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From Learning to Globalization: The influence of the market and institutions on Chinese multinationals

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Abstract

Conventional economic literature about foreign direct investment (FDI) has typified multinational companies' strategic behavior through the prism of the theory of the firm. However, FDI from developing economies has revealed the existence of multinationals whose behavior differs from that forecast by conventional theories due to the intervention of government institutions, such as in the case of China. Taking this into consideration, through conventional and institutional theories, this article attempts to reveal the factors that have influenced Chinese multinationals' strategic behavior since the 1978 economic reforms until today.

Key words: multinational companies, behavior of the firm, institutions, market imperfections, China.

JEL **Classification**: B52, D22, D23, F23.

Introduction

Economic literature includes a very important body of theories that consider foreign direct investment (FDI) the result of purely entrepreneurial and market motivations, which constitute part of the group of theories dedicated to explaining this kind of investment. These theories, which come mainly out of the research by Hymer, Casson and Buckley, and Dunning, centers on the firm, on its strategic behavior in the face of market imperfections, and its decisions about location.[1] They have been widely used to explain the reasons behind FDI, which is why in this article they will be called "conventional theories."

Nevertheless, the emergence on the international scene first of all of Japanese companies, later of Southeast Asian firms, and most recently of Chinese

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[1] Kantarelis (2007) extensively explores the theories of the firm.

companies has revealed the need to broaden economic theory out to include other possible reasons to explain world expansion of FDI from developing countries. This has led various authors to take on the task using the institutional standpoint as their starting point for an alternative explanation to the aforementioned approaches.

This need comes from the recognition of the different characteristics of firms from developing countries, which in most cases have not behaved strategically in the same way as those from developed countries, mainly for institutional reasons. In the Chinese case, this is particularly true given the government's active role in establishing legislation and promotional bodies to foster outward FDI, which has given rise to non-conventional multinationals. For this reason, different researchers think that in this case, in addition to conventional reasons, institutions also be considered a determining factor in China's FDI.

Taking all this into account, in this research, the aim is to use the theory of the firm and institutional theories to analyze, first of all, how market imperfections have influenced Chinese multinationals, and, in the second place, to confirm if during their evolution, their strategic behavior has been influenced by institutions and, if it has, how. To achieve these objectives, the temporal horizon of this analysis will span the 1978 economic reforms to the present day, and will be carried out using some elements of theories considered conventional (related mainly with market failings). Also, institutional analysis[2] will be carried out starting with the formal exogenous institutions[3] formed by the government and that intervene in some way in FDI.

When discussing public institutions, some authors refer to the government and others to the state. In this research, I will respect those terms when I talk directly about their work, but in the rest of the analysis, I will use the term "government" when I mention institutions created by the state, or when I allude to the exercise of power and the political leadership of the state.

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[2] The conventional theories were chosen because they study FDI as an entrepreneurial initiative linked to business decisions, one way or another free of other influences unrelated to the market. This is a counterpoint to institutional theories that presuppose the intervention of institutions in the behavior of economic agents. That is, using conventional theories it will be possible to achieve a non-interventionist view of firms' behavior contrasted with the interventionist view of institutional theories.

[3] By 'exogenous institutions', I mean those generated outside the firm, counterposed to internal institutions derived from the organizational structure that are created when a company decides to coordinate its resources through internal markets, as discussed by Coase (1937) and Williamson (1989). By 'formal institutions', I mean the laws, regulations, constitutions, contracts, and any other kind of written restriction, as discussed by North (1995).

This article is organized as follows: first, it will present a brief theoretical review of the theories of the firm and institutional theory and their relationship to FDI. Secondly, it will present a representative example of a Chinese company and its process of internationalization, to better understand the institutional and market context surrounding the emergence of a goodly number of these companies. Third, it will examine the strategic behavior of Chinese multinationals in the face of market imperfections. Fourth, it will look at how institutions affect the domestic market and companies. Fifth, it will point to the nature of firms' response to institutional influence. Lastly, it will present conclusions.

A brief theoretical review

Until the mid-1970s, FDI was an activity almost exclusive to multinational corporations (MNCs) from developed countries. Their performance was the basis for establishing some of the generally accepted economic theories to explain FDI. The first contributions in this field came from the pen of Stephen Hymer (1976), who differentiated this kind of investment from portfolio investment and established that the former can be explained by the need to control and exploit a firm's specific advantages, while the latter exists because of a difference in interest rates in different countries.

Other generally accepted theories are represented by the work of Buckley and Casson (1976) and Dunning (1981; 1988; 1993), which, generally speaking, could be summarized as arguing that FDI occurs when a firm is trying to maximize its profits by exploiting its ownership advantages for itself in oligopolistic foreign markets that are sufficiently attractive for developing their activity. The central argument of these generally accepted or conventional theories (as they will be called in this article) is that the internationalization of a firm rests fundamentally on its capacity to benefit from its ownership advantages in imperfect markets. At the same time, the market imperfections that foster or determine FDI, according to these theories, are oligopolies, transaction costs, knowledge asymmetries, economies of scale, and differentiated goods.

It should be underlined that Dunning (1981, 1988, 1993) developed a model that attempts to integrate elements of industrial organization and location theories, as well as the theories of the firm. Thus, Dunning's eclectic paradigm states that the international production model is determined by three types of advantages: of ownership (O), of location (L), and of internalization (I). It also affirms that FDI can be motivated by the quest for markets, resources, efficiency, or strategic assets. Given that conventional theories base their principles on the study of the behavior of multinational companies from developed countries (or conventional MNCs), that behavior became the model for study for establishing patterns of internationalization of a firm and determining its strategic behavior.

With regard to (non-conventional) institutional theories, the research of North (1979; 1993; 1995) provides very valuable elements for analyzing the relationship between the government (and its bodies), legislation, and the economy of a country —in this case FDI—, establishing a nexus with conventional theories.

North (1993) explains that, in contrast with the past, when people wanted to replace neoclassical theory, today, new institutional economics (NIE) attempts to incorporate institution theory into economic theory to broaden it. The NIE approach proposed fits with neoclassical theory because it conceives it as a theory in which choices are subject to limitations; price theory is a central part of institutional analysis, and changes in relative prices are a very significant factor that leads to changes in institutions. In addition, NIE not only takes into account the concept of neoclassical production costs, but also incorporates Coasian theory's transaction costs and makes them a central part of its analysis (North, 1993; Rutherford, 2001).

Among the different existing institutions, the right of ownership stands out since it is closely linked with transaction costs. The emergence of new ownership rights shows changes in economic values linked to the development of new technologies and the opening up of new markets for which the old property rights were insufficiently prepared (Demsetz, 1967). The latter often express themselves through laws and contracts that economic agents must comply with; at the same time, it is necessary to create bodies that watch over that compliance.

