THE OUTWARD EXPANSION OF CHINESE AND INDIAN FIRMS: A NEW CHALLENGE FOR EUROPE

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Introduction

In a reversal of decades of almost autarkic development, China and India have literally exploded onto the world economic scene in the past two decades. They are now two of the largest and fastest-growing economies; and while China has become the world's assembly plant, India is slowly becoming the world's back office. What is most surprising in this emergence – or some would say resurgence – is that both countries are now starting to become outward direct investors, not only in other developing countries but also in Europe and North America.

Chinese and Indian firms, many still largely unknown to western consumers, are making their presence felt in western markets. Iconic brands such as RCA, Rover or IBM computers are now owned by Chinese firms, just as Tetley Tea is now part of the Indian conglomerate Tata. Such takeovers are likely to become ever more routine in the future owing to the confluence of many push and pull factors which are driving Chinese and Indian firms abroad which will be described in this paper. Although takeovers are the most visible manifestation, not all emerging market investors enter Europe by this means. Investment promotion agencies in Europe are now keenly aware of the potential for greenfield investments from both India and China.

In spite of rapid growth, the absolute levels of outward direct investment (ODI) are still quite small for the two countries. Chinese firms rank 24th worldwide in terms of their ODI stock and Indian firms have invested no more abroad than Hungary or New Zealand. Even within Asia, Chinese and Indian ODI is less than that from either Singapore or Taiwan and only a fraction of the ODI from Hong Kong. Furthermore, both China and India are still net recipients of FDI, although some predict that this situation could change quickly for both countries. Even at the level of individual firms, Chinese and Indian firms are not global players on the scale of the world's largest multinational enterprises (MNEs). No Chinese or Indian firm is among the 100 largest non-financial MNEs (ranked by foreign assets), and only ten Chinese and two Indian firms are among the 100 largest non-financial MNEs from developing countries.

The significance of Chinese and Indian ODI is not in what it represents at the moment but what it could imply for the world economy in only a few years time at current growth rates. The Economist Intelligence Unit estimates that by 2011, China will be the ninth largest outward investor on an annual basis ($72 billion) – roughly on a par with Switzerland and ahead of all Asian countries, including Japan. India, at only $16 billion, will lag far behind but will still be a respectable sixteenth on a global basis. Much of this investment will go to other developing countries, often in search of raw materials to fuel the rapid growth at home, but some will also flow to developed countries, particularly in Europe and North America. Many of these latter investments will involve the acquisition of local firms.

The drivers behind investments in developed countries are an inter-play of changing corporate strategies in the two countries and of evolving government policies. Asian firms and many home governments have long recognised that outward investment in developed countries can play a role in promoting the global competitiveness of local

firms by providing greater access to foreign markets, technologies and brands. The perennial threat of trade barriers against Asian exports to Europe and North America has also encouraged this process. Many firms worldwide have also first invested abroad once they have achieved a threshold level of exports or a certain size at home, and this too might play a role in explaining the timing of outward investment.

It is sometimes easy to overplay the role of dynamic entrepreneurs behind the foreign acquisitions by Indian and Chinese firms. The global ambitions of a few large companies such as Tata are only part of the story. These prominent investors certainly dominate in value terms given the size of some of their takeovers, but numerically far more important are the myriad investments by small and medium-sized enterprises (SMEs), particularly in India. This suggests that ODI is more than just a desire of the leading Indian industrial families not to be outdone by their domestic rivals on the international stage. Wider forces are at play.

These forces include not only relatively cheap capital but also the active encouragement of the government. One thing almost all Asian home countries have in common is an implicit or explicit government policy to promote outward investment. To some extent, ODI has become the latest tool to promote industrial policies, as local firms become more confident in the global market and as other policies to promote local industries are negotiated away multilaterally.

In India as in China, outward investment was virtually prohibited during most of the postwar period through capital controls and other restrictions. Some south-south investment by Indian firms was permitted in the name of developing country solidarity, but even in this case capital outflows were constrained by the scarcity of foreign exchange. In this sense, the rapid build-up in foreign assets by Chinese and Indian firms is a catch-up to the equilibrium levels achieved by firms from other emerging markets.

Many Asian governments are also keen to recycle their export surpluses by investing increasingly in foreign equities. The rise of these so-called Sovereign Wealth Funds is a topic in itself and one that is intimately connected with ODI in terms of the political response in Europe to the acquisition of shares in local firms.

This paper will look at Chinese and Indian ODI in Europe and, where appropriate, in the United States. It will ask how these outflows fit in with a more general pattern in East Asia of rising ODI to developed regions. Indian and Chinese firms are following in the footsteps of Japanese, Korean, Taiwanese, Hong Kong, Singapore and, most recently, Malaysian firms. Levels of development vary greatly in Asia, and it would be inappropriate to try to fit the behaviour of Chinese and Indian investors into a pattern of behaviour simply on the basis of geography, but there are nevertheless similarities not just in terms of the motives and inducements for investing but also in terms of the reactions in host countries. It is also instructive to see how many of these earlier investments from elsewhere in Asia failed and, if so, why. Abundant cash flows and global ambitions are clearly not enough to guarantee success in overseas ventures, as many Asian firms have discovered in earlier decades. Have Indian and Chinese investors learned those lessons?

It is common to discuss India and China in the same breath, but the differences between the two experiences are almost as great as the similarities. The most obvious one is that Chinese outward investors are usually owned by the government while Indian investors, with the exception of the oil sector, are private firms. Indian firms are also concentrated in services or skill-intensive activities such as software and pharmaceuticals while Chinese outward investors tend to be in manufacturing or resource sectors. In this way, outward investment mirrors the different development paths taken by China and India. India is also passing much more quickly from the phase of host to inward investment to being both a home and a host to MNEs. These differences will also be explored in the paper.

I. Trends in Chinese and Indian ODI: where does Europe fit in?

The rapid growth of direct investment overseas by Chinese and Indian firms is almost unprecedented given the level of development of the two countries. Some of this investment arises to benefit from fiscal advantages offered to offshore investors, and another large part involves extractive industries channelling raw materials to fuel rapid economic growth at home. Neither Europe nor the United States looms large in these trends, but recent prominent acquisitions of western firms by Chinese and Indian investors have captured the imagination of western politicians, feeding on already heightened sensitivities in the west as a result of rapid Chinese exports and the role of India in the offshoring of services.

Information on Indian and Chinese activities can be gleaned from government statistics on foreign direct investment (FDI) as recorded in the balance of payment which are usually published with a substantial lag. More recent data exists from private sources, whether concerning mergers and acquisitions (M&As) or new projects. What private sources lack in completeness, they make up for by being up-to-date. These various sources are combined in the description of trends which follows.

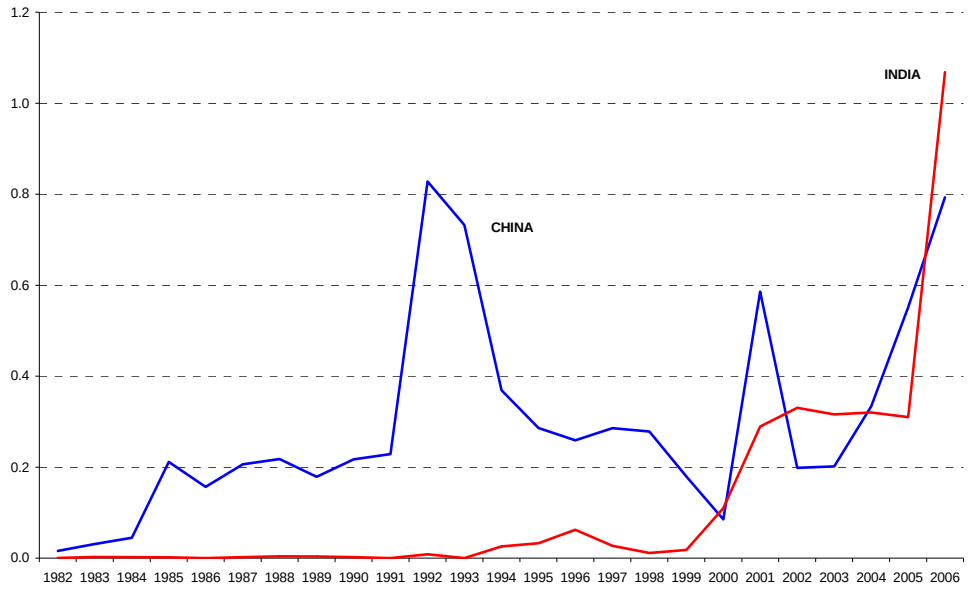
The trend in Chinese and Indian ODI since 1982 is shown in Figure 1. Chinese firms began to invest abroad earlier partly because liberalisation in China preceeded that in India. Since 2000, however, Indian firms have moved aggressively abroad and have surpassed even Chinese ODI as a share of GDP. In terms of the level of outflows, however, Chinese ODI is still twice as high as that from India.

