What Constitutes the Success or Failure of Multinational Corporations (MNCs) in Foreign Markets? A Case Study of Chinese and American MNCs

Shiwei Jiang
Old Dominion University

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WHAT CONSTITUTES THE SUCCESS OR FAILURE OF MULTINATIONAL
CORPORATIONS (MNCS) IN FOREIGN MARKETS? A CASE STUDY OF CHINESE AND
AMERICAN MNCS

by

Shiwei Jiang
B.A. July 2009, Beijing Normal University
M.A. December 2011, Old Dominion University

A Dissertation Submitted to the Faculty of
Old Dominion University in Partial Fulfillment of the
Requirements for the Degree of

DOCTOR OF PHILOSOPHY

INTERNATIONAL STUDIES

OLD DOMINION UNIVERSITY
December 2014

Approved by:

David Earnest (Director)
Brandon Yoder (Member)
Shaomin Li (Member)
ABSTRACT

WHAT CONSTITUTES THE SUCCESS OR FAILURE OF MULTINATIONAL CORPORATIONS (MNCS) IN FOREIGN MARKETS? A CASE STUDY OF CHINESE AND AMERICAN MNCS

Shiwei Jiang
Old Dominion University, 2014
Director: Dr. David C. Earnest

Scholars have identified multinational corporations (MNCs) as increasingly important and influential actors in international politics. However, mainstream international studies scholarship has failed to explain why MNCs succeed or fail in entering foreign markets. Market entry is a particularly vexing question for U.S. and Chinese firms seeking to compete for each other's consumers. As this study shows, surprising differences in success among U.S. firms in China, as well as Chinese firms in the U.S., suggest that statist and market factors interact with corporate strategies in confounding ways. Through case studies in the internet, automobile and fast food industries, this dissertation builds a theoretical framework that better explains why some MNCs succeed in foreign markets while others fail. Empirical studies show that two contrasting cultures (universalism vs. particularism, individualism vs. collectivism, and rule-based vs. relation-based governance) make it more difficult for Chinese MNCs and American MNCs to adapt to their counterpart's market. Although the study finds some support for the cultural dissimilarity argument, it finds that culture alone is an insufficient explanation. The results suggest that statist and market factors like ownership, sector industry, interest groups, entry mode and choice of location are also determinants of a MNC's success in a foreign market. Based on those findings, the study provides suggestions for both Chinese MNCs and
American MNCs seeking to compete in each other’s markets.
This dissertation is dedicated to my family for their love and support
ACKNOWLEDGMENTS

First of all, I would like to thank all my dissertation committee members: Dr. Earnest, Dr. Li and Dr. Yoder. Without their guidance, encouragement, criticism and invaluable input, I would never have been able to accomplish my dissertation.

Second, I would like to express my deepest gratitude to my dissertation director, Dr. Earnest. During the long process of writing my dissertation, I was not only inspired by his insightful thoughts and academic excellence, but also by his patience, caring, and friendliness.

Third, my special thanks go to the Graduate Program of International Studies, Office of Institutional Research and Assessment, Office of Distance Learning, Office of Graduate Studies, Linda Hyatt Wilson, Tabernacle Church of Norfolk, First Chinese Baptist Church, and Christ the Redeemer Anglican Church of Norfolk. Without their financial and spiritual support, I would never have been able to complete my Ph.D. coursework, publish papers and attend conferences.

Finally, I would like to express my heartfelt thanks to my family and friends who accompanied and comforted me during my Ph.D. program.
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CHAPTER I

INTRODUCTION AND LITERATURE REVIEW

The Research Question: Why Do Some Succeed While Others Fail?

What factors determine MNCs' failure or success in a foreign market? The Sino-U.S. relationship is described by leaders and academics as the most dynamic and important bilateral relationship in the 21st century. Actually, it is very challenging to define the Sino-US relations as they are neither friends nor enemies. The politicians of both countries came together to coin an interesting term, "stakeholder." China and the U.S. are not political and military allies, but they are close business partners. We know that business conflicts can cause political conflicts; in return, political conflicts will damage mutual benefits. The trade deficit, China's purchase of American companies, American companies' failure in China, fights over oil, and RMB exchange rate are some major conflicts that further deepen distrust between China and the U.S.

This dissertation is an examination of Chinese Multinational Corporations (MNCs) and American MNCs and their interaction with domestic and international politics, and how MNCs' failed or succeeded in foreign markets due to multiple factors.

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1 In summary, there are two opposing views toward China's rise in the U.S. One is "engage with China but not contain it", which is embraced by Bill Clinton and some American scholars like Robert Keohane and David Lampton. The other is "China threat theory" supported by John Mearsheimer and some hawks in the U.S. Congress or military.

2 Zhao, Suisheng, China -U.S. Relations Transformed: Perspectives and Strategic Interactions (New York: Routledge, 2007).
News media often attribute the failures of Chinese MNCs or American MNCs in their counterpart’s markets to the distrustful and competing China-U.S. relationships. However, bilateral relationships are not enough to explain MNCs’ performances in a foreign market. Some American MNCs have failed while some succeeded in China, so did the Chinese MNCs in the U.S.

In general, the factors that affect MNCs’ success can be categorized into two kinds: internal and external. Internal factors are “within the company.” These internal factors are often discussed in classes of business administration, finance and management. Internal factors will be briefly examined in the dissertation when I discuss company cases in later chapters, but they are not the major part of my analysis. For instance, when I discuss state-owned Chinese companies, I may probe their leadership structures to show the interaction between government and business. But I will not go deep into some questions regarding internal factors, like what is Facebook’s hiring process and average salary?

The major difference between American multinational companies and their Chinese counterparts is who they serve and what goals they pursue. The different political economy structures between China and the U.S. determine this major difference. Private American MNCs serve themselves and they pursue maximum profit, because their survival relies on their business performance. By contrast, state-owned Chinese enterprises may submit themselves to the Chinese government and do not necessarily pursue maximum profits. Their survival is not merely dependent on their revenues and market share, but also on the political support and

---

3 A company’s management, average salary, accounting, strategic plan, risk investment, human resource, hiring process, etc.
policy preferences from local and state governments. With China's opening-up reform in 1978, many American MNCs entered China in the 1980s like KFC. By contrast, Chinese MNCs are quite new to the U.S. market. Most Chinese MNCs entered the U.S. after 2000. Therefore, American MNCs are generally more experienced in tackling the challenges of overseas markets than Chinese MNCs. This dissertation does not seek to compare American MNCs with Chinese MNCs.

International business scholars usually pay much attention to internal factors such as cost control, organizational structure design, management of subsidiaries, and corporate strategies, whereas they neglect those factors that outside the company, which are called external factors. For Chinese and American MNCs, their failures or successes in the counterpart's market cannot only be simply explained by internal factors. Based on a strong body of literature showing that multifaceted external factors can affect MNCs' overseas performance, this study focuses specific attention on three major external factors that influence an MNC's success or failure in a foreign market. They are culture, statism, and market entry. They serve as independent variables (IVs), while the dependent variable (DV) is MNCs' failure or success in a foreign market.

How do IVs relate to the DVs? First, I argue that MNCs are more likely to fail in the host country with a contrasting culture compared to the home country. The cultural approach is adopted to show that China and the U.S. are indeed two contrasting cultures in three primary dimensions: universalism vs. particularism, individualism vs. collectivism, and rule-based vs. relation-based cultures. Second, states' interventions or support can greatly affect MNCs' overseas business practices.
and performance. Those interventions or support are frequently seen in three areas: sectoral politics, ownership and interest group. Sectoral politics exist in both China and the U.S. In China, local officials favor foreign investments in capital-intensive or labor-intensive sectors based on their personal interests and concerns for social stability. In contrast, foreign investments in the internet sector are heavily regulated and discouraged. In the U.S., government agencies and U.S. media are cautious about foreign purchases of American firms in sensitive sectors. The Committee on Foreign Investment in the United States (CFIUS) has blocked some deals by Chinese investors in recent years. I find that the murky ownership of Chinese MNCs is a major concern for American investigators, while the complicated nature of American interest group politics is a major concern for Chinese investors. Third, different entry modes pose different risks. Usually, joint ventures and international franchising imply less control but lower risk than wholly-owned subsidiaries. A firm wholly owned by foreign MNCs through acquisitions may make the host country feel uncomfortable, particularly in sensitive or key industrial sectors. In addition to entry modes, location choice is an important component of market entry. When foreign MNCs invested in China in their early years, they usually chose big cities and were more likely to succeed. In this power-centralized country, big cities imply more relational assets which are called "Guanxi" in China.

Admittedly, those cultural dissimilarities between the U.S. and China play an important role for Chinese MNCs and American MNCs seeking to compete in each other’s markets. However, cultural differences between the U.S. and China are fairly constant. Moreover, this dissertation is not a cross-cultural case study (e.g. eBay in
China versus eBay in Europe). Therefore, the cultural variable does not vary. This dissertation will highlight statist interventions and market entry while controlling cultural factors.

Before delving into literature review and hypotheses, it is necessary to explain what do MNCs and their successes/failures mean.

Define MNCs and Their Successes or Failures

A. What Are MNCs?

What does “MNC” mean and how to define their success/failure in this study? Some historical studies show that the Dutch East India Company (founded in 1602) is the world’s first MNC.\(^4\) Compared to the Dutch East India Company, today’s MNCs have changed a lot, but some of their characteristics have not. Behind giant MNCs, we often see the shadow of states’ power and hunger for profits.

Multinational Companies or corporations (MNCs), multinational enterprises (MNEs), international corporations and transnational corporations (TNCs) are the terms scholars often use interchangeably. Although their distinctions are very ambiguous, some scholars treat MNCs and TNCs separately (Table1.1).

---

Table 1.1
Comparisons between MNCs and TNCs

<table>
<thead>
<tr>
<th>Multinational Corporation</th>
<th>Transnational Corporation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Has national identity</td>
<td>No principal domicile</td>
</tr>
<tr>
<td>2. Control is centralized in the national headquarters</td>
<td>Control is dispersed</td>
</tr>
<tr>
<td>3. Monolithic organization</td>
<td>Confederation</td>
</tr>
<tr>
<td>4. Head of foreign subsidiary reports to the head of the international division</td>
<td>Global operating units report directly to chief executive or executive committee</td>
</tr>
<tr>
<td>5. Limited integration between foreign subsidiaries</td>
<td>More integration between global operating units</td>
</tr>
<tr>
<td>6. Ownership is concentrated in home country</td>
<td>Ownership is internationally dispersed</td>
</tr>
<tr>
<td>7. Business plans are for national markets</td>
<td>Global planning considering the whole world as a single market</td>
</tr>
<tr>
<td>8. Differentiates between domestic market and foreign market</td>
<td>The whole world is viewed as a single market</td>
</tr>
</tbody>
</table>


In this dissertation, I prefer to use MNCs rather than TNCs, because an MNC has national identity while TNC does not necessarily have a principal domicile.

There is no universally accepted definition of MNCs. According to the *International Dictionary of Finance*, an MNC is defined as "a company having production and other facilities in a number of countries outside the nation of origin. Also, and more correctly, called multinational enterprise (MNE), or transnational corporation. According to the United Nations (UN) there are about 35,000 multinationals controlling some 170,000 affiliates, though the largest 100 account for 40 percent of
cross-border assets. Kogut further argues that the economic definition emphasizes the ability of owners and their managerial agents in one country to control the operations in foreign countries. It is recognized widely that capital flow is not the distinguishing characteristic of a multinational corporation. Capital can flow from one country to another in expectation of higher rates of return. However, this flow may be invested in the form of bonds, or in equity amounts too insignificant to grant control to foreign owners. In this case, this type of investment is treated as a portfolio investment. The central aspect of direct investment is the ownership claim by a party located in one country on the operations of a foreign firm or subsidiary in another. The multinational corporation is, thus, the product of foreign direct investment that is defined as the effective control of operations in a country by foreign owners.

B. Corporate Success/Failure

What is corporate success or failure? In 1964, Warren Bennis and Philip Slater proposed at least three traits that would define corporate success in the future: 1. High-level employee satisfaction, 2. Strong conflict management competence, and 3. Wide acceptance by consumers. Similarly, in the Foundations of Corporate Success, John Kay defines corporate success as good relationships with its suppliers, customers, or employees and successful localization of products and leaderships.

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In this study, there are three specific ways to define the abstract concept of corporate success or failure.

First, does this MNC establish a foothold in that foreign market? If an MNC continues to lose bids or acquisitions and lacks strong business presence in a foreign market (let along market penetration), it is an obvious failure for that MNC in that market. For example, compared to Samsung, China’s Huawei lost several bids and failed to establish a strong presence in the U.S. market. Likewise, both Facebook and Twitter are absent in China. In this scenario, those MNCs had the worst level of corporate failures in that foreign market.

Second, does the MNC’s presence in that foreign market endure? In other words, does this MNC penetrate the market and win acceptance by both consumers and the host government? An MNC might easily establish its presence in a foreign market. However, it might exit that market quickly for various reasons (e.g. fierce market competition, cultural differences and political intervention). For example, unlike Facebook and Twitter, eBay and Google survived the Chinese market for several years (eBay: 2002-2006, Google: 2006 - 2010). Although they finally exited the Chinese market, they did make some profits and learned some lessons from their mistakes in China. These MNCs experienced a lower level of corporate failures than those in the first scenario. However, their exits are still considered as a corporate failure, because they did not fully penetrate that foreign market in which similar products and current strong competitors already exist (e.g. eBay vs. Taobao, or Google vs. Baidu).
In the third scenario, corporate success or failure is a context-specific and relative term. Why is this? Two different MNCs may both establish a strong presence in a foreign market. Both are welcomed by the host government and consumers in that foreign market (e.g. KFC and McDonald's, or Ford and General Motors in China). In this scenario, we may wonder which one enjoys more corporate successes than the other and how to measure those successes? Scholars have used various indicators or conducted surveys to compare different MNCs in that foreign market. For example, a survey\(^8\) of young consumers in the U.S. and China showed that the Chinese respondents were more apt to eat KFC foods and spend more time doing so, than the Americans. The Chinese also had much more positive impressions of KFC than their US counterparts. Also, some business data show that KFC and General Motors are more successful than McDonald's and Ford in China, respectively. For example, table 1.2 and table 1.3 show that KFC enjoys more successes than McDonald's in China in terms of brand power index and number of outlets, respectively. This study will use multiple indicators to assess corporate success or failure, including percentages of market share, numbers of employees, numbers of chain stores or subsidiaries, FDI, brand power index, profits and revenues.

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Table 1.2

Top 10 International Power Brands in China, 2013

<table>
<thead>
<tr>
<th>Rank</th>
<th>Brand</th>
<th>Brand Power Index (average =100)</th>
<th>Nationality</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Kentucky Fried Chicken (KFC)*</td>
<td>564</td>
<td>US</td>
</tr>
<tr>
<td>2</td>
<td>Pampers*</td>
<td>482</td>
<td>US</td>
</tr>
<tr>
<td>3</td>
<td>Colgate*</td>
<td>424</td>
<td>US</td>
</tr>
<tr>
<td>4</td>
<td>Olay</td>
<td>371</td>
<td>US</td>
</tr>
<tr>
<td>5</td>
<td>Crest</td>
<td>355</td>
<td>US</td>
</tr>
<tr>
<td>6</td>
<td>Apple*</td>
<td>336</td>
<td>US</td>
</tr>
<tr>
<td>7</td>
<td>McDonald's*</td>
<td>324</td>
<td>US</td>
</tr>
<tr>
<td>8</td>
<td>Omo</td>
<td>286</td>
<td>UK/NL</td>
</tr>
<tr>
<td>9</td>
<td>Coca-Cola*</td>
<td>281</td>
<td>US</td>
</tr>
<tr>
<td>10</td>
<td>Carrefour</td>
<td>260</td>
<td>France</td>
</tr>
</tbody>
</table>


Table 1.3

Number of Fast Food Outlets in China, 2012

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>4,260</td>
</tr>
<tr>
<td>KFC</td>
<td></td>
</tr>
<tr>
<td>McDonald's</td>
<td>1,730</td>
</tr>
<tr>
<td>Real Kung Fu</td>
<td>596</td>
</tr>
</tbody>
</table>

Source: Yum!Brands company records

This section has briefly discussed the definitions of corporate success/failure and one important question: how to measure it? The third question is very important. If an MNC has already established a lasting presence in that foreign market, then we can use multiple measures to assess their corporate success or
failure. These measures include but are not limited to profits, power brand index, employee satisfaction rates, number of employees and subsidiaries, market shares, amount of direct investment and revenues. The next section will address existing studies related to the research question. Why have some MNCs succeeded in a foreign market while others have failed? The literature review section will be organized into three major sections: culture, statist and economic aspects. For each section, I explore previous research first and then propose at least one hypothesis and numbered it by section (e.g. H1a is the first hypothesis in the first section).

Culture

A. Broad Definitions of Culture

In the first place, what is the broad definition of culture? Culture has been defined in a wide variety of ways. Inglehart defines culture as "a system of attitudes, values and knowledge that is widely shared within a society and is transmitted from generation to generation."9 According to Lustig and Koester, culture is a learned set of shared perceptions about beliefs, values, and norms, which affect the behaviors of a relatively large group of people.10 Chen and Startosta define culture as "a shared, learned, and symbolic system of values, beliefs, ideas, and attitudes that shapes and influences our perceptions and behavior."11 Clearly, culture is often associated with

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core values, specific beliefs, social organizations, social action, and a way of life. According to Mark Irving Lichbach and Alan Zuckerman, culture organizes meanings and meaning-making, defining social and political identity, structuring collective actions, and imposing a normative order on politics and social life. In summary, the broad definition of culture can be understood through two dimensions: the intangible subjective culture and the tangible objective culture. For example, Google's corporate culture -- "Don't be evil!" is an intangible subjective culture. KFC's logo and universal design of chain stores belong to tangible objective culture. Guanxi (relations) in China is a hidden business culture, while the outcomes of Guanxi are usually visible and tangible.

B. Academic Research on the Relationships between Culture and an MNC's Overseas Performance

Both International Political Economy (IPE) scholars and International Business (IB) scholars agree that cultural differences play an important role on MNCs' performance in foreign markets. A school of literature compares contrasting cultures and their impacts on the practices of international business. For example, IB scholars argue that failures of expatriate managers in host countries often result from the inability to adjust to a foreign culture.

Hofstede’s cultural dimensions theory is a framework for cross-cultural communication and is frequently utilized by many scholars\(^\text{14}\) to analyze a variety of issues regarding MNCs, including expatriate managers, international colleagues, design of organizational structure and market entry modes. Hofstede’s cultural theory scrutinizes culture from various dimensions and analyzes how cross-national cultures affect management of firms in foreign markets. In the 1960s Hofstede originally proposed four rudimentary cultural dimensions: 1. Individualism versus Collectivism; 2. Uncertainty avoidance; 3. Power distance (strength of social hierarchy); and 4. Masculinity versus femininity (task orientation versus person-orientation).\(^\text{15}\) Later in the 1990s, Michael Bond and Minkov’s research led them to adding two more dimensions: long-term orientation versus short-term orientation (also called “pragmatism”) and indulgence versus restraint.\(^\text{16}\) How is Hofstede’s cultural study related to MNCs’ overseas performance? By measuring these dimensions through individual surveys and scores, Hofstede shows that China and the U.S. are two contrasting cultures, which can cause difficulties for the working relationship between expatriate managers and local colleagues. Usually, countries with high scores in individualism are often rule-based cultures (e.g. the U.S.), while those with high scores in collectivism are relation-based cultures (e.g. China). Therefore, those MNCs that emerged in a relation-base culture tend to fail in a rule-based market.

\(^{14}\) Drogendijk & Slangen, 2006; Tse & Au, 1997.


\(^{16}\) Ibid.
Another well-recognized scholar in the field of culture and MNCs is Fons Trompenaars. His famous work, *Riding The Waves of Culture*, is a wealth of information helping to explain how cultures differ and offering practical ways in which MNCs can do business in various countries. Similar to Hofstede's Individualism vs. Collectivism, Trompenaars uses Universalist and Particularist to depict cultural differences between the U.S. and China. One of his illuminating arguments is: Universalists are more common in Protestant cultures. The USA, credited with being the most litigious society on earth, has considerably more lawyers per head of population than particularists – East Asia.\

Universalists try to use the courts to mediate conflicts while particularists tend to use social networks and relations to resolve disputes. Trompennars used many real examples and personal experience to support his argument. For example, when an American manager brought a weighty contract to a subsidiary in East Asia in the 1980s, his local colleagues were quite upset by the eighty-page contract because they were not comfortable with such a formal contract. Trompennars argues that “one serious pitfall for universalist cultures in doing business with more particularist ones is that the importance of the relationship is often ignored. The contract will be seen as definitive by the universalist, but only as a rough guideline or approximation by the particularist.” Indeed, businessmen in the particularist culture like China prefer to make the contract as vague as possible and may object to clauses that tie them down.

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18 Ibid.
Beyond Hofstede’s and Trompennars’s cultural dimension theory, some IB scholars use the governance environment to explain failures of MNCs in foreign markets. Li compared rule-based governance culture (the U.S.) with a relation-based governance culture (China). His examination of Human Resources (HR) research shows that past studies of expatriate managers’ failures in foreign markets did not consider "how elements of societal governance such as the legal system, political factors, level of trust, and information quality may affect the ability of expatriate managers to develop effective working relationships with local employees."\(^{19}\)

Indeed, Guanxi has a major influence on the management of businesses based in China, and also those owned by overseas Chinese in Southeast Asia, known as the bamboo network.\(^{20}\) Guanxi is rooted in traditional Chinese culture and it is also at the center of debate about business practice today. Social network or social capital is well researched in American scholarship. Famous scholars are Robert Putnam and Nan Lin. Guanxi is a Chinese equivalent of social capital. Guanxi plays a more important role even than regulations and contracts in various areas of Chinese life. When American MNCs come to China, they find they need to follow the Chinese way, that is, Guanxi. Previous studies\(^{21}\) have shown that Guanxi can serve as substitutes for formal institutional support. Guanxi can also be a source of sustained competitive advantage for doing business in China.


