How Chinese firms benefit from the diversity of foreign direct investment

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New research from Rice University's Jones Graduate School of Business shows that the diversity of foreign invested firms' national origin helps businesses in China benefit from foreign direct investment (FDI).

The study, "FDI Spillovers in an Emerging Market: The Role of Foreign Firms' Country of Origin Diversity and Domestic Firms' Absorptive Capacity," was co-authored by Rice business professors Yan Anthea Zhang and Haiyang Li and two other colleagues in Beijing. The study will be published in a forthcoming edition of the *Strategic Management Journal,* a leading academic journal in the business management field.

Since its open-door policy began in the late 1970s, China has steadily become the largest recipient of FDI. At the same time, Chinese firms have also developed rapidly. Some of them have already become multinational corporations themselves, such as Lenovo, Haier and Huawei.

"China is currently the most active internationalizing economy among the emerging markets," Zhang said. "But how Chinese firms have learned from foreign firms and eventually developed their global competitiveness is not well-understood."

The authors examined the heterogeneous nature of FDI in China in terms of foreign firms' country of origin. They found that the more diverse the national origins of foreign investors in an industry, the higher the productivity of Chinese firms in the same industry.

"When foreign firms from different countries operate and compete in an industry in China, Chinese firms in the industry are exposed to a variety of technologies and management skills brought by these foreign firms and can learn more and faster," Li said.

"In the Chinese market, foreign firms are not only competing against Chinese firms but also competing among each other," Zhang added. "As a result, Chinese firms can leverage the competition among foreign firms from different countries to get greater benefits."

Not all Chinese firms will benefit equally from the diversity of FDI, however. "Large Chinese firms can benefit more than small ones. Also, Chinese firms with intermediate levels of technology gap with foreign firms benefit the most," Li said. "When the technology gap is too small, there are limited opportunities for Chinese firms to learn from foreign firms. However, when the technology gap is too large, foreign firms are too advanced to be learned by Chinese firms."

Although these findings are based on firms operating in China, they have important implications for U.S. firms and policymakers.

"Foreign firms want greater access to American markets," Zhang said. "American firms can also learn from foreign firms. Particularly, firms from emerging markets have not been widely viewed as knowledge sources from which American firms can learn. We suggest that the U.S. expand and broaden its use of foreign investment and encourage the inflow of foreign direct investment from a variety of foreign countries. With appropriate policies and strategies, this can be a win-win situation."

Zhang and Li used longitudinal data from 1998 to 2003 based on the Annual Industrial Survey Database, which was collected by the Chinese National Bureau of Statistics. In total, the researchers looked at 158,746 Chinese firms that were 100 percent domestically owned and 29,067 firms that were 100 percent foreign-owned across 509 manufacturing industries in China.

More information: To read the complete study, visit www.rice.edu/nationalmedia/multimedia/fdi.pdf

Source: Rice University (news : web)