A study by the Associated Chambers of Commerce and Industy (Assocham) estimates that in the current fiscal year (ending March 2008), Indian ODI will reach $15 billion and will exceed foreign direct investment in India. According to the study, much of this investment will go to Europe, the United States and Africa. Looking instead at figures for Indian M&As abroad which tend to be higher in value terms because they include all capital raised both at home and abroad, a recent report estimated that Indian companies are expected to spend $35 billion abroad in 2007, rising from only $4.3 billion in 2005 and $15 billion in 2006.[1] Already M&As abroad in the first quarter of the fiscal year (April to June) showed overseas acquisitions of $11.4 billion compared to foreign ventures in India of only $2 billion.

Over 70 per cent of Chinese annual ODI goes to Hong Kong, the Cayman Islands and the British Virgin Islands, suggesting that fiscal motives are likely to be an important influence at an aggregate level. Some Chinese outflows, like inflows, represent round tripping in order for Chinese firms to benefit from the more favourable status accorded to foreign investors compared to private Chinese investors which prevailed until the end of 2006. Fiscal incentives are likely to be less of a factor behind Indian ODI, although a high share of inflows and outflows involves Mauritius, with whom India has a double taxation treaty.

[1] Report by Ernst & Young and the Federation of Indian Chambers of Commerce and Industry (FICCI) "Study on mergers and acquisitions during April-July 2007-08"

Figure 1. **Total Chinese and Indian ODI (percentage of GDP)**



Source: UNCTAD, MOFCOM

Other than investment in tax havens, Chinese and Indian firms have invested in the resource sector in other developing countries in order to supply the home economy with the raw materials to sustain economic growth. Three of the largest Chinese MNEs, and the largest Indian one, are all in the petroleum sector. Much of this investment has gone to Africa, including countries such as Sudan which are sometimes virtually off-limits to western investors. Cumulative Indian outflows from 1995 to 2005 were strongly oriented towards developing countries, with only 11 per cent heading to Europe and 19 per cent to the United States.

This emphasis on developing countries is even more pronounced for China, with 71 per cent of the stock of ODI in Asia, 20 per cent in Latin America and another 3 per cent in Africa as of the end of 2005. Europe and North America each received less than 3 per cent. This geographical distribution is heavily influenced by Hong Kong and tax havens in the Caribbean, for fiscal reasons described earlier. Perhaps a more accurate measure of the importance of each region is a recent FIAS/MIGA survey of 132 Chinese firms with at least one overseas investment. East Asia and South and Southeast Asia both represent 20 per cent of total projects, followed by Africa (18 per cent), North America (14 per cent) and Europe (12 per cent). Surveyed firms suggested that Southeast Asia is likely to be the most popular destination for Chinese ODI between 2005 and 2008.[2]

Europe and the United States as hosts to Chinese and Indian ODI

[2] Battat (2006).

Chinese and Indian ODI in either Europe or the United States is still a small share of total ODI from those two countries and a minuscule portion of global FDI flows. But it is growing quickly and could soon play a significant role in certain countries and sectors. The relative importance of Chinese and Indian ODI in each market varies according to the data source. The Indian ODI stock in the United States is four times as high as that from China. In Europe, the positions are reversed, although not by the same magnitude: as of 2004, the stock of Chinese ODI in Europe was 50 per cent higher than for Indian ODI. But at the same time, many European countries have taken in more FDI from India than from China: only Germany, Belgium and Luxembourg have received relatively more direct investment from China. Looking at employment levels of Chinese and Indian investors in the United States reveals a strong imbalance in favour of India: 1,700 employees in Chinese affiliates and 12,300 in Indian ones.

Figure 2 shows annual outflows from China and India to Europe and the United States. In many years and for many countries, actual flows from China are negative, suggesting that Chinese firms are either withdrawing funds (such as in the form of loans from the affiliate to the parent) from their affiliates or are not making profits. This suggests that for Chinese firms financial considerations still loom large in their investments decisions. Chinese ODI in Europe took off only in 2006.[3]

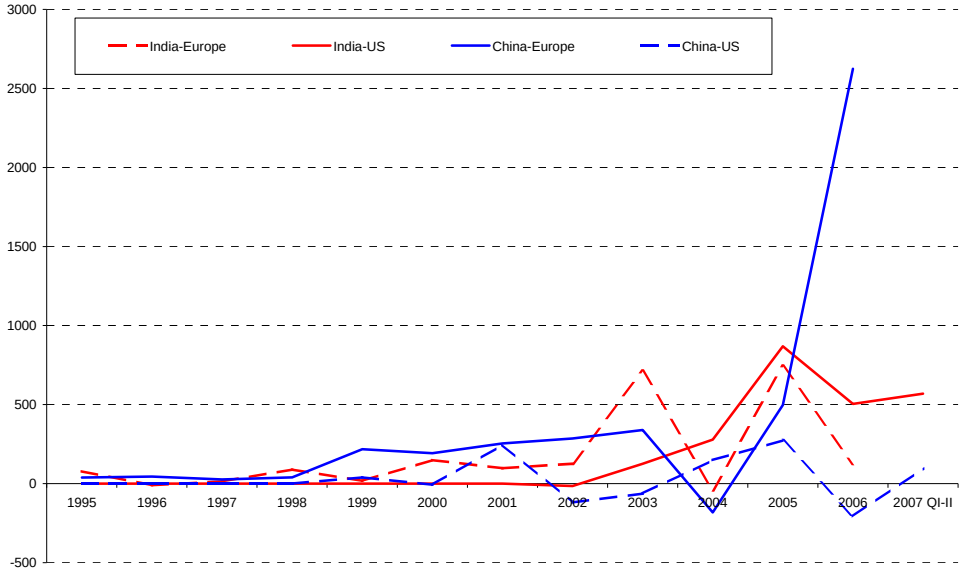


Figure 2. **Chinese and Indian ODI in Europe and the United States ($ million)**

Source: OECD, Eurostat, US Bureau of Economic Analysis

To put these levels of investment in perspective, the stocks of Indian and Chinese FDI in the European Union as of 2004 – the latest year for which data are available and

[3] Some of the large outflows of ODI which are usually attributed to Hong Kong might be by mainland Chinese firms, some of whom are registered or listed in Hong Kong.

before the real takeoff in ODI – were 1.2 and 1.7 billion euros respectively. These sums pale in comparison with what the largest outward investors have sent to Europe, but more recent figures are likely to see India and China on a par with what other prominent emerging market economies have invested.

An Ernst & Young study of investment projects estimates that India was the ninth most active investor in Europe (including by European firms) in 2006, with 78 projects. While this number is impressive for a developing country, it is still only 8 per cent of the number of projects involving US MNEs. The UK received the largest share of this investment.

Most estimates place the United Kingdom in top place for Chinese and Indian investment, followed often by Germany, depending on the sector. This pattern resembles very closely that of Japanese investment in Europe in the 1980s or even American investment in the 1960s. The United Kingdom is favoured partly for its liberal policy environment for foreign acquisitions of local companies. The political resistance to the sale of Arcelor to Mittal (legally a Dutch company) were not present in the United Kingdom when Tata Steel acquired Corus (formerly British Steel). Another advantage of the United Kingdom is its Indian community: London alone is home to 144,000 people born in India and a further 290,000 people of Indian ethnicity.[4] A third consideration is that the UK market is often among the most important for exporters from China and India. This is particularly the case for information technology (IT) and services outsourcing where the UK market is bigger than the rest of Europe combined for Indian firms. Continental European firms have been more reluctant to outsource these activities.

Very little information exists on the sectoral composition of Chinese and Indian ODI. In the United States, FDI statistics and M&A data both point to a prominent role for the IT sector. Reflecting the strength of Indian outsourcing, 71 per cent of the total inward stock of FDI into the United States from India is in IT and professional services. Chinese investment in the United States is largely in the wholesale sector, perhaps reflecting the importance of controlling distribution channels for Chinese exports to the United States.

Software is also important in terms of European FDI inflows from India, but much less so than in the United States because of less aggressive outsourcing in Europe. The Ernst & Young study suggests that software services represented almost one half of all projects by Indian investors between 1997 and 2004. Another prominent sector for Indian ODI in Europe is pharmaceuticals, as will be discussed later.