\(^{21}\) Tsang, 1998; Xin&Pearce, 1996.
C. Individualism vs. Collectivism

With regard to the dissertation's case studies--Chinese MNCs and American MNCs--we all know that the Chinese culture and American culture are different. But, to what extent of degree are they different? Are they slightly different or contrastingly different? This study applies an integrated cultural approach to examine whether China and the U.S. have two contrasting cultures which create miscommunication and misunderstanding in business practices and thus thwart MNCs’ performance in the counterpart’s market. The integrated cultural approach is based on three major theories: Hofstede's cultural dimension theory, Trompennars's universalist versus particularist distinction, and Li's rule-based versus relation-based governance.

How do we know China and the U.S. are two contrasting cultures and in what ways are they different from each other? First, Hofstede’s study (Figure 1.1) tells that China is a highly collective society (score over 90) while the U.S. is a highly individual society (score less than 90). Each country in this model is characterized by a score on six different dimensions. Those scores in Figure 1.1 are chiefly based on Geert Hofstede’s recent book: Cultures and Organizations.22 This book is a combined research, which chiefly uses IBM survey data between 1990 and 2002 and the recent World Values Survey data.

What are the implications of culture dimension theory for MNCs? In a collective culture like China, personal relationships prevail over task and company. In addition, people act in the interests of the group and the subordinate-superior

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relationship is obvious. Chinese state-owned enterprises do not necessarily act in the interests of themselves. They have non-economic goals or social responsibility established by the state authorities. They also have a sense of superiority over private Chinese firms because they get support from the Central Bank and they control China's strategic industries. However, when Chinese state-owned enterprises (e.g. PetroChina, Sinopec) enter the U.S. market, they lose the protection like they have in domestic market as well as the sense of superiority. In a highly individual culture like the U.S., firms are much less submissive to state authorities and businessmen are accustomed to doing business or interacting with people they do not know well. Witkowski & Ma also showed that cultural differences can explain why Chinese consumers have a higher satisfaction rate toward KFC than American consumers. America is with an individualistic culture. When American respondents are satisfied with KFC, they are more likely to go again, often by themselves. Personal feelings take precedence. By contrast, in collectivist China, people visit KFC more often as part of a group, which might attenuate the tie between their own feelings and behavior.

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24 Ibid.
Another dimension that makes China and America the two contrasting cultures is pragmatism. This dimension was examined by Hofstede and Bond's Confucian Work Dynamism. Long-term oriented societies foster pragmatic virtues oriented towards future rewards. Most East Asian countries score high in pragmatism and they are long-term orientation cultures. Their personal and business relationships are maintained and reinforced through continuous, long-term associations and connections. These connections have different names in

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East Asian countries—Kwankye in Korea, Guanxi in China and Kankei in Japan.\(^{27}\) East Asians consider relationships and ambiguity between people to be very important, whereas Westerners consider contracts and explicitness between people to be important. Figure 1.1 shows that China scores almost 90 in the cultural dimension of pragmatism while the U.S. is less than 30. In societies with a long-term pragmatic orientation like China, people have a strong propensity to save and invest. Thriftiness is obvious. For example, Taobao knew that the average Chinese people like haggling and saving money. Thus, Taobao quickly launched a communication platform, Ali Wangwang, which enables direct communication between the Chinese buyers and sellers. EBay failed to do so in its early years in China.

**D. Universalism vs. Particularism**

Another theory that compares Chinese culture and American culture is Trompennars's universalist versus particularist distinction. The U.S. is high in universalism and advocates for global standards, democracy and universal human rights, which are often challenged by China, a particularist culture. What is the implication of universalist versus particularist cultures for MNCs? According to Trompennars, in the U.S., the head office tends to hold the keys to global marketing, global production and global HR management. However, within more particularist national cultures like China, the writ of the head office might fail to shape local ways...

of operating.\textsuperscript{28} Table 1.4 is a summary of characteristics of Universalism vs. Particularism based on readings of Trompenaars's school.

Table 1.4

\begin{tabular}{|l|l|}
\hline
\textbf{Consistency} & \textbf{Flexibility} \\
\hline
Systems & standards & Pragmatic \\
\hline
Rules & Make exceptions \\
\hline
Uniform procedures & It depends \\
\hline
Demand clarity & At ease with ambiguity \\
\hline
\end{tabular}

Source: Riding the Waves of Culture

In a universalist culture, firms have strong propensity to follow standards and uniform procedures. The designs and decorations of American grocery stores (e.g. Walmart) and fast food chains (e.g. KFC) are very similar in different cities. Standardization is a double-edged sword, however, which makes some succeed while some fail. For example, eBay replicated its American models and have succeeded in most Western countries, but its global platform failed in China. For Americans doing business in China, they might often hear the words “Zou Hou Men” (literally, through the back door), which means to make exceptions. Also, in the

particularistic culture, business practices lack consistency. According to Trompenaars, China is a particularistic culture where people look at relationships and circumstances in a specific situation to decide what is right. For the Chinese, the legal contract communicates a starting point for an agreement. As circumstances change so too should the terms of the agreement. For the Chinese, the situation and the particular individuals involved are what define relationship.29

**E. Rule-Based vs. Relation-Based**

Li's study on governance environments shows that political, regulatory, and cultural contexts have a major impact on foreign subsidiary success. He depicts the U.S. and China as two contrasting cultures: rule-based and relation-based societies, respectively (Figure 1.2). In a relation-based society, it is better for MNCs to hire host country nationals or parent country nationals with host country origins. Headquarters in the U.S. should decentralize decision-making and downplay global standardization, because local knowledge and adaption to local market conditions is of primary importance.30 Harzing’s empirical study of executive staffing practices in MNCs’ foreign subsidiaries supports this argument.31 He found that MNCs operating in industries such as food and advertising services tend to hire host country nationals as managing directors. KFC in China is a strong case. Previous studies32 show that not only did KFC localize its food menus, but it also localized its

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executives and managers in China. According to Zhao and Luo, KFC is a foreign brand with Chinese characteristics, which expanded on its fried chicken staple and converted some 40% of its menu items to Chinese flavors.\textsuperscript{33} In addition, KFC recognizes the importance of Guanxi in China and maintains good relations with the state and local Chinese governments. The majority of KFC managers in China are either Chinese nationals or Taiwanese nationals. Some other American MNCs may also hire parent country nationals with host country origins. For example, Meiwei Cheng, an American national of Chinese origins, successfully directed several American affiliates in China, including AT&T, General Electric, and Ford.\textsuperscript{34}

**Figure 1.2**

A Comparison of Governance Environment Index

<table>
<thead>
<tr>
<th>Country</th>
<th>Governance Environment Index</th>
<th>Governance Environment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Norway</td>
<td>6.02</td>
<td>Rule-based</td>
</tr>
<tr>
<td>Sweden</td>
<td>4.69</td>
<td></td>
</tr>
<tr>
<td>United States</td>
<td>4.47</td>
<td></td>
</tr>
<tr>
<td>United Kingdom</td>
<td>4.26</td>
<td></td>
</tr>
<tr>
<td>Taiwan</td>
<td>2.45</td>
<td></td>
</tr>
<tr>
<td>South Korea</td>
<td>1.15</td>
<td></td>
</tr>
<tr>
<td>France</td>
<td>1.09</td>
<td></td>
</tr>
<tr>
<td>Italy</td>
<td>0.56</td>
<td></td>
</tr>
<tr>
<td>India</td>
<td>-1.48</td>
<td></td>
</tr>
<tr>
<td>Greece</td>
<td>-1.99</td>
<td></td>
</tr>
<tr>
<td>Russia</td>
<td>-6.27</td>
<td></td>
</tr>
<tr>
<td>China</td>
<td>-7.26</td>
<td></td>
</tr>
</tbody>
</table>

Source: Li & Filler, 2007


To sum up, this section explores previous academic research on the relationship between cultures and MNCs’ overseas performance. IB and IPE scholars agree that cultural differences are a primary factor to the success/failure of MNCs. Despite the fact that their angles of analysis are different (e.g. collectivism vs. individualism, universalism vs. particularism, and rule-based vs. relation-based societies), they all support the hypothesis that in a comparison of foreign MNCs, those investing in culturally similar countries will enjoy more success than those which invest in culturally different countries.

Based on the existing literature, a cultural hypothesis of this study is:

\[ H1a: \text{In a comparison of foreign MNCs, those investing in culturally similar countries will enjoy more success than those which invest in culturally different countries.} \]

Given the cultural dissimilarity between China and the U.S., I expect the case studies will show American MNCs and Chinese MNCs face more obstacles to investment in each other’s markets. For instance, while eBay replicated its American model and established a foothold in Europe, it failed to do the same in China. The cultural hypotheses can be validated by numerous cases. However, cultural hypotheses are still insufficient. Cultural dissimilarity cannot fully explain why General Motors are more successful than Ford in China in terms of sales? To better understand MNCs’ overseas development, I will introduce other factors (statism and market) that can affect MNCs’ success in foreign markets.
The previous section discusses how two contrasting cultures affect MNCs' success/failure from three perspectives: 1. Individualism versus Collectivism; 2. Universalist versus Particularist; 3. Rule-based versus Relation-based societies. This section will focus particularly on the role of the state and discuss how political power can influence an MNC's overseas performance. This section is organized into the following subsections: 1. sectoral politics, 2. interest groups, and 3. ownership.

A. Sectoral Politics

Beyond cultures, industrial sectors are another important factor that affects success or failure of MNCs. Foreign investment flows into different sectors of the host country. Existing studies show that the level of restrictions varies widely by industrial sectors. For example, the airline industry was completely closed to FDI in the U.S. in the 1980s. A federal department of the U.S. government, the Department of Homeland Security, names those sensitive sectors as “critical infrastructure”, which is officially defined:

Critical infrastructure are the assets, systems, and networks, whether physical or virtual, so vital to the United States that their incapacitation or destruction would have a debilitating effect on security, national economic security, national public health or safety, or any combination thereof.

When CFIUS screens cases, it pays particular attention to critical infrastructures such as nuclear power, telecommunications, energy, and

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transportation. Beyond the general rules of the Committee on Foreign Investment in the United State, some scholars argue that the main reasons for limiting foreign ownership in services are non-economic, relating to national security or economic nationalism. Industries such as telecommunications, banking, transportation and electricity provision are often viewed by host countries as "strategic" or "sensitive."

In recent years, many examples support this argument. Transportation, for instance, is relevant to U.S. national security and anti-terrorism. In 2006, The Dubai Ports World, a state-owned company in the United Arab Emirates, attempted to purchase six major U.S. seaports. Eventually, this transaction was blocked because some U.S. politicians worried that these seaports might be vulnerable to the entry of terrorists or illicit weapons if they were managed by the Dubai Ports World. Another illustrative case is China's Huawei. Huawei, A Chinese telecommunication giant, had several attempts to acquire American IT firms and also failed in the end due to national security concerns. The U.S. National Infrastructure Protection Plan states that “establishing a strategic framework for protecting the Nation's critical communications infrastructure is crucial to ensuring national security.”

How can sectoral politics influence a MNC's business practices in a foreign market? Owen's study shows that domestic firms in some sectors (e.g. oil, resources) are politically skilled and can erect political obstacles to foreign MNCs. Owen cited the famous case of the CNOOC-Unocal acquisition. She argued that the

38 Hoekman, 1995; Golub, 2009.
oil sector is characterized by high levels of capital flows and political skills, because American oil and gas firms are usually some of the biggest donors for political campaigns and elections. When the state-owned Chinese firm CNOOC bid high for Unocal in 2005, its U.S. competitor Chevron was able to use effectively the supposed threat to national security as a smokescreen and won political support from U.S. Congress. Ultimately, CNOOC withdrew its bid under political pressure and Chevron acquired Unocal with a lower bid.

Sectoral politics are not limited to the U.S, however. When U.S. firms are doing businesses in China, they also face challenges caused by sectoral politics. The level of openness to foreign investment vary varies by sector in China. Among the three sectors (food service, auto and internet), the food service sector enjoys the highest level of openness to foreign investment, the next is auto sector and the last is internet (Table 1.5).\footnote{Baker and McKenzie, “Revisions to the Catalogue for Guiding Foreign Investment in Industry 2011,” \textit{Client Alert}, January, 2012; James Jensen, Fabiola Suwanto, and Sarah Zhao, “China’s New Foreign Investment Industrial Guidance Catalogue: Update,” February, 2012.}
Table 1.5

China's Catalogue for Guiding Foreign Investment in Industry

<table>
<thead>
<tr>
<th>Industry sector</th>
<th>Government Attitudes</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food processing</td>
<td>Encouraged</td>
<td>Projects for production of natural food additives and ingredients are no longer subject to foreign shareholding restrictions. The New Catalogue has removed storage of vegetables, dried and fresh fruits, livestock or poultry products from the encouraged category.</td>
</tr>
<tr>
<td>Auto</td>
<td>Encouraged/Neutral</td>
<td>Although automotive manufacturing no longer falls in the &quot;Encouraged&quot; category, the manufacture of key components of alternative fuel vehicles has been added to the &quot;Encouraged&quot; category and foreign investors may hold up to 50% of the equity interests in these types of industrial projects</td>
</tr>
<tr>
<td>Internet &amp; media</td>
<td>Restricted</td>
<td>The 2007 Catalogue prohibited foreign investment in news websites, network audio and video program services, internet access service venues, and internet cultural operations. The 2011 revision only excluded musical production.</td>
</tr>
</tbody>
</table>

In 2005 the Chinese government issued the Administrative Measures on Commercial Franchising, which allowed KFC and McDonald's to establish wholly foreign-owned franchises, instead of being limited to joint venture. By contrast, the Chinese government still requires foreign automakers to establish joint ventures with Chinese firms and their shares should not be more than fifty percent.\(^{42}\) Compared to the food service and auto sectors, the internet sector in China is the worst case in terms of openness to foreign investment. American internet firms are less welcomed by the Chinese people than American auto makers or food franchises. For example, a recent report issued by China Internet Media Research Center (May 26, 2014) blames Yahoo and Google for stealing data of hundreds of millions of Chinese customers.\(^{43}\) Unsurprisingly, the internet sector in China is deeply tied to politics and some scholars call China a "networked authoritarian society."\(^{44}\)

Although the Chinese government promotes the development of internet technologies, the internet sector in China is still heavily regulated. Why did American internet firms enjoy less success than American auto and food firms in China? Existing studies show that American internet firms enjoy less success than other American firms because they face at least three challenges regarding sectoral politics in China:

1. Internet Content Providers (ICPs). The ICPs are supervised by China’s State Council Information Department. Overseas ICPs are allowed to operate in the

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country under the condition that ICP subsidiaries must be registered in China, and all the contents must be provided and self-filtered by locally registered subsidiaries (Batjargal, 2006). The case of Google is a good example, which will be addressed in the empirical chapters.

2. Internet filtering censorship. The Internet is a sensitive sector in China. Western media news and academic publications (Economist, 2006; Beckman Center for Internet and Society, 2005) show that China's filtering is considered as an important daily duty of government officials. The mechanism of internet filtering is very sophisticated and involves multiple departments and technical control. Compared to foreign firms (e.g. Google), often domestic internet firms (e.g. Baidu, Sina) are more cooperative with the Chinese government to filter out sensitive online information.

3. Sectoral incentives of the local Chinese officials. In communist regimes, local government officials are neither directly voted nor elected by the people in their regions. Instead, they are promoted or appointed by higher-level government supervisors. Existing studies show that the GDP growth rates and job creation are two important factors for local Chinese officials' promotion. Government reports or provincial yearbooks often contain detailed information on the relative rankings of the provincial performance, ranging from GDP growth, to steel production, to numbers of new jobs, and to miles of road constructed. In general, capital-intensive sectors can lift GDP growth rates drastically (e.g. auto, steel, real estate, and

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infrastructure construction) and also create huge personal gains for local Chinese officials. Thus, foreign investment in capital-intensive sectors is favored by local Chinese officials. Corruption is pervasive in capital-intensive sectors in China. Labor-intensive sectors can create more jobs (e.g. clothing, food), which is helpful for easing public anger and stabilizing local communities. Take Coca Cola for example. Its independent suppliers have 350,000 Chinese employees. Its independent vendors, wholesalers and retailers have 5,000 Chinese workers, and the company itself directly employs 14,000 Chinese. However, fewer IT firms could offer such incentives (1. Creating many jobs, 2. Building large construction projects) to the local Chinese officials. They are thus more likely to fail in the Chinese market.

B. Interest Groups

Unlike tariffs or administrative procedures of CFIUS, interest groups politics is an informal barrier to the market entry. Scott’s study shows that the U.S. aviation and auto industries favor normal relations with China. American automakers and Boeing have enjoyed many successes in China. In the mid-1990s, then chairman of General Motors, John F. Smith Jr. argued that China’s “most-favored-nation” (MFN) status is the basis for a stable, credible economic policy toward China. By contrast, the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO), U.S. Business Council and American makers of movies and computer software

pressed Washington to revoke MFN status of China due to China's human rights violations and piracy of intellectual property. Interest groups are also called pressure groups or special groups which are interchangeably used by various scholars. Interest groups can be classified in a multitude of ways. The simplest is to categorize them according to their primary purpose ---economic and noneconomic.\(^4\)

Economic interest groups tend to promote favorable economic conditions and opportunities for their members. Noneconomic interest groups focus on specific issues and ideological perspectives instead of commercial and business interests. With regard to China-U.S. conflicts, those specific issues include, but are not limited to, environment protection, human rights, labor rights, religion, democracy and Tibet. Chan's research shows that human rights advocacy groups are actively pressuring MNCs on minimum wages, work hours, health, and safety conditions.\(^5\)

Noneconomic interest groups often overlap with advocacy non-governmental organizations (NGOs), which form to influence governments' policies. Schepers's research shows that MNCs are the frequent target of NGOs in their advocacy efforts.\(^5\) Many advocacy NGOs or noneconomic interest groups urge MNCs to promote their corporate social responsibilities.

An interesting study by India's Central Bureau of Investigation shows that the total number of NGOs in the U.S. is three times that in China (Figure 1.3). In addition,

1 NGO for every 209 Americans, while 1 for every 3,000 Chinese. (Figure 1.4). Chinese MNCs grew up in China, a society where NGOs are controlled and the disputes between NGOs and companies are often mediated by the state or local governments. When Chinese MNCs come to the U.S., a contrasting society where NGOs and social responsibility are encouraged, Chinese MNCs become quite inexperienced in managing relationships with American NGOs.

Figure 1.3

Number of NGOs

![Graph of NGOs.]

Source: Quartz and India's Central Bureau of Investigation

Figure 1.4

People per NGO

![Graph of people per NGO.]

Source: Quartz and India's Central Bureau of Investigation
C. Ownership: State-owned Enterprises vs. Private Firms

Since China's "Opening-up Reform" in 1978, the relationships between the Chinese government and its companies have gradually changed. Unlike Mao who punished millions of Chinese businessmen and prohibited all private entrepreneurship in communist China, Deng Xiaoping realized the importance of private businesses for the economic health of a country. Deng started building private sectors in Southeast China, like Shenzhen. He once said: "it doesn't matter whether it's a white cat or a black cat, I think; a cat that catches mice is a good cat."52 Private companies have sprung up like mushrooms since Deng's reform. However, Deng and his companies were cautious that the fast development of private businesses would outperform state-owned companies. In addition, they thought that liberal values and privatization would lead to social instability.53 Therefore, they allowed the state-owned companies to keep control key industries in China, such as railways, banks, energy and telecommunications. Today, most giant Chinese MNCs are state-owned and they are top ranked in Fortune Global 500.54

State-company relationships are more transparent in developed countries than in authoritarian regimes, because the relationships in democratic countries are

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52 For more details, please refer to Orville Schell and John Delury's new book: Wealth and Power: China's Long March to The Twenty-First Century. For instance, in Chapter 11 "Black Cat, White Cat: Deng Xiaoping", the authors state that Deng summarily canceled two decades of Maoist policy with a single sentence, "From this day forward, we renounce class struggle as the central focus, and instead take up economic development as our central focus." pp.281-282.

53 A good example is The Tiananmen Square Incident in 1989. Limited reforms and privatization brought about fast economic development, but at the same they also caused inflation and corruptions of the party elite. The business and government officials' personal interest are always heavily overlapped in China. The young Chinese asked for more transparency, freedom, reform and privatization; however, their protest finally became a tragedy.

54 Three Chinese MNCs are in the Top 10 list (Sinopec, China National Petroleum, and State Grid). They are all state-owned Chinese companies. Two American companies are in the Top 10 list (Walmart and Exxon Mobil). For a full list, please visit http://money.cnn.com/magazines/fortune/global500/
legalized by embedded regulations and laws. Scholars called most Western
governments "small governments" or "limited governments." The ownership
structure, leadership appointment and government relationships of Chinese MNCs
are not as transparent as those of Western counterparts. The existing studies show
that Chinese state-owned enterprises (SOEs) are more likely to fail in the U.S.
market than private enterprises. The reasons can be disaggregated into two aspects.

