys (Liu and Tian, 2008) and case studies (Warner *et al.*, 2004; Deng, 2008; Rui and Yip, 2008). Among the research based on case studies, two very recently published articles focus on M&A-related issues, analysing the reasons why Chinese companies apply a strategic asset-seeking strategy (Deng, 2008; Rui and Yip, 2008). What is missing to date is a contribution that analyses the overall development of Chinese companies' cross-border M&As, the geographical and sectoral distribution patterns of Chinese M&As, and Chinese companies' equity participation in overseas acquisitions. Our paper intends to fill this gap and to contribute to a more comprehensive understanding of the cross-border M&A transactions of Chinese companies.

Owing to the varying statistical methodologies[1] and data collection problems, statistics on China's inward and outward FDI are not comparable to international standards in terms of quality and coverage (Schüller and Turner, 2005, p. 5; UNCTAD, 2007). Chinese FDI data are reported by the Ministry of Commerce (MOFCOM) and the State Administration of Foreign Exchange (SAFE). Owing to each agency applying a different statistical methodology, significant discrepancies exist. Another criticism of the quality of Chinese official FDI statistics relates to the problem of "round-tripping" (Hong and Sun, 2004, p. 5). There are no official estimates on the extent of this phenomenon, but some studies suggest that such inflows may account for up to 25 percent of total inflows (UNCTAD, 2007) or about half of Hong Kong's FDI to China during the last two decades (Geng, 2005, p. 3). Because of the many deficiencies in China's statistical system and the reporting of capital flight, Chinese OFDI statistics from MOFCOM and SAFE require careful interpretation. Official statistics seem to offer some explanation of the broader trends, but these need to be complemented by additional databases. In contrast to studies based entirely on official statistics, our contribution relies on information from the Dealogic M&A investment database. Dealogic is a global market leader in information provision for the investment-banking industry. This database allows us to study the development patterns of Chinese cross-border M&A transactions in terms of regional and sectoral distribution and also with regard to the equity participation of Chinese companies investing abroad.

The paper is organized as follows. Section 2 discusses the literature on the theoretical foundations of the internationalization of companies. This allows us to derive a number of propositions which will be examined later. In Section 3, we present our methodology and describe the database. Section 4 presents our findings based on the Dealogic data on Chinese cross-border M&As and contrasts these findings with the official OFDI statistics. In the final section, Section 5, we discuss our findings and

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conclude the paper by pointing out both the limitations of our work and possible future research on the internationalization of Chinese companies.

## 2. Theoretical background and hypotheses

Two theoretical perspectives predominate in the research on Chinese OFDI[2]. First, the resource-based view argues that firm-specific capabilities and resources determine strategy and performance (Barney, 1991). Second, the institution-based view, which has received much attention in recent years, argues that the dynamic interaction between organizations and institutions drives the internationalization strategy (Hoskisson *et al.*, 2000; Peng, 2003; Yamakawa *et al.*, 2008). The institution-based view of firms has evolved in line with the research on the emerging economies. In contrast, the resource-based view was originally used for analysis of the internationalization of companies from the developed countries and thus needs to incorporate the perspective of latecomer firms.

### 2.1 *The resource-based view of a firm's internationalization*

According to the resource-based view, a firm's internationalization strategy and performance depend on the existence of unique tangible and intangible resources in its home country which give it a competitive advantage compared to firms in the host country. Intangible resources such as management know-how, R&D capability, brand names, and proprietary technologies are crucially important (Barney, 1991; Tan and Vertinsky, 1996; Teece *et al.*, 1997). Companies with strong competitive advantages often try to exploit their strength by creating a "clone" of the parent in the host country (Mathews, 2006). In this case, greenfield investment is the preferred mode of entry as it is the most effective way to transfer the investing company's advantages to overseas markets and to introduce the firm's best practices. Research by Hennart and Park (1993) has shown that Japanese investors with strong R&D advantages prefer greenfield investment as the major entry mode into the US market. In contrast, companies with weak competitive advantages must acquire new resources that they cannot generate themselves. Under these circumstances, a foreign acquisition is more effective as it allows the firm to extract such assets from the acquired company (Homburg and Bucerius, 2005).

Latecomer firms do not possess many intangible strategic resources relative to their global rivals and therefore are eager to access superior resources and skills in order to compete successfully (Rui and Yip, 2008, p. 215). More importantly, however, these companies want to combine their own advantages developed at home with other new assets available in foreign countries. Their own advantages lie mostly in small-scale and labour-intensive production as well as in the ability to adapt quickly to changes in products and production processes (Makino *et al.*, 2002, p. 406). Since the required complementary inputs, such as more advanced products and technology, belong to the mature firms in the advanced countries, latecomer firms tend to prefer the developed economies as their asset-seeking location. These assets can only usually be accessed through a takeover or a subdivision of these firms (Dunning, 2001). In addition, through an acquisition a firm can gain access to tangible as well as intangible assets and thus is able to buy not only a single asset but also "an entire knowledge system under a unified control" (Rui and Yip, 2008, p. 216).