Large investments receive the most attention, but SMEs are also involved. Although Chinese and Indian companies facing rising costs or labour shortages have the option to invest in their own hinterlands where labour costs are far lower, they could also invest either in other developing countries or closer to final markets. Like Korean firms before them, many smaller Indian and Chinese firms have invested in Eastern and Central Europe where costs are lower than in Western Europe to sell in the European

[4] GLA Economics and Think London (2005).

market. The Chinese television maker Hisense, for example, has decided to establish a factory in Hungary in a building that was vacated by Microsoft which moved its production to China. A Chinese electronics manufacturer, Sichuan Changhong, hopes to complete the construction of a factory in the Czech Republic.[5]

It is difficult to go beyond this general discussion based only on official FDI statistics which are reported with a considerable lag and are sometimes only a loose proxy for actual MNE investment decisions, as they record only the foreign component of acquisitions.[6] Given how recent most Chinese and Indian ODI is, it is more instructive to review the largest acquisitions by these firms in Europe and the United States. Not all ODI involves acquisitions, but a large share of such investment into western economies by emerging market MNEs is likely to take this form for reasons which will be explained later.

Tables 1 and 2 provide lists of some of the most significant recent acquisitions by Chinese and Indian firms in Europe and the United States. Indian investments in the pharmaceutical sector in Europe are shown later in Table 3.

To judge from Table 1, most Chinese M&As in western economies have been in the United States or the United Kingdom, with certain notable exceptions. Some major privately-owned Chinese companies have invested in Europe and the United States, such as TCL, Lenovo or Haier, but much of the total Chinese ODI involves state-owned enterprises (SOEs). This tendency is even more apparent in developing countries such as in Africa given the importance of the state in the Chinese raw materials sector. By the end of 2005, out of a total stock of Chinese ODI worldwide of $57 billion, 81 per cent was by SOEs directly managed by the State Assets Supervision and Administration Commission (SASAC). SASAC was established in 2003 with a mandate of turning the country's top SOEs under its control into 50 global MNEs, all featuring on the global Fortune 500 list.[7] Four sectors stand out for Chinese ODI in Europe and the United States: banking, electronics, petroleum and telecoms.

Table 2 provides similar estimates of Indian M&As in western economies. In contrast to China, Indian investors are more diversified in terms of sectors and destinations. They are also far more likely to involve publicly-listed companies. The steel sector stands out in value terms and the pharmaceuticals sector in terms of the number of acquisitions. Information technology and business process outsourcing (BPO) are less prominent in M&A tables because Indian software and BPO firms such as Infosys prefer to grow organically through greenfield projects. The Tata conglomerate is prominent across many sectors, with acquisitions in chemicals, food and beverages, hotels, IT, steel and telecoms. Tata comprises 430 corporate entities and 90 operating companies. Partly as a result of its overseas acquisitions, the share of international revenue rose from 21 per cent in 2003 to 30 per cent in 2006.

[5] Accenture (2007), p. 10.
[6] Retained earnings of affiliates are also included, as if all profits are repatriated and then reinvested by the parent in the affiliate.
[7] Pamlin and Baijin (2007), p. 19.

Table 1. Major mergers and acquisitions attempts by Chinese firms in Europe and the United States
(failed bids are in italics)

Company	Sector	Target	Country	Value	Year	Comment
China National Blue Star	Chemicals	Rhodia Group	France		2006	specialty chemicals
China National Blue Star	Chemicals	Addiseo	France	$480 million	2006	animal feed
Lenovo	Computers	IBM (personal computers)	US	$1.75 billion	2004	world's third largest computer producer
TCL	Electronics	Schneider Electronics	Germany		2002	
TCL	Electronics	Thomson Electronics (television division)	France		2003	world's biggest TV maker
TCL	Electronics	Alcatel (55% of mobile handset operations)	France	$55 million	2004	$46 million loss in first quarter; later dissolved
Citic	Financial services	Bear Stearns	US		2007	bid for up to 20% of equity; no decision
China Minsheng Bank	Financial services	United Commercial Bank	US		2007	9.9% share in parent company
China Development Bank	Financial services	Barclays	UK	$3 billion	2007	3.1% stake
Ping An Insurance	Financial services	Fortis	Dutch-Belgian	$2.7 billion	2007	4.2% stake
Nanjing Automotive	Motor vehicles	Rover	UK		2005	one of many Chinese suitors; bulk of production to move to China, while R&D is kept in UK
Huaxiang Group	Motor vehicles	Lawrence Automotive Interiors	UK	$6.7 million	2006	
Sinopec	Petroleum	First International Oil Corporation	US	$153 million	2004	
CNOOC	*Petroleum*	*Unocal*	*US*	*$18.5 billion*	*2005*	*failed bid*
China Investment Corporation	State holding company	Blackstone	US	$3 billion	2007	non-voting shares
Huawei Technologies	Telecoms	Marconi	UK		2005	joint venture
Huawei Technologies	Telecoms	3Com (networking)	US	$2.2 billion	2007	joint acquisition with Bain Capital (80%); could require CFIUS approval
Haier	*White goods*	*Maytag*	*US*	*$1.28 billion*	*2005*	*failed bid*

Source: Various sources

Table 2. Major mergers and acquisitions attempts by Indian firms in Europe and the United States*

Company	Sector	Target	Country	Value $ m.	Value euros m.	Year
Bharat Forge	Manufacturing	Carl Dan Peddinghaus GmbH	Germany			
Ceramed Engineers Pvt. Ltd.	Manufacturing	Action Finishing Pvt. Ltd.	UK			
Sakhi Auto Components	Motor vehicles	Intermet Europe	Germany	129		2007
Bharat Forge	Motor vehicles		UK, Germany, Sweden			
Escorts	Motor vehicles	Farmtrac Tractors	Poland		8	
Sona Koyo Steering	Motor vehicles	Fuji Autotech	France		5	
Dr. Reddy's Laboratories	Pharmaceuticals	Betapharm	Germany	572		2006
Dishman pharmaceuticals	Pharmaceuticals	IO3Sm	Switzerland			2006
Dishman pharmaceuticals	Pharmaceuticals	Solutia	US	75		2006
Sun Pharmaceuticals	Pharmaceuticals	Taro Pharmaceuticals	Israel/US	454		2007
Jubilant Organsys	Pharmaceuticals	Hollister Steir Laboratories	US			2007
Ranbaxy	Pharmaceuticals	Ethimed	Belgium			
Ranbaxy	Pharmaceuticals	Mundogen	Spain			
Matrix Laboratories	Pharmaceuticals	Docpharma	Belgium		184	
Aurobindo Pharma Mtd.	Pharmaceuticals	cGMP Facility	US	19		2006
Orchid Chem. & Pharma.	Pharmaceuticals	Bexel Pharmaceuticals	US	3		2006
Tata Steel	Steel	Corus (former British Steel)	UK-Neth.	8000		2007
Mittal**	Steel	Arcelor	Luxembourg	38000		
Essar Global	Steel	Minnesota Steel	US	100		2007
VSNL (Tata)	Telecoms	Teleglobe (voice, data and mobile services)	US	239		2006
VSNL (Tata)	Telecoms	Tyco Global Network (undersea cable network)	US	130		2007
Raymond India	Textiles	Regency Textiles Portuguesa	Portugal		2.4	
GHCL	Textiles	Best Manufacturing	US	35		2007

*Indian pharmaceutical acquisitions in Europe are shown in a separate table.

**Mittal is registered in the Netherlands and its owner resides in London. The owner was nevertheless born in India and follows a similar low cost growth strategy as that of Indian companies. His firm was treated as Indian both by Arcelor and by many Indians themselves.

Source: India Brand Equity Foundation and various other sources

Table 2. Major mergers and acquisitions attempts by Indian firms in Europe and the United States* (ctd.)

