Strategic Motivation of Foreign Direct Investment of Malaysian Investors in China

Abstract

This paper examines the underlying motives of foreign direct investment from Malaysia to China. Adopting a qualitative approach in this exploratory research, purposes and patterns of FDI of Malaysian firms can be explained by employing Dunning's OLI paradigm and the concept of asset seeking. Our in-depth interviews reveal that Malaysian firms tend to take a conservative approach to internationalization strategy that involves FDI. Most of the firms invest in China following invitation from long-time clients as a result of strong customer relationship building. These firms possess ownership advantages such as managerial skills that enable timely delivery of products, consistent quality, and efficient resource allocation and management. These advantages are strategically matched with locational advantages to benefit Malaysian investors which are resource and efficiency seekers in China. They operate in close proximity to their clients so as to provide support and hence are located in areas with locational advantages such as cluster industry with skilled/cheap labors and SEZ that provides various governmental incentives. A small number of the firms ventured to China as market seekers. Most of the Malaysian firms interviewed believe they have ownership advantages such as managerial and leadership skills that place their operation in China in a strategic and superior position in China. It is found that institutional theory is useful in explaining investment behaviours of Malaysian investors in China. Future research should consider employing institutional theory in understanding investment behaviours.

INTRODUCTION

For the past three decades, many international corporations are exploring their business opportunities in China as a result of the economic reform in 1979 (Morrison, 2009). Since then, there is an influx of foreign direct investment (FDI) into China market. FDI inflows to China peaked at over US$45 billion a year in 1997-1998 ("Foreign Dircet Investment", 2008). The surge in FDI is more significant after China joined the World Trade Organisation in 2001(Sinchew online, Apr 11, 2008). As a result, China becomes one of the world's largest destinations of FDI (Morrison, 2009). The recent global financial crisis, however, had resulted to the fall of inflow FDI in China for eight straight months (The Star online, June 14, 2009). Nevertheless, China is still considered as the top destination of investment for many companies (The Star online, June 14, 2009). Besides Hong Kong, which now part of China, the majority of the FDI in China are from the Asian countries, such as Singapore, Japan, South Korea and other Asian developing countries (Zhang, 2001; Gao; 2005).

Malaysian companies' investment in China has also increased significantly from 1980s to 2000s due to China's economic reform and the closer diplomatic ties between the two countries. According to China official data, Malaysia FDI in China had increased from USD202.88 million in year 2000 to USD393.48 in year 2006 (China Statistic Yearbook). China market is attractive to many investors due to its huge market size (e.g. Chen, 1996; Zhao & Zhu, 2000; Zhang, 2001) and cheap resources (e.g. Zhang & Yuk, 1998; Zhao & Zhu, 2000). Nevertheless, China market today is becoming much more competitive then before due to the increase number of multinational firms as well as the rise of local market leaders (Child, 2009).

Nevertheless, China is also a country rife with unpredictability and uncertainties, following an initiation of major reforms of industry and business environment in the mid 1980s. International corporations have explored their business opportunities in China during the last two decades. Both successful joint ventures and failed investments were reported with mixed feelings and evaluations (Miller, Glen, Jaspersen, and Karmokolias, 1997).

Much of the past research has been investigated on the character of inward FDI to China following the accession of China to World Trade Organisation in 2001 that promise to bring about more opening of various industries (Child and Lu, 1996; Wei and Liu, 2001). There have been studies into the FDI effect on the domestic economy in term of growth (Buckley, Clegg, Wang and Cross, 2002) and productivity (Liu, Parker, Vaidya and Wei, 2000). Some researchers examined the implications of China's accession to the WTO

(Martin and Fukase, 2000) whilst others administered comparative analyses between China and ASEAN's economy as a consequence of the rising economy of China (Buckley, Clegg, Cross and Tan, 2005). There was also a study on the increase in free trade agreements between China and ASEAN (Ba, 2005). Zhang and Yuk (1998) investigated into the determinants of investment in China by Hong Kong manufacturers and found that determinants are mainly economic factors. In a research on policy-making aspect, Fung, Iizaka, and Tong (2002) found that unfriendly policies and bureaucracy resulted in difficulty for foreign investors to repatriate profit. In a research by Ouyang (1988), she found that key elements of a successful joint venture should be real decision-making rights, labor management, raw materials management, financial management and export orientation.