### 2.2 *The institution-based view of a firm's internationalization*

The crucial role of institutions as an incentive structure and as a driver of change has been highlighted in the research of institutional economists such as Douglass North. North has defined institutions as constraints that structure human interaction. These constraints consist of formal constraints (for example, rules, laws, and constitutions), informal constraints (for example, conventions and norms), and their enforcement characteristics (North, 1993). The institution-based view of strategy research adopts the core proposition of institutional economics that "variation in national institutional environments enables and constrains different strategic choices such as product and geographic diversification" (Peng and Delios, 2006, p. 389). That companies' internationalization strategies are also shaped by the home institutional environment has been shown by Buckley *et al.* (2007, p. 502) in their recent research on the determinants of Chinese OFDI. Institutional constraints in the emerging economies tend to be much stronger than those in the developed countries and include the substantial influence of the government on the companies' strategy decisions (Deng, 2008).

Active government involvement in business via ownership or through the regulatory framework is a rather common phenomenon in most of the latecomer and transition economies, especially in Asia (Peng, 2000, cited in Child and Rodrigues, 2005, p. 384). In contrast to the market-oriented model of the West, the emergence of Japan and South Korea was much more related to the intervention of the governments, which "orchestrated oligopolistic competition" among large-scale companies (Sutherland, 2003, p. 5). The development-state model of the newly industrialized economies (NIEs) in East Asia incorporates developmentally oriented policies and applies an interventionist set of industrial policy instruments (Nee *et al.*, 2007; Liu, 2005). The experience of the Asian latecomer firms shows that government support has been a decisive factor in these companies' successful internationalization (Hoskisson *et al.*, 2000, p. 257). Furthermore, the role of government in transition economies relates to the definition, diffusion, and enforcement of the norms and requirements of the companies' business conduct. In these countries, rules and organizations are constantly being adapted in an evolutionary process in which formal and informal institutions work as the "rules of the game" in interactions between companies and government institutions. The government can restrain or facilitate the internationalization of firms through different policies.

### 2.3 *Propositions regarding Chinese cross-border M&A investment*

According to the resource-based view, greenfield investment is the most effective way to transfer a company's competitive advantages to foreign countries. In contrast, acquisition is regarded as more effective when the intent is to absorb knowledge from the acquired foreign company (Sarala and Sumelius, 2005). Following this line of argument, M&As will be chosen by Chinese companies when they invest in a country with mature industries. Compared to their Western rivals, the competitive capability of China's national champions is estimated to be less than that of the global giants, even after two decades of reform (Nolan, 2001, p. 187). Although know-how transfer through inward FDI has contributed to an increase in the competitiveness of Chinese enterprises, Chinese firms still lack R&D capability, knowledge of overseas markets, internationally known brands or trade names, and brand-development ability

(Huang, 2003; Nolan, 2001). Their advantages are related to their manufacturing capabilities, primarily in the low- and medium-technology segments of industries that characterized by increasing competitive pressures and decreasing profit margins. Advanced technology is still largely controlled by mature foreign companies. Therefore, Chinese companies must engage in strategic asset-seeking OFDI. Acquisitions in the developed countries provide Chinese firms with the opportunity to access higher value-added markets and to catch up with global market leaders. This also supports their competitiveness *vis-à-vis* multinationals in their home market (Child and Rodrigues, 2005, p. 389).

Cross-border M&As by Chinese companies are a relatively new development. Following the blueprint of Korean and Taiwanese companies' actions in the 1970s and 1980s, Chinese firms began to focus on "inward internationalization" in the 1990s. Joint ventures with foreign companies or original equipment manufacturer partnerships were used as channels to overcome the distance to foreign markets and to leading technology companies. Through the absorption of know-how, Chinese companies strengthened their innovation capabilities. Although this "market-for-technology" strategy is regarded as a passive means of internationalization, it apparently supported Chinese firms' expansion abroad (Warner *et al.*, 2004, p. 339). After attaining a certain size and sufficient competencies, the firms directed their attention to the leading markets in the developed countries in order to build up new capabilities. In their empirical study of Chinese OFDI, Buckley *et al.* (2007) reveal that prior to 2001 the goal of Chinese investment abroad was not the acquisition of strategic assets. It is in recent years as the government has stressed its "Going Global" policy through measures such as the relaxation of control over foreign exchange and overseas investment approval that Chinese OFDI has increased rapidly (Buckley *et al.*, 2007).

Government support has also played a crucial role in the financing of Chinese OFDI. Through the accumulation and the realization of reasonable profits in the domestic market, many Chinese firms gained cash resources (for example, Lenovo and TCL) (Child and Rodrigues, 2005, p. 394). However, it is still unlikely that Chinese firms can frequently make risk-taking acquisitions abroad if they cannot count on sponsorship and financial support (Warner *et al.*, 2004, p. 340). After China's accession to the WTO in December 2001, support for cross-border M&As became part of the country's overall industrial policy in order to promote the internationalization of Chinese companies (Schüller and Turner, 2005, p. 9). Hence:

- P1.* Cross-border M&As have become an important market entry mode for Chinese firms since 2001 and they tend to focus on the developed countries.

