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Outward FDI from Developing Countries: A Case of Chinese Firms in South Africa

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Abstract: Outward foreign direct investment (FDI) from developing countries is increasing. In the research on FDI, it has been considered that only competitive and productive firms can invest in foreign countries. However, since the differences in competitiveness and productivity between multinational enterprises (MNEs) from developed and developing countries have not been explicitly investigated, we cannot say whether MNEs from developing countries can or cannot survive in competition with MNEs from developed countries as well as against competitive and productive indigenous firms in host countries. To examine the activities of MNEs from developing countries, this study investigates Chinese firms in South Africa. It reveals that in order to compensate for the weak brand recognition of Chinese products and to expand sales, Chinese firms have mainly been making products that are sold under the brand names of indigenous South African firms. Chinese firms have expanded their business in South Africa relying on the business resources of indigenous firms in the host country. This indicates that business with indigenous firms is significant for MNEs from developing countries in boosting competitiveness.

Keywords: foreign direct investment (FDI); multinational enterprise (MNE); China; South Africa

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1. Introduction

Outward foreign direct investment (FDI) from developing countries is increasing.[1] According to UNCTAD (2001; 2012), the ratio of outward FDI from developing countries to total outward FDI in the world was just 8.7% in 2000, but rose to 26.9% in 2011. In the course of only a decade, investors of FDI have gone from being almost exclusively from developed countries to a sizable number now being from developing countries. This has made it all the more important to understand the characteristics of outward FDI from developing countries.

Among developing countries, China has become a major outward investor. According to a UN report (UNCTAD, 2012), the ratio of outward FDI from China to that from all of the developing countries was 17.0% in 2011. China's manufacturing industry developed rapidly starting from the 1980s, and since the mid-1990s Chinese firms have had to find further growth factors, such as expanding sales in overseas emerging markets, developing natural resources, and enhancing their research and development (R&D) capabilities. Consequently they began to establish sales offices and factories in foreign countries to acquire a presence in overseas markets; they formed joint ventures with indigenous mining firms in host countries to get natural resources, and set up laboratories in developed countries to increase their R&D capabilities.[2, 3] To encourage the outward FDI of Chinese firms, the Chinese government has been implementing a "Going out" (*Zouchuqu*) policy since the late 1990s. This study focuses on China's outward FDI for expanding sales in order to investigate how Chinese firms try to realize further growth amidst the fierce competition in the global market.

Research on outward FDI has mainly investigated the determinants of this type of FDI. One of the main propositions in this research is that only competitive and productive firms can invest in foreign countries and become multinational enterprises (MNEs) (Dunning and Lundan, 2008; Helpman et al., 2004; Antràs and Helpman, 2004).[4] The reason is that outward FDI has both advantages and disadvantages for

[1] The definition of FDI is investment having a controlling interest in an investment-grade firm, which in essence means acquiring more than 10% of voting common stock.
[2] The objectives of outward FDI by indigenous Chinese firms have been investigated by, among others, Ohashi (2003), Zhang (2009) and Buckley et al. (2007).
[3] Jiang (2011) examined outward FDI to accumulate technological capabilities in his case study of Huawei, a Chinese global telecommunication equipment manufacturer.
[4] Dunning and Lundan (2008) show that the OLI framework is the determinant of outward FDI. "OLI" combines the initials of "Ownership," "Location" and "Internalization" advantages. The ownership advantage means that investors must have competitiveness, such as technology,

investing firms. Although investors can increase sales in host countries, at the same time they must bear additional costs in order to sell products in wholly unfamiliar markets. To put it more precisely, they must overcome the cost and time needed to learn about consumers' tastes and about the information and practices of businesses in host countries. Therefore, MNEs must be competitive and productive to bear the additional costs.[5]

From this reason we can say that MNEs are champions in their own home countries in comparison with non-investors in the same countries. However, it cannot necessarily be said that every MNE is similarly competitive and productive in a host country. In particular, it is strongly expected that champions from developing countries are not as competitive and productive as those from developed countries and, in some cases, those in host countries. Since the main proposition in the research is on outward FDI, it tells us only the determinant of outward FDI from a country, not the feasibility or potential of outward FDI from developing countries to foreign ones, therefore we need to find the condition where MNEs from developing countries can survive in competition with more competitive and productive MNEs from developed countries as well as against indigenous firms in host countries.[6]

To find the condition, this study examines Chinese manufacturers of television sets in South Africa (SA), because they are a typical example of MNEs from developing countries. Chinese TV-set manufacturers use low-wage workers and make cost-competitive products. But while their assembling capabilities have developed to a high degree, they have not accumulated a similar level of capabilities in R&D.[7] In the 1990s as competition tightened in the Chinese market, some Chinese manufacturers begun to export and invest in overseas markets. At that time, Chinese manufacturers began targeting the SA market as a place to invest for the following reasons One was

