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Dragons in the West: Localizations Strategies of Chinese Multinationals in Developed Economies

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Abstract

[Excerpt] According to the Bureau of Economic Analysis, Chinese foreign direct investment (FDI) in the U.S. increased more than three-fold - from $3.3 billion to $14 billion - between 2010 and 2015. This rapid rate of expansion was accomplished in a variety of ways. In many cases Chinese firms formed their own wholly-owned subsidiaries, but often they chose to merge with, acquire, or otherwise engage in formal alliances with U.S. counterparts. In 2015, for example, Chinese multinationals completed 103 mergers and acquisitions in this country, an increase of 30% over the previous year. Despite current political uncertainties, there is every reason to believe that the upward trend in Chinese FDI in the U.S. and, thus, in the frequency and intensity of both competitive and cooperative interactions and relationships between Chinese and American firms will continue in the years ahead. Thus, the more we can learn about the motives and methods of Chinese MNCs operating in the U.S., the better off we will be. Although these issues have generated some research, there clearly is more to learn. This study represents a solid step toward filling the gap.

Keywords

human resources, HR, Chinese Multinational Corporations, MNCs, multinational, economy, local talent, local strategy, globalization, firm ownership, localization strategy, liability of origin, liability of foreignness, China, Chinese, localization, foreign direct investment, FDI

Disciplines

Human Resources Management | International Business | Strategic Management Policy

Comments

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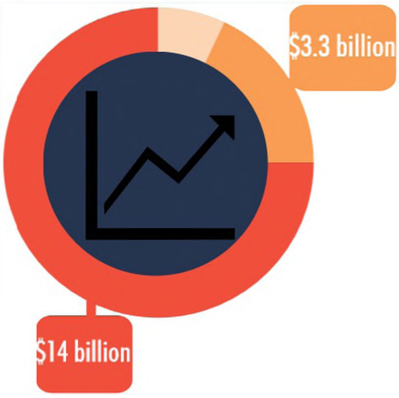
Key Findings



According to the Bureau of Economic Analysis, Chinese foreign direct investment (FDI) in the U.S. increased more than three-fold – from $3.3 billion to $14 billion – between 2010 and 2015. This rapid rate of expansion was accomplished in a variety of ways. In many cases Chinese firms formed their own wholly-owned subsidiaries, but often they chose to merge with, acquire, or otherwise engage in formal alliances with U.S. counterparts. In 2015, for example, Chinese multinationals completed 103 mergers and acquisitions in this country, an increase of 30% over the previous year. Despite current political uncertainties, there is every reason to believe that the upward trend in Chinese FDI in the U.S. and, thus, in the frequency and intensity of both competitive and cooperative interactions and relationships between Chinese and American firms will continue in the years ahead. Thus, the more we can learn about the motives and methods of Chinese MNCs operating in the U.S., the better off we will be. Although these issues have generated some research, there clearly is more to learn. This study represents a solid step toward filling the gap.

Chinese foreign direct investment (FDI) in the United States has increased more than three-fold -- from $3.3 billion to $14 billion -- between 2010 and 2015

- Bureau of Economic Analysis

"Think globally, act locally" is a well-known battle cry of environmentalists that applies as well to multinational corporations (MNCs) as they move into new markets. Invariably these firms encounter what have been called "liabilities of foreignness" stemming from unfamiliarity with local laws, customs, and norms. In addition, Chinese MNCs encounter unique issues that researchers have labelled "liabilities of origin"; that is, they often suffer from a generalized reputation as top notch producers of low-cost goods for foreign firms (Apple and the like), but not as creators and purveyors of their own high quality products and services (surveys show that 94% of Americans are unable to name even one Chinese brand). To help overcome these liabilities, the Chinese MNCs studied adopted two types of localization strategies:

* an internally-focused strategy in which local managers were granted extensive authority to adapt their firms' human resource policies and programs to bring them more in line with local practices and

* an externally-focused strategy involving efforts to network with outside stakeholders as a way of enhancing visibility and developing positive reputations among local companies, business associations, community leaders, universities, and government leaders.

This study provides data pertaining to the utilization of these two strategies, the effect of the strategies on firm growth, and the factors that influence the decision to emphasize one strategy over the other.

Among the Chinese MNCs studied:

1

Both internal and external localization strategies were employed with some frequency. On a 4 point scale, the mean score on the internal localization strategy was 2.90 (s.d. = .69), while the mean score on the external localization strategy was 1.99 (s.d. = .90). In general, then, local managers were granted a fair amount of autonomy in deciding HR issues, while they had a moderate degree of interaction with community stakeholders.

2. Both internal and external localization strategies were related to the rate of business growth (including increases in the number of employees, market share, and revenues). The relationship was stronger when the focus was on improving internal operations than when the emphasis was on enhancing external relations.

3. Choice of localization strategy was heavily influenced by firms' dominant business strategies. As the foregoing would suggest, the internal localizations strategy was favored by firms pursuing a market expansion strategy where the emphasis was on building market share and attaining and sustaining profitability. In contrast, the external localization strategy was more likely to be adopted by firms following an asset-seeking strategy aimed primarily at learning, and specifically at acquiring knowledge pertaining to brands, emerging markets, cutting-edge technologies, and potential acquisitions or business partners.

4. Choice of localization strategy was partially influenced by the extent to which firms faced regulatory oversight by U.S. government agencies. As expected, the external localization strategy was favored by firms that were under these types of strictures since it served as a means of mitigating or otherwise coping with them. Adoption of the internal localization strategy was not influenced by the presence of regulatory oversight.

5. Choice of localization strategy was somewhat influenced by the form of firm ownership (wholly or primarily owned by the Chinese government vs. primarily private ownership). Use of both internal and external localization strategies was somewhat less common in state-owned or controlled firms than in the other firms. In other words, the autonomy of local managers was to some extent constricted or constrained – particularly with respect to the management of human resources – when they were under the watchful eyes of government bureaucrats back home.

Specifics of the Study

Data for this study were gathered via a questionnaire sent to members of the China General Chamber of Commerce – U.S. (CGCC) which represents over 1,000 Chinese MNCs doing business here. Design of the questionnaire was a cooperative venture between the author and researchers at the CGCC. The survey was distributed by the CGCC in 2015. Two hundred questionnaires were mailed and 121 were returned, although the final sample was reduced to 82 (41%) after eliminating questionnaires with missing or incomplete information. The data were provided by the firms' CEOs or General Managers. In addition, interviews were conducted with executives and managers at 15 of the responding firms in an attempt to add context to the responses received.

The vast majority of the responding firms (83%) were wholly-owned subsidiaries of larger Chinese firms. The Chinese government had more than a 50% ownership share in 46 of the 82 firms in the final sample. On average, the responding firms had 12 years of experience operating in the U.S., although over half had entered the American market within the last seven years. Major industries represent in the sample included manufacturing (21 firms), finance and banking (12 firms), and energy (12 firms).

The Hypotheses and the Results

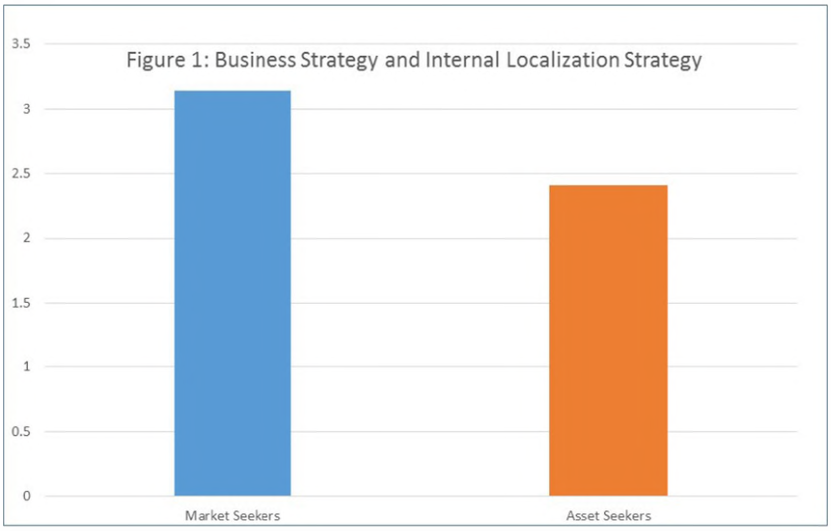
China, the world's largest developing nation, has taken the lead among Asian countries in the most recent round of global expansion. The rate of Chinese FDI in the U.S. is growing apace, for example, although all has not necessarily gone well for Chinese MNCs seeking to do business in America. Some of the stumbles have been attributable to the types of challenges encountered by all firms seeking to penetrate unfamiliar markets. These so-called liabilities of foreignness pertain to a general unfamiliarity with the way things are done. For example, the Agricultural Bank of China ran afoul of U.S. laws pertaining to money laundering and ultimately paid a $215 million fine for its transgressions. All MNCs encounter liabilities of foreignness. Somewhat unique to China, however, is another set of challenges referred to as liabilities of origin; that is, to roadblocks presented because of stereotypes pertaining to Chinese firms, including a generalized reputation for having low standards of corporate governance, engaging in product dumping and other forms of unfair competition, and spying. For instance, Huawei and ZTE, two top Chinese manufacturers of telecommunications equipment, were banned from acquiring U.S. companies and from doing business with the U.S. government because of security concerns.