Company	Sector	Target	Country	Value $ m.	Value euros m.	Year
Hindalco	Aluminium	Novelis	Europe	6400		2007
Tata Chemicals	Chemicals	Brunner Mond	UK		139	
Bharat Forge	Chemicals	Imatra Klista AB	Sweden		48	
United Phosphorus	Chemicals	Cequisa	Spain		11	
United Phosphorus	Chemicals	DowAgro Sciences	US	25		2006
Videocon	Electronics	Thomson SA	France		228	
Suzlon Energy	Energy	REPower Systems	Germany	1350		2007
Suzlon Energy	Energy	Hansen (wind turbine gearboxes)	Belgium	565		2006
Tata Tea	Food & beverages	Tetley	UK	435		2000
Tata Tea	Food & beverages	Energy Brands Inc. (30% stake)	US	677		2006
United Breweries Group	Food & beverages	Whyte & Mackay	UK	1160		2007
Tata Coffee	Food & beverages	Eight O'Clock Coffee Company	US	220		2007
Gitanjii Gems	Gems & jewelry	Tri-star Worldwide LLC	US	48		2007
Gitanjii Gems	Gems & jewelry	Samuels Jewelers	US	44		2006
Tara Jewels Exports	Gems & jewelry	Fabrikant Lear International	US			2006
Indian Hotels Company (Tata)	Hotels	Hotel Campton Palace	US	60		2007
Indian Hotels Company (Tata)	Hotels	Ritz-Carlton Hotel (Boston)	US	170		2006-07
Taj Group (Tata)	Hotels	The Pierre, NY (30-yr management contract)	US			
HCL Tech BPO Service	IT, BPO	BT's Apollo Contact Centre, Belfast	UK			
Wipro	IT, BPO	various	Finland, Portugal, US	45		2006
Wipro	IT, BPO	Newlogic Technologies	Austria		44.3	
Subex Systems	IT, BPO	Azure Solution	UK		110	
Tata Consultancy Services	IT, BPO	Pearl Group (life insurance & pensions division)	UK		53.5	
HOV Services	IT, BPO	Lason Inc.	US	148		
Sundaram Fasteners	Manufacturing	Dana Spicer Europe (precision forging unit)	UK			

II. Why are Chinese and Indian firms investing abroad?

For most of the post-war period, internationalisation through ODI has been seen to be the preserve of the largest, most technologically sophisticated and hence most competitive firms. The American, European and Japanese firms that invested most abroad tended to be more competitive than their rivals both at home and in the host country. It was never the full story behind the growth of FDI, but it was seen to explain the largest part of what was going on. After all, if the investor did not possess some sort of ownership advantage or intangible asset, on top of its financial resources, it would not be able to compete effectively against local firms already in the market who presumably would otherwise have some 'home market advantage'. Ownership advantages include firm-specific assets such as technology, know how or brands which the firm can transfer from one location to another.

While this model has generally been satisfactory in accounting for earlier waves of international direct investment, it seems inadequate as an explanation for Chinese or Indian ODI. Many of these investors have little state-of-the-art proprietary technology and only poor brand recognition in Europe. Many Chinese firms in particular began as original equipment manufacturers (OEM) supplying goods to western companies to sell under their own brand. In this sense, Chinese investors are like the earlier wave of investment from Korea.

An alternative model has been developed which better captures the essence of ODI by emerging market firms. It sees ODI as a way of improving the competitiveness of the investing firm and grew out of the research into 'learning by exporting' whereby firms learn to 'improve the quality of their products and production processes through contact with more advanced foreign competitors in global export markets'[8]. Analogously for investment, rather than investing abroad to exploit assets developed at home, the firm expands internationally in order to develop those assets more effectively than could be achieved in the domestic market alone, known as asset-seeking or technology-sourcing investment. This possibility is more satisfactory in explaining why firms often invest abroad when they are most threatened in the home market, such as during periods of liberalisation.

Many studies have identified technology sourcing as a motive for ODI, and not just by Chinese and Indian firms but by any firm which is a technological follower. Technology sourcing clearly emerges as a strategy for Japanese firms in Europe and North America, particularly in the earliest stages of their outward expansion. Caves (1982, p. 198) cites studies suggesting that "Japanese companies expanded their foreign investments in research-intensive countries such as the United States and West Germany in order to improve their access to technology flows after companies in those nations, conscious of the burgeoning Japanese competition, grew more reluctant to licence".

[8] Branstetter (2000), p. 2.

More recently, Branstetter (2000, p. 11) interviewed Japanese investors in the United States and found that acquiring or absorbing US technologies is often an explicit part of the decision to invest. "By purchasing a firm in the United States, Japanese firms potentially acquire not only the proprietary knowledge assets of the acquired firm but also entrée into the informal technological networks and knowledge sharing relationships possessed by the research personnel of the acquired firm." Similar strategies have been identified for Korean and Taiwanese firms in Europe, North America and Japan. Sachwald (2001) cites several studies finding that technological upgrading has been an important strategy for large Korean groups in their investments in other OECD countries.

We will look for evidence of technology sourcing or asset seeking by Chinese and Indian firms below. For the moment, it is useful to consider the evidence that such a strategy actually delivers the competitive gains for which it is designed. Unfortunately, it is very difficult empirically to determine whether a firm's productivity or technological-strength is a reason for its multinationality or a result or it. A recent OECD review of the literature finds that "outward FDI tends to increase output, employment and exports in the parent firm in the home country, in part because of the positive impact on the parent's competitiveness…The academic literature is divided over the degree to which these benefits accrue to a broader segment of the home economy through spillovers and other externalities."[9]

Hoesel (1999) calculates human capital in Korean electronics firms based on earnings per employee and finds that those investing in developed economies have accumulated more human capital than those that have invested only in developing countries or are purely national firms. Barba Navaretti and Castellani (2002, 2004) find that Italian firms investing abroad for the first time see their performance in the domestic market improve compared to the period before the ODI. They also outperform strictly national firms following their investment abroad. Chen and Ku (2002) find that ODI by Taiwanese firms improves the competitiveness of outward investors, thereby raising the firm's domestic output and employment.

Thus competitive gains from a technology sourcing strategy are certainly a theoretical possibility which has been confirmed in a number of empirical studies, including of firms from Asia. The following section looks at key sectors for Indian and Chinese investors to assess the strategies underpinning their investments. The evidence suggests that emerging economy ODI is driven by a mixture of ownership advantages and technology sourcing. It remains to be seen to what extent the investing firm will reap a competitive dividend.

Motives for Chinese and Indian acquisitions in Europe and the United States

A review of motives for Chinese and Indian ODI in Europe suggests that technology sourcing or asset seeking more generally is a key component of firms' strategies in a wide variety of sectors. Not only does it seem to be occurring at a time when Chinese

[9] Thomsen (2006), p. 116.

and Indian firms are on the defensive as a result of liberalisation at home, but it is also occurring through the acquisition of western firms with well-developed intangible assets but nevertheless in financial difficulty. These two elements are discussed separately below.

ODI as a defensive move

The sudden emphasis on ODI by Chinese and Indian firms is partly a defensive response to liberalisation at home. As India and China liberalise, in the latter case partly as a result of WTO accession, firms from OECD countries are expanding their presence in an increasing number of sectors. "As foreign multinationals enter China and benefit from the low-cost sourcing, local knowledge and booming consumer markets, the natural competitive advantages of Chinese companies in their home and foreign markets will diminish. In response, there is an urgent call for Chinese companies to master new skills that traditionally reside with non-Chinese multinationals: in areas like marketing and branding, higher value-added goods and services, advanced technological innovation and management."[10] Even the widely reported acquisition of IBM's personal computer division by Lenovo was undertaken "not to devour the US market, but to support Lenovo at home, where it is being squeezed by the likes of Dell and Hewlett-Packard".[11] Likewise, Indian pharmaceutical companies are investing in Europe partly in anticipation of liberalisation (in the form of improved protection for foreign patents) of the Indian market (see Box 1).

Sourcing technology or other intangible assets

Export-led development in China, as in much of the rest of developing Asia, has not solved the problem of dependence on foreign technologies. Many Chinese exporters are simply following the blueprints provided by western investors. Outward investment has been seen to be a way to overcome this deficit in technology for both Indian and Chinese firms, and technology sourcing is a central feature of their ODI, particularly for Chinese investors.

Acquisitions of pharmaceutical companies in the United States and Germany by Indian investors are partly a way to tap into the technological strengths of these two countries in this sector. Acquisitions of shares in western commercial and investment banks by Chinese banks and by the China Investment Corporation, the state holding company, provide expertise in western banking and fund management skills.

Many sectors provide evidence of acquisitions partly motivated by the desire to obtain valuable brands: TCL's acquisition of Thomson's television business in Europe (which also provided it with a brand, RCA, in the United States) and of Schneider Electronics in Germany; Lenovo's purchase of IBM's computer business; Nanjing Automotive's purchase of Rover MG; and Haier's attempted bid for Maytag in the United States. The pattern is most frequently to search for a brand whose owner is facing financial difficulties or even bankruptcy. In almost all cases, the western firm is selling the division because of cut-throat competition and low profitability.

[10] Accenture (2007), p. 5.
[11] Steinbock (2005), p. 5.