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management know-how and trademarks. The location advantage means that host countries must have advantages like low wages, raw materials and high tariff rates. The internalization advantage means that investors themselves have a rationality for investing because of some tacit knowledge and/or trade secret(s). In this study, the ownership advantage is regarded as the competitiveness of investors. Helpman et al. (2004) and Antràs and Helpman (2004) show that productive firms tend to invest and export. Their studies focused on heterogeneity among firms and showed that the most productive firms are investors, followed by exporters, then firms focusing only on domestic markets.

5 A great number of empirical studies show that the productivity of investors is higher than that of non-investors.

6 Yuan (2011) is one of the few studies focusing on competition between MNEs from developing countries and firms in host countries.

7 The average productivity of indigenous firms in the electrical and electronics industry in China is lower than for MNEs (Kimura, 2012a).

that the SA market had begun to grow rapidly after the end of apartheid in the early 1990s.[8] The SA government was democratized and it eliminated racial discrimination; as a result, the income of black people rose, and many foreign firms, including ones from China, decided to enter the market and capture some of the growth. A second reason was that SA and China started to have economic exchanges in the early 1990s. The two countries did not have diplomatic relations because the Chinese Communist Party had relations with the African National Congress, led by Nelson Mandela, that opposed SA's white government. After the transition to black leadership and democratization, the two countries started to have economic transactions, and they established diplomatic ties in 1998. The change opened the way for Chinese firms to export to SA and invest in the country.

Chinese manufacturers in SA are not as competitive and productive as MNEs from developed countries and indigenous SA firms. To compensate for their weakness, they have been producing and selling products under the brand names of indigenous SA firms. They do not have the power of brand recognition nor the R&D capabilities to differentiate their products; therefore they have depended on the brand recognition and sales channels of indigenous SA firms to expand sales. We will investigate the strategies of Chinese MNEs as an example for such firms from developing countries and seek to determine the condition for their survival amidst the competition in foreign markets.

This article is organized as follows. Section 2 gives and overview of Chinese firms in SA and their tariff-jumping investment. Section 3 looks at the business methods of Chinese manufactures in SA. The final section sets out this study's conclusions.

2. Chinese Firms in SA and Tariff-jumping Investment

2.1. Overview of Chinese Firms in SA

Soon after economic exchanges began taking place between China and SA in the early 1990s, some Chinese firms took the opportunity to move into SA and built factories in order to expand sales. Table 1 shows the Chinese companies that have invested in SA's home appliance manufacturing industry. The first investor was the SVA Group (SVA).

[8] The SA market has continued to grow in the 2000s with the boom in natural resource. The country is included among the emerging countries known as the "BRICS."

SVA is one of Shanghai's state-owned enterprise (SOE). It set up operations in SA in 1993 and as a major Chinese manufacturer, has produced TV sets, flat panel displays (FPD) for TVs, and various home-appliance and consumer-electronics products. However, SVA suffered financial difficulties and was taken over in 2009 as part of the Shanghai Yidian Holding (Group), which is also a Shanghai SOE, to rebuild it business. The company was reorganized as SVA Electronics (Pty) Ltd., and a factory was built near Johannesburg in 1993 to produce black and white (B&W) cathode-ray tube (CRT) TV sets (*Lingdao Xinxi Juece*, No. 26, 2008). The company produces white goods (appliances such as refrigerators and washing machines) and black goods, such as TV sets. They employ 500 workers at the factory (interview in Beijing with an official in the Ministry of Commerce of the People's Republic of China on June 25, 2010).

Table 1 Chinese Home Appliance Manufacturers in SA

Name	Headquarters	Entry year	Mode	Products	Remarks
SVA	SOE of Shanghai	1993	Local production (1993–present)	White goods (e.g., refrigerators, washing machines), TV sets and other electronic products	500 workers
Hisense	SOE of Qingdao, Shandong	1993	Export → Local production (1997–present)	TV sets and other electronic products	Purchased the SA factory of Daewoo (S. Korea) in 2000
XOCECO	SOE of Xiamen, Fujian	1998	Local production (?–present)	TV sets, DVD players and other electronic products	130 workers

Sources: Interviews with: officials in the Ministry of Commerce of the People's Republic of China in Beijing (June 25, 2010); employee at Konka company in Shenzhen, China (December 2, 2010); Professor S. Gelb in Johannesburg, SA (University of Johannessburg) (September 5, 2011); employee of HiFi Corp in Johannesburg, SA (September 10, 2010; Sep. 9, 2011); employee of Hisense in Qingdao, China (October 28, 2011). Also Gelb (2010) and other literature.