1. SOEs are less efficient than private firms.

A substantial volume of literature indicates that SOEs are less efficient than
private firms. One of the most prominent studies was done by Boardman and Vining
(1989). They evaluated the performance of five-hundred of the world's largest
MNCs for the year 1983. They found that controlling for a variety of factors, SOEs
and mixed enterprises perform worse than similar private companies. With
regard to China, this argument is also embraced by some Chinese scholars. For
example, Liu argues that Chinese private firms have a lower hierarchy in
organizational structure than SOEs and thus they are more efficient than SOEs. Bai
et al. argue that Chinese SOEs are less efficient in enterprise productivity than
private firms because Chinese SOEs are not profit maximizers.

56 Sumit K. Majumdar, "Assessing comparative efficiency of the state-owned mixed and private sectors in
57 Liu Xiaoxuan, "The Impact of the Structure of China's Industrial Enterprise's Ownership on Its
58 Bai Chong-en, David D. Li and Wang Yijiang, "Enterprise Productivity and Efficiency: When Is Up Really
2. Host countries view SOEs as arms of the home government.

Many SOEs are viewed as arms of the state by host countries and thus suffer from transparency and accountability issues. To understand the relation between the MNC and the home government is crucial for an understanding of the autonomy of MNCs. Some observers argued that economic concerns focused on the possibility that state-backed Chinese companies choose to invest 'based on strategic rather than market-based considerations,' and are free from the constraints of market forces because of generous state subsidies. In 2012, the U.S.-China Economic and Security Review Commission asked CFIUS to conduct mandatory reviews of all controlling transactions by Chinese state-owned and state-controlled companies investing in the U.S (e.g. CNOOC, Sinopec, PetroCina, and Huawei). The Commission also called for prohibiting investment in a U.S. industry by a foreign company whose government prohibits foreign investment in that same industry.

This section examines how political power can influence MNCs’ overseas performance from three aspects: sectoral politics, interest group and ownership. First, existing studies show that sectoral politics exist both in China and America. For example, U.S. state agencies (the Homeland Security Department and CFIUS) have defined “critical infrastructure” and paid particular attention to those acquisitions by foreign investors in sensitive sectors (energy, telecommunication and transportation). Likewise, China’s State Council Information Department erects

60 Ibid.
obstacles to the internet sector as it requires foreign IT firms to obtain the Internet Content Providers (ICPs) in China.

Second, the interest group politics is a hallmark of American politics. A simplest categorization is economic and noneconomic groups. In the past, Chinese MNCs faced challenges from both economic (e.g. Chevron Corporation, AFL-CIO) and noneconomic interest groups (e.g. Human Rights Watch). Interest groups and social corporate responsibility are encouraged in the U.S. while controlled by the state in China. Some Chinese MNCs are not competent in dealing with American interest groups and are more likely to fail.

Third, previous literature on MNCs' ownership shows that the failures of state-owned or state-controlled firms in foreign markets arise from two factors: 1. they are less efficient than private firms in business practice; 2. they are viewed as arms of the home state and thus the host state is cautious of them. Gilpin stated that "The MNCs cannot be explained solely in terms of market forces and/or corporate strategies. The state-centric position also assumes that MNCs are essentially national firms competing with one another around the world." Based on the above discussions, two hypotheses are proposed:

\[ H2a: \text{In a comparison of foreign MNCs, those with closer ties to the home state are more likely to fail in the host state than MNCs independent from the home state.} \]

\[ H2b: \text{In a comparison of foreign MNCs, those investing in sensitive sectors in the host state are more likely to fail than those investing in consumer goods.} \]

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It is widely believed that SOEs act as agents on the behalf of their home
governments. For example, Chinese SOEs are less worried about capital shortage as
they can receive cheap loans from state-owned banks. In 2009, 85% of loans were
issued to Chinese SOEs. Chinese SOEs also control key industry sectors in China.
However, when Chinese SOEs come to do business in the U.S., those financial and
political support from home government may become their weakness. Given that
China and America distrust each other, I expect the case studies will show Chinese
MNCs and American MNCs with close ties to their home governments will be
frustrated by political resistance from the host countries. I also expect that those
Chinese SOEs or private firms with government background investing in strategic
resources and critical infrastructures will trigger a CFIUS audit.

Market Entry

Traditionally, the debates on the roles of a government in a market can be
boiled down to two competing views: the statist views (e.g. Jackson, 2014; Gilpin,
2001), in which it governs the market, and the market-friendly view, according to
which government intervenes little in the market. The previous section has
already illustrated the relationships between MNCs’ success or failure and state
support/intervention. This section will review some key studies that address the
relationships between MNCs’ successes or failures and market entry.

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62 Eve Cary, “Reforming China’s State-owned Enterprises,” The Diplomat, accessed on August 18, 2014,
http://thediplomat.com/2013/06/reforming-chinas-state-owned-enterprises/
63 Masahiko Aoki, etc., The Role of Government in East Asian Economic Development: Comparative
A. Entry Modes

Business scholars believe that the choice of mode for market entry is very important for a firm doing international business. Based on a review of several international business textbooks, firms often use at least four major modes to enter foreign markets: exporting, franchising or licensing, establishing joint ventures with a host-country firm, and setting up or acquiring a subsidiary partially/wholly through FDI.

First, different choices of entry modes will make an MNC face different obstacles which can affect corporate success in a foreign market. For example, for the export mode of entry, the foremost obstacle is duties and tariffs. China set high tariffs on foreign-made cars to protect its infant industry. Thus, most foreign cars sold in China were not directly imported from their home countries. Instead, they were made by Chinese workers of joint ventures in China. For all foreign automakers selling cars in China, establishing a joint venture with Chinese firms is a must. Ford, Volkswagen, General Motors and Toyota all have Chinese partners with which they have to share some technologies.

Lu shows that the success of international joint ventures investing in emerging economies, most notably China, largely depends on the selection of local partners and the performance of local partners. So far, many foreign automakers have chosen Chinese state-owned enterprises (SOEs) as their partners (e.g. Shanghai Auto and First Auto Works). They clearly knew that partnering with SOEs

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in this country would allow them to enjoy more successes. Indeed, most of them are successful so far (e.g. General Motors). According to figures from LMC Automotive, a forecasting company; foreign joint ventures now capture three out of every four new car sales in China, the highest level in six years.\(^6^6\)

Second, the degree of risk varies by entry mode. Acquiring a wholly-owned subsidiary (WOS) means greater control but also implies greater risks compared to setting up joint ventures (JVs) and international franchising.\(^6^7\) Makino & Beamish, using a sample of more than 900 Japanese foreign subsidiaries, argued that the performance of WOSs was considerably lower than that of JVs.\(^6^8\) Likewise, Chinese scholars\(^6^9\) examined activities of more than 14,000 foreign firms in China and argued that WOS enjoyed less success than JVs in terms of profits. Also, Guisinger and Li\(^7^0\) compared foreign-owned firms and domestically owned firms in the U.S. They found that foreign-controlled firms entered through acquisitions are more likely to fail than those with other entry modes. The degree of risk is ranked from low to high by entry mode: exporting, franchising/licensing, JVs, and WOS.


B. Location Choice

Beyond entry modes, some scholars\(^\text{71}\) argue that location choice is another important component of market entry and has direct effects on MNCs' overseas success/failure. From 1978 to the late 1990s, Deng Xiaoping and Jiang Zemin, then the most powerful figures in China, favored the Eastern part of China for economic reforms. Once Deng said: “Let some people get rich first!”\(^\text{72}\) During that period, the Chinese government had established some Special Economic Zones (e.g. Shenzhen, Shanghai Pudong) and gave favorable policies to FDI in those regions. Some MNCs caught this opportunity and finally succeeded there. However, this state intervention has created a huge wealth gap between East China and West China.

Today, the Eastern Coast of China has already become the most developed area. According to a Chinese government report, in 2010 the East shared 78.32% of FDI while the West only shared 7.86%.\(^\text{73}\) In order to narrow the gap, the state government is now directing the flows of FDI from East China to West China under a national policy called “Xi Bu Da Kai Fa” (The Great Development of China’s West). Moreover, the average labor costs and land prices of East China are much higher than those of West China. Two decades ago, KFC was able to open its first Chinese store near Tiananmen Square and thus attracted many Chinese consumers’ eyes. Nowadays, it is almost impossible and unwise for a new international food franchise to obtain such an expensive location.

\(^{71}\) Agarwal&Ramaswami, 1992; Flores&Aguilera, 2007.
Interestingly, KFC is more successful and popular than McDonald's in China, which is in contrast to their situations in the U.S. market. The secret of KFC enjoying more success than McDonald's can be traced back to their different choices of locations at the very beginning. Many developing countries like China lacked formal and reliable institutional systems in their early development of market economy. To cope with this, MNCs could develop relational assets, such as Guanxi, which plays an important role in facilitating business operations in China. KFC clearly knew that Guanxi was a key determinant of location choice, and that the Capital city was the most effective starting point to build Guanxi in a centralized governance model. Therefore, KFC chose China's capital, Beijing, as the home of its first outlet (1987) and then quickly spread to the east and south coast. According to David Bell, associate dean of Harvard Business School, when the first Chinese KFC opened in Tiananmen Square, Western-style fast-food restaurants were a novelty in China. Many Beijingers still wore the tunic suits of the Mao era, and bicycles were the main means of transportation.

By contrast, McDonald's expansion has been relatively more conservative. McDonald's opened its first outlet in Shenzhen (1990), then an emerging city in South China. The primary reason why McDonald's chose Shenzhen is because it is close to Hong Kong where McDonald's had already established a foothold. However, Shenzhen cannot match Beijing in terms of market size, reputation, and strategic

importance of corporate relationship with the government. Also, in its early years of
development, McDonald's limited its entry to only a few big cities close to Shenzhen,
which made McDonald's far less influential than KFC.

In summary, two major points regarding to market entry are addressed in this
section. First, typically the entry modes of joint ventures and franchising (e.g.
Shanghai General Motor, KFC) involve less control and risk than the wholly-owned
subsidiaries entry mode (e.g. Google China, eBay established eBay China after it
acquired a Chinese company called Yiqu). Compared to joint ventures and
international franchising, wholly-owned subsidiaries by foreign MNCs in certain
sectors may make a host country with strong nationalism feel uncomfortable.
Second, beyond market size, labor costs and land prices, relational assets are
another important determinant of location choice. In China, a country with a
centralized government and collective culture, big cities often provide more
relational assets. Foreign MNCs usually set up their first outlets in those famous
Chinese cities such as Beijing and Shanghai. However, choosing big American cities
may not be the best strategy for Chinese companies. Gary Locke, former U.S.
Ambassador to China, said: "When considering where to invest, Chinese companies
often gravitate toward cities they know. Usually this means big cities such as New
York, San Francisco, and Los Angeles....But, some of the best opportunities for a
good return investment can be found in second-tier cities."76

In this dissertation, I anticipate that there are some interactions between
statist and market factors. For instance, in the case of CNOOC buying an American

firm Unocal, the geopolitical rivalry is overlapped with domestic market
competitions. American oil firm Chevron, a domestic competitor against CNOOC,
raised national security issues and lobbied U.S. Congress, which caused CNOOC to
fail in acquiring Unocal.

In addition, we may wonder among cultural, statist and market factors, which
is the most important factor for explaining an MNC's success or failure. Actually, the
degree of their importance varies by different conditions. So, under what condition
are statist factors more important than the other? Numerous cases show that when
Chinese state-owned enterprises invest in U.S. sensitive sectors or strategic
resources, statist interventions are the most important factor for explaining their
successes or failures. In contrast, when American consumer goods producers invest
in China, those market factors, such as choice of location, entry modes, localization
and corporate strategies, are more important for their successes.

Summary of Chapter One

In this chapter I start asking the research question, why some MNCs have
failed in foreign markets while others have succeeded there. There are two
categories of causes, internal factors and external ones. A strong body of literature
shows that external factors of culture, statism and market can affect an MNC's
success or failure in foreign markets. First, cultural dissimilarities can create
numerous obstacles to MNCs. Some obstacles may be unavoidable. The U.S. and
China are starkly different cultures identified in three dimensions: universalism vs.
particularism, individualism vs. collectivism, and rule-based vs. relation-based cultures. Three hypotheses regarding culture are proposed in the first chapter. I expect that the failures of some Chinese MNCs and American MNCs in each other's markets are caused by their difficult adaption to local cultures. However, cultural explanations are not the whole picture because cultural explanations have limits (Cultures do not vary within the U.S. and China). Therefore, I introduce statist explanations in this dissertation. I will explain how sectoral politics, ownership and interest group politics can affect a MNC's success or failure in foreign markets. Those MNCs investing in strategic resources or critical infrastructures and in the meantime keeping close ties to home government are more likely to fail in the host country, particularly when the home government and the host government distrust each other (e.g. China and the U.S.).

The study of MNCs is an interdisciplinary field of both International Politics and International Business. Therefore, in this chapter I also borrow some knowledge from International Business. I examine mode of entry and choice of location in the market section. I briefly discuss how entry modes and choices of location can affect MNCs' overseas success. Different entry modes pose different levels of risks. Usually, joint ventures and international franchising imply less control but lower risk than wholly-owned subsidiaries. Location choice is also an important factor that can affect an MNC's early development in foreign market. In a centralized-power like China, foreign MNCs tend to choose big cities where they can expect more relational assets and market demands, whereas some of the best
opportunities for Chinese investors in the U.S. do not necessarily exist in America’s big cities.

Finally, I wish to point out the significance of the study. The result of this study will be useful for explaining the recent increase of investments by Chinese private investors in the U.S. For example, following China Shuanghui’s 2013 acquisition of Virginia-based Smithfield Foods, in June, 2014 Shandong Tranlin Paper, a private Chinese pulp and paper company announced it would invest $2 billion over five years to establish its first U.S. operation in Chesterfield, VA. This move is welcomed by the Virginia Governor.77

How can my studies explain this recent investment? First, from the perspective of statism, both Shuanghui and Tranlin are private Chinese investors. No media reports show that they are affiliated with the Chinese government like Huawei. They are also investing in consumer goods rather than sensitive sectors or strategic resources. Therefore, they face less resistance from American sectoral politics. In addition, local officials often welcome those investments that can create jobs. Governor McAuliffe said: “An investment of this magnitude, with the creation of 2,000 new jobs by 2020, represents the largest Chinese greenfield economic development project in the United States.”78 Second, from the perspective of culture, Tranlin’s subsidy in the U.S. will be led by University of Virginia Darden Graduate Jerry Peng, who understands both American culture and Chinese culture.79

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Third, from the perspective of market and location, why did Tranlin choose Virginia? Because Mr. Peng has roots in Virginia where he can gain relational assets and Chesterfield is also close to the political center of Virginia, Richmond. Arguably, my studies provide an integrated framework (culture, statism and market) for analyzing MNCs' penetration in countries of mutual distrust.

An Overview of Dissertation Organization

The rest of this dissertation is organized as follows: In the next chapter I look at American Internet firms in China. First, I will present an overview of China's Internet Industry. Then, three cases (Google, eBay and Facebook) will be discussed in details. Through case studies, I can show how my independent variables (cultural, statist and market) relate to their failures. Beyond difficult adaption to the Chinese culture, many American internet firms face statist and market obstacles to their penetration in China. The internet is one of the most heavily regulated industry sectors in China. Unlike foreign investments in consumer goods (e.g. food and automobile), foreign investments in China's internet industry lack enough protection by local Chinese officials and also receive some political resistance. In Chapter 3, I will study cases of American firms succeeding in China. Generally, American fast food chains and American auto makers are more successful than American Internet firms in China. However, it is more meaningful to compare firms when industry sector is controlled (e.g. KFC vs. McDonald's, General Motors and

Ford). I will discuss why KFC and General Motors are more successful than McDonald’s and Ford, respectively. Put simply, Chapter 2 and Chapter 3 compare cases of American MNCs in China. Chapter 4 and Chapter 5 turn to discussing cases of Chinese MNCs in the U.S. Due to the nature of Chinese politics, I group Chinese MNCs into two kinds: state-owned (Chapter 4) and private (Chapter 5). State-owned Chinese enterprises investing in strategic resources (PetroChina, Sinopec, CNOOC) or private Chinese firms with government background investing in critical infrastructures (Huawei, Sany Heavy) are more likely to be examined by the host country than others (e.g. Shuanghui). Finally, Chapter 6 presents conclusions and implications.
CHAPTER II

CASE STUDY 1: AMERICAN INTERNET AND MEDIA COMPANIES FAILED IN CHINA

China is now the world’s largest Internet user - which is why we were so pleased to include the Internet as a part of today’s event. This country now has the world’s largest mobile phone network, and it is investing in the new forms of energy that can both sustain growth and combat climate change - and I’m looking forward to deepening the partnership between the United States and China in this critical area tomorrow.¹

Barack Obama

Introduction

This chapter highlights American internet and media firms and their fates in China. Two kinds of corporate failures will be examined: 1. Failure in gaining market share and establishing an enduring presence. Google and eBay are successful in the U.S. and many other areas of the world. However, they were defeated by Baidu and Taobao in China, respectively. When the host and home country have uncertainties and conflicts caused by starkly different cultures and political regimes, an MNC investing in sensitive sectors is more likely to face pressure from the host country and finally exit the host county, unless there is adequate interest for the MNC to stay. This study finds that Google’s and eBay’s exits were not only caused by cultural dissimilarity between China and the U.S., but were also caused by statist interference and market competition. For example, the Chinese government can erect obstacles to Google through holding on issuing Internet Content Provider (ICP)

license. Moreover, due to political resistance from the host country, Google’s services and products were not fully available in China. With regard to market competition, this chapter shows that both Google and eBay faced strong Chinese competitors who received state support in the past. 2. Failure in entering China, let alone market penetration. This kind of failure might be more severe than the previous one. Google and eBay exited from China, but they are allowed to reenter the market. In contrast, Facebook along with numerous other American social network sites (SNS) are blocked in China. Their absence in China has created a vacuum in the SNS sector that Chinese firms have rushed to fill, which makes Facebook’s future penetration in China almost impossible. Based on analyses and comparisons, in the last section this chapter offers some recommendations for American MNCs doing business in China.

A. An Overview of the Internet Industry in China

China is currently the largest prize for global internet companies. According to KPMG and China’s Ministry of Industry and Information Technology, 565 million people were using the Internet at the end of 2012, up from 513 million in 2011: an increase of 140,000 Internet users per day. China’s Ministry of Industry and Information Technology forecasts over 800 million Internet users by 2015, a 700 percent increase in 10 years, yet only a 59 percent penetration rate; this is less than the penetration rate from the US, Japan and Germany, at 78 percent, 80 percent, and 82 percent respectively.2

Today, internet technologies and social media are highly intertwined. China’s Internet and media market has great potentials. China Internet Network

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2 "Social media in China: Local innovation connecting the country," China 360, KPMG April 2013
Information Center (CNNIC) reported that from 2005 to 2014, China’s online population has increased dramatically. Giant American Internet and media firms are catching opportunities to set up businesses in China. However, numerous pioneers have failed in China. As defined in the first chapter, there are different levels of corporate failures in a foreign market. Numerous American internet firms or media firms experienced at least two kinds of corporate failures in China: 1. Never entered China, let alone market penetration (e.g. Facebook, Twitter, and YouTube) 2. Entered China, but finally failed to establish an enduring presence (e.g. Google, eBay, and the New York Times).

There are many factors leading to their failures. However, in this chapter, I will focus on my independent variables (IVs) and try to build a causal relationship between the IVs and DVs. First, from a statist perspective, American internet and media firms are frustrated by China’s internet censorship. China has a special system called the “Great Firewall”, which is a national project developed by a group of Chinese computer scientists. The Great Firewall blocks foreign websites that China’s government does not want its people to visit. Today, two popular U.S. social network sites, Facebook and Twitter, still remain unavailable in China. Some Chinese Internet users know how to evade the Great Firewall, whereas most average Chinese Internet users do not. Due to Internet censorship and regulatory resistance, Google.cn has much less information than Google.com. Google users in China achieved only limited success from their Google searches, and they started to use the Chinese search engine website, Baidu. In 2009 when President Obama
visited Shanghai, China; he criticized Internet censorship at a gathering of 400 young Chinese students.

And that is why America will always speak out for these core principles around the world. We do not seek to impose any system of government on any other nation, but we also don't believe that the principles that we stand for are unique to our nation. These freedoms of expression and worship -- of access to information and political participation -- we believe are universal rights.³

Second, cultural differences thwart efforts by U.S. providers. For instance, a recent Chinese television program selected elderly people randomly in the streets of Chinese cities and asked them, "Do you agree with the proposal that your children must visit and take care of you, or else they will violate the law?" One elderly Chinese man astonished Chinese viewers with his answer. Asked by a chic female reporter, he responded furiously: "My daughter is your age. I do not mind if she does not visit me regularly. But it is a crime that she does not want to get married. Crazy! She is turning 30 years old. You know, too late!" Today, many Chinese still refer to single women older than age 27 as "left-over ladies." In Western society, people are more accepting of unmarried women. Language is an important component of culture. Language differences can bring challenges for American internet and media firms when they attempt to adapt their products and service to the Chinese context. For example, some Chinese internet users just scoffed at Facebook's name, because the word "Facebook" expressed in English sounds like the Chinese word "非死不可" (must die). Put simply, American internet and media firms face some unavoidable cultural obstacles to their market penetration in China.