Buying up brands of companies in difficulty is a cheap way of acquiring market access, but it clearly begs the question of what Chinese or Indian investors bring with them to allow them to exploit the brand more profitably than did its former owners. If it were simply a question of shifting production to China, then this would most easily be achieved through European investment into China, as has been the case in many sectors. For Chinese or Indian ODI to arise in these cases, the investor must have some inherent advantage in producing a particular good in its home country compared to a foreign MNE.

Morck et al. (2007, p. 20) explain why an ownership advantage in a certain sub-sector might shift over time from a western MNE to an emerging market firm. "In maturing industries, intensifying price competition in increasingly standardized products renders manufacturing quality more important than cutting edge R&D, and rigorous cost control more important than brand name recognition. In such circumstances, a reversal of roles becomes rational: the production unit takes over the R&D or brand-building unit because its non-contractible effort becomes more important in creating value." In this way, the prey becomes the predator.

Many of the acquisitions listed above fit with this scenario, as does ODI by Indian pharmaceutical companies. Box 1 describes these latter investments in more detail because they demonstrate how much of the recent ODI to Europe is both defensive and offensive, both technology seeking and strategic asset exploiting.

As the pharmaceutical example demonstrates, the distinction between seeking new strategic assets and exploiting existing ones as motives for ODI should not be overdone Most ODI is likely to involve some combination of the two: it is both the reward for competitive strengths in the home market and a way of developing skills to compete in the global one. Even the largest, most technologically-advanced MNEs seek out intangible assets in other locations. The acquisition of Daewoo Motors by General Motors was motivated in part by the desire of the American investor to tap into the skills of the Korean company in producing small, energy-efficient vehicles.

And nor are emerging market MNEs merely absorbers of technologies and intangible assets developed elsewhere. Indian and Chinese investors bring something more to the table than just cash. To a certain extent, the advantage offered by the new investors is neither technology nor product innovations but rather a greater knowledge of, hence improved access to, emerging markets. These markets which will be the greatest source of growth in demand in the future as well as a growing location for outsourcing and offshore production.

Box 2. Indian pharmaceuticals

The indigenous Indian pharmaceutical industry was nurtured as a result of the Indian Patents Act in 1970 which provided some protection from foreign competition. Building on the strength of the local chemicals industry, the Act allowed Indian firms to compete against larger foreign rivals both at home and abroad, and in particular to develop an expertise in generic drugs. Although some Indian companies such as Ranbaxy Laboratories began to invest abroad at an early stage, the recent wave of mergers (Table 3) has arisen as a result of a combination of pull and push factors. The greatest push has come from the acceptance by the Indian government of the WTO's patent law which will increase the scope for competition from global MNEs entering the Indian market. Pull factors include the growth of demand for branded generics in Europe in order to reduce health costs and the fact that many European firms were eager to divest from the generics sector owing to low margins. Germany is the preferred location for Indian investments in this sector, a choice dictated partly by its ranking as the largest market for generics in Europe and also because of its strength in drugs and pharmaceuticals.

Table 3. Indian M&As in the pharmaceutical sector in Europe

2000	Bayer-Generics Pharmaceutical	Germany	Ranbaxy Labs
2001	German Remedies	Germany	Zydus Cadila
2003	CP Pharmaceuticals	UK	Wockhardt
	RPG Aventis	France	Ranbaxy Labs
	Alpharma France (Alpharma/US)	France	Zydus Cadila
2004	Esparma	Germany	Wockhardt
	Pharmaceutical Services	Belgium	Jubilant Organosys
	Temmler Pharma	Germany	Wockhardt
2005	Docpharma	Belgium	Matrix Labs
	Heumann Pharma	Germany	Torrent Pharmaceuticals
	Beltapharm	Italy	Strides Arcolab
	Polish Sterile	Poland	Strides Arcolab
	Efarmes	Spain	Ranbaxy Labs
	ICN (Valeant Drugs/UK)	Hungary	Sun Pharmaceuticals
2006	Explora Labs	Switzerland	Matrix Labs
	Betapharm	Germany	Dr Reddy's Labs
	Terapia	Romania	Ranbaxy Labs
	Ethimed	Belgium	Ranbaxy Labs
	Allen (GlaxoSmithKline/UK)	Italy	Ranbaxy Labs
	IO3Sm	Switzerland	Dishman Pharmaceuticals
	Mundogen (GlaxoSmithKline/UK)	Spain	Ranbaxy Labs

Source: Milelli (2006) drawn from Thomson Financial, updates from various other sources.

Going beyond cost competition to create genuine global ownership advantages

The acquisitions described so far all derive from the ability of the investor to leverage lower costs in the home market into an advantage that can add value to acquired firms in developed economies. But some Indian and Chinese firms, notably in the IT sector, have gone beyond this stage to create genuinely global ownership advantages which can be transferred to any market. Their strategies are far more motivated by market opportunities abroad than by defending entrenched positions at home. Infosys and Wipro, two of the giants in the Indian BPO sector have invested in both Europe and North America, including a software development centre in Atlanta. The aim is to have outposts in major markets in order to be more responsive to customers' needs.

It is too soon to tell whether firms in other industries will be able to follow their lead. Bonaglia and Goldstein (2007) provide evidence of the internationalisation of emerging market firms in the white goods sector which suggests that these firms might too evolve in this direction. The Chinese company Haier has a strong brand at home but chose initially to serve foreign markets through OEM contracts. With growing competition and rising raw materials prices, Haier found its profits squeezed with only limited possibilities for an aggressive expansion of market share owing to the nature of the OEM agreements. It responded by investing or acquiring firms in Asia (1995), the United States (1999) and Europe (2001).

In spite of this rapid internationalisation, the company still relies heavily on foreign components and technology, and its management style based on 'humiliation and ritual embarrassment' could not be transplanted to its factories in Italy or the United States. In these ways, the Haier example fits badly with the traditional model of internationalisation as described earlier. But at the same time, Bonaglia and Goldstein (2007, p. 32) suggest that while traditional incumbent MNEs are still very much tied to a 'home base' and to date have demonstrated little appetite for engaging in truly 'global' competition, emerging market MNEs are more likely to be global in their outlook, strategy and organisation. "This is giving them rapidly acquired advantages over slower-moving and less-focused incumbents – even in markets that have traditionally been viewed as global."

The proof of this assertion will depend on the performance of Chinese and Indian investors abroad. It is possible that the competitive advantages of Indian and Chinese MNEs in emerging markets are oversold and that these firms are pursuing a high-risk strategy that could see a high share of mergers fail.

III. Why are Chinese and Indian investors pursuing such high-risk strategies?

Mergers are notoriously difficult to make work, and none more so than cross-border ones. Overseas ventures by relatively inexperienced Chinese or Indian firms have an even higher risk of failure. The factors which might drive these firms to pursue a high risk strategy are a combination of capital abundance, oligopolistic rivalry mixed with a dose of hubris, and implicit and explicit government support.

Foreign exchange reserves and corporate liquidity

Both India and China have ever-increasing reserves of foreign exchange: $1.4 trillion in China and over $200 million in India. These reserves do not have to be recycled as ODI, and indeed until recently they generated very little direct investment outflows. But the importance of ODI is likely to grow in the future in large part because record reserves have brought about a dramatic shift in Chinese and Indian governments policies towards ODI, from restrictions to encouragement, as we shall see later.

Foreign exchange reserves are matched by an abundance of liquidity for Chinese and Indian companies on the back of rapid economic growth and swelling corporate profits . An additional element contributing to liquidity in the Chinese case is the presence of SOEs that are not subject to the same dividend pressures as private firms and that receive preferential loans from state-owned banks.

In India, "[t]he stockmarket has been booming…rupee interest rates, although they have been edging upwards for the past two years, are still, in real terms, at about half their levels of a decade ago. And, despite capital controls that place limits on external borrowings, India's big companies can raise huge amounts of money abroad."[12] India is also the darling of emerging markets in terms of portfolio flows, taking in one quarter of such flows from 1999 to 2005. A Morgan Stanley index of eight emerging markets found that in 2006 India took in one half of portfolio inflows, up from 28 per cent in 2005.[13] In spite of turmoil in emerging economy capital markets in mid-2007, they are currently vastly outperforming other markets on the back of robust earnings growth and reduced country risk. Since 2002, emerging markets have outperformed other markets by 100 per cent.[14]

Oligopolistic rivalry

Oligopolistic rivalry is widely acknowledged as a motive for FDI.[15] Competitors are compelled to invest in the wake of the first mover out of fear that a rival's investment will confer some advantage both abroad and at home. These subsequent investments are defensive in nature, not driven by market opportunities abroad but by the need to offset any potential gain for the first mover. In this ways, mistakes are multiplied in the case where the initial investor miscalculated the benefits from investing.