State influence on the globalization of Chinese companies has been incorporated into the theoretical discussion by a number of authors. Child and Rodrigues (2005, p. 404) point to government restrictions on firm decision making. The active role of Chinese local governments in regulating and supporting domestic companies has been discussed, for example, by Law *et al.* (2003, p. 255). That government support has been one of the main drivers in the internationalization of Chinese companies is argued by Buckley *et al.* (2007, p. 503), Child and Rodrigues (2005, p. 399) and Hitt *et al.* (2004).

State ownership of large companies has remained an important channel of government influence as well. Despite the legal restructuring of Chinese firms, state-run companies still play an important role in key industries such as energy,

natural resources, transport, heavy industry, aviation, and telecommunications. An examination of the 30 largest Chinese firms in terms of OFDI volume at the end of 2006 (Table I) reveals that most are state-owned or are characterized by large equity participation by ministries or municipalities. The top three Chinese investors are the three largest state-owned oil companies (China Petrochemical Corporation, China National Petroleum Corporation, and CNOOC). China Resources (Holdings) Co., Ltd ranks fourth. Companies within the subsequent ranks are either state-owned enterprises (SOEs) or joint-stock companies with a state-controlled share in key industries. These industries are subject to both heavy policy regulation and industrial policy support.

The predominance of state ownership among Chinese companies investing abroad is also revealed in the companies involved in cross-border M&As. Most of these companies are owned by the Chinese Government or by governmental agencies (Luo and Tung, 2007). When such firms invest abroad, their locational and sectoral decisions are strongly influenced by the government. By directing overseas investment

Ranking	Company name
1	China Petrochemical Corporation
2	China National Petroleum Corporation
3	China National Off-shore Oil Corporation
4	China Resources (Holdings) Co., Ltd
5	China Mobile Communications Corp.
6	China Ocean Shipping (Group) Company
7	CITIC Group
8	China Nat. Cereals, Oils & Foodstuffs
9	China Merchants Group
10	Sinochem Corporation
11	China State Construction Engineering Corp.
12	China National Aviation Holding Corporation
13	China Telecommunications Group Corporation
14	China Shipping (Group) Company
15	China Network Communications Group Corp.
16	GDH Limited
17	China Power Investment Corporation
18	China Automotive Industry Corporation
19	China National Chemical Corporation
20	China Minmetals Corporation
21	Legend Holdings Ltd
22	Shum Yip Holdings Company Ltd
23	China National Foreign Trade Transportation (Group) Corporation
24	Huawei Technologies
25	Shanghai Baosteel Group Corporation
26	China Huaneng Group
27	SinoSteel Corporation
28	China Poly Group Corporation
29	China Nonferrous Metal Mining & Construction (Group) Co., Ltd
30	Haier Group

**Table I.**  
Ranking of the 30  
largest Chinese  
companies in terms of  
OFDI

**Note:** Accumulated OFDI value in 2006, excluding financial investment  
**Source:** MOFCOM (2007, p. 72)

into targeted locations and sectors, the government seeks to enhance China's international political and economic influence (Hong and Sun, 2004, p. 8; Wang, 2002, p. 194).

Government promotion of OFDI serves specific objectives. First of all, the government supports overseas investment in order to secure its access to scarce natural resources, which can ensure further domestic economic growth. Most important are outward investments for iron ore exploitation and for the joint exploitation of oil. Recently, the acquisition of foreign petroleum assets by Chinese petroleum companies has become part of the overall government-supported "Going Global" policy (Wenke and Liu, 2006). Another important government objective is to support domestic companies in the acquisition of advanced technology, brand names, and modern manufacturing know-how (Schüller and Turner, 2005, pp. 10-11; Wong and Chan, 2003, p. 285; Zhan, 1995, pp. 69-70). The policy instruments to achieve these aims have been broadened over the last few years and include both financial and non-financial instruments. In addition to the relaxation of capital controls, special loan programmes have been established as well. In November 2004, the National Development and Reform Commission and the Export-Import Bank of China issued a joint circular on the establishment of programmes to facilitate overseas investment in natural resources in general and strategic asset M&As in particular (Schüller and Turner, 2005, p. 10). Hence:

- P2. The sectoral distribution of Chinese cross-border M&As is influenced by government policies and tends to be concentrated in natural resources and manufacturing.

Regarding the degree of equity control, Anderson and Gatignon (1986) point out that a relatively high level of control is necessary for transaction-specific assets. Hill *et al.* (1990) utilize a broader approach which also takes into account the global strategies of multinational companies (MNCs) and the risk of disseminating firm-specific knowledge. A high-control entry mode will be preferred if a firm is pursuing an aggressive internationalization strategy, intends to protect its highly firm-specific know-how, or hopes to absorb another firm's specific know-how.