Third, from the market perspective, strong competition from rival Chinese firms limited American firms’ penetration into the Chinese market. After China’s economic reform in the late 1970s, Chinese people were eager to learn from foreign countries. Like Japanese parents did thirty years ago, Chinese parents are sending their children to study in the U.S. Most Chinese students in the U.S. are studying science. The founders of many popular Chinese websites have traveled to or studied in the U.S., where they gained ideas and learned about inventions. They also understand the Chinese market, the psychology of Chinese consumers and their needs better than an average American business executive. Thus, following their entries into China, American internet and media firms immediately experienced fierce competition from their Chinese counterparts. In addition, China’s slack supervision of intellectual property rights creates a hotbed for Chinese internet firms. Numerous Chinese internet firms simulated or even copied American platforms. A popular Chinese social network site, Renren, is very similar to Facebook.

American internet and media firms differ from each other in various ways. For example, their offered products or services are different. Google is a search engine site. EBay is an e-commerce platform. Facebook is a social network site (usually known as SNS). Despite the fact their fate in China are the same; their experiences and lessons are different. Therefore, in the next section I will discuss them in detail.

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4 Refer to the Chinese economic reform since the late 1970s. The Chinese leader Deng Xiaoping advocated “Change, reform, and open up.”
Google’s Development in China

On March 23, 2010, Google officially announced that it would discontinue its search business in mainland China and move its Chinese operations to Hong Kong. Google's exit from mainland China quickly drew much attention from media agencies around the globe. American media criticized China for strict internet censorship.6

In response, Chinese state media Xinhua and China Daily fought back against their Western counterparts by saying that Google did not follow Chinese rules and broke promise made to the Chinese government. A Chinese official in charge of the Internet bureau under the State Council Information Office said,

Google has violated its written promise it made when entering the Chinese market by stopping filtering its searching service and blaming China in insinuation for alleged hacker attacks. Online opinion exchanges are very active in China and e-commerce grows rapidly here. As facts have demonstrated, the environment for internet investment development in China is sound.7

Google and the Chinese government are the two players in the dispute over censorship of Internet searches. One of Google's goals is to establish a foothold and then penetrate the Chinese market without much interference from the host government. In the meantime, the Chinese government aims to make Google accept its strict supervision. As time passed, Google became reluctant to comply with regulations and policies imposed by the Chinese government. And, the Chinese

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government erected numerous obstacles to Google’s expansion in China. In the globalized today, many neoliberal scholars believe that MNCs have tremendous influence on world economy, politics and mass media. However, Google’s exit shows that MNCs still have their limits when they confront powerful nation states.

A. Google: An Internet Giant and “Don’t be evil.”

Google is the world’s largest internet search engine company, which has billions of visits per day. It is also one of the most valuable brands. Scholars and business reports attribute its success to Google’s innovation, corporate culture and social responsibility. Google is always a pioneer in the high-tech sector. For instance, Google Glass is a recent breakthrough in technology. It combines new IT technologies with regular eyeglasses. By wearing Google Glass, a person can record what he or she sees and then sends videos, images and texts to friends. Google’s driverless car is another innovation that has been admired by many car aficionados. Google Glass and Driverless Car are not publicly available yet, but they have already received overwhelming inquiries and orders.

Google has expanded its overseas market to obtain more customers. For instance, Google Maps is currently used in every continent of the world. It is definitely a symbol of globalization as well as a symbol of U.S. soft power. The “street view” function of Google Maps makes people’s daily lives easier and is

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8 For example, Google + and Google Map’s street view remains unavailable in Mainland China.  
9 According to Interbrand’s 2013 ranking, Google’s brand value is No.2 next to Apple.  
10 Google is the pipeline of innovation. It has many channels for employees to express their ideas, such as Google Cafes, Google Moderator, Google Universal Ticketing Systems and Google +. For more details, please read “Google’s Secrets of Innovation: Empowering Its Employees” by Laura He.
finding acceptance in many countries. Most U.S. allies have permitted the use of Google Maps in their countries, including both developing countries (e.g. Mexico, India, and the Philippines) and developed countries (e.g. South Korea, Europe, and Japan). However, due to political mistrust and concern over military facilities, some countries block Google Maps. For example, China blocked Google Maps' "street view" function. China's concern is that Google's business satellite may take photos of its military facilities. So, instead of using Google Maps, China encouraged a Chinese company to build its own map search service like Google Maps called QQ Maps.

Google executives believe that Google has the ability to promote democracy and freedom through spreading information. Google's informal corporate motto is "Don't be evil." Google, together with other U.S. companies, are often viewed as a part of American soft power and world supremacy. They played an important role in the Arab Spring and protests in Ukraine. However, Google seems incompatible with China, an ancient civilization currently mixed with communist regime and capitalist economy. After five years of investment and development in China, Google had to depart. Google's annual revenues are larger than some small nation-states in the world. Google is not only influential in world business and technology; it can also shape U.S. foreign policies. However, when Google faces communist China, it is still very vulnerable.

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11 The full motto is "Do the right thing: don't be evil. Honesty and integrity in all we do. Our business practices are beyond reproach. We make money by doing good things." See, "Corporate Information. Our Philosophy, Google." (http://www.google.com/about/company/philosophy/)
B. Google Failed to Establish an Enduring Presence in China

1. Infancy

Currently, China’s market is the world’s largest prize for business investment. Some commentators have asserted that the 21st century belongs to China. With China’s accession to the WTO in 2001, China gradually became the world’s manufacturing powerhouse. More and more global companies flooded into China and set up businesses. Google is one of them. In 2005, Google established its first research and development center in Beijing, China. Like many other American companies, Google hoped to capitalize on the Chinese market.

In 2006, Google launched its Chinese website Google.cn. Then, Google appointed the Taiwanese business leader, Lee Kaifu as its China chief. Google opened three offices in Beijing, Shanghai and Guangzhou. It employed hundreds of sales personnel and technicians in 2006. But, at that time its competitor Baidu already had 4,000 employees. A report from the China Internet Network Information Center (CNNIC) shows that in 2006 Baidu’s Chinese market share was 62.1%, whereas Google accounted for only 25.3%. Local cultures and location choice matter. The report also shows that Beijing residents prefer Baidu, while Shanghai residents prefer Google. Empirical studies indicate that Beijing as China’s political center is more relationship-driven. Beijing is good starting place for foreign MNCs to build up relational assets. Shanghai is virtually the opposite.

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12 There are two camps. One holds that the 21st century is China’s century. China is in rise while the U.S. is decline. The other opposes this view and insists the dominance of U.S. power. See, Michael Beckley, “China’s century? Why America’s edge will endure.” International Security, winter 2011/12
Shanghai as China’s economic center is famous for its openness and welcoming attitude to outside influence and foreigners. The Bund of Shanghai is a street with different styles of foreign buildings. Shanghaiers are more open-minded, but sometimes other Chinese mock Shanghaiers’ “Chong Yang Mei Wai” (worship of foreign things and fawning on foreign countries).

2. Early Development

Google’s development in China was not smooth. After 2007, however, Google encouraged Chinese employees to innovate and gave full play to their talents. "Google’s 20% Time" is a successful management style. The basic idea is that Google employees may use 80% of their time to do work projects, while they may spend the other 20% of the time on their hobbies, new ideas and inventions. 2007 was the most productive year for Google China. For instance, Google China released twenty-four new products and services such as the Google Chinese Pinyin input method, hot Chinese topics, and 265.com (a website navigation service). All products, operations and services launched in China were based on decisions from local Chinese teams and did not require approval from Google’s headquarters in the U.S.

In 2008, China experienced a devastating earthquake in Sichuan province. Google China immediately released a link to a useful website - www.google.cn/qinren - that helped people to find their families and friends who lost contact in the earthquake. It was very popular and highly praised among the Chinese general public and state authorities. Also, in 2008, Google China released a

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new online advertisement product, Google AdSense, for small and medium Chinese companies. When then-Google China chief Lee Kaifu was interviewed in December, 2008, he was very optimistic about Google China’s future. He said “Google China’s market share increased about 5% from 2007 through 2008.”

3. Decline and Farewell to China

Year 2009 is the watershed for Google China. In the afternoon of June 18, 2009, Google China’s administrators were summoned by the Chinese government. Google was then ordered to shut down its overseas search in mainland China. China’s state media CCTV reported this incident and blamed Google for spreading a large amount of pornography images and videos. Google China was also sued by a Chinese company because of similar Chinese names.

In September, 2009, Lee Kaifu, a Chinese-American entrepreneur and the founding president of Google China, announced his decision to resign, saying that his cancer forced him to leave. This was great shock to both Google China and the Chinese general public. Lee Kaifu was an outstanding business leader in eyes of many Chinese. Many young Chinese business students adored him. His effort led Google market share to increase steadily from 2006 to 2009 although Google was still far behind to Baidu in 2009. Many believed that Lee’s resignation was a great challenge for Google because it was uncertain if his successor John Liu would be able to advance Google’s development in China. It was reported that following Lee’s

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resignation, several Google China employees involved in customizing the company’s programs for the Chinese market, had left.\footnote{Malcolm Moore, “Is Google China Throwing in the Towel,” \textit{China Economic Review}, December 15, 2009.} 

John Liu was unable to reverse Google’s deterioration in China after Lee’s resignation. When Google was in trouble, its rival Baidu continued to grow and also got support from the government. Finally, on January 12, 2010, Google announced that it had been attacked by Chinese hackers. Google asked for negotiations with the Chinese government and requested for waiver of censorship. Not surprisingly, Google’s request was rejected by the Chinese government. On January 21, U.S. Secretary of State Hillary Clinton delivered a speech on the Internet freedom and severely criticized the Chinese government. In a press conference, Chinese government spokesman Qizheng Zhao responded by reiterating China’s stance that all foreign companies must obey Chinese law. But, he illustrated the point with yet another analogy: “Darwin’s theory of evolution tells us a species needs to adapt to its environment in order to evolve. I’ve never heard of the environment adapting to the species.”\footnote{“CPPCC Spokesman Waxes Metaphorical on U.S.-China Ties, Google” \textit{The Wall Street Journal}, March 2, 2010.}

Google’s exit from China is viewed as corporate failure in China. Why did Google leave China? In the next section, I will try to relate my IVs (statist, market, culture) to the DVs and build the causal relationship.
Why Did Google Finally Exit From China?

A. The Host Country Is Concerned about Google's Close Ties to Its Home Government

Some Chinese media reports have suggested that Google has a close tie to the U.S. government. Particularly, after the Snowden Incident, Google, Facebook and other major American Internet companies were blamed for releasing private information to the U.S. government. Google denied this charge, saying that Google was independent and did not violate laws of privacy and that NSA hacked into Google.

However, the Chinese government and some Chinese nationalists did not buy this idea. China was afraid or distrustful of Google. For instance, Google Earth has never been admitted into Mainland China. Why? Many Chinese believe the primary reason is Google Earth's high-definition world map, which uses images taken by Google's business satellites, would allow its home government to spy on military facilities in China. Chinese military analysts often question Google's satellites and whether there is a relationship between Google's business satellites and U.S. intelligence satellites, or if Google's satellites are really independent of the U.S. government and military. Given that Google's services and products were not fully available in China, Google had some disadvantages in attracting internet users compared to its Chinese competitors.

20 http://tech.ifeng.com/internet/detail_2013_07/15/27502754_0.shtml
B. Sectoral Politics in the Host Country: ICP and China’s Internet Sector

The internet sector of China is heavily regulated by a set of laws. Google, in order to operate a website in China, must obtain an Internet Content Provider (ICP) license every other year from China’s Internet authority, the Chinese Ministry of Industry and Information Technology. In reviewing renewal applications, the Ministry inspects operations over a period of time and verifies that the website qualifies for renewal. Google had trouble getting an ICP license in 2009 because it was involved in spreading pornography, although Google eventually was able to renew its ICP license. It remains unclear what obstacles Google faced and what changes Google had to make in order to secure approval of its Chinese ICP certificate.

C. Attacks from Chinese Hackers

Like many other well-known organizations, we face cyber-attacks of varying degrees on a regular basis. In mid-December, we detected a highly sophisticated and targeted attack on our corporate infrastructure originating from China that resulted in the theft of intellectual property from Google.

David Drummond, Google senior executive

In January 2010, David Drummond, Google’s corporate development and chief legal officer, published an article “A New Approach to China” on Google’s official blog. He pointed out three major reasons why Google left China: First, Google and other U.S. Internet companies had been the victims of a sophisticated cyber-attack.

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22 This ICP license regime was introduced in September, 2000. It is regarded as a part of China’s Internet censorship.
originating from China in January, 2010. Second, Gmail accounts of several Chinese human rights activists are under surveillance for years. Third, in 2009 China further limited free speech on the web including the persistent blocking of websites such as Facebook, Twitter, YouTube and Google Docs.23

Why did Google enter China in 2005? David Drummond argued that at the very beginning Google can tolerate some censorship, because Google wanted to let more Chinese have the access to obtain information freely. Since then, Google had been closely watching the limits of Chinese laws and regulations on Google’s service. However, in the past few years, Chinese restrictions on freedom of speech on the Internet had completely broken Google’s bottom line, which caused Google to reevaluate the feasibility of its operation in China.24 Finally, Google decided not to follow the Chinese rules and stopped eliminating sensitive information on Google.cn. This angered the Chinese government, which blamed Google for spreading pornography.

D. Fierce Market Competition with Baidu

Baidu is currently the largest Chinese search engine. It was established in 2000 by Yanhong Li. It is necessary to introduce Li’s life because his personal experience is related to Baidu’s competition with Google.

Li’s overseas experience benefited Baidu’s development. Li studied at Peking University, China’s Harvard, where he gained some useful relational assets. Later, he

24 Ibid.
studied at the State University of New York and majored in computer science. After graduation, Li fortuitously landed an engineering job in Silicon Valley. During his work in the U.S., he developed the Rankdex algorithm. Later, he utilized this technology for Baidu's search engine. Li's work experience in Silicon Valley including Infoseek was very important to the build-up of Baidu, because he honed his technical and business skills in the U.S. In 1999, Li raised $120 million in venture capital to fund his search engine concept.

Li established Baidu in ZhongGuan Chun in January, 2000. Seven months later, Baidu started to provide search services for Sohu and Sina, two popular news websites in China. China's intellectual property law (IPL) was then less strict than it now. In addition, Baidu's establishment was prior to China's admission to the WTO. There was no strong external force that pushed Baidu to obey international standards set by the WTO. Therefore, in its early years Baidu was able to provide free music and videos and allow users to download them for free. By contrast, Google could not do the same as Baidu did, because the U.S. had strict intellectual property laws. If Google did the same as Baidu did, Google would get lawsuits from other American companies. After 2004, the piracy issue was getting worse, so the U.S. government urged the Chinese government to follow international practices and to solve the piracy problem. Even though China joined the WTO in early 2002, the Chinese government did not take this issue seriously, because the WTO gave

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27 ZhongGuan Chun is a technology hub in Beijing. In the late 1980s, Chinese governmental officials visited the U.S. and realized that China should also build a high-tech area like Silicon Valley.
China a five-year transition period. During the five years of transition, the Chinese government actually tolerated piracy and protected its infant industries including Baidu. To some extent, Baidu's fast development benefited from China's state-led development. However, we cannot argue that Google's failure and Baidu's success is merely due to state intervention or support. We should also consider market competition.

Market competition was ruthless. As Google's major competitor, Baidu repeatedly attributed Google's failure to fierce market competition and Google's wrong strategies. Zhansheng Wang, Baidu's financial director, said,

With the development of Chinese language and the growth of China's unique economy, we believe that fully dependence on imported technology will not last, and we also believe that Chinese people will better understand their culture using their own search engine technology.

Some surveys have shown that Baidu is better than Google for searching Chinese words.²⁸ Both Google.com and Google.cn exist side by side. Google founder Sergey Brin said: "Only one percent of Chinese surfers use the censored site. But the American site is frequently slow and intermittently inaccessible inside China."²⁹ Many Chinese Internet users also pointed out that Google's search results were often less relevant compared to Baidu. Indeed, the quality and substance of results on Google.cn can vary radically from the main search engine.³⁰ Despite the fact that Google had invested a lot in China, its search engine was not widely accepted by the Chinese public. According to statistical data published by CNNIC in September 2009,

²⁸ http://searchenginewatch.com/article/2179779/Baidu-We-Do-Semantic-Search-Better-Than-Google
only 12.7% of Chinese Internet users chose Google China as their first choice, down 3.9% from 2008. By contrast, 77.2% Chinese Internet users chose Baidu.\textsuperscript{31}

\textit{E. Difficult Adaption to Host Country}

Most people attributed Google's exit to censorship, hacking or market competition in China. However, some had other explanations. They thought Google's failure was due to its failed adaption to Chinese culture.\textsuperscript{32} When Google was doing business in China, Google itself should have expected some differences arose from the rule-based \& relation-based cultures. According to \textit{Financial Times}, the chief executives of Microsoft and Hewlett-Packard have declined to back Google's threat to pull out of China over censorship and cyber-attacks. Steve Ballmer, former Microsoft chief executive, described Google's row with China as "the Google problem."\textsuperscript{33} He argued that "every large institution is being hacked."\textsuperscript{34} So, attacks from hackers cannot be an excuse to withdraw from China. Mark Hurd, CEO of HP, mentioned that China is "an amazing market with tremendous growth"\textsuperscript{35} and Google should overcome challenges instead of leaving the world's largest online market. Both Microsoft and HP played down the threats to Internet security which Google mentioned.

China is a relation-based country, where the enforcement of laws and regulations was on the books in some situations (e.g. Intellectual Property). China is

\textsuperscript{34} Ibid.
\textsuperscript{35} Ibid.
also a developing country. It is costly for an average Chinese wage earner to purchase authentic Windows software. Thus, piracy was rampant in China. Microsoft along with HP did not support Google's explanation for exit. Instead, Microsoft thought Google itself failed in adapting to China. Microsoft leaders argued that Microsoft did not leave China because of piracy. Instead, Microsoft took efforts to persuade more Chinese people to buy authentic copies and is experiencing more success now. With more and more Chinese having the means to afford Microsoft products and the development of intellectual property laws, the situation is improving in China and Microsoft continues to profit.

Google set up a research and development center in China in 2005. In 2010, it exited mainland China. Some Chinese college students and well-educated urban residents are disappointed by Google's exit. In order to obtain foreign information accessible through Google, they have to evade China's Great Firewall, which is time-consuming and requires special computer skills and software. However, Google's exit did not affect most average Chinese internet users. During the intervening five years, Google encountered numerous problems. China, as one of several emerging markets, had unique cultural and political circumstances with which Google had to contend. The case of Google's Chinese development shows that American internet and media firms are facing either one or two of these issues while doing businesses in China: cultural relevance for the Chinese users, fierce market competition and statist intervention from the host country. The next two cases, eBay and Facebook, will further support the above argument.

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Ten to 15 years from now, I think China can be eBay's largest market on a
global basis.... We think China has tremendous long-term potential and we
want to do everything we can to maintain our No. 1 position.\textsuperscript{37}

Meg Whitman, former eBay CEO, 2004

eBay along with Google entered China with confidence and expectation.
However, both failed to establish their enduring presence in China. Unlike Google,
eBay did not receive regulatory resistance or censorship from the host government.
So, what led to eBay's failure in China? Before answering this question, let's look at
what motivated eBay to enter China and how did it enter China.

What Motivated eBay to Enter China?

The emerging online consumer-to-consumer (C2C) market is shaping China's
economy. It has benefited both buyers and sellers. Online shopping has at least three
advantages compared to shopping at a physical store. First, online products are
usually cheaper than those in physical stores. Second, buyers can get products not
available in the stores nearby their homes. Third, it can lower sellers' costs and thus
increase the number of potential sellers. Over the past two decades, China's fast
development is largely due to its export-led economy model. For this matter,
China's domestic household consumption is weak. In recent years, the Chinese

\textsuperscript{37} William Barnett, Xiaoqu Luo, Mi Feng: "Taobao vs. eBay China", Stanford Graduate School of Business,
Case No IB88, 2010.
central government has realized that China's growth could not depend on exports in the long run. Thus, China needs to shift from exports to domestic consumption. In order to increase domestic consumption, the Chinese government has opened up e-commerce market to foreign investment since the early 2000s. Under this background, eBay chose to enter China.

On August 18, 1999, Eachnet was established in Shanghai, China. It was the first C2C e-commerce platform in China. The founders are Yibo Shao and Haiyin Tan. They were both Shanghai residents and graduated from Harvard business school. At the very beginning, in order to attract customers, Eachnet was free for both buyers and sellers. With fast development and expansion, Eachnet started to charge users in 2001.

In March, 2002, eBay invested 30 million dollars in Eachnet and became a strategic partner with Eachnet. In a short time, Eachnet developed into the largest online seller in China. In June 2003, eBay officially purchased Eachnet and entered China. At the same time when eBay entered China, a Chinese rival Taobao was established. It was also free for all users at the beginning.

Eachnet was once a leading online seller in China, accounting for 80% of market share in China, because it was experienced in sales either internationally or domestically. In addition, Eachnet maintained good relations with its customers. Thus, at that time many business analysts believed that with purchase of Eachnet, eBay would become a leading online commerce platform in China. Although eBay

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39 eBay invested US$180 million to capture 80% of China's ecommerce market in 2002, only to see that shrunk to 36% by 2005 (http://www.psycheselling.com/eNewsletter%20Jun%202008.htm)
had failed in Japan prior to entering China, many business observers optimistically believed that eBay could succeed in China through learning lessons from the past. Moreover, eBay was then growing very fast and dominated the online market in the U.S. However, eBay’s later failure in China let down those optimists.