[12] "India's acquisition spree – circle the wagons", *The Economist* 14 October 2006.
[13] Jo Johnson, "Extended self-imposed exile ends", FT.com, 25 January 2007.
[14] "Emerging markets", Lex column, FT.com, 4 October 2007.
[15] The idea was first mooted by Knickerbocker (1973).

Even if the herd instinct appears strong, it is not necessarily irrational. Size or multinationality can matter in more ways than one: it can strengthen the hand of the firm in relations with the government – an important consideration where credit is directed by the government; it can improve the reputation of both the firm and its products; and it can aid in the recruitment of talented staff. But with family-controlled oligopolies in India and state-controlled monopolies in China, it is possible that in a climate where overseas acquisitions are treated like national sporting victories, there will be a tendency for each local entrepreneur to try to outdo the international exploits of his competitors.

Government support

Recycling export earnings might foster more liberal policies towards ODI, but the main motives of governments for actively supporting ODI go much deeper. In some cases, particularly when state-owned enterprises are involved, ODI reinforces foreign policy. The Indian government, prior to liberalisation, allowed some ODI to other developing countries to reinforce ties, and Chinese foreign policy towards Africa is intimately linked to the activities of its SOEs in the African raw materials sector. Another consideration is simply the national pride which derives from foreign acquisitions, with hoped-for spillover effects for the government in power.

But the most important consideration for home governments is the effect that ODI might have on the competitiveness of local firms. Although the Indian government offers no direct financial support for ODI, it clearly recognises the advantages which might accrue from it. "Indian corporates are increasingly able to establish synergies with overseas units, to make up for a lack of scale that has been a legacy problem in India, and to quickly acquire domain knowledge through acquisitions."[16]

Recognising that ODI, like trade or inward FDI, might contribute to national development is one thing, actively encouraging local firms to venture abroad is another. Financial inducements to local firms to invest abroad create a new form of industrial policy, replacing many of those which have been negotiated away in multilateral fora.

In this section, we discuss how the Indian and Chinese governments influence ODI, compare this with the experience of Korea in the 1990s and then draw conclusions about the possible misallocation of capital which might ensue from government targeting of sectors or firms for ODI.

<u>India</u>

The liberalisation of measures restricting ODI was an important first step in the internationalisation of Indian firms, particularly SMEs. Limits on the ownership share in foreign ventures were removed in 1992, and an automatic clearance was established below a certain threshold: raised from $15 million in 1995 to $100 million in 1999 to up to 200 per cent of net worth in 2005 and now standing at 300 per cent of net worth. Investments above this level can still be made, subject to the approval of the RBI. This

[16] Reddy (2007).

limit does not apply in cases where the Indian company finances the investment either through issues of American or Global Depository Receipts (ADRs/GDRs) or through balances in the Exchange Earner's Foreign Currency (EEFC) account.

In the raw materials sector, the state-controlled Oil and Natural Gas Company (ONGC) has invested $5 billion abroad, sometimes in cooperation with competitors from China, and is India's largest multinational. It is present in 15 countries, including many where a western firm might encounter difficulties from its home government: Cuba, Iran, Libya, Myanmar, Sudan and Syria.

China

China's "Go Global" strategy for key firms is also intended to enhance competitiveness. It was first envisaged in the mid-1990s and formally adopted in 2000. The Eleventh Five-Year Plan encourages qualified Chinese firms to invest overseas. According to UNCTAD,

> A selective support policy has been adopted to encourage outward FDI. In October 2004, the NDRC and the Export-Import Bank of China issued a circular to promote (i) resource exploration projects to mitigate the domestic shortage of natural resources, (ii) projects that promote the export of domestic technologies, products, equipment and labour, (iii) overseas R&D centres to utilize internationally advanced technologies, managerial skills and professionals, and (iv) M&As that could enhance the international competitiveness of Chinese enterprises and accelerate their entry into foreign markets. To promote these selected types of FDI, the Government offers preferential credit and other incentives.

This policy was reiterated in an announcement by the Development and Reform Commission of China in May 2007 of support for ODI projects which included the same criteria but added the need to facilitate industrial upgrading through government-supported ODI.

In spite of the political encouragement of ODI, a recent survey of Chinese investors found that investing abroad is shackled by government procedures and that the key impediments are limitations on foreign exchange use (58 per cent of firms) and the time involved filling in applications (44 per cent).[17] Only since 2002 have Chinese investors been allowed to reinvest the profits of their foreign affiliates abroad. In 2004, the Chinese government eased investment restrictions on ODI by doing away with the need for a government feasibility study for each investment, but companies still required the approval of the state administration of foreign exchange (SAFE) before sending money abroad.[18] Partly to address the complaints of potential overseas investors, quotas on the purchase of foreign exchange for ODI were abolished in 2006.

Helping private firms invest abroad is not the principal aim of China's Go Global policy: its purpose was to create between 30 and 50 "national champions" from among the most promising or strategic SOEs. Although some large private players are starting

[17] Battat (2006).
[18] "Chinese companies acquire a taste for western targets, FT.com, 19 October 2004.

to venture abroad, the biggest sources of Chinese ODI are still the highly profitable listed SOEs. "Lenovo is the only FDI heavyweight not explicitly state controlled. Private-sector firms may well conduct some outward FDI; but the scale is too small to register…[V]irtually every one of these significant players has an officially-sanctioned monopoly in some major industry, such as natural resources or telecommunications."[19]

These firms are favoured not only by monopoly status but also by explicit government support through the state-controlled banking sector. The $18.5 billion bid by CNOOC for Unocal included $7 billion "via a parent entity from its ultimate owner – the government" and $6 billion from one of the four big state banks.[20] The China Development Bank has increased its support for the overseas expansion of Chinese firms.

As with industrial policies which seek to allocate capital domestically on the basis of some government-defined industrial criteria, the Go Global policy could lead to a misallocation of domestic capital overseas. "China's recent outward FDI surge is likely a manifestation of its inability to reinvest efficiently its high corporate and individual savings. This distorted capital flow is propelled by the governance structure of large SOEs and by inefficiencies in its banking sector. Grandiose and patriotism-inspiring initiatives, like takeovers of foreign companies, legitimise the continuation of the political *status quo*. Over the longer term, deflecting capital away from more efficient private sector ventures may compromise both continued economic growth and political stability."[21]

Conclusion

If abundant liquidity, oligopolistic rivalry and government support can all contribute to a surfeit of highly risky ODI, then we would expect to see some of these investments fail. According to an annual report by the Chinese government on Chinese ODI, only a third of all investments were profitable in 2004. The World Bank found in a survey of Chinese MNEs that two thirds of joint ventures abroad failed.[22] Some of this might be explained by the recent nature of many investments, by fact that some are simply vehicles for placing funds offshore or by cross-cultural differences. And not all failures involve SOEs: private Chinese firms investing abroad have also run into difficulties.

Many Japanese investments in Europe and the United States in the 1980s, particularly in real estate or financial services, failed to live up to expectations or simply failed. Korean investors in the 1990s also saw many setbacks. And, more recently, an acquisition by a Taiwanese firm, BenQ, of Siemens' mobile unit in Germany was in receivership within a year. Box 3 provides the example of Daewoo which illustrates how the combination of abundant capital, oligopolistic rivalry, personal ambition and government favouritism can all serve to push local firms overseas into ventures which might ultimately prove to be unprofitable.

[19] Morck et al. (2007), p. 6.
[20] "The dragon tucks in", *The Economist*, 30 June 2005.
[21] Morck et al. (2007), p. 15.
[22] Accenture (2007), p. 7.

Many Chinese and Indian acquisitions are too recent to be able to assess their success rate, although the example of TCL does suggest that some of the lessons of past waves of Asian investment in Europe have not been learned. In 2004, TCL formed a joint venture with the French company Alcatel to give it an entry into the European mobile telephone market. Within nine months and with mounting losses, Alcaltel had sold its share in the venture to TCL, thus depriving TCL of Alcatel's patents.

A similar disaster struck TCL's acquisition of the television division of Thomson in France (also owner of the RCA brand in the United States).[23] The deal was intended to give TCL better access to western markets by circumventing anti-dumping rules, while Thomson would benefit from a low cost production base in China. Faced with cut-throat competition and the demise of demand for the cathode-ray tube models produced by Thomson, the company announced in 2006 that "the European operations in the joint venture with Thomson would be shrunk, sold, closed, or returned, including a factory in Poland and an expensive distribution network".[24]

Failures can arise because of over-optimistic forecasts of demand or because the expected synergies – western technology combined with low cost Asian production – are not achieved, but an additional element in the case of Chinese investment is the difficulty of integrating very different corporate cultures. The problems encountered in Chinese investments in the white goods sector were mentioned earlier. A World Bank survey of Chinese MNEs found that 85 per cent of CEOs cite differences in management styles and corporate cultures as the main reason for failure in foreign ventures. Conflicts also sometimes arose for Japanese and Korean investors in Europe and the United States.