According to the resource-based view on internationalization, a high degree of control will give the acquiring firm an increased chance of success because the firm can deploy key resources that are essential to achieving success (Gatignon and Anderson, 1988; Isobe *et al.*, 2000). These resources include intangible properties, such as brand names and marketing know-how, or tangible properties, such as patents or process blueprints.

Chinese companies investing in developed countries seek control not only over tangible resources but also over intangibles such as management know-how because they are unfamiliar with distant markets. They look for local managers with strong organizational abilities and technical expertise who are capable of operating successfully in the local economy. In order to transfer knowledge about local markets to Chinese managers, a high level of control is necessary. Although the link between the level of equity participation and the firm's effective operational control over its overseas subsidiary may not be straightforward (Lecraw, 1984, p. 30), it can be assumed that Chinese firms desire a high level of equity participation in order to

increase their control over key complementary resources, such as access to local distribution channels or exclusive brands. Hence:

P3. Chinese companies seek a high level of equity participation in M&As.

### 3. Methodology and data

Official statistics on Chinese OFDI are supplied by MOFCOM and other government agencies[3]. The annual reports published since 2003 offer comprehensive data on Chinese OFDI but do not provide substantial information on Chinese cross-border M&As. To analyse the patterns of cross-border M&As, our research uses the Dealogic database, which covers transactions for Chinese acquisitions during the period from January 1999 to May 2007.

M&A is a general term for deal activities, including not only M&As but also takeovers, consolidations, and management buyouts, to name just a few (Business Library, 2007). Owing to the different disclosure rules of (stock) markets worldwide, the Dealogic data are especially reliable with respect to M&A transactions of publicly held companies. In addition to published information based on notification requirements, other sources are also included. For example, many financial advisors submit transaction details in order to be covered in league tables. However, if all of the parties involved in an M&A transaction agree to maintain the utmost confidentiality and if they are not subject to disclosure requirements, a transaction may not show up in the database. This should be kept in mind when looking at the activities of Chinese SOEs or if illegal capital outflows are involved in a transaction. Owing to anti-trust and other regulatory requirements, it may take years before a transaction is legally closed (Schüller and Turner, 2005, p. 5). To understand the market, it is important to look not only at completed deals, but also at announced deals. Therefore, our analysis includes completed M&A transactions and also intended and pending transactions. The failed bid of China National Offshore Oil Corp. (CNOOC) to acquire the US company UNOCAL, with a bid value of US\$18.5 billion, is not included in our analysis, nor is the acquisition of a 9.9 percent stake in the Blackstone Group for US\$3 billion by the state-owned China Investment Corp. In the first case, the inclusion of the UNOCAL deal would have distorted the transaction volume in the respective year. In the second case, the acquisition is related to the Sovereign Wealth Fund, which requires special analysis[4].

The original database supplied to us by Dealogic covers 1,522 transactions, including announced and completed deals, and acquirers from both Hong Kong and Mainland China. Starting from this database, we selected only those deals with acquirers from Mainland China. In total we found 342 such transactions, including both completed and announced transactions. We then analysed the group of more than 1,000 Hong Kong acquirers in order to find those companies that originated in China. An example of such a firm is Lenovo, which acquired the PC branch of IBM through Lenovo Hong Kong Ltd. Adding these Hong Kong acquirers to our list, we ended up with a total of 364 M&A transactions.

## 4. Results

### 4.1 Chinese cross-border M&As

According to our M&A data analysis, the value of Chinese cross-border M&As shows a strong upward trend between 2002 and 2006, with an average annual growth rate of



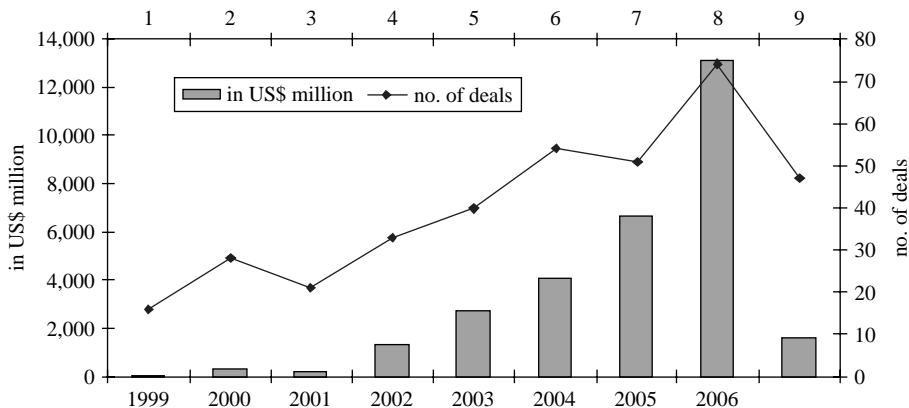
212 percent and reaching an unprecedented level of over US\$13 billion in 2006[5] (Figure 1). The majority of transactions occurred in Asia (37 percent in terms of the number of deals), whereas Europe was the main target for Chinese cross-border M&As in terms of bid value (absorbing 24 percent) (Figure 2). If we divide the target countries for M&As into developed countries and developing countries according to OECD classifications, 55 percent of the number of transactions took place in the developed countries, absorbing 52 percent of the total bid value. Within the developing countries, the Asian countries were the major destination for Chinese cross-border M&As, followed by the Commonwealth of Independent States.