It takes a lot of effort and resources for Chinese MNCs to overcome the liabilities of foreignness and, especially, origin. Thus, they put considerable effort into developing what are called localization strategies which are of two general types. Internal localization strategies are aimed at facilitating the adaptation to U.S. laws, customs, and norms and consist in large part of granting local (often U.S.) managers considerable discretion when it comes to aligning their practices – including human resource policies and programs – to fit the environments in which they are operating. External localization strategies, in turn, are managerial actions that are aimed at developing relationships with important outsiders including local companies, business associations, community leaders, universities, and government leaders. While it is expected that liabilities of foreignness and origin are both mitigated to some extent by internal and external localization strategies, it nonetheless seems reasonable to assume that specific factors come into play when firms choose to emphasize one of these strategies over the other.

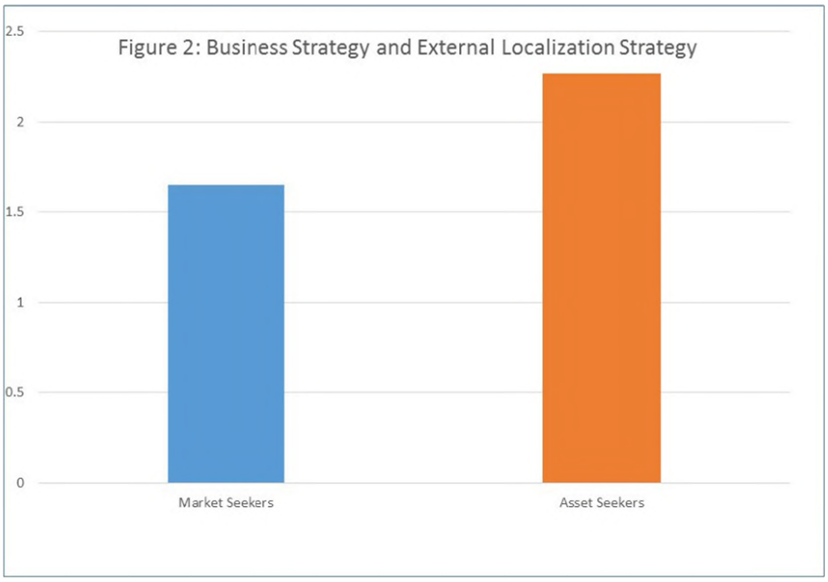
Thus, the primary purpose of this study was to provide insights into the factors that influence the choice of localization strategy. Specifically, the study focused on three major research questions.

Research Question 1:

To what extent do Chinese MNCs' primary business goals influence the choice of localization strategy? Previous research suggests that Chinese MNCs tend to pursue one of two rather distinct business goals in their U.S. operations. On the one hand, there are the so-called market-seekers; firms that are here mainly to grow market share and to make money. On the other hand there are those that are primarily asset-seekers; they come to the U.S. with the longer-term goal of acquiring knowledge about emerging markets, leading brands, cutting-edge technologies, and, eventually, firms they might acquire or partner with. It was expected that the market-seekers would favor the internal localization strategy since this approach is specifically aimed at improving company operations and, thus, enhancing short-term competitiveness in the marketplace. In contrast, it was anticipated that asset-seekers would favor the external localization strategy as a means of developing valuable networks to generate potentially useful business intelligence for later use.



As shown in Figures 1 and 2, the data partially supported these suppositions. Among market-seekers, the mean utilization rating of the internal localization strategy was 3.14, whereas among asset-seekers the comparable figure was 2.41. Among asset-seekers, the mean utilization rating for the external localization strategy was 2.27 while among the market-seekers it was only 1.65 (all figures in this and subsequent sections are on a 4-point scale).