How Did eBay Exit from China: Cultural, Statist and Market Causes of eBay’s Failure

The year 2006 was the watershed for eBay and Taobao, a leading Chinese E-commerce firm. By the end of 2006, eBay had invested three hundred million dollars in China, but with little success. Its market share was decreasing yearly. By contrast, its Chinese rivals, Alibaba’s Taobao and Tencent’s Paipai surpassed eBay. eBay’s market share was only 20% in 2006 and former Eachnet leader Yibo Shao left eBay. Taobao actually became the largest online seller in Asia in 2006. According to Bloomberg Business Week, Taobao occupied 72% market share. Its transaction was more than 1.7 billion US dollars. It had more than eighteen millions items online and its registered users were increasing faster than eBay. In December 2006, eBay had to shut its main website in China and entered into a joint venture with a Chinese company instead.

A. A Cultural View: eBay Failed in Localization

Localization is a popular term used in many areas, such as computing, website building, language, video games and human recourses. In the field of international political economy, localization often comes with glocalization, which refers to the idea of "think globally, act locally." There are many comparison studies of Taobao and eBay. They compare websites, customer service, corporate cultures and localization strategies of the two companies. EBay as an American MNC faced more localization problems than Taobao, such as website translation, decision-making between Chinese officers and officers in the U.S. headquarters. EBay’s Chinese leaders complained that the eBay headquarter in San Jose did not listen to their opinions. The former head of strategic planning at eBay China, Charles Shen, complained,

As the service is now running from the global platform in San Jose, California, if we have to add a new feature, it takes quarters, instead of months. Taobao is more flexible and faster in responding to users.

EBay’s Chinese leaders felt that they were remotely manipulated. Although eBay’s CEO Meg Whitman had spent some time in China, her knowledge of the Chinese market is still limited. EBay has succeeded in Europe. However, China’s different culture made eBay’s adaption to the Chinese market more difficult. One example shows that the lack of cultural awareness from some U.S. managers can cause problems. A senior eBay manager visited China and brought some green hats

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as gifts for his Chinese colleagues. His Chinese colleagues were shocked and felt very embarrassed. In the U.S. people wear green hats on Saint Patrick's Day. But, in China wearing a green hat signals that you are a cuckold.45

To some extent, eBay failed in localizing its managers as well as services. When eBay entered China, it copied its formula from the U.S., such as charging multiple listing fees and a final price percentage while Taobao did not have such fees.46 In 2006, eBay had to cancel the fees for basic service, but it was too late. At that time Taobao had already attracted many customers from eBay. Another factor which makes Taobao more popular than eBay in China is its instant messaging service. In 2003, Taobao started Aliwangwang, an instant communication tool to help buyers and sellers interact.47 Paul Pavlou, professor of management information systems at Temple University said: "Those Chinese buyers really want to get to know the sellers."48 Culturally, most Chinese buyers have the habit of cutting the price. But, eBay China's website did not allow buyers to contact sellers directly at the beginning. Rosella said:

Successful in dozens of countries, the multi-billion dollar business was no match for China, where citizens place a premium on interpersonal relationships and high-quality social interactions.49

Besides, many Chinese customers prefer to use Taobao's Alipay than eBay's Paypal. They think Alipay is a more comfortable way to pay online. As Ma said,

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49 Rosella Elenanor Lafevre, "Why eBay failed in China?" Pacific Standard, June 2013
All for the summarize of the success of Taobao are simple two sentences, because we are a very native of local Chinese pioneering group, so we know what Chinese consumers need and eager, because we know, we respect everyone's needs, we have to make it out, thus is our secrets of success.50

B. Market Competition

Paipai is another rival to eBay besides of Taobao. Taobao in Chinese means find treasures while Paipai means auction. Paipai was launched in September, 2005. Less than half a year after its establishment, Paipai announced that its total listings had already exceeded that of eBay Eachnet.51 Why could Paipai overtake eBay in such a short period of time? Paipai is a subsidiary of China's largest internet firm, Tencent. Compared to eBay, Paipai could take the advantage of Tencent's QQ (QQ is a well-known instant message software in China). As of March 2013, there were around eight hundred million active QQ accounts.52 Through the platform of QQ, an E-commerce firm can quickly reach majority of young Chinese people who are actually the most active online shoppers. Indeed, QQ served as a powerful marketing tool for Paipai in competitions.

Moreover, Paipai and Tencent's founder Huateng Ma majored in computer science and is familiar with online marketing and new technologies. In the early stage of development, Paipai did the same thing that Taobao did, that is, getting risk investments from foreign countries, particularly the U.S. In the 1990s, Tencent received risk investments from at least two American companies, International Data

Group Inc. and Pacific Century CyberWorks Limited. Tencent and Taobao also learned or copied some technologies from U.S. companies in the 1990s when many Chinese IT companies ignored intellectual property rights. For instance, Huateng Ma copied American messaging software ICQ and developed its Chinese version called QICQ, which caused ICQ to sued Huateng Ma. Although Mr. Ma lost the lawsuit and had to change the name QICQ to QQ, this did not bring much trouble to him. With a better understanding of the Chinese market and invisible Guanxi, Ma’s QQ beat MSN messenger and ICQ in China. Today, QQ is an inseparable part of Chinese people’s daily life. As a powerful marketing and messaging tool, QQ helped Paipai outperformed eBay in China.

C. A Statist View: Taobao Has State Support While eBay Doses Not

Admittedly, cultural and market factors play important roles in the case of eBay vs. Taobao and Paipai. However, we should never neglect the role of state. In China’s sectoral politics, Chinese firms in young industry sectors are often encouraged by the state. E-commerce is a young industry sector. Given that Taobao is a Chinese firm, it does enjoy some benefits from the state that eBay does not. Yun Ma, founder of Taobao, beat eBay and made the Chinese leadership proud of Chinese firms. In recent years, he was greeted by top Chinese leaders including President Xi and was cited as an example of China’s national pride. Indeed, we have to acknowledge that the success of Taobao is mixed with China’s rapid economy growth, nationalism, and political support from the government. Today, Yun Ma (or

Jack Ma) is one of the richest Chinese businessmen. He is frequently interviewed by Western media such as CNN, Financial Times and Forbes. Paul Gillis of Peking University said,

People say China hasn’t created a Steve Jobs but I think they have, I think it is Jack Ma...... and he doesn’t want to make the same mistake Steve Jobs did, which is to give other people control over his company.54

TaoBao’s success over eBay is related to two points: Ma’s U.S. experience and his Guanxi with the Chinese government. Previous studies show that Yun Ma had no idea of the Internet until a lucky trip to the U.S. In early 1995, Yun Ma had a chance to visit the U.S. With his friends’ help, Yun Ma got to know the trend of Internet development in the U.S. He envisioned the bright future of Internet business in China. So, he immediately collected 20,000 Chinese Yuan and started a website called “China Yellow Pages”,55 which is one of the earliest websites in China. Less than three years later, he made 3 million Yuan from this website.56

Yun Ma’s ambition is beyond the 3 million Yuan. He wanted to build a business empire in China. He clearly knew that without support from the government, he could not make it. Thus, in 1997 he traveled to Beijing and persuaded government officials to build government websites. Yun Ma suggested that he would like to build those websites for free. It turned out that Chinese government officials were amazed at the U.S. new technology, the Internet. They praised Yun Ma for his innovation and contribution. With money earned from his first website and support from the Chinese government, Yun Ma became much more self-confident. Therefore,

54 Jamil Anderlini, “Jack Ma, the Mogul heading to Wall Street.” Financial Times, September 27, 2013.
55 Jamil Anderlini, “Jack Ma, the Mogul heading to Wall Street.” Financial Times, September 27, 2013.
56 Ibid.
in March, 1999, he started Alibaba, one of the earliest e-commerce websites in China. Several months later, he received five million US dollars of risk investment. In 2003, he used some of this investment to build Taobao. Without support from local and state governments, Taobao could not grow such fast and reach every province in China. When Taobao beat eBay in 2006, Ma’s business empire reached its climax.

Facebook and Social Network Sites (SNS) in China

Google and eBay entered China, but they failed to establish a foothold. They may learn lessons from the failures and later reenter the market. Their situation is better than those American internet and media firms which are banned in China. Due to the absence of Facebook, YouTube and Twitter in China, their Chinese counterparts have emerged quickly and gained large market shares. For instance, Youku is the most popular video website in China. Renren, China’s Facebook, has a webpage layout extremely similar to that of Facebook. Weibo is the Chinese Twitter. Facebook is built upon the “six degrees of separation” or “small world phenomenon.” This theory suggests that the average number of steps to know a stranger between any people is six. Like many other Internet companies, Facebook’s success is largely due to its innovation. Facebook makes the world and people more connected.

Facebook is the world’s largest social network website. Its users are about one billion a month, accounting for one seventh of the world population. Its major founders started it when they were still college students. Today, Facebook has already developed into a business giant. Mark Zuckerberg’s success is encouraging more and more young entrepreneurs. Freedom of speech is a major characteristic of Facebook. Basically, you can find or discuss any topics on Facebook, like the U.S. election, India’s social movements, and China’s human rights issue. The world is divided into the Haves and Have Nots. China, North Korea, Syria and Iran do not have Facebook, because authoritarian leaders know that political and social stability is crucial to their interests and survivals. In the Arab Spring, Facebook served as an online gathering place for anti-government riots. There are also many sensitive topics regarding Chinese politics on Facebook, including Fa Lun Gong, human rights, Tibet, leadership scandals and corruptions. Yongkang Zhou and Yunshan Liu, two members of China’s Politburo Standing Committee, were tasked with stability maintenance. Under their guidance, China built the “Great Firewall.”

59 Jemima Kiss, “Facebook Hits 1 Billion Users a Month”, Guardian, October 2012.
A. The Great Firewall of China

“If you open the window for fresh air, you have to expect some flies to blow in.”

Deng Xiaoping

Two thousand years ago, China’s first emperor Qin Shihuang built the Great Wall to stop barbarians invading China. The Great Wall is one of the world’s seven wonders. Although it has already lost its military function, it is a symbol of China tourism today. The Great Wall had many drawbacks and actually did not fully protect China. In history, Mongolians broke some corners of the Great Wall and invaded China. Likewise, the Great Firewall also has its drawbacks. It cannot stop every Chinese to visit Facebook or YouTube. Immediately after the Great Firewall was invented, Chinese Internet users found new methods to evade it. For example, they can use foreign proxy servers or install special software. By doing so, it is either time-consuming or much slower than normal visit. Moreover, for average Internet users who have limited computer skills, they probably do not know how to find foreign proxy servers. Until today, there is no accurate statistic to show how many websites have been blocked by the Great Firewall.

Economic development and democracy is not necessarily causal to each other. Shue argues that,

In light of “modernization” in Asia generally, we certainly cannot assume that systemic “reform”, pursued primarily to attain economic efficiency and administrative rationalization, will necessarily bring with them enhanced political influence or democratic freedoms for the masses of rural people.61

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Facebook was in China for a while. It has been blocked by the Great Firewall since 2008. Mark Zuckerberg with his Chinese-American girlfriend visited China several times. However, as long as Internet censorship is strict in China, Facebook has no plans to launch in China. Many people thought that the Chinese authority would make China become more democratic with double digit GDP growth rate from 2000 to 2008. But, they were wrong. The Great Firewall, an Internet censorship system, was invented at the time when China's economy was fastest-growing. Senior public security leaders were very cautious about mass incidents caused by land expropriation and huge income gap. The Great Firewall helps prevent separatist and terrorist movements in China, which is embraced by some Chinese people. However, it blocked many foreign websites and received much criticism either domestically or internationally.

B. Social Network Services (SNS) in China

Innovation in Chinese SNS helps explain the lack of market penetration by American firms. According to iResearch, in 2011 the population of China's social network users is 370 million and is expected to reach 510 million in 2014. The population of U.S. social network users is 150 million. iResearch divides the development of SNS in China to three periods: 1. Infancy (1999-2004); 2 Start-up and slow development period (2005-2007); and 3. Populace and fast development period (2008-present). iResearch also categorizes four types of SNS in China: entertainment; marriage and dating; business and others. Entertainment SNS has

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62 "Mark Zuckerberg visits China, sparking 'new business' speculation", Telegraph, December, 2010
63 iResearch China Social Network Market Research 2010-2011.
the much more users than other types of SNS, accounting for 75.1%. Dating and marriage SNS are second, accounting for 16.1% of the total population. Since many foreign SNS platforms are not available in China, Chinese SNS companies did not face strong competition. Moreover, their initial features and functions are very similar to foreign SNS platforms, but now find themselves innovating beyond the initial look and feel of Facebook or Twitter. Today, there are various SNS in China. The top ones are QQ, Sina Weibo, Renren, Tencent Weibo, Douban, Kaixin001 and WeChat. On the next page is a chart of top Chinese SNS platforms provided by KPMG.

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64 “Social media in China: Local innovation connecting the country,” KPMG: China 360, April, 2013.
Table 2.1

Top SNS Platforms in China

<table>
<thead>
<tr>
<th>Owner</th>
<th>Active users (million)</th>
<th>Platform(s)</th>
<th>Description and functions</th>
</tr>
</thead>
<tbody>
<tr>
<td>QQ</td>
<td>800</td>
<td>Desktop, PC, Mobile</td>
<td>One of Tencent's oldest applications. Used as a person-to-person (P2P) communication tool. Works on any smart phone, even 2G versions.</td>
</tr>
<tr>
<td>Qzone</td>
<td>600</td>
<td>Desktop, PC, Mobile</td>
<td>Facebook-like SNS website – allow users to create home pages, blog, upload photos and videos. Links seamlessly with QQ</td>
</tr>
<tr>
<td>Weixin (WeChat)</td>
<td>300</td>
<td>Mobile only</td>
<td>First China-base app to launch in English. Instant message and talk platform</td>
</tr>
<tr>
<td>Sina Weibo</td>
<td>350</td>
<td>Mobile, Desktop and PC accessible</td>
<td>Twitter-like blog with Facebook advertisement features.</td>
</tr>
<tr>
<td>Tencent Weibo</td>
<td>250</td>
<td>Mobile, Desktop and PC accessible</td>
<td>Very similar to Sina Weibo, capitalizes on its large user base from QQ.</td>
</tr>
<tr>
<td>RenRen</td>
<td>100</td>
<td>Desktop, PC, Mobile</td>
<td>Facebook-like SNS niche website. Popularity among college students.</td>
</tr>
<tr>
<td>Douban</td>
<td>100</td>
<td>Desktop, PC, Mobile</td>
<td>SNS niche website – allows users to record information and create content related film, books, music, and recent events and activities in Chinese cities.</td>
</tr>
</tbody>
</table>

Source: KPMG

Many SNS and TV programs in China are relatively new. They are only two or three years old, “yet they are tailoring innovative and fun platforms that not only meet the needs of China's online population, but also satisfy government regulations.”65 Like YouTube in the U.S., there are various Chinese TV programs and videos on the Internet. One of the most famous TV programs is called “Fei Cheng Wu

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Rao (If you are the one). This TV program serves as a good example of statist intervention. In 2010, Chinese central government propaganda officials issued a directive calling the shows “vulgar” and faulting them for promoting materialism, openly discussing sexual matters and “making up false stories, thus hurting the credibility of the media.”

Summary and Suggestions for American Internet Firms

In this chapter, I have chiefly discussed several major factors that resulted in the failures of American Internet companies in China. First, China did not take piracy seriously until recently, because when China joined the WTO in early 2002, the WTO gave China at least five years of transition. In other words, China was not required to fully open its market in the transition period, which benefited Baidu, Google’s major competitor in China. For example, in its early years of development, Baidu put free movies and music on its website. By contrast, Google could not put any Hollywood movies or American music on its Chinese website because Google is an American firm and might be sued by other American firms if it did so. Second, Google’s failure is not merely due to the intervention by the Chinese government. In terms of searching Chinese words, Baidu did a better job than Google. Google advocated for a higher degree of internet freedom. On one hand, it exposed much sensitive information regarding Chinese politics that the Chinese internet users could not find.

through Baidu. But, on the other hand Google did a poor job of blocking pornography compared to Baidu.

Third, similar to Google’s situation in China, eBay also faced a strong competitor in China. Taobao beat eBay in both government-company relations and market entry. Prior to eBay’s launch in China, Yun Ma, founder of Taobao, had already established good relations with the Chinese government as he built a series of websites for the Chinese authorities for free in the late 1990s. In addition, eBay lost market competition at the very beginning when it entered the Chinese market. For instance, eBay charged fees for basic services and its Chinese website did not have an instant messaging tool between buyers and sellers. Taobao knew the Chinese consumers better than eBay. Taobao promised free listings to the Chinese consumers and also created Aliwangwang, a free online tool, through which buyers could haggle with sellers.

Fourth, unlike eBay and Google who voluntarily exited the Chinese market, Facebook did not really enter China as it was blocked by the Great Firewall of China. Due to the absence of Facebook in China for years, Chinese SNS have already grown up and the Chinese internet is already accustomed to using them. Even though the Chinese government lifts bans on Facebook in the future, it would be very difficult for Facebook to gain a huge success in China, because the market for SNS in China is already saturated.

Finally, it is necessary to draw some lessons from the failures of Google, eBay, and Facebook. Not all American companies failed in China. Some are doing good business in China. IBM, Intel and Apple provide high-tech physical products, which
are welcomed by the Chinese public and government. They do not have strong Chinese competitors. In addition, they do not publicly comment on Chinese politics and just focus on doing business. By contrast, YouTube, Twitter, and Facebook only provide online services. In their online content, there is criticism of Chinese politics which upset the Chinese government. As I discussed before, government intervention and localization are the two major causes of failures for American Internet companies.

EBay does not talk about Chinese politics, but it still has failed in China. The major cause of its failure is market competition instead of government censorship. Taobao, EBay’s Chinese rival, has a better understanding of the Chinese customers’ demand than eBay. The founder of Taobao, Yun Ma said, “eBay maybe a shark in the sea, but I am a crocodile in the Yangtze River. If we fight in the sea, I’m sure to fail; but if we contest in rivers, we can win.”

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Table 2.2
Comparisons among American Firms in China

<table>
<thead>
<tr>
<th>U.S. companies</th>
<th>Type</th>
<th>Strong Chinese rivals</th>
<th>Service/products</th>
<th>Discuss Chinese politics</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>Google</td>
<td>search engine</td>
<td>Baidu</td>
<td>Service</td>
<td>Yes</td>
<td>Failed</td>
</tr>
<tr>
<td>eBay</td>
<td>e-commerce</td>
<td>Taobao</td>
<td>Service</td>
<td>No</td>
<td>Failed</td>
</tr>
<tr>
<td>YouTube</td>
<td>video</td>
<td>Youku</td>
<td>Service</td>
<td>Yes</td>
<td>Failed</td>
</tr>
<tr>
<td>Facebook</td>
<td>social network</td>
<td>RenRen</td>
<td>Service</td>
<td>Yes</td>
<td>Failed</td>
</tr>
<tr>
<td>Twitter</td>
<td>Social network</td>
<td>Weibo</td>
<td>Service</td>
<td>Yes</td>
<td>Failed</td>
</tr>
<tr>
<td>Apple</td>
<td>hardware</td>
<td>None</td>
<td>Products</td>
<td>No</td>
<td>Succeeded</td>
</tr>
<tr>
<td>IBM</td>
<td>comprehensive</td>
<td>None</td>
<td>Service/Products</td>
<td>No</td>
<td>Succeeded</td>
</tr>
<tr>
<td>Intel</td>
<td>hardware</td>
<td>None</td>
<td>Products</td>
<td>No</td>
<td>Succeeded</td>
</tr>
</tbody>
</table>

Source: author's data

Based on Table 2.2, there are some suggestions for American internet companies in China.

1. Depoliticization of services and products. Google, YouTube, Facebook and Twitter all failed in China due to their criticism of Chinese politics or connection with the U.S. government.

2. Provide online services as well as high-quality physical products. Chinese companies emulate American companies' websites or IT services at first and later make them better adapted to Chinese consumers. However, high-quality physical products (e.g. iPhone, Intel CPUs, ThinkPad, and iPad) are not easy to be copied by
Chinese companies. American companies should think about how to provide physical by-products beyond online services.

3. Do not invest by yourself. American IT service providers often face the problem of localization. Therefore, Cooperating with Hong Kong or Taiwan companies can help lower investment risks. Hong Kong and Taiwan companies can serve as a bridge between mainland China and the West. At the same time, we also hope that China could continue to reform its political and financial systems.
CHAPTER III

CASE STUDY 2: AMERICAN COMPANIES THAT HAVE SUCCEEDED IN CHINA

With only 5% of the world's population, the U.S. controlled about 75% of its television programs. Combined with the influence of brands and products such as Hollywood, Kentucky Fried Chicken, McDonald's, jeans and Coca-Cola, American culture has permeated almost the entire world.

Complained by a Chinese propaganda official, January, 2011

Introduction

Unlike an Internet company, a fast food chain or an auto plant hires more people. For instance, by the end of 2007, KFC has employed more than 160,000 Chinese employees. KFC announced that it would insist to employ more local people. In 2013, McDonald's has approximately 90,000 employees in China. McDonald's is planning to hire 75,000 more new employees. KFC together with other fast-food companies have also created huge tax revenues and stimulated China's domestic market demands which are exactly desired by the Chinese government. Even though in recent years KFC was warned by the Chinese government due to its "45-day-old chickens" problem, the Chinese government and public's positive attitudes toward KFC are still unshakable.

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1 "Sun Tzu and the art of soft power," The Economist, December 17, 2011.
2 Longyu Zhou and Qinjie Zhang: "Cultural Adaptation Pattern Analysis of McDonald's and KFC in the Chinese Market", Uppsala University, spring 2012.
In the life of Chinese people, 衣 (clothing), 食 (food), 住 (shelter) and 行 (transportation) are usually the four most basic necessities and often come together. In other words, their daily lives and survivals depend on the four basic aspects. However, the concepts of the four necessities have changed a lot alongside China’s fast economic development. Thirty years ago, a bike was a necessity of an average Chinese family. Many old photos showed that Beijing was a city on bike. Today, an average Chinese family could afford to buy one or two cars. Instead of owning a bike, owning a car gradually becomes the necessity of Chinese people’s daily lives. Also, Fan Piao (food ticket) was a necessity of Chinese people’s daily lives under the planned economy, because many people had to use Fan Piao to exchange food in schools, factories, and other public sectors. Today, people no longer use Fan Piao and just collect them for fun like stamp collecting.