These results support our first proposition regarding the impact of government support on OFDI after China’s accession to the WTO at the end of 2001. The dramatic growth of Chinese M&As after 2001 can be seen as a positive reaction to the government’s “Going Global” policy.

That Chinese firms turn to M&As as an important market entry mode to catch up with their Western rivals in the developed countries can also be demonstrated by the accumulation of resources through inward FDI over the recent decades. Our M&A data show that the number of deals and the volume of M&A transactions in the developed countries were higher than those in the developing countries. However, the concentration of M&As in the developed countries was not as high as expected. This can probably be explained by the sectoral distribution, which shows a strong bias toward the energy sector.

Regarding the sectoral distribution, we found that Chinese M&As are heavily concentrated in the mining sector, accounting for 65 percent of the total M&A stock, followed by the manufacturing sector, with 25 percent. In terms of the number of transactions, the mining and manufacturing sectors accounted for the largest shares (Figure 3). This points to the fact that the average transaction volume in the mining sector is much higher than that in the manufacturing sector.

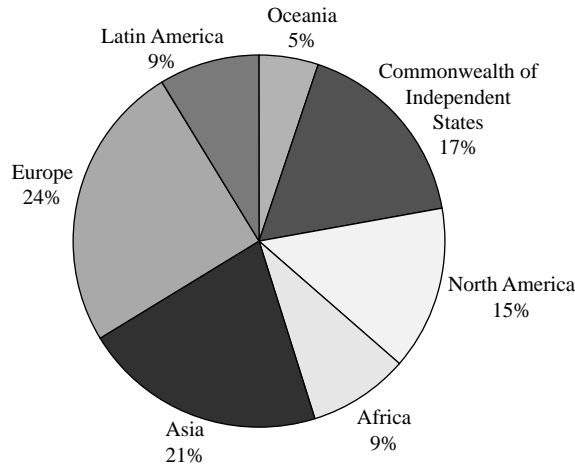
These results support our second proposition: that the locational and sectoral distributions of Chinese cross-border M&As are strongly influenced by the government. They also support our argument that latecomer firms are motivated to complement their resource base rather than to achieve an ownership advantage



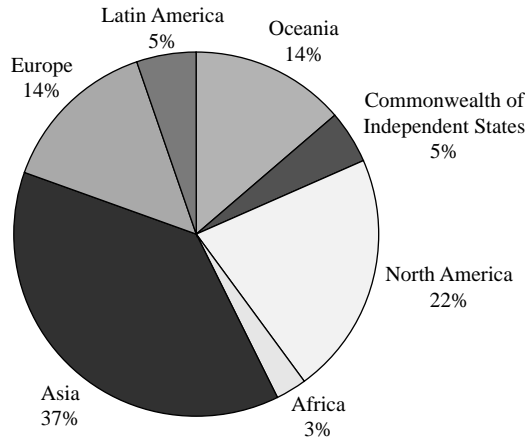
**Figure 1.**  
Chinese companies’ equity  
purchases,  
January 1999-May 2007

Source: Authors’ own calculations based on Dealogic data (data as of May 2007)

Target region of Chinese cross-border M&As (bid value)