North (1993) differentiates between institutions and bodies, defining the former as the structure of incentives for individuals who interact in society, while the latter are groups united by the same end: that of maximizing benefits. Thus, bodies and political and economic institutions are fundamental determining elements of long-term economic performance. Given that organizations seek the maximization of benefits, they will tend to modify the existing institutional structure if that allows them to achieve their objectives (North, 1995). These changes may take place with an increase or a decrease in transaction costs.

Institutions provide the key to understanding the relationship between politics and the economy, and, at the same time, to understanding the consequences of that relationship for economic growth. The state is the maximum body that establishes and monitors the institutional framework in which exchanges will be realized, which is very convenient, because it does it at a lower cost than if it were done by a private person or body, although it can also create inefficient institutions that lead to a counterproductive effect, increasing transaction costs (North, 1995).

The maximization of benefits must adjust to the "rules of the game" imposed by the state. In turn, they must be designed to facilitate economic activities and diminish transaction costs, which have an impact on total costs, and these, in turn, on benefits. By decreasing transaction costs, totals decrease and benefits increase, just like taxes that must be paid by economic actors. This creates a benefit for the state. However, what can happen is that the state, in order to increase its own rents or benefit specific groups, establishes ownership rights that, instead of encouraging, are a barrier to economic growth (North and Thomas, 1973; North, 1979; 1995).

The interest in promoting economic growth has led governments to establish policies to increase national companies' competitiveness, to promote exports, and to foster FDI. They have also created and amended legislation, norms, and government bodies so they can have an institutional framework that allows them to achieve their economic, political, and social objectives. The ultimate aim of this strategy is to prolong their stay in office. Thus, North (1995) establishes a relationship between the government, the creation of institutions and bodies to achieve certain objectives, and remaining in power.

Scott (1985) recognizes the importance of the state in the creation of a healthy business climate. One example of this are the firms in East Asia that grew extraordinarily internationally thanks to the decided participation of their governments in the design of a national strategy to promote investments, research and development (R&D), cheap loans, initially protected markets, and close collaboration with companies to achieve first-world quality and productivity. Thus, the author establishes a relationship among the state, institutions, and companies, in which the first creates a series of institutions to favor economic activity, making it possible for national companies to grow beyond their borders.

For their part, Giddy and Young (1982: 62) dub companies 'non-conventional MNCs' when they do not come from developed countries or have the characteristics typical of this kind of company, but rather are small, low-tech, non-differentiated manufacturers that enter into joint ventures —but tending to retain control— to internationalize. In most cases, they make investments that flow toward other developing countries, usually geographically close.

Many non-conventional MNCs, in turn, are state-owned enterprises (SOEs), founded or acquired by the government. In any case, these companies cover a broad range of industries and have played a very important role in developing countries, as Jones (1975) and Sheahan (1976) underline.

The SOEs are often utilized by the government as an instrument of industrial policy to develop backward sectors, or those under pressure from external competition, or to create and maintain jobs. It should be pointed out that although SOEs are often managed independently, they do have to answer to state bodies. In fact, frequently, their objectives are far from relating to generating profits and are, rather, related to political matters (Walters and Monsen 1977).

In addition to Scott (1985) and Giddy and Young (1982), other authors like Lecraw (1983), Heenan and Keegan (1979), and Lall (1983) noted the emergence of FDI from developing countries, characterizing a new type of MNC different from their conventional counterparts studied up until then. Despite the fact that the new MNCs were clearly different from the conventional ones, the different attempts to explain their behavior were framed within the generally accepted economic theories and considered that their performance could be explained based on existing FDI theories.

That is, the authors did not go deeply enough into what had caused the emergence of multinationals in developing countries, but only adapted some of the existing theories to analyze them. This is why these explanations only partially clarified the phenomenon.

In the specific case of China, the research by Child and Rodrigues (2005) revealed that the FDI from these companies did not follow some of the patterns common among those from developing countries and at the same time perceived a vacuum that conventional theories did not fill. They proposed incorporating institutional elements to the conventional analysis to overcome this deficiency. In other words, institutions can also be considered a determining factor in FDI. This proposal was echoed by the research of Peng (2005), Buckley *et al.* (2007), and Deng (2009), among others.

Beijing Shougang Group: the transition of a non-conventional firm

The Shougang Corporation —later Beiing Shougang Group Co. Ltd.— was founded in 1919 in Beijing to make steel products. After the Chinese Communist Party took control of the mainland in 1949, the company was managed by a commander of the Chinese army, who reported to the government of the capital (Nolan and Yeung 2001a and 2001b). Like other state-owned companies, Shougang had to fulfill production quotas and other obligatory benefits established in state economic plans. Most of the production was sold at government-fixed prices, but 15% could be sold at higher prices in the framework of the dual-track system implemented in the 1980s.[4]

With the beginning of the economic reforms, in 1978, a large part of industry turned to cheap manufactured goods, with low technological content and quality. The Shougang Corporation was no exception. Between 1978 and 1994, the Beijing city government served as the company's Board of Directors. The central government controlled both wages and firings, and company executives received no special compensations or dividends. In addition, the company was forced to grow before firing anyone to eliminate an excessively large workforce. From here was derived a strategy of diversification as a way of decreasing the excess number of people on the payroll in the plants; this strategy spread to the majority of industries in that period (Nolan and Yeung, 2001b).

Just as happened with other SOEs (Nolan and Zhang, 2002), in 1983, Shougang merged with 17 other steel producers, but despite this, its assets continued to be so obsolete that it was known as the "historical museum of metalworking" (Nolan and Yeung, 2001a: 446). In the face of this, the company obtained a permit to invest in machinery and imported equipment to renovate its plants so that it could continue generating the benefits established in the state plan. During the 1980s, the company had a limited line of products, some affiliates that produced low profits —or even losses—, an excess number of workers, and was under governmental budget control. When it tried to expand operations in other provinces in the country, the central government would not give its permission.

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4 The dual-track system allowed companies to sell their products using two kinds of prices: one set by the government (generally lower) and another by the market (generally higher). The aim of this was to gradually replace the planned economy with a market economy (Naughton, 2007).

Starting in 1990, budgetary controls began to be relaxed and the firm obtained the government's financial help and was even able to establish its own bank, the Huaxia Bank. In this period, it began a series of national mergers and acquisitions (M&A) coordinated from the central government so that by the early 1990s, it had 157 plants and 65 joint ventures, making it the fourth largest company nationwide according to its total sales. By 1993, it already had seven H-share companies in Hong Kong,[5] and in 1995, it set up a business in Singapore to control its exports in Asia. In 1994, it already had investments and alliances in Asia, the Americas, Europe, and the Middle East, operations which it expanded to 13 countries. With barely any experience the company made several wrong decisions and leveraged too much, which finally led it to bankruptcy and having to be bailed out by the Chinese government in the late 1990s (Nolan and Yeung, 2001b; Movshuk, 2004).