In this chapter, I will examine both American fast food firms and auto makers in the Chinese market. How and why have they succeeded in China? The goal is to find out factors that differentiate American IT firms from American restaurant franchises and automotive manufacturers. This chapter is divided into two major parts: American fast food companies and American auto companies. Under each part, there are two cases (KFC and McDonald’s, Buick and General Motors). At the end of chapter is a brief summary that draws inferences from the case studies.
An Overview of American Fast Food Firms in China

American fast food is very popular in China. Walking on major streets of any Chinese city, you are very likely to come across an American fast food restaurant, such as KFC, McDonald’s, and Pizza Hut. Their advertisements are everywhere. Despite the fact that some Chinese people think that fast food is not healthy, American fast food is still getting more and more popular among urban residents in China. Why did American fast-food companies succeed in China when IT companies failed?

There is an old saying in China, “民以食为天, 食以安为先” (Food Comes First to Human, So Does Safety to Food).\textsuperscript{4} China is rich in cuisine culture. Basically, there are eight culinary traditions in China (Sichuan, Fujian, Cantonese, Hunan, Jiangsu, Anhui, Shandong, and Jiangsu). My hometown is Chongqing, Southwestern China, which has the Sichuan food style. Chongqing food is usually spicy and numbing. Hot pot is the symbol of my hometown. In ancient China, many peasant revolutions were directly caused by natural disasters and great famines. Thus, most Chinese emperors put food production as their top priority. In Mao’s China, the three years of Great Famine caused about 36 million deaths from 1959 to 1961.\textsuperscript{5} My father was born during the Great Famine. My grandparents were too poor to feed my father well. So, they had to find some wild fruits and plants in mountains. One of my close

\textsuperscript{4} Originated from Book of Han, AD 111.

American friends, now in his fifties, told me that back to then his elementary teacher told him not to waste food as the Chinese were still hungry.

Since economic reforms in 1978, China has transformed from a centrally planned economy to a semi-free market economy today. According to the World Bank, China’s GDP growth averaging about 10 percent a year has lifted more than 500 million people out of poverty.6 With the improvement of living standards, Chinese people’s consumption level has increased. Today, they are not just satisfied with enough food. They are looking for various food and exotic tastes. Some American food companies caught the great opportunity and entered China two decades ago. KFC and McDonald’s were the pioneers. They opened branches in China in 1987 and 1990, respectively. Their success stories have encouraged more American food companies to set up businesses in China. According to China Daily, there are about 1,300 franchise companies in the U.S. but only 15 percent of them have entered the Chinese market. A group of American franchisors visited four major Chinese cities in 2013. They look to follow KFC’s lead.7 Nancy Weingartner, editor of the Franchise Times, said:

Franchises such as Wing Zone, CKE, Rita’s, Fuddruckers, Round Table Pizza, Right at Home, Jani-King and Sotheby’s International Realty are hoping to follow KFC’s path to success and view China as a great long-term growth opportunity. Food and beverage brands are usually the first to enter international markets, and we believe more US restaurant brands will come to China, following the success of the large franchisors.8

Following KFC’s and McDonald’s huge success, Hooters, the Atlanta-based restaurant chain, opened its first restaurant in Beijing in 2007. It attracted the
Chinese news media immediately after its opening. Although the waitresses are all Chinese girls, their outfits are much like their counterpart in the U.S. Beijing Hooters has attracted many young customers, particularly the Chinese returnees from the U.S. When customers come in, they call out in garbled English, "Welcome to Hooters!" For those elder Chinese, their opinions are divided into two groups: the open-minded and the stubborn. The former think that importing Hooters is good because it is a new addition to the Chinese food market. Hooters is full of excitement and enthusiasm which most Chinese restaurants do not have. The latter cannot accept the outfit of the Hooters girls. They think those girls are too sexy and are worried that this may mislead their young children.

Hooters has not received any intervention from the Chinese authorities so far. Beijing, once a forbidden city during Qing Dynasty, has become an international metropolis full of vigor and variety. Hooters's launch in Beijing is a good example of globalization and American culture spreading in China. Compared to the internet sector, the Chinese government's control on foreign food companies is much looser.

In the next section, I will address the success of three major American food companies in China in more details.

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KFC and McDonald’s in China

A. KFC: A Subsidiary of Yum! Brands

Kentucky Fried Chicken (KFC) is the world’s chicken restaurant chain with more than more than 40,000 KFC chain stores around the globe. There are more than ten million customers buying KFC products every day. In China, KFC is ranked number one in the fast food sector. It has 4,600 chain stores in over 900 cities in China. The KFC logo can be seen from the Great Wall of China to the bustling downtown area of Chongqing. After KFC is McDonald’s which has about 1,800 restaurants in China.

KFC was founded by Harland D. Sanders in the early 1950s. “Colonel Sanders” is a modern business legend and chicken cooking genius. People liked the fried chicken cooked by him personally. He wore a white suite and black tie. He smiled a lot. His image became the KFC logo which is one of the world’s most recognizable brands. Today, KFC is a subsidiary of Yum! Brands. Two other powerful subsidiaries of this firm are Pizza Hut and Taco Bell. Yum! Brands has more than 40,000 restaurants around the world. Yum! Brands ranks number one in the world of food and beverage industry. Its U.S. headquarter is in Louisville, Kentucky and the Chinese headquarter is in Shanghai, China.

10 http://www.yum.com/company/
12 Ibid.
B. Why Did KFC Enter China in the Late 1980s?

In 1986, China was still in the early stages of market liberalization. Its planned economy was gradually shifted to a market economy. The Chinese government started to set up various special economic zones in the coastal areas and gave foreign companies many preferential policies. Market liberalization made Chinese people eager to communicate with the international market and seek advanced management concepts. Prior to China, KFC had launched stores in Japan, Singapore and Hong Kong. Therefore, KFC had learned many lessons from those stores before it entered China. Besides, Tony Wang, then-vice chief of KFC in Southeast Asia, had successful cooperation with the Chinese government in Tianjin city.

China has the world’s largest population and the demand for new flavors is very strong. The huge Chinese market is very attractive to KFC. Yum!Brands, parent company of KFC, has a statement on its official site:

Yum!Brands is focused on building leading brands in China in every significant category. We think China is the best restaurant opportunity of the 21st Century with a consuming class that is expected to double from 300 million to more than 600 million people by 2020.13

China is also a multi-ethnic country. The majority is Han people. There are 55 minority groups like Zhuang, Tibetans, Mongolians, Koreans, Hui and others. In history, the Han Chinese continued to absorb new flavors, new ideas and new ways of doing business from other ethnic groups. For example, my former college, Beijing Normal University, has a Moslem restaurant for the Hui people and Uyghurs. The Hui people and Uyghurs are Chinese Muslims. The restaurant offers a popular dish called "DA PAN JI" (literally, Big Plate Chicken). Most Chinese families like eating

13 http://www.yum.com/brands/china.asp
Chicken. In the traditional Chinese cuisine culture, chicken has the function of “yang sheng bu shen” (preserving heath and invigorating human kidneys).14

C. KFC Chose the Right Location: At the Center of Downtown Beijing

On November 12, 1987, KFC opened its first store in Qian Men, Beijing. What is Qian Men? Qian Men is a famous pedestrian street crowded with various stores. It is located at the central axis of Beijing. Not far away from Qian Men are the Tiananmen Square, Mao Zedong’s tomb and the Forbidden City. Buildings in Qian Men are traditional Chinese styles. At that time, KFC was probably the first foreign fast food company in China and the housing price was very low. China’s housing price has soared in the past decade. Nowadays, when other American fast food companies enter China, they have to go to other locations farther away from the center of Beijing or go to the second tier of major Chinese cities for cheaper rent. Taking Beijing as a starting point, KFC’s development is like “a little spark that kindles a great fire.” By 2001, there were more than 500 KFC units throughout China. In 2007, the 2,000th store opened in Chengdu, and the 3,000th outlet opened in Shanghai three years later. In 2012, a new KFC railway station branch which opened in Dalian’s Xinghai Park became the 4,000th KFC units in China.15 Now we are expecting the 5,000th KFC store at some point in the next five years. However, KFC’s fast development was not always smooth. In the next section, I will discuss what major problems KFC had met in China.

14 http://baike.baidu.com/view/3209384.htm
D. Treated Differently in the 1989 Tiananmen Protest and the 1999 Anti-American Protest

Opportunities and challenges both existed when KFC entered China. First, during the 1980s the Chinese economy and politics were experiencing a difficult transition. There were many unstable factors for KFC's business in China. For example, two years after KFC's launch in Beijing, the Tiananmen Square Incident happened. Thousands of Chinese college students flooded to the Tiananmen Square, protesting corruption and asking for democracy. KFC is on the edge of Tiananmen Square, just across the street from Mao Zedong's tomb. In this incident, the KFC store served as a gathering place for some protestor:

As numbers grew, protesters began circulating their own daily newspaper and erected a broadcasting tent. Many conducted meetings and shared ideas in the southwest corner of the Square at the Kentucky Fried Chicken.16

They set up, in the heart of the ancient nation, their own world within the world, complete with a daily newspaper, a broadcasting tent, even a 30-ft. plaster-covered statue they called the "Goddess of Democracy." Their "conference hall" was a Kentucky Fried Chicken parlor on the southwest corner of the square, and their spokesmen were 3,000 hunger strikers who spilled all over the central Monument to the People's Heroes.17

On May 8, 1999, the Chinese embassy in Yugoslavia was bombed by an American aircraft. Three Chinese died and more than twenty were injured. This incident immediately triggered the outbursts of anger among the Chinese public. Thousands of Beijing residents and college students marched in streets and threw stones at the U.S. embassy in Beijing. Some college students also came to McDonald's and KFC's stores in Beijing and persuaded other people not to buy American

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products. It is said that in Changsha city three KFC stores and one McDonald's were attacked on May 9. These examples illustrate challenges KFC faced in the Chinese market.

E. Challenges and Market Competition

Price and costs were challenges for KFC during its early development in China. The Chinese people's average income was quite low in the 1980s. Even today, China's GDP per capita is one seventh of America's. In addition, due to differences in species, the right potatoes for making mashed potatoes and fries were also hard to find in China. So, KFC had to import them from the U.S., which increased the cost. KFC is pricy for average Chinese people. Take myself for an example; I had not got a chance to eat KFC until I was in high school. I remembered a simple KFC meal was about twenty Yuan while an average Chinese meal was about three or four Yuan in the early 2000s.

KFC is popular among young Chinese; however, many elder Chinese without international experience cannot accept its price and taste. The attitudes toward KFC are starkly different between the young Chinese and the elders. In the U.S., KFC is just so regular. But for young Chinese, they think KFC is clean and well decorated. They even choose KFC for dating. They post their KFC meals on social network websites like Weibo and Renren. By contrast, their parents do not think KFC is worth the money. Besides, the elder Chinese are still not get used to hamburgers and the flavor of ketchup.
There is increasing competition from local Chinese fast food companies. Chicken chain Dicos, Country Style Cooking, and Kung Fu Catering are local fast food brands. They are innovating new kinds of food by combining KFC style with the Chinese food style, like rice burgers with lotus roots. Weitang Zhuang, spokesman for Dicos said: “After all, since ancient times rice has been the key staple of the Chinese people.”\(^{18}\) Besides, lunch at Dicos costs less than 17 Yuan ($2.80) compared with a similar offering from KFC, which costs 25 Yuan ($4.11), according to Mintel. Dicos says it aims to “break the traditional Western fast food mould.”\(^{19}\)

\(F. \text{KFC's Valuable Experience in China}\)

Despite of those challenges, KFC provides valuable experience for both American and Chinese fast food companies. For example, KFC demands every store to follow the principle of “CHAMPS” (Clean environment, hospitable service, accurate orders, maintains facilities, product quality and speed of service). I have observed a number of average Chinese restaurants here in the U.S. and back in China, and I have to admit that they are dirtier than their American counterparts. According to Mintel, a London-based market research company, “foreign outlets have the advantage in terms of hygiene perception – with 18% of Chinese consumers saying foreign fast food outlets perform a lot better in this area (compared to 1% for Chinese outlets) as well as ambience – with 14% of Chinese


\(^{19}\) Ibid.
consumers thinking foreign fast food outlets perform better in this area compared to 1% for Chinese.\textsuperscript{20}

American fast food companies are also more professional than the Chinese. Their employees have outfits. They print their logos and slogans on boxes, bags, cups and menus. They build pretty websites and provide by-products like T-shirt, cups, and photo frames. Credit cards are widely used here in the U.S., which makes order service quicker. In China, most restaurants still do not accept credit cards. Sometimes, the Chinese restaurants owners have to inspect those large bills (like 100 Yuan) very carefully in case they are counterfeit. A large amount of cash also makes them more cautious. After a full day of busy work, they often lock their money in a secure hidden place.

KFC's localization strategy is successful in China. For example, in the 2003 Spring Festival, over 800 KFC stores in China changed their outfits to the traditional Chinese costume “Tang Zhuang.” Due to competition from local Chinese fast food companies, KFC further implemented its indigenization policy in China. For example, “the Chinese KFC menu may include fried dough sticks, egg tarts, shrimp burgers, and soymilk drinks, as well as foods tailored to the tastes of specific regions within China.”\textsuperscript{21} Furthermore, KFC maintains good relationships with the Chinese local governments. Some local officials of small Chinese cities are trying to attract KFC to their cities. On the one hand, a KFC store can benefit local economy. On the other hand, having a KFC store means a higher degree of modernity or globalization.

\textsuperscript{20} “Breakfast key to growth of foreign fast food market in China, reports Mintel,” \textit{Food and Drink}, August 16, 2012.
for a small city. Indeed, globalization or modernization gradually changes Chinese people's daily lives either visibly or invisibly. Sometimes, people may ask "Does your city have KFC, Starbucks or something like that?" I clearly remember I was asked the question several times by some same-age children from bigger cities before my hometown had KFC. I was a little bit disappointed and answered "We do not have KFC in my hometown, but we have Country Style Chicken (a local Chinese fast food restaurant) which is quite similar to KFC." Then, I could see their pride from their facial expression.

Also, KFC and McDonald's are doing great for attracting children. They have facilities for children's fun. Besides, they play English-language songs and have American cartoon characters and some simple English words on the wall. When walking in the street, the kids beg for KFC food in front of their parents. Besides, many Chinese parents want their children to learn English at an early age. So, they are willing to buy KFC food despite its price. KFC is keen on public service. KFC has invested a lot in the Chinese youth education. China's state news agency Xinhua News praised KFC for its social responsibility. According to Xinhua News, over the past decade KFC has contributed more than sixty-six million Yuan to the education of Chinese children and teenagers. McDonald's did the same. According to a 2006 Modern Weekly interview with Gary Rosen, McDonald's Marketing president in China, the company had commenced a long-term "beef education" campaign targeted at children under the slogan "Do you have enough beef?"

invited children to join the Beef Club online."^{23} Both KFC and McDonald’s have built up positive images in the view of Chinese consumers as well as the Chinese government. People trust their brands and food safety.

G. KFC Enjoys More Successes than McDonald’s in China

McDonald’s was founded in Des Plaines, Illinois in 1955, three years later than KFC. KFC is the world’s largest fried chicken chain. McDonald’s is the world’s largest hamburger chain. In its home market, the U.S., McDonald’s has a larger market share than KFC. But, in China McDonald’s is no match for KFC. Euromonitor International is a London-based research firm. Several sources have used its data to compare KFC and McDonald’s in China and the U.S., respectively. For example, KFC’s parent company Yum had a 40 percent market share among fast-food chains compared with 16 percent for McDonald’s in China in 2010.\(^{24}\)

McDonald’s entered China in 1990, three years later than KFC. Unlike KFC choosing Beijing for its first store, McDonald’s chose Shenzhen. Shenzhen was a small fishing town before China’s economic reform. After Deng Xiaoping’s visit, Shenzhen became a special economic zone. Due to its geographic advantages (bordering with Hong Kong), Shenzhen attracted huge FDI in a short time and quickly became the most successful city in China. In the early 1990s, Shenzhen was still in its prime time of fast development. As a latecomer, McDonald’s did not want


to compete with KFC directly in Northern China. Thus, KFC chose Shenzhen, a vibrant city in Southern China.

Why is McDonald's less popular than KFC in China? After more than two decades' development, both KFC and McDonald's became successful in China, but, KFC is more successful. KFC is usually two or three Yuan more expensive than McDonald's in China. KFC has three times as many stores as McDonald's. According to the *China Expat*, there are four reasons that make McDonald’s less successful than KFC in China:

First, marketing campaigns may have convinced people that KFC is healthier in China than America – Their message is that KFC in China is the new fast food – healthier than other fast food options abroad and in China. Second, More Chinese people like fried chicken more than hamburgers – Although McDonald’s rolled out a new marketing plan aiming at young adult Chinese consumers last year. Third, KFC has more China-specific choices than McDonald’s – by far. They have a much more China specific menu. Fourth, KFC has better coupon deals than McDonald’s – which is very important to most Chinese consumers. About half of customers of either restaurant use coupons – but the best tasting stuff at McDonald’s, the beef, rarely has good coupon deals.25

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H. American Fast Food Chains: Globalism and Localism

Compared to China, McDonald’s and KFC’s global penetration in South Asia is also limited by local cultures and religions. India has more than one billion population and is also one of the major emerging countries like China. The market demands for fast food should be strong. However, India is still a small market which just has 271 McDonald’s restaurants in 2012. Why? It is said that “religiously observant Hindus see cows as sacred and avoid beef, while Muslims view pigs as

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unclean and avoid pork."26 By contrast, most Chinese people today have no food
taboo (except a small number of ethnic minorities like Hui and Uyghur). For
instance, many Chinese people from other provinces often mock China's Cantonese
people: “they eat everything with four legs except tables.”27 The breakout of SARS
epidemic in Southern China Canton in 2002 was caused by eating non-farm animals
like the masked palm civet.

Globalism and localism are equally important. Big American fast food firms in
foreign markets often keep some of its traditions (e.g. classic American food recipes,
logos, and similar store decorations) and in the meantime they are also seeking
some adaptations to the local market. For example, with competition from KFC and
local Chinese fast food firms, around 2005 McDonald's started to offer rice burgers
in some of its Asian stores. From Big Macs to rice burgers, this is a great move for
McDonald's.28 In 2013, all 1,700 McDonald's stores in China added four new menu
items: chicken rice wrap, beef rice wrap, chicken rice bowl and beef rice bowl.

Kenneth Chan, CEO of McDonald's China, said:

Our new platform is all about winning the night by listening to what
consumers want from McDonald's for dinner and after...... They want more
filling portions but at the same price, quality and convenience they
have come to expect from McDonald's. 29

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27 This saying was first reported by the French writer Simone De Beauvoir in her 1958 book, The Long
March, p.81.
29 Anita Chang Baettie, “Catering to Local Tastes, McDonald's Finally Adds Rice to the Menu in China”,
Advertising Age, June 7, 2013.
An Overview of American Auto Makers in China

A. The WTO and Foreign Cars in China

According to the Wall Street Journal, China surpassed the U.S. to become the world’s largest auto market in 2009.30 With a growing middle class, more and more average Chinese families are able to own a car or two. For American auto companies, they experienced market decline in the U.S., whereas their cars are welcomed by the Chinese public and the sales are still increasing.

China’s accession to the World Trade Organization (WTO) was not smooth. In the early 1990s, China’s several attempts failed as it did not reach a deal with Western countries led by the U.S. The Chinese leaders did not stop negotiating with their American counterparts. China was so eager to integrate itself into the world economy. Joining the WTO was such an important step for China to stimulate its exports as well as import natural resources and high-quality products. After years of negotiation, President Clinton came to reach a deal with the Chinese. In the late 1990s and early 2000s, the U.S. accepted China’s admission to WTO. I remember I watched the live broadcasting show at night on November 10, 2001. When the fourth WTO ministerial conference Chairman Mr. Kamal knocked his wood hammer on the table, announcing China was approved to be a member a WTO, I could hear sounds of excitement from my neighbors in our big apartment complex. Joining the WTO brought opportunities and challenges to China. Before China joined WTO, the import tariffs on foreign cars were 70%-80% of the price. The WTO gave China five

years to lower the tariffs down to 25%. By the end of the 1990s, there were not many choices for Chinese car buyers.

\[B. \text{ Chinese Consumers' Stereotypes on Foreign Cars}\]

After China joined the WTO, foreign cars flooded into the Chinese market, which brought about more competition and thus benefited the Chinese consumers. Foreign auto companies are continuously setting up new branches and releasing new models in China. The Chinese consumers have gradually formed some stereotypes on foreign cars. They think the Japanese cars are cheaper but unsafe, because the Japanese sell their best cars in Europe and the U.S. and sell their worst cars in China. Japanese cars often described as light and made of plastics. But, the Japanese cars can save gas compared to American and European cars.