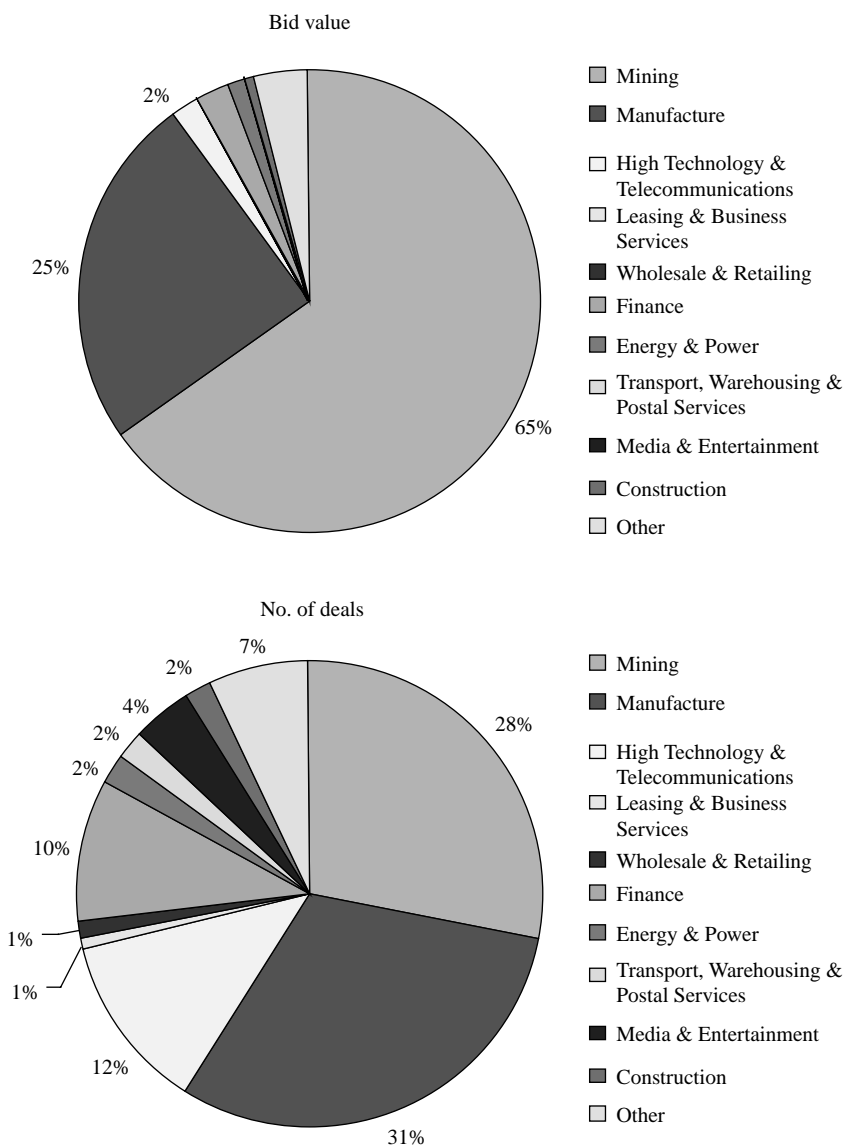
Target region of Chinese cross-border M&As (no. of deals)



**Figure 2.**  
Regional distribution of  
Chinese cross-border  
M&A activity, January  
1999-May 2007

**Source:** Authors' own calculations based on Dealogic data (data as of May 2007)

*vis-à-vis* the local competitors. Chinese manufacturers in general have a strong market position, but it is mainly in the low- and medium-price segment due to the cost advantages. The acquisition of companies in developed countries is intended primarily to secure advanced technology and/or brand names, thus complementing existing cost advantages. In contrast to our expectations, the high technology and telecommunication sectors (software development and IT services provision) attracted only a negligible share of 2 percent of the total M&A transaction volume. This seems to be consistent with the trend whereby software development and IT services are increasingly being relocated to countries such as India and China.



Source: Authors' own calculations based on Dealogic data (data as of May 2007)

**Figure 3.**  
Sectoral distribution of  
Chinese cross-border  
M&A activity, January  
1999-May 2007

Looking at the geographical and sectoral distributions simultaneously, we can conclude that M&As are the preferred market entry mode in the mining sector. The developing countries have attracted 62 percent of the total M&As (in terms of value) in this sector. A large share of these M&As have occurred in Africa and Latin America as natural-resource-seeking investment was strongly supported by the government in recent years. Owing to the huge investment in this sector, the sectoral and geographical

distribution is distorted and this explains why there is not a higher concentration of Chinese cross-border M&As in the developed countries.

With regard to the ownership participation of the acquired foreign companies, we can conclude that Chinese companies prefer ownership participation of more than 75 percent in cross-border acquisitions. Out of the total 364 M&A transactions, 195 offer information on their ownership participation. Among these, 112 or 57 percent of the transactions are reported to involve a share of more than 75 percent in the acquired foreign companies (Table II). The overwhelming majority of transactions (100) among the 112 transactions noted above are reported to involve 100 percent ownership participation. A high level of equity control is preferred by Chinese companies in the developed countries. Among the 118 transactions reported for the OECD countries, 75 transactions involve an equity share of more than 75 percent. We can conclude that the majority of Chinese companies for which data are available seek a controlling stake in the acquired foreign entity, thus confirming our third proposition.

#### 4.2 Contrasting Chinese cross-border M&As with OFDI development patterns

Owing to the differing databases, we cannot directly compare the results from our M&A analysis with the OFDI development results based on the MOFCOM statistics. Therefore, we will concentrate on a comparison of the patterns in both cross-border M&As and OFDI development in order to arrive at a more comprehensive understanding of the internationalization of Chinese companies.

*4.2.1 Development trend.* According to statistics from MOFCOM, which include the FDI components of equity capital, reinvested earnings, and intra-company loans (Frost, 2004), the accumulated amount of China's OFDI totalled US\$90.63 billion by the end of 2006 (MOFCOM, 2007). The annual FDI outflow from China grew rather slowly until 2001 (Figure 4). Over the following five years (2002-2006) the development trend changed significantly. During this period, OFDI grew from US\$2.7 billion to 21.16 billion (MOFCOM, 2007), with an average annual growth rate of 46 percent.

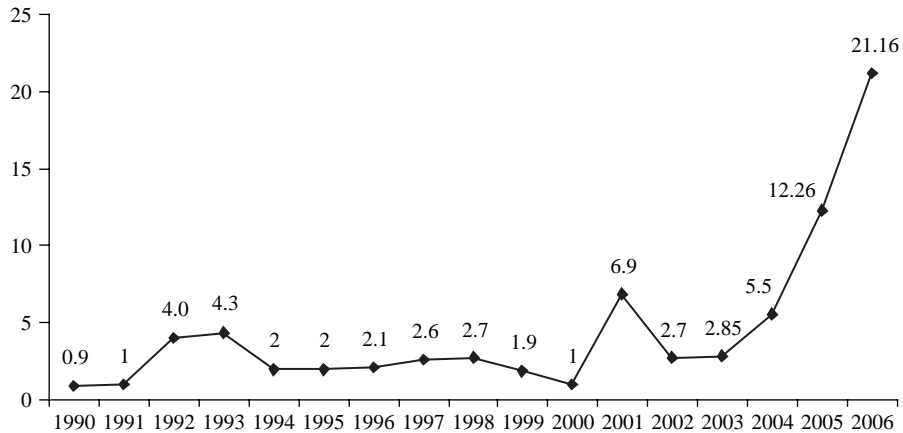
The development trend of Chinese OFDI is consistent with that of Chinese cross-border M&As. Both have exhibited a strong increase since 2002. With regard to the average annual growth rate in the 2002-2006 period, however, cross-border M&As reveal a much steeper acceleration, with an average annual growth rate of more than 200 percent. This indicates that in recent years M&As have become a more frequent market entry mode for Chinese companies.

*4.2.2 Geographical distribution.* Regarding the geographical distribution of Chinese OFDI, we agree with Cheng and Ma's (2007, p. 9) analysis "that the true breakdown of the destination of China's FDI [is] basically unknown". According to MOFCOM

Equity participation (%)	OECD countries	Developing countries	Asia NIEs	Total
≤ 25	26	6	6	38
> 25, ≤ 50	8	13	7	28
> 50, ≤ 75	9	6	2	17
> 75, ≤ 100	75	23	14	112
Total	118	48	29	195

**Source:** Authors' own calculations based on Dealogic data (data as of May 2007)

**Table II.**  
Equity participation in firms acquired through Chinese cross-border M&As, January 1999-May 2007



**Note:** For 1990 to 2001, the statistics are based on UNCTAD. For the period after 2001, the statistics are based on MOFCOM. The data also include financial investments

**Source:** MOFCOM (2007, p. 6)

**Figure 4.**  
Development trend for  
Chinese OFDI (in US\$  
million), 1990-2006

statistics for the 2003-2006 period, Chinese OFDI was mainly concentrated in Latin America and Asia, with a shift toward Latin America in 2005 (with a share of 52 percent) and 2006 (with a share of 48 percent), whereas Europe and North America absorbed only minor shares of 3.4 and 1.5 percent, respectively, in 2006 (Table III).

However, the geographical distribution is distorted to some extent by the phenomenon of “round-tripping” of investment capital. With regard to inward FDI to China, UNCTAD points out that “round-tripping is driven by differences in the treatment of foreign and domestic investors, which may motivate investors to channel funds out of, and subsequently into, an economy in the form of FDI” (UNCTAD, 2007). We can relate this problem to Chinese OFDI. Official statistics from MOFCOM show that within Latin America 98.8 percent of the investments went to offshore financial centres and tax havens such as the Cayman Islands and the British Virgin Islands. If these tax havens are not taken into consideration, the most important OFDI destinations in 2005 would have been Hong Kong, South Korea, the USA, Russia, Australia, Germany, Sudan, and Kazakhstan (Cheng and Ma, 2007, p. 9). The problem of capital round-tripping is reflected in this inflow into tax havens in Latin America, and to some extent this is the case for Hong Kong as well. If we do not take this OFDI into tax havens into account, the growth of China’s overseas investment has not been as rapid as the official statistics suggest. In this case, our findings regarding Chinese cross-border M&As may reveal a more realistic geographical distribution.

	2003 (%)	2004 (%)	2005 (%)	2006 (%)
Asia	52.5	54.6	36	43.5
Latin America	36.5	32	52	48
Europe	5.3	3.1	4	3.4
Africa	2.6	5.8	3	3
North America	2	2.3	3	1.5

**Source:** Authors’ own calculations based on MOFCOM (2007)

**Table III.**  
Geographical distribution  
of China’s outward FDI,  
2003-2006

*4.2.3 Sectoral distribution.* MOFCOM statistics do not reveal any distinctive pattern of sectoral concentration of OFDI stock until 2006 (Table IV). Chinese OFDI in leasing and business services accounted for more than US\$19 billion (corresponding to a 21.5 percent share of the total stock) at the end of 2006; the mining sector came in second with nearly US\$18 billion (corresponding to a 19.8 percent share). The recipient of the third-largest amount was the finance sector, with a share of 17.2 percent.