Beginning in 1995, the firm began to go through important changes: it introduced a modern management system; established a board of directors, managers, and a supervisory committee; established legal status for the group's companies; and fixed market prices for intra-group transactions (Nolan and Yeung 2001b). In the mid-1990s, the Beijing government decided to change its profile to base itself on knowledge and high-tech products. Despite its financial problems, in 1996, the company turned into one of the leading non-conventional MNCs on the international market (Nolan and Yeung, 2001b). In accordance with the 1997 Communist Party agreement, it was decided that Shougang Corporation, together with three other steel companies (Baogang, Angang, and Wugang) would become national champions to compete with their international world-class counterparts (Nolan and Yeung, 2001a). In 1997, the company had 71 affiliates, of which 25 were losing money; this was being compensated for with the profits produced by their foreign affiliates (Nolan and Yeung 2001b).

Once the new century began, the group continued to be restructured to eliminate all the companies producing a loss by 2005, set up new R&D centers, improve product quality, and increase total sales and profit margins (Nolan and Yeung 2001b). Today, it has 148 companies and research institutes inside China and abroad. It also has holdings in the mining, manufacturing, gas production

[5] H-share companies are firms established in mainland China and authorized by the China Securities Regulatory Commission (CSRC) to trade on the Hong Kong stock market.

and electrical energy sector, real estate, construction, and maritime transport, just to mention a few.

Strategic behavior of Chinese multinationals in the face of market imperfections

The history of the Beijing Shougang Group is just like that of a good part of Chinese SOEs that after 1978 headed up some of the most important changes in the country. Knowing the evolution of these SOEs makes it possible to understand the history of their internationalization. Therefore, for analytical reasons, this research will distinguish three main phases of evolution: *a*) learning and early internationalization; *b*) growth on the international market; and *c*) global expansion.[6] By analyzing each of the phases, I hope to clarify these firms' behavior in the face of the market imperfections mentioned in the theoretical review. I also hope to see if the institutions have affected their behavior and in what way.

First phase: learning and early internationalization

The first Chinese investments overseas focused on commerce, mainly to ensure a supply of natural resources and technology. Therefore, it was trading companies and certain research institutes that began to set up shop abroad under the 1978 Fifteen Measures of Economic Reform, which authorizes this kind of investments. Once the Circular concerning Approval Authorities and Administrative Principles for Opening Up Non-Trade Joint Ventures Overseas, allowing non-commercial ventures to invest abroad, was approved in 1984, other SOEs began to invest outside the country (Buckley *et al.*, 2007). For the first year of the opening, state companies were big bureaucratic apparatuses subjected to different limitations and to competition from township and village enterprises (TVE) and private firms, which enjoyed relative freedom that the SOEs did not have (Naughton 2007). As we will see later, the fragmentation of the market and the difficulty in generating O advantages, such as everything involving intellectual property protection, and I advantages marked the firms in this phase.

[6] These phases are not limited to a specific period and their duration varies for each company. However, in general, we can say that the first phase lasted the entire 1980s and the early 1990s; the second, from the mid-1990s to the first years of the 2000s; and the third, from then until now.

Fragmentation of the market

This situation came about due mainly to three things: first, as part of the decentralization policy,[7] the central government made provinces and municipalities responsible for their own economic development.

In the second place, between 1980 and early 1990, some SOEs began to be managed by provincial and local governments as part of decentralization. At the same time, SOE performance began to be measured in terms of profits and no longer according to production goals fixed in state plans. This had a very important effect on provinces and municipalities since they were responsible for job benefits (education, health care, and pensions), which is why they were particularly interested in the SOEs making a profit (Naughton, 2007).

In the third place, the provinces could negotiate a fixed tax rate so that they could retain all their revenues over that amount (Boisot and Meyer, 2008). Therefore, the obligation to be responsible for their own development, for paying workers' job benefits, and the possibility of retaining tax revenues over and above the rate fixed by the government turned the provinces and municipalities into highly protected areas due to their fear of losing both revenues and power.

This not only elevated transaction costs, putting a brake on horizontal and/or vertical growth of the firms, but also increased operating costs within the national borders. In turn, this made it difficult to establish an efficient multi-modal transport service that would have facilitated the supply chain and intra-firm operations.

Difficulty in generating O advantages

Since its product line and the sale prices were fixed by the government, the SOEs could not easily generate ownership advantages. At the same time, the institu-

[7] The decentralization policy was a fundamental part of the reforms of the 1980s. The government's monopoly of industry relaxed somewhat and new competitors were allowed entry, many of whom were controlled by local governments. In addition, activities less important to the government were decentralized, as were certain administrative competencies, and companies were allowed to grow outside the limits of the central plan. Nevertheless, although in the 1990s, the division of responsibilities between central and local governments was maintained, the control of resources was again centralized because the government needed to strengthen its macro-regulatory functions (Naughton, 2007).

tions for overseeing private property were in their infancy. In 1982, a Brand Registration Law was issued, and in 1984, the Patent Law, to establish the basis for the protection of intellectual property in China (Trade Lawyers Advisory Group, 2007). However, both were rife with weaknesses (Landry, 2008).

For example, the Brand Registration Law did not protect any company it considered discriminated against nationalities, violated socialist morals or customs, or were under other "noxious" influences. The Patent Law did not guarantee protection for foods, beverages, or aromas, or for pharmaceutical products and substances obtained by any chemical process. In addition, it was to the detriment of the interests of Chinese nationals, since citizens could only patent something they had invented by themselves or while they worked in a non-state entity, something quite improbable at that time (Trade Lawyers Advisory Group, 2007).

The justice system also had its defects: there were no qualified judges or agencies for registering patents or brands, or lawyers trained to litigate in this field. This left Chinese inventors defenseless *vis-à-vis* large foreign corporations with more experience and resources (Landry, 2008). Therefore, one of the factors that contributed to discouraging investment in R&D was the precariousness of the legal framework for protecting rights. As a result, most Chinese firms decided to copy technologies and products instead of developing them themselves (Deng, 2009).

Difficulties for generating I advantages

The advantages of internalizing could not develop for three main reasons: fragmentation of the market, unbridled growth in the work force, and inefficient diversification.

As has been explained above, the competition among provinces and municipalities to achieve greater economic benefits gave rise to the fragmentation of the domestic market, pushing up transaction costs (Boisot and Meyer, 2008). Fragmentation, in turn, made efficient company growth through horizontal or vertical integration of activities impossible. As a result, they also did not have access to economies of scale.

Excessive growth was due to the fact that a series of peripheral business ventures were imposed on them in order to safeguard companies and jobs (Nolan and Zhang, 2002; Naughton, 2007). Both the central and provincial governments intervened in the case of national mergers and acquisitions (Child and Rodrigues, 2005). So, they did not develop by way of the efficiency provided by internalization, but through diversification and the lack of competitiveness. In addition, the large number of workers laboring in the SOEs caused excessive numbers of supervisory levels with the resulting organizational and bureaucratization problems (Nolan and Zhang, 2002).