The Chinese consumers think American and European auto makers do not “Tou Gong Jian Liao” (cheat in work and cut down on materials) like the Japanese did. American cars are built with more good steels. So, American cars are heavier and safer than the Japanese ones. On Chinese blogs and social network websites, there are many photos comparing Japanese cars and American cars in some real accidents. American and European cars are often ranked in the first tier, then the Japanese and Korean cars, the last choice is the Chinese ones. Even though many Chinese still think that buying Chinese cars may lose their face in front of relatives, friends and colleagues, there is still increasing demand for the Chinese cars because foreign brands are more expensive.
C. China's Nationalism and Hatreds toward Japan: Do Not Buy Japanese Cars

China's nationalism and hatreds toward Japan are still popular among the general public despite of the close economic tie between the two countries. Some Chinese radicals damaged Japanese cars and beat the Chinese owners in several anti-Japanese protests in 2012 and 2013. For example, in 2012 due to the Diaoyu Islands dispute, an anti-Japanese protest broke out in Xi'an, Central China. Jianli Li became a victim of a mob that stopped his Japanese car. His skull was smashed in and later he became partially paralyzed. At that time, similar cases happened in other Chinese cities. Many Chinese owners of Japanese vehicles were scared. So, they either covered their Japanese cars' logos or gave up driving. Some put bumper stickers that attempt to discourage potential vandals. A popular one reads: “The car is Japanese, but the owner's heart is Chinese. The Diaoyu Islands belong to China.”

After this incident, the Chinese government and media blamed those Chinese radicals and educated the public to treat China-Japan disputes rationally. Those who inflicted severe injuries on the Japanese car owners were arrested and put into prison. However, this did not stop some potential car buyers shifting from Japanese cars to American cars. Thus, in 2013 there was a decline in the sales of Japanese cars while the sales of American cars increased dramatically.

Definitely, the success of American cars in China is not due to China's anti-Japanese sentiments. Then, what makes American auto companies successful in China? There are many factors, such as advanced technology, safety, management,

Chinese consumers' attitudes toward American products, and American auto makers' good cooperation with Chinese companies. In the next section, I will address two major American auto makers in details: General Motors and Ford.

General Motors in China

A. A Brief History of General Motors

General Motors (GM) was founded in 1908. It is headquartered in Detroit, Michigan. From its inception to the world's largest auto maker, GM has acquired famous auto brands such as Buick, Cadillac, Chevrolet, Pontiac, and Saturn. In 2007, according to Fortunes, GM is ranked 7th among 500 global multinational corporations after Wal-Mart, Exxon Mobil, Royal Dutch Shell and Apple.33

The GM official website lists seven periods of GM history. First, the creation is 1897-1909. There were fewer than 8,000 cars in America at the turn of the 20th century. GM was the pioneer of auto industry in the world. William “Billy” Durant founded this company. Second, the acceleration is 1910 – 1929. During this period, new innovations emerged. GM embraced the philosophy and strategy of “a car for every purse and purpose.” Third, the emotion period is 1930-1959. GM made contributions to World War II. “By 1942, one hundred percent of GM’s production was in support of the Allied war effort.” Then, the fourth, fifth and sixth periods are

33 "Fortune 500", CNNMoney, 2013.

Like other auto companies in the U.S., GM's sales were not good since the 2000s. GM tried to obtain government loans but failed. In June 2009, GM filed for Chapter 11 bankruptcy in New York City. Later, GM closed its Hummer, Saturn and Pontiac brands. GM sold SAAB to Spyker. The U.S. government started reduced its holdings of GM shares. At the end of 2013, "the U.S. Treasury sold the last of its GM stock bringing an end to the controversial government ownership of the car company. The final cost of the GM bailout cost the U. S. taxpayer $12 billion." GM's decline in the U.S. leads to job cuts and increased taxes for Americans. But President Obama and former GM CEO Fritz Henderson both promised that a more viable GM will emerge from bankruptcy. Today, GM is focusing on selling cars in foreign markets, particularly China. China is the key market for GM. According to CNNMoney, "GM has roughly roughly 15% market share in China now, and has said it will introduce 17 refreshed models there in 2013." Former GM CEO Dan Akerson visited GM's Shanghai office in 2011. He made a speech about GM's expansion and success in China.

Seven out of ten automobiles were made outside of the United States. We have 11 joint ventures in China with Shanghai Automotive Industry Corp (SAIC) and FAW Group. We operate 11 assembly plants in China, four power train plants in eight cities across the country. We have more than 2,700 dealerships and sales outlets nationwide. We regard our eleven joint ventures as 11 keys to success. Not just in China but globally. Our

34 http://www.gmchina.com/gm/front/about/legacy
commitment to working in China, with China, for China remains strong and focused in the future. We are now building out the advanced technology center which will bring our research and development that is centered largely in the U.S.; we are going to diversify that more into China because we think this market is so critically important to the success of our company. GM is a company well established for the future in China.39

Immediately, this speech drew some criticism in the U.S. Some think that GM is not American government motors, but China motors. They blamed GM for sending jobs and moving research centers to communist China. 40

B. GM’s Buick Won Success in China

Buick, a brand of GM, has a long and interesting history in China. Both GM and Ford are successful in China. But, GM is doing better than Ford. According to recent released documents, Ford missed a great opportunity 90 years ago to become Sun Yat-sen’s favorite brand, the founder of modern China. Sun Yat-sen was the founding father of democracy in China and also the founder of China’s Nationalist Party (the current regime in Taiwan). In the 1910s, Sun Yat-sen and his companies overthrew the Qing Dynasty, the last dynasty in China. Sun Yat-sen had traveled to Japan and Hong Kong before he returned to China. So, he knew the industrial revolution and new technology in Western countries.

In the 1920s Sun Yat-sen invited Henry Ford to build factories in China. But an assistant in Ford’s office rejected Sun Yat-sen’s request, saying “We desire to advise, however, that Mr. Ford has made no plans for visiting China in the very near

40 http://www.canadafreepress.com/index.php/article/48732
future."\(^{41}\) Sun Yat-sen was disappointed and had to look for other American cars.

Finally, he chose GM's Buick. David Chen, vice president of GM elaborated GM's early history in China in an interview.

GM first entered China in the 1920s. There was a Chevrolet dealer in Shanghai during that time. Records also show that the father of Chinese democracy, Sun Yat-sen; the first premier of China, Zhou Enlai; and the last emperor, Puyi, owned Buicks. If you're wondering why Buicks are doing so well in China; the historical linkage may help. I've heard that in the 1930s, one out of every six cars in China was a Buick. GM stopped operating in China in 1949 and restarted in late 1993 or early 1994 when we began negotiating our first JV, Shanghai GM, with our partner Shanghai Automotive Industry Corp (SAIC).\(^{42}\)

Today, GMC is thriving in China. In September 2013, G.M. shipped 71,002 Buicks to dealers in China - compared to only 15,623 Buicks in the U.S.\(^{43}\) The Chinese people have a different view of Buicks. They regard Buick as a luxury brand. They think Buicks are the choice of businessmen. Although Buicks are not as good as BMW or Mercedes, Buicks are still better than most Japanese and Korean brands. Chinese drivers of Buicks will not lose their face at least. An interesting article in the *New York Times* compares stereotypes of car brands in China and the U.S., saying "the Buick, long associated in the United States with drivers who have a soft spot for the early-bird special, is by contrast one of the hottest luxury cars in China."\(^{44}\) Moreover, in the U.S. Buicks are viewed as old man's car. In China Buicks do not have this negative image. With many young buyers from China, Buicks actually lower the average age of buyers.

\(^{42}\) "General Motors Races Ahead in the China Market", *China Business Review*, April 1 2011.
C. GM's Relationship with the Chinese Government

GM believes that a multinational corporation must understand the political situation in a foreign country or a new market. GM must win official recognition and support from the foreign government. If so, GM can smooth away obstacles and sell cars effectively. Back in 1978, then-CEO of GM Thomas Murphy visited Beijing. He proposed the joint venture as a way to "jumpstart China’s automotive industry."\(^4\)\(^5\) Six years later, China's first automotive joint venture, the Beijing Jeep Corporation, was established with GM.\(^4\)\(^6\) GM saw that the Chinese labor cost and land price were very low. In the meantime, the Chinese badly wanted advanced automotive technology from the U.S. The Beijing government also wanted to improve the Sino-U.S. relations after Mao’s death. Beijing Jeep immediately became a well-known brand to the Chinese people. Its early classical model was BJ212 which was commonly used by the Chinese government and military in the 1980s and even the 1990s.

Thirty years later, GM’s advanced research center was set up in Shanghai, China. The Shanghai research center is focusing on developing new and clean energy vehicles in China. GM unveiled its electric car, the Chevrolet Volt, in 2011. At the same time, the Chinese government enthusiastically advocated the development of electric vehicles (EV) in China. From 2010 to 2013, the Chinese government has announced three groups of test cities. The government built power chargers and facilities in these cities. The Chinese customers will get compensation if they buy EVs. According to Boston Consulting Group, China and Europe - not the U.S., as many

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might think - will be the largest markets for EVs in 2020. Currently, no one company is dominant in the EV market in China. Nissan, GM, Volkswagen and other foreign auto makers are competing for huge orders from the Chinese government. At the same, Chinese auto makers are also developing their own EVs.

D. GM’s Chinese Partner: Shanghai Automotive Industry Corporation (SAIC)

When foreign auto makers entered China, they had to find a Chinese partner and built joint ventures together. GM’s major Chinese partner is SAIC, a large state-owned auto company in Shanghai. The fast development of SAIC is largely due to FDI, market demand, government guidance and new technologies from Volkswagen and GM. In the 1970s, SAIC was just a small company. In 1984, SAIC started to contract with Volkswagen. In 1985, SAIC built its first joint venture with Volkswagen. At that time, SAIC was simply an extension of the Shanghai Municipal government. The Shanghai Municipal government wanted to make SAIC as a pillar for the local economy. Thus, SAIC was the top priority and got many resources from local government. From 1985 to 1996, SAIC’s annual production capacity increased ten-fold. 

SAIC enjoyed the successful cooperation with German auto maker Volkswagen and decided to build a second joint venture. SAIC chose to cooperate with GM. They built Shanghai GM together in 1997, with 50% investment from each other. Their proud car is the Buick Regal. SAIC absorbed

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technologies from Volkswagen and GM. Later, the Chinese joint venture made 90% of the components locally.49

Ford in China

A. Ford: A Revolution to the U.S. Auto Industry

Ford is headquartered in Dearborn, Michigan. It was founded in 1903 by Henry Ford. Henry Ford liked small animals, so logo designers painted the English letters “Ford” into a pattern of small rabbit.50 On Ford’s Chinese official websites, there are some important historical events. For example, in 1914 Ford’s model T car revolutionized the auto industry. Prior to model T, cars were not mass produced and were very expensive. Ford model T was called “the car that put the world on wheels.”51 In the 1930s more and more American families could afford cars due to economies of scale and reduced costs of Ford’s mass production.

In 1941, Ford released the Lincoln Continental, which became the U.S. president’s favorite choice. In the 1950s, Ford released the Mercury and the Thunderbird. In the 1960s, Ford released Volvo 1800s and the Ford Mustang. The Ford Mustang debuted in New York Auto Show in 1964. Even today it is still a popular brand for young drivers. Volvo was a Swedish car. It was called “the safest car in the world.” In 2010, Ford sold Volvo Car Corporation to the Chinese

50 Ford Chinese official website: http://www.ford.com.cn/clubford/history#overlay=1248990254681
automaker, Geely.\textsuperscript{52} In 1994, Aston Martin became a part of Ford. Aston Martin is a luxurious car from the U.K. In 1995, Ford China Corporation was founded. So, in the next section I will discuss Ford's history in China.

\textbf{B. Ford's Development in China}

In the 1910s, Ford made its first show in China as model T cars were sold to China. In the 1920s, when the founder of modern China, Sun Yat-sen, invited Ford to build factories in China; Ford actually rejected. Ford missed this opportunity. So, GM's Buick became Chinese leaders' car.

When Mao started to rule China from 1949, Ford stopped selling cars to China. In Mao's China (1949-1976), almost all American companies and missionaries left China. In 1978, the new Chinese leader Deng invited Henry Ford II, then-CEO of Ford to build factories in China. After Henry Ford II's personal meeting with Deng, Ford opened an office in Beijing in 1978. Although Henry Ford II expressed an interest in China, Ford did not really enter China and build factories until the early 2000s. Compared to GM and Japanese auto makers, Ford is a late mover.\textsuperscript{53}

In the early 1990s, the Chinese government encouraged its largest domestic producer of passenger cars, SAIC, to build joint venture partnership with a foreign company. Both GM and Ford bid. Finally, Ford lost. After this failure, Ford waited to pursue other opportunities. From the mid-1990s to late 1990s, China and the U.S.


were in negotiations regarding Permanent Norma Trade Relations (PNTR) status. The U.S. government pressed the Chinese government to loosen restrictions on foreign investors. Finally, the two parties reach an agreement which eliminates many restrictions for the automobile industry in China.\textsuperscript{54} Ford seized this opportunities and built a joint venture with the Chinese auto manufacturer, Chang An, in 2001.

Although Ford entered China much later than GM and Volkswagen, Ford is catching up. According to Angelo Young, "Ford is working hard to become a significant presence in China, where it surpassed Honda and Toyota in sales volume in 2013, for a total volume of 935,813 commercial and passenger vehicles. The company tripled the number of models offered in China in 2013 compared to 2012."\textsuperscript{55}

\textbf{C. Ford’s Chinese Partner: Chang An}

On April 25, 2001, Ford and Chang An established Chang An - Ford Automobile Co., Ltd. Chang An traced its origin back to the Shanghai Foreign Gun Bureau which was founded by Hongzhang Li in 1867.\textsuperscript{56} Hongzhang Li was a major politician in late Qing dynasty. He advocated the Self-Strengthening Movement in the 19\textsuperscript{th} century. Basically, he sought Western technologies to make China strong and rich. During the World War II and Mao’s China, Chang An still served as a

\textsuperscript{55} Angelo Young, "Ford Delivers Over 73,000 Cars in China in February 2014 As It Plays Catch-Up in World’s Largest Auto Market", \textit{International Business Times}, March 6, 2014.
\textsuperscript{56} Chang An’s official website, “About Chang An”, http://www.globalchangan.com/About/
military factory. In the 1980s, Chang An gradually shifted from military to civil production under the background of Deng’s economic reform.

Most Chinese auto makers are located in East China which is more developed than the West. But, Chang An is a state-owned auto maker from my hometown, Chongqing, Southwest China. Chongqing is a major city in Southwest China. In 1997, Chongqing separated from Sichuan province and became one of China’s four municipalities directly under the central government. After Chongqing’s independence from Sichuan province, Chongqing experienced fast economic development. In 2010, Chongqing became one of the five national cities in China (the other four are Beijing, Tianjin, Shanghai, and Guangzhou).

Chang An has made a great contribution to Chongqing’s rapid development. Chang An is said to be the largest company in Chongqing. Chang An has been the No.1 taxpayer in Chongqing for years. It provides at least 43,000 jobs in Chongqing. In 1983, Chang An learned minibus technology from the Japanese company, Suzuki. Since then, Chang An has become one of China’s largest domestic producers of minivans. Thanks to government policies including “a halved purchase tax for small vehicles”, Chang An’s minivans are in great demand.

D. Ford’s Relationship with the Chinese Government

China has become an area of tremendous potential for companies as the nominally communist country has embraced capitalism. The hybrid result,

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58 Kelly Sims Gallagher, China Shifts Gears: Automakers, Oil, Pollution, and Development (MIT Press, 2006), p.84.
59 Xiaomin Chen, “Chongqing Chang’an plans 4 billion yuan add-issuance”, Global Times, February 11 2010
according to Ford CEO Alan Mulally, is in some ways an improvement on what's been a pretty sluggish and inefficient democratic process elsewhere in the world. Unlike American internet companies, American auto companies do not mind Chinese politics and human rights issues. In some ways they even think the current Chinese political regime is better than some sluggish democracies like India and the Philippines. When Ford CEO, Alan Mulally, was interviewed by Bloomberg, he praised the Chinese communist party and government. Asked if the Chinese are easier to work with than democracies, Mulally answered: "They are a pleasure to work with. You're welcomed; you're part of the fabric. 'What can we do to help? What can we do to work together?' There's nothing like it in the world... It's fantastic. The working relationship between the party and the government is tight. They both have the same objective, to grow the economy." 

Another example also supports the fact that Ford has a sound relationship with the Chinese government. Geely is a Chinese auto company in Zhejiang province. Geely attempted to purchase Volvo's passenger car division from Ford in 2009. Before the final purchase, Geely must obtain the necessary approvals from the Chinese government. The Chinese government fully supports the purchase between Geely and Ford and approved paperwork very quick. Obtaining Volvo can increase national pride and improve the public's confidence in the Chinese government. The Chinese government welcomed Ford's Volvo sale. Ultimately, the transaction was

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61 Ibid.
very smooth in 2010. The Chinese government left a good impression on Ford through this transaction.

In March 2014, the new Chinese President Xi Jinping visited Europe. He and the first lady Peng Liyuan toured the Chinese-owned Volvo plant in Ghent, Belgium. The Chinese media reported Xi’s visit in details with videos and images. Xi stood in front of a Volvo XC60 with the Belgian King Philip, both clapping their hands and smiling. Nationalism is popular in the communist China. It has been criticized by Western media as a tool for strengthening the legitimacy of Communist Party’s rulership in China. Ford’s Volvo sale is beneficial to both parties. On the one hand, Ford shed the heavy burden Volvo which was in a great deficit. On the other hand, the Chinese are willing to buy Volvo for the purpose of increasing national pride and economic benefits.

Summary

In a nutshell, there are at least four factors that explain the success or failure of American firms in the Chinese market. First, “indigenization”, the ability of firms to cater to the demands of Chinese consumers rather than simply replicating products designed for the Western market. In its early years of development eBay simply replicated its American website, it might work in Europe, but it failed in China. Also, in the previous chapter I mentioned that eBay’s Chinese leaders complained that the eBay headquarter in San Jose did not listen to their opinions. By

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62 News.Sina
63 This summary draws on suggestion from Dr. Earnest.
contrast, KFC and McDonald have done much better in localization. KFC adapted its menu to local tastes. KFC insisted to employ more local people and respect local managers.

Second, the success of American auto makers in China tells that partnerships with Chinese firms are extremely important. This seems really apparent with Buick partnership with SAIC. As required by the Chinese government, Buick accepted to build a joint venture and share some of new technologies with SAIC. By contrast, Google competed fiercely against Baidu instead of seeking cooperation opportunities and compromising with the Chinese government.

Third, American IT companies are selling services in China, whereas restaurants and automotive firms are selling products. IT service providers are new companies and have relatively low levels of direct investment, whereas automakers have high levels of direct investment. Instead of attracting service providers, the local Chinese officials and leaders are more interested in big construction projects, because they could gain huge private interests from selling lands and building concretes. Moreover, building an automotive plant can also create thousands of jobs and stimulate local GDP and revenues. However, IT service providers do not need a large land, because they can do their work virtually online. IT service providers do not create many jobs, either. Thus, they have few opportunities either for partnerships or for developing support among local and regional leaders in China, whereas American automotive manufacturers have built good relations with the local government. This seems really apparent with the Buick partnership with the Shanghai government.
Finally, although there are differences between service and product industries, the within-industry comparisons also show that an earlier entry plus better government-company relations make American companies more likely to succeed in China. KFC and General Motors entered China earlier than McDonald's and Ford, respectively. General Motors have a stronger tie to the Chinese government than Ford as it accepted China's offer that Ford rejected at first. Today, although GM and Ford are both successful in China, GM is more popular than Ford. Also, when KFC launched its first store in China, it chose Beijing, the political center of China, whereas McDonald's chose Shenzhen, far away from Beijing. Today, it proves that KFC's early choice of location was very correct. This chapter concludes the cases of American companies in China (either success or failure). The next chapter will examine the cases of Chinese companies in the U.S.
CHAPTER IV

CASE STUDY 3: CHINA'S STATE-OWNED OIL COMPANIES IN THE U.S.¹

Introduction

The previous two chapters discuss American MNCs doing business in China. Their failures were caused by cultural, statist and market factors. For example, American MNCs suffered from numerous problems regarding to piracy and Chinese hackers. This can be explained by cultural theories. China is relation-based country where the enforcement of numerous laws is on books. Beyond cultural dissimilarity, statist interference and market completion also pushed some American MNCs out of China. Likewise, when Chinese MNCs come to the U.S., they also face numerous dilemmas caused by culture, the state and market. Therefore, this and the next chapter will probe Chinese MNCs doing business in the U.S. First, Chinese MNCs which emerged in a particularist and relation-based culture will be frustrated by the universalist and rule-based culture of the host country. Second, empirical studies of the three giant Chinese state-owned oil companies show that Chinese MNCs investing in strategic resources are more likely to receive political resistance from the host country and thus fail in acquiring U.S. assets. Those failures were not only caused by cultural factors, but were also caused by statist factors (e.g. ownership, interest group politics and CFIUS investigation) as well as market competition (China National Offshore Oil Corporation - CNOOC vs. Chevron in 2005). Third, ¹ Part of this chapter draws on Shiwei Jiang, The China Lens, A Political-Economic Analysis of Changing China (Xlibris Corporation, 2013).
given the nature of Chinese state-owned enterprises (arms of the home government) and rising Chinese military power, we can expect that it will be more challenging for Chinese state-owned oil companies to obtain U.S. assets in the near future.

An Overview of Chinese State-Owned Oil Companies

With a large amount of foreign reserves, the Chinese government is encouraging Chinese companies to speed up their internationalization and purchase overseas assets, especially oil assets. There are three major state-owned companies in China: PetroChina, Sinopec, and China National Offshore Oil Corporation (CNOOC), which are called the "Big Three." Their success at entering those markets in developing countries is chiefly based on three strategies: first, to choose the place where Western oil companies are not willing to enter because of high risk and instability; second, to help build local infrastructure; and third, to provide financial aids to oil-rich developing countries. However, these strategies do not apply to Chinese oil companies' business in the U.S.