The second Chinese investor was the Hisense Group (Hisense). Hisense is an SOE belonging to Qingdao in Shangdong. Its predecessor was established in 1969 as a company producing radios. They expanded their product lineup into home appliances and consumer electronics, especially from the 1980s, and have become a major manufacturer. In the course of its rapid development, the company entered SA in 1993. It first chose to export its home appliances from China to SA in order to evaluate the potential of the SA market. Confident of the potential for growth, the company set up the Hisense S.A. Development Enterprise (Pty) Ltd. along with a factory near Johannesburg in 1997. It produces mainly TV sets.

The third investor was Xiamen Overseas Chinese Electronic Co. (XOCECO). Although they were a SOE of Xiamen, Fujian, a Taiwanese firm is the biggest shareholder at present. They were established in 1985. As a major manufacturer and exporter of TV sets, they have been developing rapidly. They established Sinoprima Investment & Manufacturing S. A. (PTY) LTD. near Johannesburg in 1998 to expand sales in SA.[9] Although the year when they started local production in SA is not known, they have a factory for now at least. They have produced TV sets and DVD players, etc. They are employing 130 workers (interview with Ministry of Commerce of People's Republic of China in Beijing, China, on June 25, 2010).

As mentioned above, these three investors are major Chinese manufacturers, meaning they are champions in China. Table 2 shows an abbreviated list of the top 100 firms in China's home appliance and information and communication technology (ICT) industries in 2011. The 100 firms were ranked by the Ministry of Industry and Information Technology (MIIT) according to a comprehensive evaluation that included sales, profits and R&D expenditures. SVA, Hisense and XOCECO are ranked nos. 32, 6 and 84, respectively.

[9] "Prima" in "Sinoprima" is the company's brand name that it uses in markets other than in SA; in SA it goes by the brand name "Sinotec".

Table 2 The Top 100 Firms in China’s Home Appliance and ICT Industry, 2011 (abbreviated)

Rank	Name
1	**Huawei**
2	**Lenovo**
3	Haier
4	Great Wall Technology
5	ZTE
6	**Hisense**
7	Changhong
8	**TCL**
9	Founder
10	BYD
11	Panda
12	Jinglong
13	Inspur
14	Skyworth-RGB
15	Tongfang
16	Alcatel-Lucent
17	**Konka**
⋮	
32	**SVA**
⋮	
84	**XOCECO**
⋮	

Source: Ministry of Industry and Information Technology (MIIT).

In addition to these three investors, other firms are also doing business in SA to expand sales. For example, Huawei, a global telecommunication equipment provider, is selling telecommunication equipment mainly to telecommunication carriers in SA. It has sales offices and technical centers in SA (interview with a Huawei employee in Johannesburg, SA, on September 10, 2010). Lenovo, a global personal computer (PC) maker, is selling PCs in the SA market. Konka is exporting TV components to Tedelex, an indigenous SA manufacturer. Also, TCL was exporting TV components to an indigenous SA manufacturer during the 2000s, but it is not known whether it is still doing such exporting. Konaka and TCL are also major home appliance and consumer electronics manufacturers. From the above discussion it can be seen that a number of Chinese firms have entered SA to expand sales in its growing market.

2.2. Tariff-jumping Investment

The reason VSA, XOCECO and Hisense established factories in SA is because the country's import tariffs on TV sets are very high. Table 3 shows the tariff rates of TV sets (finished products). When firms in countries other than the European Union (EU), the European Free Trade Area (EFTA) and the Southern African Development Community (SADC) export TVs to SA, an import tariff of 25% is levied on finished products. TV sets are primarily classified as CRT, FPD and B&W CRT types (their respective classification codes are 8528.72.20, 8528.72.90 and 8528.73.20).[10] On the other hand, TV set components can be imported almost duty free. Consequently, firms mainly import components and assemble them in SA.

Table 3 SA's Import Tariff Rates, 2011 (%)

Classification code	Item	Tariff rate General	EU	EFTA	SADC
8528.7	TV				
8528.72	Color				
8528.72.20	CRT	25	3.25	13	free
8528.72.40	Other, with a screen with no side exceeding 45 cm	free	free	free	free
8528.72.50	Other, with a screen size exceeding 3 m x 4 m	free	free	free	free
8528.72.90	Other	25	3.25	13	free
8528.73	B&W				
8528.73.20	CRT	25	3.25	13	free
8528.73.40	Other, with a screen with no side exceeding 45 cm	free	free	free	free
8528.73.50	Other, with a screen size exceeding 3 m x 4 m	free	free	free	free
8528.73.90	Other	25	3.25	13	free

Source: South African Revenue Service (http://www.sars.gov.za/).

By putting high import tariffs on TV sets, the SA government has caused firms to establish factories in the country. However, although this protectionist policy has promoted local production, it has led investors to set up factories that simply assemble components, known as semi-knockdown (SKD) production.[11] SKD production is

[10] TVs that are not categorized as "ordinary" TV sets are exempt from import tariffs. These include very small TVs, those having a screen with no side exceeding 45 cm, or very large ones, those having a screen size exceeding 3 m x 4 m. Moreover, all black and white TV sets are made using CRTs.

[11] By comparison, complete-knockdown (CKD) production is defined as the assembling of various components and printed-circuit boards (PCBs) that are not mounted semiconductor parts. Therefore firms need to mount semiconductor parts on the surface of PCBs (interview with an employee at Sony South Africa in Johannesburg, SA, on September 8, 2011).

defined as the assembling of various components and printed-circuit boards (PCBs) that are mounted semiconductor parts. This production takes place because the SA component industry has not developed, a big reason being that while TV sets imported as finished goods carry high tariff rates, parts and components can be imported almost duty free. As a result, such production does not employ many workers. The SVA and XOCECO factories in SA employ only 500 and 130 workers respectively, as shown in Table 1.

SKD production is not limited to Chinese firms. Samsung, LG and Sony also just do assembling in SA. A vicious circle exists because of SA's underdeveloped component industry, and thus far the government has had no success in nurturing the TV-set industry including the manufacturing of TV components. The government has begun efforts to change the scope of import tariffs to try to make manufacturers switch to CKD production. But SKD production has continued in SA because firms have been able to import TV components practically duty free (interviews with employees at Konka in Shenzhen, China, on December 2, 2010, and at Sony South Africa in Johannesburg, SA, on September 8, 2011). Therefore we will have to see how the SA government adjusts its tariff and trade policies and what effect that will have on the development of the country's home appliance industry.

3. Investors' Operations in SA

Although the three Chinese investors examined in this study are champions in China whose products are well-known in that country, they have been confronted in SA with the problem of weak brand recognition. This has been a problem for Chinese firms generally in overseas markets. They still lack sufficient R&D capability to differentiate their products and build brand recognition when compared with global champions from developed countries and with indigenous champions in home markets.[12] Therefore they

[12] An issue for Chinese home appliance manufacturers in SA is that were they to expand local production, they would lose their cost competitiveness. The monthly wage for a worker in Shenzhen, China, is 317 USD, but that in Johannesburg, SA, is 2,938 USD (from JETRO's website [http://www.jetro.go.jp/world/search/cost/] accessed on January 29, 2013). By just conducting KD production with components imported duty-free, they do not lose their price competitiveness. This issue would apply to Chinese manufacturers conducting local production in other foreign countries. Thus for Chinese firms, their cost competitiveness cannot be

have generally bought key components from outside firms. The companies can sell their products under their own brand names in China where they have brand recognition. But when they export their products, more often than not these are sold under the brand names of indigenous firms. The products that they sell under their own brand names are mainly low-end ones.

To compensate for this brand weakness, the three investors carry on original equipment manufacturing (OEM) along with selling their own brands. OEM is the manufacturing of products for another firm and sold under the buyer's brand name. For the Chinese firms operating in SA, the buyers can be divided into two groups: indigenous SA manufacturers with their own brands and large indigenous SA retail chains that have their own private brands (PBs). The former includes such companies as Defy, Tedelex and AMAP. Although they are not well known in the global market, they are firms trusted by SA consumers. The latter group includes Pick n Pay and game. These two retail chains have their own PBs, AIM and LOGIC, respectively. Both have their own large sales channels throughout SA, therefore the Chinese investors can sell a lot of products through them. The buyers also have the advantage of being able to buy low-end products that allow them to expand their product lineup. This is very important for targeting the growing market of black people. Through OEM the three Chinese investors have been able to expand sales in SA despite their brand weakness.

Table 4 shows the OEM business in SA of the three Chinese investors that the author was able to verify. SVA makes products for Defy and Pick n Pay. Defy is a well-known white-goods manufacturer in SA, and the products that SVA makes for the company are sold under the brand name Defy. Pick n Pay is one of SA's large retail chains, and SVA's products are sold under its PB, AIM. Hisense used to make products for a manufacturer using the "Sansui" brand name, however this Chinese investor conducted no OEM business in 2011 (interview with a Hisense employee in Qingdao, China, on October 28, 2011). XOCECO has been making products for the large retail chain, game which sells them under its PB, LOGIC. In this way, the three investors have been doing business in their own brands together with OEM production with indigenous SA firms.