To summarize, during the learning phase, the fragmentation of the domestic market and the difficulty in generating O and I advantages put Chinese companies in a very weak position, with limited product lines, low added value, and low quality (Nolan and Zhang, 2002; Naughton, 2007).

Given this, state-owned companies had three options: developing joint ventures with foreign companies for the national market or acquiring licenses; establishing joint ventures on the international market; or, in exceptional cases, making diversified investments. A fourth option was the strategy used by firms making high-tech products, whose development is slightly different from that of the rest of the SOEs, as I will explain further along.

In the first case, some companies managed to set up joint ventures in the national market with foreign companies or acquired a production and maintenance service license to purchase more modern technology and to assimilate new processes and forms of organization and management. This was the case, for example, of the joint ventures between Nanjing Automobile Group and the Fiat group, Shanghai Automotive with Volkswagen and General Motors, or Haier, which acquired licenses from the Leibherr Group and Merloni (Rui and Yip, 2008; Teagarden and Cai, 2008; Deng, 2009).

In the second case, some firms opted to invest abroad through joint ventures, whether for oil and raw material supply or to set up distribution channels. Nevertheless, the lack of experience meant that some of these operations failed miserably (Wu and Chen, 2001).

A third case —at the time exceptional— was Sinochem, which due to its successful commercial management, turned into a monopoly in oil, fertilizer, and raw materials imports. But as other companies began to establish their own trading firms, Sinochem's main business was hard hit. Therefore, it was given permission to make diversified investments abroad, turning itself not only into a big multinational, but also into the basis on which the Chinese government experimented to later authorize other companies to make similar investments (Deng, 2003).

A fourth alternative was chosen by a few companies oriented to the markets for new technologies and other high-tech products like Legend Group (Lenovo) and Huawei: signing agreements to import, distribute, and repair technologically sophisticated products inside China. This allowed them to familiarize themselves and acquire more experience with imported articles (Teagarden and Cai, 2008; Deng, 2009). This way, they began to accumulate knowledge that would allow them to later launch their own products onto the market.[8]

In short, the arguments presented here can lead us to the conclusion that during the first phase of Chinese MNC's evolution, the oligopolistic structure of industry created neither economies of scale, nor savings in transaction costs, nor the generation of advantages specific to firms as the conventional theories predict, mainly due to government intervention (see Table 1).

Contact with other companies abroad through licensing, international joint ventures, and FDI allowed them to receive technology transfer from abroad to try to compete in a market economy. Their companies abroad began to export to China both tangible and intangible assets (Wu and Chen, 2001). That is, while generally accepted theories (Dunning, 1981) stated that conventional MNCs transfer technology and knowledge from the country of origin to the one where its investments are made, the Chinese MNCs made investments abroad so that, from there, they could transfer technology and knowledge to China. In other words, the firms' strategy during the first phase consisted of internationalizing in order to transfer two elements basic to their national company's learning process: industrial technology and know-how. That is how they began to diminish their disadvantages in the international market.

Second phase: growth in the international market

In the second phase, the evolution of Chinese MNCs was marked by an adverse business environment, an interest in moving up the value chain, and diverse M&A.

[8] The companies targeting the market for new or high technology are often different from SOEs like the Shougang Group because they were founded years after the beginning of the economic opening and were not subjected to some of the limitations mentioned in that phase, mainly because they were private and others belonged to research institutes whose vision was more business- than politics-oriented (Zhou, 2008).

Table 1
Summary of Chinese firms' strategic behavior in the face of market failings

Market failings/ Phases of evolution	*First phase*	*Second phase*	*Third phase*
Oligopolies	Extensive competition against township and village enterprises and private companies as main cause of outward FDI.	Competition against foreign MNCs as main cause of outward FDI. The government begins to generate specific support programs for FDI.	Same as in phase 2, plus the desire for a global presence as a spur to FDI. The government fosters expansion abroad through different programs.
Transaction costs	Very high due to fragmentation of markets and underdeveloped legal institutions. Firms adapt and seek to generate profits taking advantage of the dual-track system.	High due to a weak legislative system, which fosters informality in contract relations. FDI is a way to avoid these costs.	
Differentiated goods	Practically non-existent. Firms sell what the state plan dictates.	Firms become interested in differentiating products and services and seek alliances with foreign MNCs to do so.	Firms, especially in high-tech sectors, go for product differentiation through their own means or purchasing brands and patents.
Asymmetries in knowledge	Non-existent among domestic firms, but does exist *vis-à-vis* foreign companies. Costs are more important than differentiation and quality.	Big obstacles to technology transfer. The solution: greenfield projects and M&A.	Firms set up R&D centers in different countries.
Economies of scale	The organization and diversification of firms and the domestic market do not allow them to grow to achieve economies of scale. Specialization does exist in light industry with very low costs, facilitating FDI in developing countries	Firms' organization and market characteristics make access to economies of scale difficult. The alternative is FDI and back-and-forth FDI.	Productivity improves. Firms locate their production activities in the domestic market.

Source: Developed by the author.

Adverse business environment

The fragmentation and protectionism of the domestic market continued generating high transaction costs in this phase and the following one. The policy of attracting FDI to the internal market benefitted the foreign MNCs in ways that affected national companies, leaving them unprotected in the face of competition. Boisot and Meyer (2008) affirm that for Chinese firms the cost of investing in China was so high that some of them opted to invest abroad to access the lower costs in other markets, even before they were truly prepared to implement FDI. This attitude against national companies would motivate back-and-forth FDI (Boisot and Meyer, 2008), whereby companies would locate their headquarters and research centers abroad and return to China as foreign companies to carry out only certain activities.

Interest in moving up the value chain

In this phase, the companies opted for two kinds of FDI with very different objectives: FDI in developing countries and FDI in developed countries.

The investments in developing countries made it possible to take advantage of markets with low purchasing power and less developed light industry, where Chinese firms had achieved certain advantages, above all with regard to costs. Thanks to this, they began to control those markets and export to neighboring countries, realizing that the markets in developing countries were relatively easy to penetrate, spurring them to begin to invest there more and more. Even so, the investments were small, which is why they did not benefit excessively from economies of scale, particularly at the beginning of this phase (Wu and Chen, 2001; Wang, 2002).

However, the companies also wanted to move up the value chain, increase their quality, improve their production techniques, and be more efficient, so they began to invest in developed countries in order to speed up their modernization process. Consolidating this improvement process by thoroughly learning and applying new knowledge, as well as expanding their international activities, were their new objectives during this phase. That is why they emphasized two key points: on the one hand, improving processes and quality, and, on the other hand, acquiring the most modern technology they could (Teagarden and Cai, 2008).