In the past, when it came to oil and security, scholars have focused on the Middle East oil trade, terrorists and security issues. There was a sea of literatures and studies on the Middle East and oil. By contrast, the studies of China-U.S. oil trade were few. Despite the fact that China-U.S. trade is increasing and China-U.S.

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4 For example, Steve Yetiv’s two books, Crude Awakenings: Global Oil Security and American Foreign Policy and The Petroleum Triangle: Oil, Globalization, and Terror.
relations are improving, the two countries are still cautious about each other's investment in some sensitive sectors, such as oil and telecommunications.

In this chapter, I will address why and how China's state-owned oil companies (CSOOC) have failed in the U.S. market. First, many American readers may wonder what are the rankings of CSOOC in international business? And, how does the Chinese government influence CSOOC? An overview of CSOOC answers the two basic questions at the beginning. Second, after the overview, I examine the big three CSOOC in details. I find that their results are different in the U.S. PetroChina faced a lawsuit from American investors. Sinopec was forced to terminate three agreements in Wyoming. CNOOC received investigations from the Committee on Foreign Investment in the U.S. (CFIUS) which led to its failure to purchase the U.S. oil firm - Unocal. Third, admittedly, their failures in the U.S. market are due to complex factors (e.g., political interventions, America's strict environment protection, different cultures and more); however, I need to boil them down to some key factors relevant to international political economy. These key political-economic factors are categorized into three aspects: the U.S. government (CFIUS and the interaction between anti-China interest groups and U.S. Congress), the company itself (weaknesses of CSOOC), and the Chinese government (its rising military power makes it more difficult for Chinese companies to purchase oil assets in the U.S.).

China's three big oil companies are all state-owned enterprises; thus they have some advantages that their Western counterparts do not have. According to the 2010 American magazine, Fortune, PetroChina and Sinopec were listed as the
7th and 10th of the Global 500, respectively. In terms of market value, their rankings are even higher. PetroChina was ranked the first by *Financial Times Global 500.* Although CNOOC was listed as the 252th in 2010, it is growing very fast (it was ranked 318th in 2009). PetroChina and Sinopec always occupy the first and second place of the China's top 500 enterprises, respectively. According to Ping Deng, by the end of 2004, "Of the top 500 Chinese firms – the dominant source of Chinese outward FDI – only one is privately owned and 25 are collectives, which are usually owned by county and municipal government; the rest are state-owned enterprises (SOEs)."

The energy sector is the priority of Chinese government’s international investment. Actually, a majority of Chinese government’s overseas investment was directly or indirectly operated by the big three Chinese national oil companies. Over the past decade, China has boldly used billions of its foreign reserves (mostly U.S. dollars) to invest in oil-rich countries, including some dangerous places like Afghanistan, Iraq and Libya. With strong political support from the state government, the three oil companies have gained tremendous benefits globally. In Africa, PetroChina and Sinopec are prestigious companies because African businessmen and politicians know that the Chinese national oil companies are backed up by the Chinese central government. For this reason, their financial condition is very stable and will not have the capital shortage that some Western

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companies might have. Today, thousands of young Chinese college graduates are competing fiercely for jobs in those state-owned oil companies.

Although the Chinese oil companies have gained a certain degree of autonomy from the Chinese government in recent years, they are still under the great influence of state-controlled bureaucracy. First, the development of Chinese state-owned companies is driven by officials’ promotion instead of profits-making, because the primary instrument of power that the party-state exercises over China’s state-owned oil companies is the power to appoint, dismiss, and promote the companies’ general managers. Second, their large investment projects must get approval from the National Development and Reform Committee (NDRC). In addition, their oil prices are also regulated by NDRC. Third, as they are state-owned companies, a large part of their revenues will be taxed by the government or be turned over to the state treasury.

In 2013, China’s new president Xi vowed to crack down on both "tigers and flies" - powerful leaders and lowly bureaucrats - in his campaign against corruption. Afterwards, a series of investigations have been carried out. In early 2014, Chinese state media exposed PetroChina and Sinopec’s domestic and foreign corruption. For example, Jiemin Jiang, the head of NDRC that oversees state-owned companies is under investigation for "severe disciplinary violations." Before he became the head of NDRC, Jiemin Jiang was leading, PetroChina, China’s largest oil

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company and also the most profitable one. Jiang received expensive gifts and a large amount of cash when he was in charge of PetroChina. Jiang's downfall showed that there was a great intersection of senior Chinese leaders' private interests and the state-owned companies. Jiang's downfall also exposed the non-transparency of Chinese government's decision-making and thus caused PetroChina to face a lawsuit in the U.S.

PetroChina

A. Expansion in Africa versus Lawsuit in America

PetroChina is largest state-owned oil company in China. On its official website, it says "It is not only one of the companies with the biggest sales revenue in China, but also one of the largest oil companies in the world." Since the mid-1980s, PetroChina started to explore rich reserves of oil fields, especially in the Tarim basin in Xinjiang, China. In the 1990s, it began oversea expansion in the efforts to achieve its goal at that time: become a multinational company as soon as possible. PetroChina had two different experiences in Africa and the U.S. In Africa, it has expanded its business and purchased large oil fields. In the U.S., it has faced lawsuits. In 1997, PetroChina defeated other international oil companies and won the exploitation rights of Muglad basin in Sudan. This is the first time that PetroChina successfully bid the large-scale overseas oil and gas exploration

11 http://www.petrochina.com.cn/Ptr/About_PetroChina/Company_Profile/default.htm
Many African countries are developing countries rich in natural resources. Their laws regarding anti-corruption and exploiting natural resources are not strict, or may lack enforcement. Moreover, China did not have a law like the American Anti-Corruption Act which can investigate Chinese companies' briberies overseas. Some corruption arose from China-Africa oil business and was occasionally reported by Western media. For example:

At Chinese-run mines in Zambia's copper belt they must work for two years before they get safety helmets. Ventilation below ground is poor and deadly accidents occur almost daily. To avoid censure, Chinese managers bribe union bosses and take them on "study tours" to massage parlours in China. Obstructionist shop stewards are sacked and workers who assemble in groups are violently dispersed. When cases end up in court, witnesses are intimidated.13

Chinese oil companies' bribery strategy works in Africa, but does not work in the U.S. I observe that there are still some Americans complaining about corruption in the U.S. There might be more corruption in the U.S. than in some Northern European countries.14 However, compared to China and most African countries, the U.S. government officials seem free of corruption.

Unlike in Africa where PetroChina has purchased large oil fields and employed thousands of workers, in the U.S. PetroChina has just set up an office in Houston, Texas, where the number of employees just reached over 50 in 2013. In Africa,

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13 "Trying to pull together: Africans are asking whether China is making their lunch or eating it", The Economist, April 20, 2011.
14 Denmark, Finland, Sweden and Norway are among top 5 in the Corruption Perceptions Index 2013 by Transparency International. The U.S. is ranked 19.
PetroChina is doing upstream operations (exploiting oil fields), while in the U.S. PetroChina is doing mostly midstream work (transportation and storage of refined petroleum products). According to Shaolin Li, president of PetroChina International America Inc, in the U.S. they basically buy petroleum products at Point A, move them to Point B and do some processing for added value, and then move them to Point C to sell.

PetroChina's expansion in the U.S. is not as successful as that in Africa. For example, in 2013, Pomerantz, a New York-based law firm, filed a class action against PetroChina. Several top leaders of PetroChina were involved in corruption and were investigated by the Chinese government. PetroChina's stock share value dropped due to the corruption scandal. But, PetroChina did not report this immediately to its U.S. investors. So, there were some losses to American investors who think PetroChina's financial statements were false and misleading. They accused PetroChina of "failing to disclose a corruption scandal that has tainted the company and led to the downfall of several senior executives."

In addition, Jiemin Jiang, former PetroChina chairman, Jiping Zhou, PetroChina's current chairman, former CFO Mingchun Zhou and current CFO Yibo Yu were accused of violations of the securities laws of the U.S. Later, PetroChina said it would "vigorously contest the complaint to protect its rights and interests."

Currently, there is no much information about this incident, because the lawsuit is

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15 The oil industry is divided into three major sectors: upstream, midstream and downstream. For more information, please refer to http://www.psac.ca/business/industry-overview/, accessed on April 16, 2014.
19 "PetroChina says to contest class action suit in U.S. court", Reuters, September 6, 2013.
still ongoing and will probably continue for two to four years.\(^{20}\) However, according to a Chinese news report, PetroChina is very likely to lose the lawsuit and pay high attorney fees and compensation.\(^{21}\) This failure may thwart PetroChina’s expansion in the U.S. market.

In China, private business or individuals do not often file lawsuits against the government or those giant state-owned companies, because they know it is very difficult to win lawsuits against government or state-owned companies and get fair compensation. In the U.S., filing a civil or business lawsuit is much more common than in China. In addition, there are more detailed categories of courts in the U.S., such as traffic court, civil court, and small claims court. In the U.S., lawyers and doctors are generally viewed as admired jobs, whereas in China millions of college students are taking exams for jobs of “Gong Wu Yuan” (government employees). Either for lawsuit filing or job-seeking, many Chinese still believe that “Guan Xi” (personal connection/relationship) is more important than rules. Shaomin Li argued that in China the governance environment is based on private enforcement that can efficiently regulate market and resolve disputes and thus China is a “relation-based society”. By contrast, the U.S. is a “rule-based society,” in which firms and individuals primarily rely on laws to resolve disputes and enforce rights and contracts.\(^{22}\) So, when contemplating U.S. market entry, Chinese companies need to perform due diligence on the rule-based environment in the U.S.\(^{23}\)

22 Shaomin Li, Managing International Business in Relation-Based versus Rule-Based Countries: (Business Expert Press, 2009).
regulations regarding foreign investment are evolving. In next chapter, I will examine the involvement of CFIUS through three major U.S. regulations.

Sinopec

A. The "Going-out" Campaign

In 1998, with the restructuring of state-owned companies, Chinese oil companies expanded their business to almost every aspect of the oil industry, including oil field exploration, drilling, oil refining, and transportation. Moreover, the 1998 reform of state-owned companies also stimulated Chinese oil companies to pursue oil fields globally. From then on, the domestic and foreign sales of Sinopec have tripled. In recent years, Sinopec is implementing the "going-out" strategy.²⁴

Although Sinopec started its overseas expansion later than PetroChina, it is catching up very quickly. In 2001, Sinopec established Sinopec International Petroleum Exploration and Production Corporation (SIPC). Afterwards, Sinopec adopted the strategy of "going out". The going-out strategy is part of China's international petroleum policy, which was proposed by the State Development Planning Commission (NDRC) in 2003. According to China's Jingji (Economic Daily),

the NDRC put forward six strategies to protect the country's oil security, which are as follows:25

1. To implement the going-out strategy;
2. To carry out the diversification strategy;
3. To build globally competitive flagship oil companies;
4. To conduct petroleum diplomacy;
5. To build domestic oil tanker fleet and expand the Chinese Air Force and the Chinese Navy; and
6. To set up national petroleum investment funds.

Under the international petroleum policy drafted by NDRC, in 2004 Sinopec signed an evaluation deal with Gabon. In the same year, former Chinese President Hu paid a visit to Gabon and signed a series of bilateral trade treaties with his Gabonese counterpart, Omar Bongo, including a “memorandum of agreement aimed at showing the parties' desire to develop exploration, exploitation, and refining and export activities of oil products.”26 In 2006, China announced that it would loan $2 billion to Angola and build a joint venture between Sonangol Refineries (Sonangref) and Sinopec.27 The same as PetroChina, Sinopec also has great interest in Sudan. “In November 2005, Sinopec Group announced plans to partner with PetroChina to purchase an oil field in Sudan, and has reportedly indicated an interest in expanding its business in Sudan.”28

25 Bo Kong, China's International Petroleum Policy (Greenwood Publishing Group, 2010).
The early road map of Sinopec’s going-out campaign has covered almost every continent except North America.\(^2\) There are at least three explanatory factors. First, the U.S. is not willing to exploit its own oil, so it is very difficult for Chinese companies to get oil from the U.S. During one speech, Obama said “With only 2% of the world’s oil reserves, we can’t just drill our way to lower gas prices.” However, many Chinese believe that the oil reserves in the U.S. are underestimated. They also argue that Americans are just smart and do not use their own oils.\(^3\) In addition, as a rule-based country, the U.S. has a series of U.S. environment laws (e.g. Clean Air Act, Comprehensive Environmental Response, Compensation and Liability Act). For example, in 2011, U.S. Environmental Protection Agency (EPA) forced Shell to give up oil drilling plans in the Arctic Ocean off the northern coast of Alaska.\(^4\)

EPA updates some statistics on its enforcement website ever fiscal year. Figure 4.1 shows that from fiscal year 2011 through fiscal year 2013, it conducted 1,904 energy extraction inspections and compliance evaluations. However, only 132 cases have been concluded, which accounted for less than 7% of the total cases.\(^5\) The enforcement actions have included companies operating gas plants, compressor stations, and oil and gas production facilities in several of the most active U.S. onshore oil and gas plays.\(^6\) Many cases will be ongoing for years, because the review and investigation process is slow. How much will it cost to resolve? This

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\(^2\) Bo Kong, *China’s International Petroleum Policy* (Greenwood Publishing Group, 2010).

\(^3\) http://club.china.com/data/thread/1011/2286/79/92/6_1.html


\(^6\) Georgette Reeves, “Heads Up for Oil and Gas Companies Regarding EPA’s National Enforcement Initiative”, *Trinity Consultants*, May 28, 2013.
definitely varies based on multiple factors such as the severity of the damages, the violators' attitudes, legal defense and more. According to EPA's annual trends analysis for fiscal year 2013, EPA assessed more than in $1,000 million administrative and civil judicial penalties, a big increase from 2012 ($200 million). Indeed, the time and cost-consuming process of investigation from EPA set up high entry barriers for Chinese oil companies to invest in the upstream oil sector in the U.S. (exploration and production).

Figure 4.1
Annual Number of EPA Energy Extraction Inspections/Evaluations and Concluded Enforcement Actions

![Graph showing annual number of EPA inspections and enforcement actions from FY2011 to FY2013.](image)

Source: U.S. Environmental Protection Agency (EPA)

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Second, high labor costs and strict immigration system have reduced Sinopec’s motivation to invest boldly in the U.S. According to the *Bureau of Labor Statistics*, in 2009 China’s average hourly compensation costs were only $1.74, which was far behind the U.S.\(^{35}\) Moreover, the strict immigration system in the U.S. has basically ruled out low-skilled cheap Chinese laborers. Hiring foreign workers in the U.S. is a time-consuming process, because United States Citizenship and Immigration Services (USCIS) require the wage and education degree to meet certain criteria. Besides, the employer has to pay high fees to an immigration lawyer for filing legal paperwork. By contrast, there are fewer visa restrictions in Africa. Chinese oil companies can easily hire thousands of cheap Chinese workers and then send them to those oil fields in Africa, which is quite impossible in the U.S.

Third, previous failures of Chinese companies in the U.S. hampered Sinopec’s going-out campaign in the U.S. As discussed in the next section, in 2005, CNOOC, another Chinese oil company, bid high but failed to purchase Unocal, an American oil company. CNOOC spent over $2.2 million on hiring American lobbying firms for the purchase of Unocal, but finally gained nothing.\(^{36}\) Chengyu Fu, chairman of CNOOC, was then very disappointed by the result. He argued that CNOOC’s failure in the U.S. was largely due to the U.S. government intervention and the lack of mutual political trust between China and the U.S., which might hurt other Chinese investors’ confidence in investing the U.S. market and generated lasting negative feelings in both countries.\(^{37}\)


\(^{36}\) "China National Offshore Oil Corporation", Lobbying Database, Center for Responsive Politics, 2014

B. Sinopec: Three Agreements Terminated in Medicine Bow, Wyoming

In 2012, Sinopec Engineering Group (SEG), a subsidiary of Sinopec, signed three agreements with Fuel & Power LLC of Medicine Bow, Wyoming, to build an advanced coal-to-gasoline plant. Medicine Bow is a very small town with population less than 300 and is probably unknown to most Americans. Sinopec was selected to build the plant because "Sinopec brings to the potentially expensive and complicated project less pricey Chinese components and materials. It may also open up the doors to attractive Chinese capital" according to the Wall Street Journal.\footnote{Brian Spegele, "China's Sinopec Moves Into Small U.S. Town", The Wall Street Journal, November 5, 2012.}

Chinese media also reported this and praised Sinopec for further opening the U.S. market. Some Chinese scholars were optimistic about Sinopec's move in the U.S. Boqiang Lin, who ran the China Center for Energy Economics Research at Xiamen University and advised the Chinese government on energy policy, said: "Sinopec winning engineering work in the U.S. was important to establishing itself as a global brand." He believed that moves up the U.S. value chain would continue, and that Chinese oil majors such as Sinopec could establish retail gas stations in the U.S. in the next few years.\footnote{Brian Spegele, "China's Sinopec Moves Into Small U.S. Town", The Wall Street Journal, November 5, 2012.}

However, the reality is harsh. During the past two years, SEG was not able to build the plants in Medicine Bow successfully due to various reasons. On February 28, 2014, Sinopec Engineering Group said it had received written notice from Fuel & Power LLC purporting to terminate the three agreements from 2012. Jiming Zou, a Moody's analyst said, "Although we don't expect major impact on Sinopec..."
Engineering Group's business operations and financial profile, the incident will have a negative impact on its plans to expand into overseas markets."40

CNOOC

A. An Attempted Acquisition of Unocal and Interventions from U.S. Congress

China National Offshore Oil Corporation is the third largest oil company in China. It is also the largest natural gas supplier in China. In 2006, visiting Chinese President Hu Jintao and Kenyan President Mwai Kibaki witnessed the signing of the oil exploration agreement between Kenya and CNOOC. In 2005, it topped the bid by Chevron Texaco to buy American oil company Unocal Corporation. However, due to the U.S. Congress opposition, its bid did not succeed. CNOOC has been accused of abuses of Human rights in Burma. The campaign group Arakan Oil Watch stated in a report that CNOOC "left behind such a trail of abuses and environmental contamination on Ramree Island that outraged locals attacked their facilities."41

The U.S. Congress has great influence on China-U.S. trade and often blames China for human rights issues, the Tibetan issue, ad shortcomings of freedom of speech and democracy. Sometimes, U.S. Congressmen's actions are decisive to the success or failure of Chinese companies in the U.S. On June 23, CNOOC announced $18.5 billion bid for U.S. oil firm Unocal, higher than Chevron's $16.5 billion.42 Four days later, Joe Barton, Texas Republican and chairman of the House Energy and

40 Ibid.
42 Edward Iwata, “Chinese takeover bid for Unocal up in air”, USA Today, July 14, 2005
Commerce Committee, wrote a letter to President Bush, saying the U.S. is “threatened by China’s aggressive tactics to lock up energy supplies around the world that are largely dedicated for their own use.”

Many U.S. Congressmen believed that CNOOC was manipulated by the Chinese government. CNOOC made a bid of $18.5 billion cash among which $13 billion are from the Chinese government. They argued the sale of Unocal to CNOOC was not a free market transaction and should be prohibited. Moreover, they stated that the Chinese government prevented American companies from buying similar assets in China. So, they think the trade between China and the U.S. was unfair.

On June 30, the House passed H. Res. 344 and H. Amdt. 431. H. Res. 344 called for a thorough review of CNOOC by the Committee on Foreign Investment in the U.S. (CFIUS), while H. Amdt. 431 prohibited use of Treasury funds to approve sale of Unocal to CNOOC. So, on July 2 CNOOC had to quickly file a CFIUS notice. On July 13, Frank Gaffney Jr., president of the Center for Security Policy, told the House Armed Services Committee that the sale "would have adverse effects on the economic and national security interests of the United States." He also pointed to "the folly of abetting Communist China's effort to acquire more of the world's relatively finite energy resources" and warned of "the larger and ominous Chinese strategic plan of which this purchase is emblematic." On July 20, Chevron raised its offer to about $16.5 billion; still $2 billion lower than CNOOC's bid, which pushed

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43 Paul Bluestein, "Many Oil Experts Unconcerned Over China Unocal Bid", *The Washington Post*, July 1, 2005
CNOOC to withdraw its bid on August 2. Finally, on August 10, Unocal accept Chevron’s offer. 46

Table 4.1 is a comparison of CNOOC’s and Chevron’s bids.

Table 4.1

CNOOC and Chevron Competing for Unocal in 2005 47

<table>
<thead>
<tr>
<th></th>
<th>CNOOC</th>
<th>Chevron</th>
</tr>
</thead>
<tbody>
<tr>
<td>Country</td>
<td>China</td>
<td>The U.S.</td>
</tr>
<tr>
<td>bid per share</td>
<td>$67</td>
<td>$60.65</td>
</tr>
<tr>
<td>Total bid</td>
<td>$18.5 billion</td>
<td>$16.5</td>
</tr>
<tr>
<td>Payment methods</td>
<td>Cash</td>
<td>Cash + stock</td>
</tr>
<tr>
<td>Preferred by Unocal</td>
<td>Yes (because of higher bid)</td>
<td>No (lower bid)</td>
</tr>
<tr>
<td>Intervention from Congress</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Final result</td>
<td>Lost</td>
<td>Won</td>
</tr>
</tbody>
</table>

B. Why Was CNOOC Interested in Acquiring American Oil Assets?

Chinese oil companies are seeking foreign oil assets to transform themselves into world-class oil companies. