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China needs to complement its "going-out" policy with a "going-in" strategy

by
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China's rising outward foreign direct investment (OFDI) faces rising skepticism abroad. This is partly the result of the leading role of state-owned enterprises in her OFDI (and the fear that it serves non-commercial purposes), the speed with which this investment has grown, the negative image of the home country in some quarters, and the challenges it poses to established competitors. Moreover, Chinese multinational enterprises (MNEs) may not always keep in mind that host countries see FDI as a tool to advance their own development and hence seek maximum benefits from it.

To assuage skeptics, avoid backlash and, ultimately, build trust, China needs to complement its relatively well-established "going-out" policy with a purposeful "going-in" strategy that guides the investments of her firms to ensure that FDI projects maximize contributions to host countries' economic, environmental and social development, and take place within fair governance mechanisms. This serves the interests of both host countries and China.

First, a "going-in" strategy should *reinforce* China's current regulatory OFDI framework. It already addresses many host country issues, including economic, environment, corruption, and labor concerns. However, regulations are typically couched in general language and broad principles, and do not require Chinese investors to comply with clearly defined provisions. Out of over 20 environmental and social instruments on OFDI,[1] only a handful foresees specific penalties. China should reinforce its regulatory instruments by clearly specifying penalties for the violation of any of these instruments.

Second, a "going-in" strategy should *expand* current efforts. The government could learn from the OECD Guidelines for MNEs (or even adhere to them) by, for example, requiring that Chinese MNEs meet disclosure standards and human rights requirements.

Beyond that, China's government could guide and assist her firms in *entering, operating and prospering* in foreign markets. Many Chinese firms face special scrutiny in some jurisdictions, particularly when *entering* markets via mergers and acquisitions (M&As). In response, large M&As must be carefully prepared by taking into account the interests of affected stakeholders. Understanding how to navigate the corridors of power in host countries is important, as is coalition-building with local authorities, potential suppliers, etc. Be it M&As or greenfield projects, in-depth knowledge of a host country's regulatory regime and business practices is required. The government's "guidebooks"[2] are helpful here, but less experienced managers require special training.

To *operate and prosper* successfully in a host country, Chinese firms need to overcome the liability of foreignness—and, in some countries, the additional liability of being Chinese. They need to integrate tightly into local communities, become insiders and build a positive brand. This involves extra efforts in sourcing inputs from local firms (giving them a stake in the success of Chinese investors), hiring and training local employees, learning the local language (or at least English), respecting local customs, becoming members of local organizations, and employing corporate social responsibility (CSR) practices.

Third, the effectiveness of any "going-in" strategy requires that the government better *monitor* and *enforce* its regulations and guidance, especially for large-scale projects. A dedicated compliance unit in the appropriate ministry could do this (assisted by China's embassies/consulates), including through on-the-ground inspections. Enforcement could involve both incentives and penalties. On the incentive side, compliance with economic, environmental and socially sustainable FDI practices could become a prerequisite for the approval of OFDI projects and, indeed, a requirement (as in the case of some countries) for obtaining any of the advantages that the government makes available to outward investors.[3] Penalties could include fines, exclusion from doing business with the government and rescindment of the Certificate of Investment Overseas, as well as criminal penalties for, say, corrupt practices overseas.

Such a strategy could be underpinned by two other initiatives to build trust.

One, China's government could require that a small percentage of parent firms' earnings be dedicated to foreign affiliates undertaking clearly defined CSR activities in host countries (monitored by a board-level CSR committee),[4] creating the financial and corporate governance basis for sustainable FDI.

Two, many of China's OFDI projects are large and require extensive contractual negotiations with host countries to define the projects' economic, environmental and social dimensions. Typically, least-developing countries' governments do not have the capacity to negotiate such contracts appropriately. China could take the lead in establishing a global negotiations support facility that provides assistance to host countries in these situations.[5] China would thereby not only contribute greatly to the development of countries hosting large FDI projects, be it from Chinese or other MNEs, but also improve the stability of the contracts concluded, which is in China's interest.

A "going-in" strategy by China along these lines could become a model for other home countries, whether they are developed or developing.

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[1] *See* http://fec.mofcom.gov.cn/article/zcfg/zcfb/dwtz/201303/1741680_1.html; http://www.gov.cn/gzdt/2009-06/01/content_1329230.htm; http://www.caep.org.cn/book/中国对外投资中的环境保护政策.pdf; http://www.eximbank.gov.cn/tm/medialist/index_23_14365.html; http://www.eximbank.gov.cn/tm/medialist/index_23_14367.html; http://www.cbrc.gov.cn/EngdocView.do?docID=3CE646AB629B46B9B533B1D8D9FF8C4A; http://www.syntao.com/Uploads/file/Public-Consultation_Draft_Guideline_Chinese.pdf.

[2] *See* http://fec.mofcom.gov.cn/gbzn/gobiezhinan.shtml.

[3] *See* Karl P. Sauvant and Victor Zitian Chen, "China's regulatory framework for outward foreign direct investment," *China Economic Journal,* 7(1) (February 2014), pp. 141-163.

[4] A variation of what India's Companies Act 2013 mandates. *See* http://indiacode.nic.in/acts-in-pdf/182013.pdf.

[5] For a concept paper, see Humboldt-Viadrina School of Governance, "Establishing a negotiations support facility," available at http://www.humboldt-viadrina.org/eng/research/current-research-areas/negotiation-support-initiative/.

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