Acknowledging the tremendous contribution of these studies, however, much less has been reported on how multinational enterprises (MNEs) of a particular country might formulate or adjust investment strategies in an attempt to seize opportunities arising from China's growing prominence in the regional economy and its aggressive march into economic integration (Zhang and Yuk, 1998). Extensive online literature search only identified one such research in the German context by Parnell (2002). While research by Fung et al. (2002) was thorough and covered in great depth, it was solely in the Chinese context. Ouyang's research approach was rather simple and lack empirical support. Yang and Lee (2002) managed to extensively gather past research results,

In addition, despite the growing number and increase importance of FDI from the developing countries, the explanations and theories on the internationalization or cross border expansion of firms are largely focus on firms from developed countries. Undeniable, there is a growing number of researches on MNEs from Asian new industrialised countries (NICs), such as Taiwan, Hong Kong, Singapore and Korea (e.g. Erramilli, Srivastava & Kim, 1999; Lu & Zhu, 1995; Sim & Pandian, 2002; Zhang & Yuk, 1998), however relatively less attention is paid on the FDI from a developing nation to another developing nation. As a result, the knowledge on the characteristics and internationalization strategies of Malaysian firms with direct investment in China are still limited to general studies using economic model that relies on panel data. Furthermore, to the best knowledge of the authors, no particular attention has been paid so far to Malaysia's outflow investment to China in similar scope of research as ours through the employment of theories and concepts. The current paper attempts to fill the gap by employing concepts and theories in international business and trade in an integrated manner with great depth to identify the underlying motives of outflow FDI from Malaysia to China.

As such, the purpose of this paper is to explore the internationalization strategy and the characteristics of Malaysian firms that invest in China. It is a study of strategies of emerging Asian MNEs that may shed some light on FDI from developing economies to emerging economies. The data obtained for this preliminary study will be used to develop quantitative survey questionnaire and hypotheses for testing in subsequent research to enhance knowledge in this area.

This paper starts with a brief introduction of research in international business, followed by the literature review on the determinants of FDI. Next, methodology is covered. A summary analysis of the research findings is presented for discussion.

LITERATURE REVIEW

Internationalization strategies and determinants of FDI in China

International business and economics researchers have conducted various studies to identify the determinants of foreign direct investments. Among the popular model that frequently used by various researchers are Dunning's eclectic model or OLI paradigm (1981) and it is the leading conceptual framework for the analysis of international expansion patterns of business firms (Rugman & Verbeke, 2009). According to Dunning's (1981), three main factors that affect the foreign direct investment (FDI) decision among the companies include ownership-specific (O) advantages, location-specific (L) advantages and internalisation advantages (I). The O advantages refer to the core competencies that possess by a company, such as high product quality and innovation, large financial capability, excellent marketing strategy etc. The L advantages refers to the institutional and productive factors, which are present in particular geographical area, such as cheaper labor costs, more generous tax and other government incentives, a large and fast-growing market. I advantages stem from the capacity of the firm to manage and coordinate activities internally. Dunning (1981) suggests that multinational corporations will invest in a foreign location only if the latter offers a certain L advantages in terms of resources and facilities that make it possible for MNEs to explore their O advantage.

Another popular concept of international business is the perspective of asset-seeking. Behrman and Grosse (1990) advocated that the challenge in doing international business is the skilful match between the needs of MNEs and host countries or governments that offers different unique advantages and carries different unique demands. MNEs are defined as resource seekers, market seekers, efficiency seekers and network seekers. For instance, China favors MNEs that can offer it foreign currency, high-technology transfer, employment. It offers very little incentive to market seekers for consumer products unless it is export oriented. The degree of mutuality of interests between foreign firms and the host governments affects the intention to invest directly and the extent of the investment.

According to asset-seeking perspective, FDI has been used as a means for MNEs to tap into or develop strategic resources in a foreign market, and exploit such assets as market intelligence, technological know-how, management expertise, and reputation for being established in a prestigious market (Chung and Alcacer, 2002). MNEs expand abroad through FDI to obtain access to resources which are either unavailable or too costly in the home country. MNEs could be seeking resources such as physical infrastructure, cheap labor, skilled labor and cheap or scarce raw materials.

Consistent with resource based view (Barney, 1991), doing so is generally with the aim to create, maintain or strengthen a firm’s competitive advantage. Evidence by Caves (1996) supports this notion that asset-seeking firms seek to access new resources and to gain new capabilities or acquire necessary strategic assets such as extensive network of distribution, novel product technology and skill-related intangible resources in a host country.

Following Dunning's work, a number of studies have investigated various variables of location factors as predictor of FDI. The following table provide a summary for determinants of FDI in China based on the past literature review:

Authors	Significant determinants of FDI
Chen (1996)	Market size, good transportation linkages
Zhang and Yuk (1998)	Cheap labor and land cost, government incentive policies, stable political environment and high return
Zhang (2001)	Huge market size, liberalised FDI regime, and improving infrastructure
Sun, Tong & Yu (2002)	Market demand, market size, degree of openness, labor quality, agglomeration, country risk, labor cost, level of scientific research
Na & Lightfoot (2006)	Market demand, market size, labor quality, degree of openness and level of reform

Foreign investors prefer to invest in high productivity regions that allow the efficient allocation of economy, market extension and possess a pool of cheap labor(Dunning, 1988). Chen (1996) explained that FDI location is affected by the potential of market share and existence of good transportation linkages. However, there is no significant relationship between labor cost and FDI. Zhang (2001) assessed the effects of location characteristics and government policies on FDI flows during the period of 1987 to 1998. His findings showed that huge market size, liberalised FDI regime, and improving infrastructure are the major factors that attract FDI in China. Consistent with Chen's (1996) finding, Zhang's (2001) study also show that there is no significant effect between wages or labor costs and FDI. On the other hand, regional distribution of FDI in China has been determined largely by FDI incentive policy and historical-cultural links with investors as well as regional economic differences.

By using the data of FDI regional distribution in China for the year 2002, Na and Lightfoot (2006) results showed that regions market demand and market size, labor quality, degree of openness and level of reform in each region are positive factors in attracting FDI. Nevertheless, no significant relationship found between level of infrastructure and labor costs and FDI decision. Though many have argued that low labor cost in China is among the main factors that attract FDI, the result of Chen (1996), Zhang (2001) and Na and Lightfoot (2006) provide no evidence of any significant relationship between the two. This means that labor cost may not be a major concern for foreign investors who are motivated by accessing to China's domestic market (Na & Lightfoot, 2006).

Zhang and Yuk (1998) found that cheap labor and land cost, government incentive policies, stable political environment and high return are among the major factors that encourage Hong Kong manufacturers to establish their business in China. Other factors such as sources of raw materials, domestic market size, advanced technology and Chinese connections are not critically important. For Hong Kong investors, Guangdong is the most preferable choice due to geographical proximity to their country, better preferential treatment, good infrastructure, and absence of language barrier (Zhang & Yuk, 1998). In contrast to the research findings that have discussed earlier, Zhang and Yuk (1998) finding did not support the importance of market potential as major determinants of FDI.

The mixture findings of various researches thus revealed that investors from different country-of-origin might differ in their strategic motivations and location preference for FDI in China. The research conducted Zhao and Zhu's (2000) provided the evidence of such differences. Their findings are summarised in following table:

Country of origin	Determinants
Hong Kong / Taiwan / Macao	High market demand, large export potential, high profit ratio
Japanese	Low rental costs, abundant human resources and high technological level
Singapore and other ASEAN countries	Market demand, technological strengths
US and European	High labor productivity and better overall economic fundamentals

In general, cost factors, infrastructure adequacy, market potential and cost factors are among the major determinants of China FDI (Zhao and Zhu, 2000). However, there are some exceptions. Labor cost has no impact on FDI decision among Hong Kong/Taiwan/Macau investors, while rental costs have no impact on European investors. Obviously, their reports showed certain contradicting result with Zhang and Yuk (1998) findings on FDI decision among Hong Kong manufacturers. This might due to the different composition of sample as the later just focus on Hong Kong manufacturers, which invested in Guangdong province.

Malaysian investors predominantly choose coastal cities such as Shanghai, Guangzhou and Beijing as the location for investment due to the ease of marketing, distribution, talent sourcing and infrastructure support (FMM, 2003). Acknowledging the contribution of this finding that implies the significant role of location for investment, the finding is limited and general as it does not provide detailed information on the type of firms and industry. This is related to concerns that locational advantages could be potentially be firm-specific.

METHODOLOGY

In order to gain better knowledge on the strategic determinants that influence Malaysian firms to invest in China, interviews were conducted with senior management of MNEs. The field work was conducted from September 2008 to January 2010, involving 27 Malaysian multinational corporations which have investment in China. The companies were identified through the list of known Malaysian companies abroad: China provided by Malaysia External Trade Development Corporation (MATRADE).

The interviews were conducted both in Malaysia and China. The interviews in Malaysia primarily focus in Klang Valley and Penang, where the companies are located. The interviews in China were carried out in Shanghai and Beijing and their vicinities. Due to the busy schedule of the senior management and different location of the companies, the data collection process took about slightly more than a year.

Prior to the interview, telephone calls were made in order to contact the key person in charge of the company's operation in China. The purpose and some detail about the study were explained via telephone; the respondents were informed that all information inclusive gathered are meant for academic purpose only and the company's name will not be disclosed. In addition to the telephone call, an email was sent to the key person in charge to provide a more detail description about the purpose and content of interviews. Subsequently, follow-up were made to confirm the date and time of the interview session for the management of the companies who provide their consent for the interview. Semi-structured interviews were used in this study as it provides more flexibility. In this case, the interviewers can have a more in-depth discussion or seek clarification from the interviewee on certain complex questions and issues that arise from the interviewee's responses. Besides, such interview allows interviewee a degree of freedom to explain their thoughts and respond accurately. This in-depth approach to interview took one to two hours.

RESULT AND DISCUSSION

We focused on Malaysian firms investing in high economic zones with the understanding that provincial governments provide various incentives to encourage and attract inflow of FDI. High economic zones tend to provide locational advantages such as cheap labor cost, attractive tax reduction, local government support, access to convenient transport links for export market and logistically close to their customers. Our interviews cover questions that examine pull and push factors in the external environments, in specific, locational factors that encourage outflow FDI to China. Such research approach may help to shed some light on factors that could have spurred interest among Malaysian investors in China to engage in FDI in the emerging economy.

Trade Agreement

In recent decades, countries are active in forming trade agreements to promote international trade. Creation of free trade zone, provision of incentives and laxing of government rules and regulations are some of the strategies or policies in trade agreement to promote trade. To our surprise, only one firm noted that availability of free trade zones encouraged the firm to engage in FDI in China. On this finding, the lack of attractiveness of free trade zone could be due to specific provincial policies and incentives that are designed to benefit selective industries. Further investigation is required to assess the lack of attractiveness of free trade zone as a luring factor to Malaysian investors interviewed in our study and it is beyond the purpose of the current study.

The Use of Locational and Ownership Advantages by Market and Efficiency Seekers

Most of those 26 firms that we have interviewed are situated along the eastern coastal areas (85%) commonly populated by foreign investors in China. Coupled with feedback from Malaysia China Chamber of Commerce (MAYCHAM) that majority of the Malaysian businessmen in SMEs are less willing to invest resources to understand foreign market. It is said that such group rarely conduct thorough research before making investment and they tend to follow the common business practices of foreign firms in China. To venture abroad with lack of market survey while wanting to mitigate investment risk, their strategy in selecting locations in China indicates that most of the Malaysian firms adopt frequency-based imitation. In other words, they follow the majority form of business practices and decisions in China or follow advices from their clients that shifted to China. Such inter-organizational mimetic behavior occurs to reduce uncertainty and to fit into the clients' business requirements (i.e., close proximity, various support for collaborative product development, JIT delivery).