To achieve this, they used several strategies: companies focusing on high-tech products (TCL, Huawei, and Lenovo) became involved in manufacturing special equipment inside China for big clients (Teagarden and Cai, 2008) and continue to foster collaboration with other companies through joint ventures (Child and Rodrigues, 2005; Bonaglia, Goldstein, and Mathews, 2006; Wu and Zhao, 2007). Joint ventures were also included in the strategy of industrial companies like those of the automobile sector (Rui and Yip, 2008), while oil companies like CNOOC or Sinopec opted for M&A and greenfields projectsthanks to strong support from the government (Eurasia Group, 2006).

One characteristic of companies like TCL, Huawei, Haier, and Lenovo that distinguishes them from industrial SOEs is that they began investing in R&D (Wu and Zhao, 2007; Teagarden and Cai, 2008), while the strategy of the latter was to acquire technology through M&A, above all when, like in the cases of Nanjing Automobile Group and Shanghai Automotive, they realized that the MNCs with which they had been involved in joint ventures had no intention of giving them more advanced technology (Rui and Yip, 2008; Deng, 2009).[9] Nevertheless, companies continued to pursue joint ventures, particularly when their objective was the quest for markets. This diminished the risk of entering into large markets or those with significant cultural differences (Wu and Chen, 2001; Cui and Jiang, 2009).

Therefore, Chinese MNCs continued using joint ventures, above all as a strategy for entering into new markets, but when their aim was to obtain technology and other strategic assets, they preferred M&A,[10] and even greenfield investments. The underlying reason for this behavior was the firms' desire to make a name for themselves internationally and acquire prestige brands, technology, research centers, distribution channels, etc., whether by setting up new plants, such as in the case of Haier in the United States, or through acquisition, such as in the case of Lenovo when it acquired IBM (Child and Rodrigues, 2005; Rui and Yip,

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[9] This has been one of the biggest obstacles that Chinese firms have had to face: the scrutiny —particularly political scrutiny— and limitations imposed by the United States and other Western nations on technology transfer (Zhou, 2008).

[10] Mergers and acquisitions have taken place mostly in developed countries, through operations that were often stalled by different obstacles (such as in CNOOC's failed purchase of Unocal) related to the distrust of Chinese MNCs, and in highly competitive sectors like energy, electronics, telecommunications, electrical appliances, machinery, and automobiles (Rui and Yip, 2008).

2008; Deng, 2009). At the same time, the Chinese firms hoped that this strategy would in time turn them into global companies.

An altogether different case is that of the internationalization of Chinese construction firms, which did not go through the learning process described in the first phase and also did not make alliances with foreign firms. However, thanks to their low production costs, experience in complex, large-scale projects domestically, and their specialization in infrastructure, they have grown enormously, which has allowed them to win projects away from the big international construction companies (Chen and Orr, 2009).

Mergers and acquisitions abroad

The entry of increasing numbers of multinationals to the Chinese market pushed national firms to look for new strategies so they could respond to the competition arriving from outside (Rui and Yip, 2008; Teagarden and Cai, 2008). Not only was it a matter of growing abroad, but also of not losing their domestic market. Unfortunately, restrictions on demand, market fragmentation, and domestic supply difficulties, on the one hand, limited their growth, but, on the other hand, they also led to excessive production (Buckley *et al.*, 2008). Therefore, one way of getting rid of these problems was, in addition to the aforementioned joint ventures and new plant projects, to enter into M&A that would allow them to act more freely.

Also, as time went by, the firms became aware that the rest of the MNCs did not share their technologies through joint ventures and that their own actions awakened mistrust in the international business community. In addition, several Chinese firms began to venture into very competitive markets, like telecommunications, electrical appliances, and automobiles, which meant that the difficulty of obtaining new technology increased (Rui and Yip, 2008; Zhou, 2008).

The need to have strategic assets like mines and oil fields fostered new international M&A. The tendency to do more of this would coincide with an advanced stage of the second phase in which many Chinese firms would develop more experience and self-confidence in their international operations. This meant that they preferred penetrating markets through a fully-owned company instead of a joint venture, as can be appreciated in Table 2.

Table 2
Mode of entry of Chinese FDI: 1991-2001
(percentage of foreign affiliates)

Mode of entry	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*
Complete ownership	30	32	42	46	52	62	55	58	58	58	70
Joint ventures	70	68	58	54	48	37	45	42	42	42	30

Source: Buckley *et al.* (2008: 734).

Several reasons were behind total-ownership companies predominating over joint ventures. In the first place, state agencies began to authorize more investments fully financed with Chinese funds, in contrast with the past when they had preferred joint ventures to decrease risks. Many of these investments were financed with loans to underdeveloped countries, like those in Africa, and were aimed mainly at extractive industries in accordance with certain government support programs. This will be explained in detail when I deal with institutions as the origin of the imperfections. In the second place, at that time, government policy made it possible for SOEs to have access to more resources for financing their projects. In the third place, the SOEs themselves had also acquired experience in obtaining resources from international markets. This allowed them to make the investment required to establish a fully-owned company. In the fourth place, total ownership of subsidiaries also made it possible to better protect intangible assets and avoided dependency on others. Lastly, the worldwide wave of entries into new international markets through acquisitions also had its effect on Chinese firms (Buckley *et al.*, 2008).

The advances of companies in this phase did not stop them from making mistakes. Due to the fact that the firms' boards of directors have usually been swayed by the idea of increasing SOE assets, fostered by state policy, they made large investments that were not always profitable. One of the reasons for the inefficient use of resources can be attributed to the weakness of the banking system. Strong economic support from the banks, based more on political than economic criteria, and the relaxation of the supervisory and guarantee systems meant that unviable projects were approved and unproductive companies kept afloat (Movshuk, 2004; Naughton, 2007).

Something similar happened with regard to some international businesses. In order to improve their reputation worldwide, some companies acquired assets that turned out not to be profitable, such as in the case of TCL, which in 2000 sank US$20 million into a joint venture with the Indian firm Baron International, Ltd. Nevertheless, conflicts arose between the two companies that forced TCL to withdraw from that market, only to return in 2004 with a greenfield project (Donghong, 2009).

As a result, we can say that inexperience in international markets and mediocre management in the companies led to some of the investments abroad producing losses (Wu and Chen, 2001).

In short, during the second phase of evolution, Chinese SOEs resorted to FDI as one way of dealing with the failings of their market (see Table 1). At the same time, during this phase of evolution, firms directed their efforts at achieving three main goals: firstly, acquiring cutting-edge technology, brands and patents, and other strategic assets, mainly through M&A and new plant projects; secondly, developing more sophisticated products and processes with greater technological content, with an emphasis on quality; and thirdly, broadening out their markets and carving a name for themselves to improve their reputations worldwide and avoid being discriminated against because of their origins, leaving behind their recent past.

Most Chinese MNCs are currently in this phase and continue their learning and improvement process. They have undoubtedly made great strides, taking into consideration their origins, and some are leaders among the MNCs of developing countries. However, their presence is regional, not global, since they have not developed their products and processes, their organizational structures, their knowledge of the market, and their personnel sufficiently. In addition, some firms still depend excessively on government support. As a result, they have not yet developed enough advantages to allow them to successfully face down the developed countries' MNCs.

Third phase: globalization

One of the most open sectors of the Chinese market is that of new information and communications technologies (ICTs), making it possible for the sector's big multinationals to have an important presence in the country. This has affected national firms' performance since they have been forced to take action to defend their markets (Rui and Yip, 2008; Zhou, 2008). In other words, once internationalization began, there was no going back: the big multinationals from the developed countries had to be taken on both inside and outside China to avoid being eliminated by the competition and in order to achieve global competitiveness.

This battle has been waged mainly by companies such as Lenovo (pcs), Haier (electrical appliances), and Huawei (telecommunications). They have brand-recognition abroad and have developed their international market considerably (Bonaglia, Goldstein, and Mathews 2006; Rui and Yip 2008). To achieve their objectives, the firms have developed diverse strategies that are ushering them into a position of leadership worldwide.

In the first place, we can say that the basis for their strategy is innovation and product development, which is why they have invested in R&D centers both inside and outside China. Some of these centers have been part of the assets acquired through M&A. In the second place, they have a high-quality supply and production chain that ensures them the best components for their products. In this regard, they have set up assembly plants on Chinese soil given that their suppliers are also there, which facilitates exchanges and teamwork with them. In other words, in this phase, the companies have learned to taken advantage of the synergies created by the growth of the new technologies sector and their own export capabilities. In the third place, they have taken care to understand the market, consumer tastes and expectations. In the fourth place, the establishment of different headquarters throughout the world has been accompanied by the development of personnel in two key areas: product technology and a global business vision (Teagarden and Cai, 2008; Zhou, 2008).

With regard to market failings (see Table 1), in this stage, the firms have dealt with them in a way similar to how conventional theories predict. Nevertheless, since the domestic market has still not liberalized completely, today they continue to have to deal with high transaction costs and government intervention in their decision-making, as shown in the approval processes described by Pamlin and Baijin (2007). At the same time, extraordinary forms of support exist to foster the expansion of firms in the globalization stage and some that are still moving from the second phase (growth in the international market) toward it. They have benefitted from the advance of the Chinese economy, which registered growth rates of more than 8% between 1995 and 2011 (FMI, 2013). This gave the country a historic level of foreign currency reserves (US$3.1 trillion in 2011), which, in turn, contributed to creating a robust investment fund for

FDI (Gallagher, Irwin, and Koleski, 2012; Downs, 2011).[11] At the same time, the Chinese government changed its legislation to support mergers and acquisitions abroad, reducing the requirements for assessing loans abroad and allowing Chinese firms to utilize reserves of their own currency as well as official reserves to make loans to their subsidiaries abroad. In addition to this, the 2008 financial crisis created favorable conditions for increasing the number of Chinese M&A in the world, as can be seen in Table 3 (Cha, 2009).

Table **3**

Number of Chinese international mergers and acquisitions

2001	*2002*	*2003*	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*	*2010*	*2011**
69	66	60	81	93	125	181	180	216	252	151

Note: */ UNCTAD (2012) figures.
Source: Baird (2011).

Thus, between 2008 and 2012, the Geely Holding Group bought Volvo (headquartered in Sweden) from Ford, as well as the English company Manganese Bronze; ChemChina acquired the Norwegian Elkem through its subsidiary, China National Bluestar Group; China Huaneng Group acquired the Dutch InterGen; the U.S. company AIG agreed to sell 80% of the International Lease Finance Corporation to a group of Chinese investors; and the Tempo International Group Limited purchased Nexteer Automotive from General Motors (Baird 2011; Egan 2012). So, we can say that the globalization stage of different Chinese MNCs was stimulated mainly by two circumstances: firstly, government legislative and financial support, and secondly, the conditions created by the economic crisis.

The analysis of the three phases demonstrates how Chinese firms began to invest abroad despite their inefficient production, their lack of differentiated products and R&D, and high transaction costs. Far from discouraging their internationalization these lacks served to spur them forward to narrow the gap between them and the rest of the world's MNCs using FDI as their main strategy.

[11] For example the China Investment Corporation (CIC) was set up in September 2007 as a sovereign investment fund with an initial funding of US$200 billion from the People's Bank of China. Thus, in 2012, the CIC set up a company together with Global Logistic Properties, out of Singapore, and the Canada Pension Plan Investment Board and Government with the aim of building the biggest logistics platform in Brazil (Baird, 2011).

Reviewing what has been explained until here, we can say that what truly marks the difference between Chines and other countries' FDI is not only their MNCs' atypical behavior in the face of market imperfections —having ventured abroad in the conditions described and then moved up the value change thanks to M&A and new plant projects—, but also the impact of the imperfections caused by Chinese institutions on MNC behavior, which, on the one hand encourage FDI and on the other regulate and control it. As can be noted in Table 1, the origin of both many of the obstacles and the extraordinary support for their expansions is to be found in the institutions. It is this impact that has not been included for study in conventional economic theory, but, given the circumstances, it must be analyzed, which is what follows.

Institutions as the origin of the imperfections

Considering the information analyzed until this point, clearly the major errors Chinese firms have had to deal with in their domestic market are not those created by the market itself, but rather by the institutions. This has changed market conditions themselves, creating the disturbances that have affected companies' performance.

The failings promoted by the institutions have a dual character: first of all, the limiting factors that due to excessive control have spurred the expulsion of Chinese capital through FDI, and, secondly, the motivating factors that through different support mechanisms have fostered trans-border investments. The presence of the limiting factors can be noted mainly during the first and part of the second phase of development, and begin to decrease above all starting with the "Go Out" policy, or "Going Global Strategy," without disappearing altogether, which is when the motivating factors became strong.[12]

Push factors

In light of the arguments presented until this point, we can say that among the main limitations facing firms in the domestic market are the following.

[12] This policy was formally announced in October 2000 as part of China's Tenth Five-Year Plan 2001-2005 (Sauvant, 2005).

Fragmented markets, regional protectionism, and excessive paperwork

As explained above, all this limits access to domestic markets and makes it impossible to achieve economies of scale. To this should be added that the many different levels of public administration make it impossible to cross jurisdictional boundaries, putting the brakes on activities that require horizontal organization, like multi-modal transport services, which function based on cooperation between different providers, slowed by the limitations imposed by each jurisdiction in its territory.

This complicates transactions, lengthens operational times, and raises costs, above all in the inland provinces where transport is less developed. As a result, the high transportation costs associated with the supply chain undermine firms' competitiveness in the national market.

Institutional weakness and a dual legislative system

Institutional weakness is due to current legislation that does not provide adequate protection to intellectual property rights. In turn, this produces low motivation for developing R&D. Transaction costs rise due to the prevailing weak, uncertain legal system. At the same time, national companies are discriminated against through dual legislation favoring foreign firms, giving them greater freedom of action,[13] but constraining Chinese companies, as explained in the previous section.