[23] The original joint venture was two-thirds owned by TCL and the company was expected to take over the remaining share within 18 months.
[24] "A grim picture", *The Economist*, 2 November 2006.

Box 3. The Korean experience with ODI

The experience of South Korea with rapid growth in outward investment has many parallels with both India and China. The Korean *chaebols* were sometimes family-controlled conglomerates similar in many ways to companies such as Tata in India. They received financial encouragement from the government to expand abroad, as do many Chinese SOEs. Their ownership advantage in international markets was commonly seen to be "their mastery of production techniques and their ability to deliver goods which meet the standards of the leading markets, rather than their innovative capacities or brand name".[25] Korean firms were also seen as having a competitive advantage in other developing countries owing to their "management techniques and production processes adapted to third world conditions"[26]. And lastly, their motive for investing in developed markets was part market access in response to protectionism, part technology sourcing.

There are also differences with both China and India, including the tight restrictions on inward FDI in Korea until recently. Like Japan, this policy indirectly encouraged firms to acquire competitors in western markets in order to access technologies which might instead have come through inward investment. Korea also started investing overseas at a higher level of development than either India or China. The aim of this discussion is not just to draw parallels and distinctions between Korea and the two latecomers; it is to see what lessons, if any, the Korean experience might offer in terms of the risks inherent in rapid, government-supported internationalisation. Daewoo will be taken as an example.

Korean ODI outflows averaged $1 billion in the early 1990s but by the end of the decade were almost $5 billion annually (Figure 3). They held up during the crisis because of the need for Korean parent companies to inject cash into their affiliates but subsequently fell back. They have since recovered, but much of these recent flows goes to developing countries or Eastern Europe rather than either the United States or Western Europe.[27]

Following the liberalisation of regulations concerning ODI in 1987, the Korean government progressively increased incentives for local companies to invest abroad. The strategic objective of this policy was to improve the competitiveness of Korean firms, in part by enhancing independent technological capabilities. Public policies played a strong role in Korean ODI, both indirectly through the emergence of the *chaebol* and directly through financial support for ODI. Nicolas (2003) argues that "public policies can probably account for the apparently excessive extent of some Korea [ODI]" by encouraging firms to adopt "riskier strategies than they would do in the absence of helping hands in the form of rescue loans from the Government".[28]

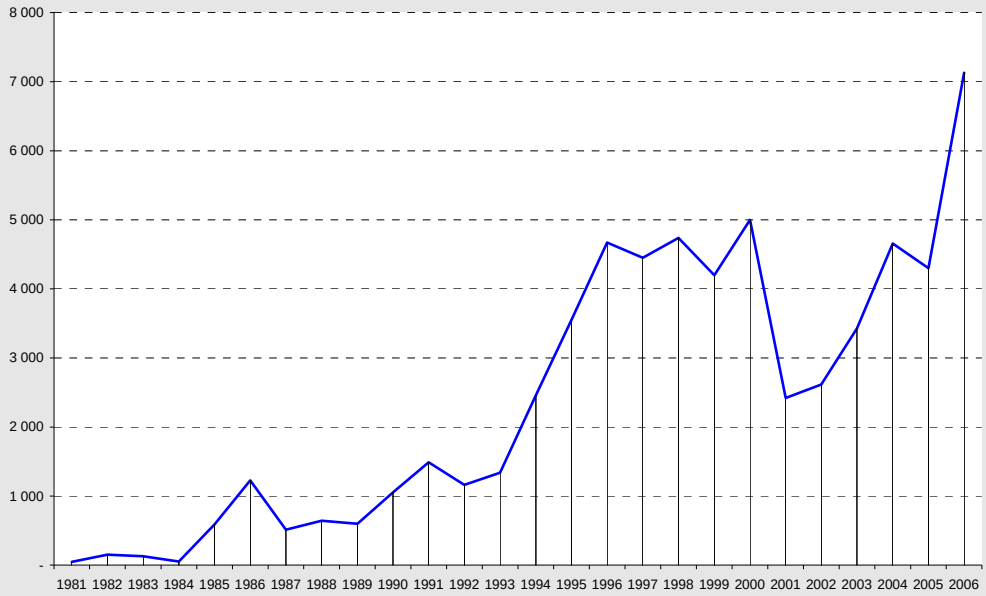
[25] Sachwald (2001), p. 7.
[26] Nicolas (2003), p. 30.
[27] Employment in Korean affiliates in the United States fell from 17,600 in 1999 to 13,600 by 2002.
[28] Nicolas (2003), pp. 33-4.

Government subsidies were combined with weak corporate governance: substandard regulatory oversight, weak bank supervision and ineffective boards of directors.[29] The heavy hand of Government through industrial policies, including its largesse towards outward investors, led to rent-seeking behaviour among local businesses. "Large conglomerates such as Daewoo designed their business plans according to the government's policies and credit control."[30]

Oligopolistic rivalry also played a role. Once one firm within an oligopoly was perceived to gain an advantage from overseas investment, whether through economies of scale or enhanced reputation, other members of the *Chaebol* would then undertake similar investments.

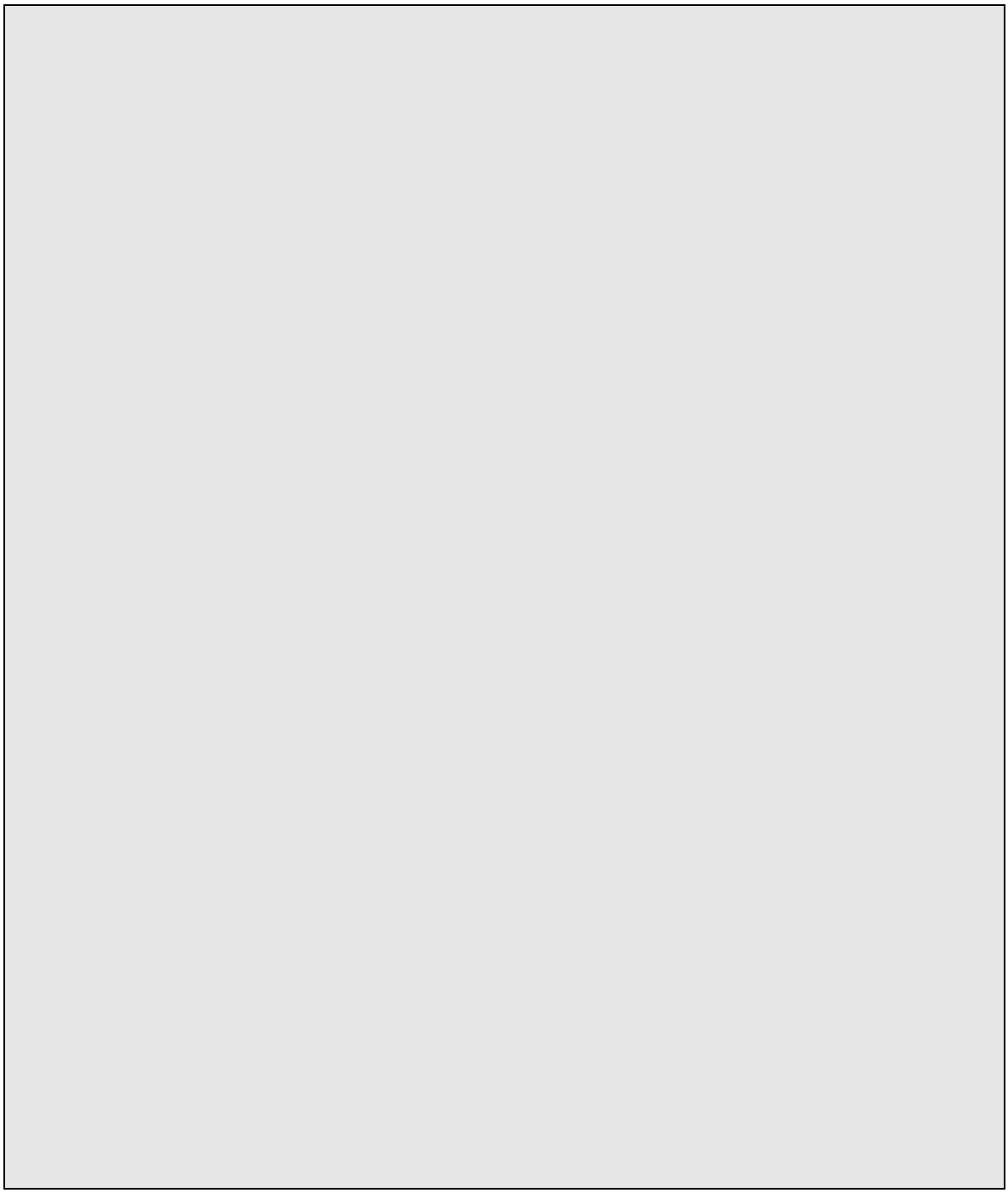
Through rapid internationalisation, Daewoo's chairman raised his international profile which served to enhance his position vis-à-vis the home government.[31] By 1998, Daewoo had 590 subsidiaries in over 85 countries. Its debt-financed rapid expansion overseas, combined with mismanagement and corrupt corporate governance, eventually led to South Korea's largest corporate loss and finally bankruptcy in 2000. Daewoo Motors and Daewoo Electronics both closed down a large number of foreign operations, including in Europe. In an ironic twist, Daewoo Motors was acquired by General Motors with whom the company had formed a joint venture to break into the industry in the early 1970s. Indian conglomerates were also keen to pick up some of the pieces: Daewoo Commercial Vehicles was acquired by Tata Motors, and Daewoo Electronics was bought by Videocon.