Nearly half of the Malaysian firms interviewed in this study invested at the eastern coastal areas of China due to the ability to use the location as a base for exporting to the world market (46%). A large number of them invest in China with the initial strategic motive to serve their long-time clients that have shifted operation to China (27%) or to focus on export market (31%). Only slightly less than half of them invested in China with the main purpose of capturing local market (38%). They consist of large and small firms in retail, shipping, plastic, semiconductor, food and service industries. Interviews reveals that Malaysian investors in the retail, semiconductor and service industries seek to expand to Chinese market with their ownership advantages or strategic capabilities such as managerial expertise, leadership expertise and core competencies. Interview respondents from the retail, semiconductor and service firms held similar view that Chinese players will take some time to compete with its firm at the same level playing field even when the firm's technology and business processes are imitated. The personnel stressed that managerial and leadership skills of which the Chinese are lacking are utmost important in managing large operation efficiently with consistency in quality delivery.

A majority of the remaining group of investors did not consider FDI until being invited by long-time clients. Some of them received assistance from their clients when making the strategic move to set up plant in China. Despite having some experience with FDI in other countries, they took a conservative approach to FDI in China and were largely not interested to gain immediate access to the Chinese market. This is due to the uncertainties faced in China, in the form of experience, such as unfamiliarity with the local business environment (i.e., economic, legal, business dealing) and past failures of others in China. However, some firms with initial intention to seek resources such as low labor cost eventually considered market expansion to the Chinese market. This can be explained using outcome-based imitation behavior of the institutional theory. Over time, based on observation and information about successful business venture from other Malaysian investors in China, a small number of the Malaysian investors that tend to be efficiency seekers started to consider local market to achieve economies of scales and scope. Malaysian firms are considered as conservative in business approach and in sustainable competitive advantage also owing to its FDI that did not take place to strategically gain the first mover advantage and did not consider on matching competitor's entry to the Chinese market.

Surprisingly, most of the firms did not consider external environment such as quality of education and stability of political and economic environments when making FDI in China. Quality of education may affect the availability of talented pool of human resources for hiring. Unstable political and economic environments can affect the smooth operation of business. Lack of concern on these factors when investing in China could be due to their objective of FDI which tend to be resource and efficiency seeking motives. Most of the respondents indicated seeking resources such as cheap labor and cheap natural resources to reduce production cost before exporting finished products to overseas clients or exporting work-in-progress goods to Malaysia for value-adding finishing and re-exporting.

Besides being resource seekers, the lack of consideration among Malaysian investors for the abovementioned external environments could also be due to the dire need to seek new or alternative solution as a result of less favorable business environment in Malaysia. The willingness of Malaysian firms to face these adversities if they arise may be due to the push and pull factors indicated by each firm. Information from respondents also reveal that most of the respondents seek economies of scale and scope through lower cost of labor and higher productivity of Chinese workers. Less favorable business environments or push factors that have been highlighted by the respondents are such as small (62%) and saturated home market (42%), difficulty in hiring and retention of workers (19%), and intense competition in the home market (31%). One firm indicated that home government's business restriction and lack of support as the main reason for FDI in China to capture market abroad. The statistics indicate a high percent that reported less favorable business environment in Malaysia. Yet there is only a small number from those we have interviewed are proactive market seekers in the Chinese market. Majority of the firms that indicated the domestic market growth in China (69%) and attractive market growth rate (73%) would influence their future corporate strategies. This implies that these firms may eventually consider access to the Chinese market in their FDI in China. These statistics reinforce the notion that, in general, the Malaysian investors in our sample tend to adopt a careful and conservative manner to investing abroad and in China even when business environment in home country is challenging.

Besides Dunning's eclectic paradigm and asset seeking perspective, our research findings reveal that institutional theory can explain investment behaviours of Malaysian investors in China. We suggest future research to employ the institutional theory to better analyse and understand research findings in a complementary and holistic approach.

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