Conditional access to financing

Financing for FDI projects is highly conditioned by the existence of documents like the Guiding Directories of Target Nations and Industries for OFDI, which list a series of countries and industries that favor investment with tax and administrative preferences; institutions like the China-Africa Development Fund,

[13] Examples of this are the 1979 Law on Sino-Foreign Equity Joint Ventures, the 1986 Wholly Foreign-Owned Enterprise Law, and the 1988 Sino-Foreign Cooperative Joint Venture Law, all of which began a system that benefitted foreign companies.

which provide FDI funds, promoting a certain kind of exports and some sectors; and the preference for a kind of ownership (SOEs over other kinds of firms).

In the same way, the existence of banks managed internally, such as the Huaxia Bank described above, contributed to creating advantages for some firms but changed money market conditions for others that did not have the same possibilities. For this reason, some firms, above all during the first phase, invested in Hong Kong and sought financing abroad (Zhang, 2008).

Numerous approval processes

Before investing abroad, the firms must go through an approval process that can even last months (Pamlin and Baijin, 2007; Buckley *et al.*, 2008; Chao and Ji, 2008). Despite the fact that controls have decreased over time and the number of procedures has dropped, a series of practices continue to be barriers to companies' freedom, even abroad. This is the case of construction companies that, before being able to bid abroad must have approval from the Office of Commercial and Economic Affairs in the destination country and the China International Contractors Association (Chen and Orr, 2009).

In light of what has been explained in the section, we can conclude that to a large extent, Chinese firms have been forced out of national territory due to the failures directly or indirectly generated by institutions. In other words, these companies have sought to locate their activities abroad in an attempt to find better organized markets that facilitate them and free them from institutional failings they are subject to at home. These observations coincide with Brewer's formulation (1993), when he states that government policies generate market imperfections that make it more attractive for a firm to invest abroad than to export. He identifies some of the elements presented here as policies that increase market imperfections: subsidies to FDI, control of outward capital flow, price controls, and subsidies to exports.

Motivating factors

Among the motivating factors created by the Chinese government, three stand out: institutional and diplomatic support, financial support, and various privileges.

Institutional and diplomatic support

One of the outstanding support mechanisms is a system of control and *in situ* help —called in this research the *CHINCA system*— linked to construction, which has been applied mainly in African countries. The China International Contractors Association (CHINCA), the Office of Commercial and Economic Affairs at each embassy, and the Exim Bank act jointly to favor hiring of Chinese firms for infrastructure projects abroad (Chen and Orr, 2009).

A second mechanism, which complements the CHINCA system, is the Angola model, known by that name because it was first implemented there. It exemplifies the institutional and diplomatic support for encouraging the exchange of products, basically raw materials, for loans from Chinese banks (Foster *et al.*, 2008). Thus, through the CHINCA system, loans are given for building infrastructure, and the Angola model allows for loans to be paid in kind, mainly oil. Other aid mechanisms are those mentioned in Guiding Directories of Target Nations and Industries for OFDI.

Financial support

The Chinese government creates imperfections in the financial market in four main ways: *a*) special loans; *b*) some conglomerates operate internal banks; *c*) joint efforts by banks, government bodies, and embassies to create mechanisms like CHINCA and the Angola model; and *d*) recent changes in the law that allow MNCs to use their own foreign currency reserves and those of the government for international M&As.

In the first case, the Chinese Government Concessional Loans and the Preferential Export Buyer's Credits given by China's Exim Bank support FDI, promoting economic cooperation among countries. This forces the contracting of Chinese companies and, if necessary, the purchase of goods from China.

In the second case, the Estate Council, for example, approved the transfer of the China Investment and Trust Corporation for Foreign Economic Cooperation and Trade (FOTIC) to the Sinochem Group so it could function as the group's internal bank. Another case was when the Shougang Group was allowed to create its own institution, the Huaxia Bank, which would guarantee that its budget be unlimited (Buckley *et al.*, 2007). With time, both the

FOTIC[14] and the Huaxia Bank were restructured;[15] this has made their operations more transparent and prevented the firms from using their resources illicitly, as in the aforementioned case of the Shougang Group.

In the third case, a good example is the Angola model and the CHINCA system explained above, which change market conditions by giving preference to handing over resources to certain companies and sectors (Foster *et al.*, 2008; Chen and Orr, 2009).

In the fourth case, in December 2008, the Bank of China's Regulatory Commission issued the Directives for Risk Management in Loans Granted by Commercial Banks for Mergers and Acquisitions to allow Chinese banks to grant loans for that purpose abroad, reduce the requirements for assessing loans abroad, expand funding sources destined to this kind of loan, and simplify verification procedures and the sending of loan monies. These directives were issued to increase bank support for international M&As, taking advantage of the window opened by the crisis that almost bankrupted many Western companies and lowered the value of their assets. In addition, in June 2009, the State Foreign Currency Administration published the *Communiqué on Matters Involving the Administration of Foreign Currency in Loans Abroad by National Companies*. Since the financial crisis made it difficult for subsidiaries of Chinese companies to get external financing, the communiqué simplified the process to finance subsidiaries by reducing the qualifying prerequisites for loans abroad, broadening out funding sources for loans, and decreasing the verification procedures and the sending of the loan monies themselves (Benesch *et al.*, 2010).

Various privileges

Among the privileges enjoyed by companies that invest abroad are preferential access to raw materials and other resources, the promotion of exports oriented

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[14] The FOTIC was created in 1987 and became a part of Sinochem in 1994 when it merged with a financial institution owned by the firm. In 2002, it was given a new license to carry out financial activities in accordance with the Regulations on Trust Enterprises and the Regulations of Collective Fund Trust Scheme for Trust Enterprises, part of the Bank of China's Regulatory Commission, and was under the supervision of that body. Today, the FOTIC continues to be a subsidiary of Sinochem (Sinochem, 2012).

[15] After several restructurings, the Huaxia Bank began trading on the stock exchange in 2003. Some of its shares were purchased by the Deutsche Bank in 2006 and 2008, but the Shougang Group still holds the majority share (Deutsche Bank 2010).

to FDI (that is, credits for sale abroad of machinery and equipment with the aim of setting up manufacturing plants abroad), and lower taxes for export companies and privileged sectors (Nolan and Yeung, 2001b; Buckley *et al.*, 2007; Deng, 2007).

In short, the institutions and bodies mentioned have favorably changed the conditions for Chinese firms by facilitating their going abroad, especially since the "Going Global" policy.

Behavior of Chinese MNCs given the market failings created by the institutions

Both the motivating factors and the push factors have caused certain forms of behavior by Chinese firms. Since they were present from the beginning of the opening, I will describe the push factors first, and later the motivating factors.

Considering the information analyzed until this point, we can state that for the entire time, firms have behaved strategically to try to minimize the negative effect of push factors.