Figure 3. Korean outflows of ODI ($ million)



Source: UNCTAD

[29] Kim (2005), p. 1.
[30] Ibid p. 2.
[31] Chairman Kim was awarded the title of Commander in the Order of the Legion of Honour by the French government, as well as the coveted International Business Award by the International Chamber of Commerce. He was also elected President of the Federation of Korean Industries.



IV. The political reaction in Europe

The political reaction to Chinese and Indian acquisitions in Europe has focused, or is likely to do so, on four inter-related issues: state ownership or control of some of the investors; the leakage of technology, for both national security and competitive reasons; the fear that the Chinese or Indian investor will transfer production back to the home country and retain only a shell company in Europe; and the perceived lack of reciprocity in opportunities for European firms to acquire local competitors in China and India.

State ownership of Chinese investors poses several potential problems. First, it could allow the Chinese government to pursue foreign policy objectives through its companies' operations overseas, much as Gazprom is accused of doing in Russia. Second, it could allow the Chinese government to obtain western technologies. And third, it poses concerns about corporate governance in the acquired firms and the lack of transparency in the parent company.

A related issue is the role of the Chinese state holding company, the investment arm of the state in what has come to be known as sovereign wealth funds. In 2007, the Chinese government created the China Investment Corporation (CIC) with registered capital of $200 billion to invest in foreign financial markets, including through direct investment. The CIC has already spent $3 billion to acquire non-voting shares in the US private equity firm, the Blackstone Group. In this way, China follows the example of other export or oil surplus countries such as Singapore or Kuwait.

The issue of technology exports is partly a concern about national security. Some in Europe, such as German Chancellor Angela Merkel, have suggested the possible benefit of establishing an investment review mechanism akin to the Committee on Foreign Investment in the United States (CFIUS) to review takeovers where strategic technologies are involved. Most countries already block foreign ownership in certain strategic sectors.

But the technology issue also arises in the context of European competitiveness. The following example from Sachwald (2001, p. 1-2) concerning the proposed takeover of Thomson Multimedia (TMM) by Daewoo in the 1990s demonstrates how technology concerns can block investment projects into Europe. Ironically, Indian and Chinese companies have since acquired parts of Thomson.

> Daewoo had already invested in the unemployment-stricken Lorraine region and Chairman Kim Woo-Choong had been praised by French Prime Minister Alain Juppé for his investments and efforts to promote economic and cultural cooperation between France and Korea. In October 1996, the French government expressed its preference for the Lagardère-Daewoo solution for privatising Thomson. It expected that 'Daewoo Electronics, having real expertise in controlling production costs of mass market products, will endow TMM with the competitive gains required for its recovery and its future development.'[32] The attitude of the government suggests that it was considering Daewoo as it would have considered a Japanese company bringing production technology and new management practices to France. The Committee in charge of overseeing privatisations in France nevertheless rejected the government's choice. The Committee had formal objections about the bid, but also considered that Daewoo Electronics would get control of TMM's first-rate portfolio of technologies without sufficient guarantees as to its future development.

In addition to fears of technology leakage, takeovers by Indian and Chinese firms also raise concerns about employment effects. Inward investment is usually welcomed for

[32] Withell (1997).

its expected contribution to employment. Chinese or Indian investment might well be perceived as having the opposite effect. According to this view, Indian and Chinese investors will not offer improved market access to emerging markets as much as they will a lower cost production base – thus accelerating de-industrialisation in Europe. Examples abound, including Nanjing Automotive's declared intention to shift production of several Rover models to China, or the decision of Thomson to close two plants in the United States and to ship the equipment to its partner, Videocon, in India.

Not even developing countries are immune to this exodus. A Chinese company with state involvement was bidding to buy a car engine plant in Brazil in 2006. The plant was originally a joint venture between Daimler/Chrysler and BMW and was considered to be one of the most sophisticated of its kind in the world. The Chinese investors were reportedly interested in shipping the entire plant back to China.[33] Economists can well argue about the potential benefits to both China and the host country from this process and the fact that the acquired firm is often in financial difficulty anyway, but populist politicians will gain political mileage by opposing such investments.

The last political issue concerns reciprocity. As they did with Japan and Korea, European firms complain about policies in India or China which deny entry into certain sectors, or about government regulations – or their absence – which hinder both exports or European ODI into these countries. The poor protection of intellectual property rights in China is one example. A recent report by the EU Chamber of Commerce in China complained of the unequal treatment of foreign firms by Chinese regulators.[34] To make matters worse, the Chinese government is currently drafting legislation which could mean that acquisitions in China by foreign companies might be screened on national security grounds. A European Commission report suggested, menacingly, that "[t]here is a growing risk that the EU-China trading relationship will not be seen as genuinely reciprocal. Political pressure in the EU to resist further openness to Chinese competition is likely to increase if these problems are not addressed, as we are already seeing in the United States".[35]

[33] Keith Bradsher, "China seeking auto industry, piece by piece", *Financial Times*, 17 February 2006.
[34] "The China trade syndrome", *The Economist*, 6 October 2007.
[35] European Commission (2006), p. 15.

Conclusion

A recent advertisement in *The Economist* by ArcelorMittal proudly proclaims that "boldness changes everything". This attitude seems to sum up the prevailing wisdom among emerging market investors and is reinforced by management consultants and business school pundits who declare that what took a decade for Japanese or Korean investors must now be achieved in a matter of a few years. Boldness is also in evidence in the scale of the acquisitions, such as when Tata Steel buy Corus, a firm three times larger.

If boldness were the only ownership advantage of emerging market investors, it would not bode well for their future. It might help win takeover battles, but the competitive war lasts far longer and calls for a different set of skills. Behind that boldness lies some traditional strengths and weaknesses, both of which help to push Indian and Chinese investors beyond their own national borders. These new investors are in effect exchanging improved access to emerging markets for greater access to developed markets and to western technologies. As these emerging markets grow as a share of world GDP, their bargaining power and hence their overseas expansion through ODI will continue to grow.

This exchange of market access and technologies is analytically similar to what occurs when western firms invest in China or India. The foreign investor provides a conduit for local goods to be exported to Europe and transfers technology to its local affiliate in exchange for greater access to the local market. Regardless of the direction of ownership, the potential for synergies between Indian and Chinese firms on the one hand and European ones on the other clearly exists. Both sides stand to gain.

China and India are already integrating rapidly with the European economy through trade and European ODI. The rise of Chinese and Indian investors in Europe will help to accelerate this process of integration by increasing the channels through which goods, services and technologies can flow.

Faced with the acquisitions of iconic western brands such as Rover or IBM by virtually unknown Chinese investors, it is easy to believe the hype that China and India are taking over the world economy, but Europe has been here before. *Le défi américain* in the 1960s and then Japanese investment in the 1980s spawned the same sort of hyperbole. In each case, the European economy ultimately emerged stronger; it is likely to do so again this time. That is not to minimise the political concerns surrounding issues of reciprocity, a lack of transparency, and national security, but these arise with trade as well. If anything, the rise of MNEs from emerging markets will make these issues more tractable in international fora because the new investors will have a greater stake in a liberal outcome.

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