DOWJONES

Overcoming liability of foreignness

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A growing number of Chinese and Indian firms have become sufficiently competitive to become important players in the global market for foreign direct investment (FDI).

Their FDI outflows have risen substantially during the past decade. Even during the recent economic crisis, when world FDI outflows dropped by 50 percent, China's outflows did not decline. In fact, in 2010, Chinese mainland's $68 billion of FDI outflows (more than the average world FDI flows during the first half of the 1980s) made it the world's fourth largest outward investor.

India's OFDI flows have also grown, but, with $13 billion, are far below China's, and they were negatively affected and delayed by the crisis.

Firms from both countries are now established in many developed and developing countries and in a wide range of sectors. Like their counterparts in developed countries, they increasingly prefer mergers and acquisitions (M&As) as their entry mode - often their investments follow the companies' trade destinations - and the economic performance of their home countries will continue to propel their international expansion.

But there are also differences. While both countries began to liberalize their outward FDI regimes some two decades ago, China has gone further. Since 2000, it has pursued an active "going global" policy to support the internationalization of its firms, and it has flanked these national policies with an active program of concluding bilateral investment treaties to protect the assets of the country's investors abroad and to facilitate their operations.

China has recognized more than India that its firms need to acquire a portfolio of locational assets to increase their international competitiveness and that the government needs to support Chinese firms competing with firms from developed countries, as these have had a head start and also benefit from a range of supporting policies of their home countries.

Moreover, while all multinational enterprises (MNEs), regardless of which country they hail from, need to overcome the "liability of foreignness" - foreigners operating in a foreign country - this challenge is greater for Chinese firms. They lack the deep entrepreneurial experience of their Indian counterparts, and they have to overcome a greater regulatory and institutional gap, especially when establishing themselves in the highly sophisticated legal environments of developed countries. On a more mundane level, Indian managers have the advantage of operating in English, while Chinese managers, especially older ones, typically still need to learn the lingua franca of international business.

Moreover, while MNEs from both countries need to be accepted as serious and equal players and have to overcome the difficulties of being the "new kids on the block", Chinese firms also have to overcome the "liability" of their home country. This particular challenge includes the fact that most of China's important outward investors are State-owned enterprises (SOEs); hence their interests are regarded by some as indistinguishable from those of China. On the other hand, India's outward investment is being driven by private enterprises seemingly pursuing only commercial objectives.

FDI by SOEs, and for that matter, by sovereign wealth funds, another vehicle of sovereign FDI, raises suspicion and has led to legislation that is arguably discriminatory, although there is no systematic evidence that State-owned MNEs - be they from China, India, Germany or the UK - behave differently from privately owned MNEs. As a rule, they do what is best for their own international competitiveness, which is typically also in the interest of their home countries. Still, Chinese SOEs face higher regulatory entry barriers, at least in those jurisdictions that screen M&As. For example, the percentage of notifications by Chinese firms to the Committee on Foreign Investment in the United States (about 4 percent) has been, at least during 2007-2009, considerably higher than China's share in US FDI inflows (0.1 percent).

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There is a consensus that FDI can make an important contribution to economic growth and development in both emerging markets and developed countries. Among other things, such investment involves employment, training, taxes, technology, and access to markets. This contribution is independent from the nature of ownership of the investing firm.

Chinese and Indian MNEs have become important outward investors and, despite their differences, their importance is bound to increase. They all need to be accepted in a non-discriminatory manner as increasingly important players in the world FDI market.

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