Research Question 2:

To what extent are Chinese MNCs influenced by exposure to U.S. regulatory pressure when it comes to the choice of localization strategy? While all firms are subject to regulatory pressure to some degree, Chinese MNCs are particularly vulnerable in this respect primarily because of security concerns (a clear-cut liability of origin). One way to escape the closer scrutiny may be to foster a degree of perceptual distance between the MNCs back home and their operations in the U.S. by adopting the internal localization strategy. In this case, local operations would hire local managers and grant them considerable autonomy to function as much as possible like U.S. firms. This approach, however, may take some time to work. The other approach would be to tackle the issue directly by adopting the external localization strategy – using networking and even lobbying to demonstrate the desire to be law-abiding and otherwise good corporate citizens. Since this approach is more direct, it was expected that firms under the most regulatory scrutiny would gravitate in its direction. And they did. Among firms under strong regulatory pressure the mean utilization rate of the external localization strategy was 2.28; the comparable figure for firms under weak regulatory pressure was only 1.87.

An interview with the public relations manager of a Chinese bank in New York illustrates how this works. Despite a relatively short history of operations in the U.S., the bank wasted no time when it came to establishing strong business partnerships with several local firms. It also quickly became an active participant in influential industry associations while also establishing a solid social responsibility program as well as positive working relationships with local government officials. Accordingly, the bank was able to acquire a U.S. bank with operations in major metropolitan areas fairly early on, a relatively rare occurrence the time. Management has no doubt that its external localization strategy was instrumental in clearing the legal and cultural hurdles involved in the acquisition and thus speeding up the process.

Research Question 3:

3: To what extent are Chinese MNCs influenced by their form of ownership when it comes to the choice of localization strategy? As noted earlier, the Chinese government owned more than a 50% share of 46 of the 82 firms studied (56%). Research suggests that government controlled MNCs are more likely than privately held MNCs to maintain centralized control over their foreign operations. And the present study confirmed this tendency. Overall, state-owned firms were less likely than their privately held counterparts to utilize any type of localization strategy (i.e., to delegate authority to managers of their U.S. operations). There was no significant relationship between form of ownership and the utilization of the external localization strategy. But the relationship between form of ownership and the utilization of the internal localization strategy was negative and significant; for state owned firms the mean utilization rate was 2.63, while for privately held firms it was 3.14. That is, the Chinese MNCs that were state owned showed a particular proclivity for assuring that their far-flung enterprises did not stray from the party line when it came to the management of their human resources.

The So What

Clearly, Chinese MNCs operating in the U.S. face not only liabilities of foreignness but also liabilities of origin. This makes it particularly essential that they adopt localization strategies to help mitigate the particular challenges they face. Overall, the results of this study suggest that this works best when firms adopt a combination of internal and external localization strategies; that is, when they focus on adapting human resource activities to local customs and practices, as well as on networking with key players in their external environments. In terms of prioritizing, however, attention should be paid to both their business strategies and the extent to which they are subject to exposure to regulatory requirements.

So-called market-seekers (i.e., firms focusing on the pursuit of short-term growth and profitability) would do best to focus first on developing effective internal localization strategies to enhance the effectiveness of their in-house operations, whereas so-called asset-seekers (i.e., those in pursuit of longer-term knowledge accumulation for strategic purposes) would be better off taking the opposite tack. Firms operating in challenging regulatory environments naturally would gravitate toward the external localization strategy first, while those operating in more benign regulatory environments would initially adopt a more internal focus. The situation is particularly challenging for market-seekers in highly regulated industries since they have little choice but to tackle both types of localization strategies more or less simultaneously.

These imperatives pose a particular challenge for state owned enterprises that establish outposts in the U.S. specifically to grow market share and generate cash. In these cases, there may well be clashes between business objectives and cultural imperatives; that is, between the need to localize internal operations and the reluctance to hire local managers and give them the authority they need to adapt to local conditions. Thus, the choice may well come down to either subsidizing the local operations or easing up on the centralized controls – or otherwise satisficing with some type of compromise.

Of course, care must be exercised in drawing conclusions from this study since it is based on a relatively small sample of Chinese MNCs selected from a population that does not include all such firms operating in the U.S. And it is important to keep in mind that the study focused only on Chinese MNCs

and thus the findings may well not apply to MNCs from other countries, especially those with less powerful central governments. Clearly further studies are in order. One useful approach would be to expand the sample of Chinese MNCs involved to test the veracity of the results obtained in the present study. Another would be to branch out to MNCs from other countries, particularly those with less powerful central governments, in the interest of greater generalizability. It also would help to have more data pertaining to the relationship between firm performance and the nature of MNCs various localization strategies.

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