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separated from the low wages in China.

Table 4 OEM Business of the Chinese Investors

Name	Buyer	Remarks
SVA	Defy (manufacturer), Pick n Pay (retailer)	No OEM business in 2011
Hisense	A manufacturer using "Sansui" brand name	
XOCECO	game (retailer)	

Sources: The same as Table 1.

Along with the OEM business, Chinese firms have been involved in supplying components. This has been another way that Chinese firms have been able to maintain their operations and expand sales in SA.[13] TCL and Konka (both listed in Table 2) export TV components to SA manufacturers. Finished products containing these components are sold under the SA manufacturers' brand names. In the early 2000s, Konka sold CRT TVs under its own brand in the SA market; however at present the company is only a component supplier.

As indicated in the above discussion, the share of the SA market for Chinese firms under their own brand names is small, but their "production share" by firm is much larger. In 2011 the market share by brand name in SA was as follows. For CRT TVs, 40% of the sets were sold by LG and Samsung (South Korea). As in other overseas markets, these two Korean firms account for a large share. The remainder is shared by Telefunken (SA), Hisense, Tedelex (SA), XOCECO and retailer PBs (SA). In the LCD TV market, 70% is held by Samsung, LG and Sony (Japan). The remainder is shared by XOCECO, Hisense, Telefunken and retailer PBs. In the CRT and LCD TV markets, Hisense and XOCECO have approximately 10% shares in the CRT and LCD TV markets. In the white-goods market (e.g., refrigerators, washing machines) indigenous manufacturers, notably Defy and KIC, dominate. This is because white goods are close to the daily lives of local consumers, and products designed by indigenous firms sell well. Two of the three Chinese investors have only a small share of the SA market; SVA has none at all. However, through their OEM business, they

[13] There has been a case where a Chinese firm acquired by a European company entered the SA market under a European brand name (Kimura, 2012b). Thus although Chinese firms generally do not have powerful brand names, there are various ways to compensate for this problem and enter overseas markets.

make parts and components for the white goods sold by Tedelex, Defy and retailer PBs.

The degree of dependence on the OEM business differs among the three investors. SVA once emphasized business in its own brand but now depends on its OEM business. XOCECO is putting equal emphasis on both businesses, while Hisense's emphasis is on expanding its own brand, although it also does some OEM business. The differing approaches of the three companies need further investigation; however it appears that expanding business in their own brands will be essential for the further growth of the three Chinese investors. From Hisense's experience in SA, the OEM business has both advantages and disadvantages; therefore firms have to balance the business in their own brands with that in OEM (interview with an employee of Hisense in Qingdao, China, on October 28, 2011). Although the OEM business provides the investors with opportunities to expand sales, it has disadvantages. Their sales fluctuate with those of the buyers, and their margins are low. Since OEM sales depend on the performances of the buyers, it is difficult for the Chinese firms to maintain the stable expansion of their business. Moreover, the investors' dependence on the brands and sales channels of the buyers weakens their bargaining power to control prices and improve profits. For these reasons, Hisense is trying to promote its own brand and not depend on the OEM business.

4. Conclusion

This study investigated the behavior of MNEs from developing countries through an examination of Chinese TV-set manufacturers in SA. MNEs from developing countries have difficulty competing with MNEs from developed countries and with indigenous firms in host countries largely because MNEs from developing countries do not have strong brand recognition. Previous studies on the determinants of outward FDI have shown that competitiveness and productivity among firms in the same home countries are decisive for investing in foreign markets.

However, although weaker in competitiveness and productivity, MNEs from developing countries can invest and perpetuate their business overseas. As shown in the case of Chinese firms in SA, they can overcome deficiencies in competitiveness and expand sales by dealing with indigenous manufacturers and distributors who have their own strong brands and sales channels.

This indicates that relations with indigenous firms in host countries are more important for MNEs from developing countries than for those from developed countries. While such relations are needed by MNEs from developed countries, because every MNE has to bear the additional costs that come with entering unfamiliar markets, these relations are particularly important for MNEs from developing countries, because along with overcoming the additional costs, these relations help them compete against champions from developed countries and indigenous champions in host countries. MNEs from developing countries, unlike those from developed countries, need to do business with indigenous firms in order to overcome the disadvantages of weak brand recognition and R&D capabilities that come with being MNEs from developing countries.

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