In contrast to official Chinese statistics on OFDI, we found that M&As are heavily concentrated in the mining sector, with a share of 65 percent of the total M&A stock, followed by the manufacturing sector, with a share of 25 percent. In terms of the number of transactions, 31 percent of the total transactions took place in the manufacturing sector and 28 percent in the mining sector. We can conclude that M&As are mainly used as a market entry mode in mining and the manufacturing sector, whereas greenfield investment or other entry modes are preferred in other sectors such as leasing and business services.

### 5. Discussion and conclusion

Owing to the deficiencies in China's statistical system, official reports leave us with only a limited understanding of the growth and pattern of Chinese OFDI. Through an analysis of Chinese cross-border M&As and the study of their evolution in the context of China's overall OFDI development, we have been able to obtain a complementary view and understanding of the internationalization of Chinese companies. Our findings reveal, first, that the growth of OFDI has not been as rapid as expected if we consider the issue of "round-tripping" investment. In contrast, the development of cross-border M&As has been very impressive. This is supported by our data for recent years, particularly after China's accession to the WTO at the end of 2001. Second, although official OFDI statistics reveal that Asia and Latin America have remained the most important investment regions in recent years, our M&A data analysis shows that the developed countries in the West attracted most of the Chinese cross-border M&As. Third, in contrast to the official OFDI statistics, which point to a more even distribution of investment in stock across sectors until 2006, our findings reveal a heavy concentration of M&As in the mining and manufacturing sectors. Finally, our cross-border M&A data reveal that Chinese companies predominantly seek a high level of equity participation in the acquired target companies abroad. This finding complements the official OFDI data that do not examine this issue.

	2004	2005	2006
Mining (petroleum and natural gas)	5,951.37	8,651.61	17,901.62
Manufacturing	4,538.07	5,770.28	7,529.62
Leasing and business services	16,428.24	16,553.60	19,463.60
Wholesale and retailing	7,843.27	11,417.91	12,955.20
Transport, warehousing, and postal services	4,580.55	7,082.97	7,568.19
Finance	-	-	15,605.37
IT	1,192.37	1,323.50	1,449.88
Total	44,777.26	57,205.62	90,630.91

**Table IV.**  
Distribution of Chinese outward FDI stock by sector (in US\$ million), 2004-2006

Source: MOFCOM (2007)

Given the strong increase in Chinese cross-border M&As in recent years and the concentration of M&As in the mining and manufacturing sectors, we conclude that the institutional environment has significantly shaped Chinese OFDI. That we were not able to confirm a higher concentration of M&As in the developed countries as we had expected can be explained by a recent policy shift toward support of investment in natural resources in Africa and Latin America by domestic energy companies. For strategic asset seeking, however, the developed countries are the more attractive destinations. Chinese companies' locational decisions in this respect can be directly related to the learning perspective. Owing to the rapid technological changes in the global economy, an experiential learning approach through an "established chain" is difficult. Latecomer firms like Chinese firms are forced to skip stages even if objectively their knowledge is too limited to do so.

This paper offers an initial analysis, based on a commercial database, of the development patterns of Chinese cross-border M&A transactions in terms of geographical and sectoral distribution and with regard to the equity participation of Chinese companies investing abroad. The next step of research should focus on Chinese companies as objects of study, concentrating on factors that determine:

- the success or failure of Chinese companies' international expansion; and
- the level of equity participation and the degree of control Chinese MNCs exercise over subsidiaries in host countries.

Future analysis should also capture the effects of local equity participation and control on the success of company investments abroad.

## Notes

1. FDI represents an investment in a local enterprise made by a foreign firm, involving a long-term relationship and a certain degree of control over the company by the foreign equity owner. Two types of data on FDI exist. One is the financial data based on balance of payment (BOP) accounting, which record inward and outward flows of FDI and the resulting stock. The other is the data on FDI operations between their affiliates and their parents, including sales, production, employment, assets, and expenditures on R&D data (Yang, 2003, pp. 19-20). Although financial data are the only statistics on FDI that are available for most countries, data on FDI operations can reveal more detailed information. Their comprehensiveness, however, depends on how the home country carries out its surveys (Lipsey, 2001).
2. In international management research, the industry-based view is also important. However, research on Chinese internationalization focuses on the resource- and the institution-based views.
3. The annually published comprehensive report on OFDI by MOFCOM is available for the 2003-2006 period, whereas BOP statements from the SAFE exist for previous years.
4. Owing to the growth of foreign currency reserves in recent years, the government set up a specialized agency (China Investment Corporation (CIC)) to invest some of the foreign currency in foreign assets. CIC, with registered capital of US\$200 billion, can be a driver for further government-directed equity investments abroad.
5. Since the bid value is not known for each transaction, the real volume of the Chinese M&As must be much higher. Therefore, in our analysis we consider the bid value as well as the number of deals.

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