In the first place, the restrictions imposed and permits required for FDI have triggered illegal capital outflows (Ding, 2000; Gunter ,1996). In the second place, once a first authorization has been given, they have ensured that the firms do not repatriate their profits and, instead, reinvest abroad without notifying the Commerce Ministry (Shan, 1989). In the third place, protectionism, excessive public bureaucracy, and government interference in firms' decisions discourage the creation of I and O advantages. This puts them at a disadvantage *vis-à-vis* the rest of the multinationals, so they had to make FDI to generate those advantages and be able to survive, as explained above. In the fourth place, the failings in the financial markets (conditioned financing, permits, privileges to certain companies) favored companies' leaving to seek financing abroad, such as in the case of investments in Hong Kong to be able to register on the stock market (Zhang, 2008).

Certain forms of behavior are also linked to the market failings caused by the motivating factors.

First institutional and diplomatic support has facilitated companies' leaving, encouraging them to send FDI to countries that they otherwise would not have chosen. This is either because they did not present optimum market conditions (countries with political risk), or because they were relatively new firms with little experience in developed markets, as described by Buckley et al. (2007). Also, the recent expansion through M&As in developed countries increased partly due to support from the government.

Secondly, the market distortions brought about by financing and other forms of help described have caused the firms to behave highly unusually, unlike conventional MNCs, underestimating risks when they invest. To explain this, it is necessary to look at the study published by Buckley et al. in 2007 about the determining factors for Chinese FDI. One of the elements they studied was political risk, which was measured econometrically using total FDI approved by the State Foreign Currency Administration as a dependent variable, while they used political risk based on the International Country Risk Guide as an independent variable.

The research used the hypothesis that Chinese FDI would be negatively associated to high risk levels in the destination country. However, surprisingly, the results of their measurement showed that there was a growing relationship between risk and FDI, but the opposite of what they had expected. That is, with a greater degree of political stability, the FDI was lower.

After analyzing possible explanations, the researchers came to the conclusion that the financial market's imperfections and the institutional factors had generated an underestimation of risk. That is, Chinese investors seemed to perceive risk very differently from the way Westerners did, since they felt covered by their institutions and inexpensive loans. Another possible explanation for this behavior would be that part of that underestimation of risk was also due to many of the companies' lack of experience in international markets, particularly in the first stages. When Cui and Jiang (2009) took a similar measurement about Chinese FDI, they found results similar to those of Buckley *et al.* (2007).

Conclusions

As conventional theories state, in China's domestic market, the firms formed oligopolies with great market power that competed against other very large firms, and that, given that some of them entered into joint ventures with foreign MNCs, they had comparatively more advanced know-how and could produce differentiated goods. However, contrary to what conventional theories lead us to expect, the oligopolistic structure of industry did not necessarily lead to economies of scale, to savings in transaction costs, the development of know-how asymmetries, or differentiated goods, basically for institutional reasons.

The institutional reasons that Chinese firms did not benefit from market imperfections, primarily in the first and part of the second phase of evolution, have to do with the fact that the internalization of activities was not a product of rational and efficient decision-making, but of political decisions, among them, the annexation of business on the periphery of the big SOEs in order to preserve workers' jobs. The analysis has also revealed that in the development of Chinese firms, each of the phases of evolution (learning, growth in the international market, and globalization) was marked not only by the changes of the firms themselves in their development from national to global companies, but above all by the institutional changes generated from the different levels of government. As a result of these institutional changes, the firms' development process, which allows for the creation of an increase in OLI advantages, changed, giving rise to forms of behavior different from those of conventional MNCs.

The first differentiated form of behavior is making outward FDI without generating O and I advantages, something fostered by what this article has called push factors (fragmented markets, regional protectionism, and excessive levels of administration; institutional weakness and a dual legislative system; conditioned access to financing and numerous approval processes), factors that were present mainly during the first phase and that, though they relaxed somewhat in the middle of the second phase, did not disappear altogether.

The second differentiated form of behavior is the acquisition —instead of the internal generation as established by the OLI paradigm— of technology and know-how through: *a*) joint ventures with foreign MNCs both in the domestic and the foreign markets (mainly in the learning and international market growth phase); *b*) international M&As (fundamentally in the phases of growth in the international market and globalization), and *c*) greenfield investments, mainly in developed countries.

The third differentiated form of behavior is that, due to their need for technology and know-how, several firms skipped over some of the stages of internationalization (concretely, the exporting phase and establishing points of sale abroad), moving directly to the stage of setting up new productive plants.

One more difference, the fourth, is that the firms did not undertake FDI as an activity that would allow them to expand their domains, as conventional theories predict, but as: *a*) a way of freeing themselves from government control and getting external financing, or *b*) the road to getting the privileges that foreign MNCs in China have, by doing outward and inward FDI. This behavior is present in all the phases, but tends to decline with the arrival of the "Go Global" policy given that the push factors decrease.

A quite separate case is that of construction firms and companies that make electrical appliances and products related to new technologies like Huawei, Haier, and Lenovo. As explained above, Chinese construction companies generated ownership advantages in a period before their internationalization due to their experience in big, low-cost construction projects in adverse geographical conditions. This meant that, when they began to internationalize, they were able to compete without great difficulty with other construction companies on the international market, gaining from that moment in experience and the number of projects carried out.

The history of companies in sectors with medium or high technology levels, most in an early phase of globalization, is different from the construction companies and most of the SOEs, in that several of them did not even exist in the period prior to the opening, but were founded later, like Haier and Lenovo (1984) and Huawei (1988). Also, before their internationalization, they were able to acquire experience by doing maintenance and repairs of electric appliances, personal computers, and other high-tech products. Later, they even got licenses to make those products domestically, and then invested in their own R&D centers both domestically and abroad, which brought them more know-how. All this made it possible for them to rapidly ratchet up their advantages, moving from one development phase to another in less time, and making progress similar to that of conventional MNCs. Therefore, it is possible that some of the conclusions of this article explain the FDI of SOEs of other industries better than that of those in this particular sector. This does not imply, however, that electrical appliance manufacturers and information technology companies were not influenced by the institutional elements examined in this research. It should be added that some research on Chinese MNCs (Sauvant, 2005; Bonaglia, Goldstein, and Mathews, 2006; Accenture, 2008) have made their observations fundamentally based on companies described in this paragraph. This is why it should come as no surprise that their authors think that firms have based their internationalization on developing advantages in accordance with conventional theories.

This research shows that in addition to market failings or conventional determinants, we must add those that have originated with the government (push and motivating factors) to understand firms' behavior and, therefore, the profile of Chinese FDI. Given the enormous weight of both factors in the Chinese business climate, and the information presented here, clearly they have both generated failings of such magnitude that they have probably weighed more than conventional market failings when deciding to make investments abroad. Lastly, the companies that in recent years have acquired strategic assets in the United States and Europe, marking a trend in Chinese M&As, should be more closely researched in the future.

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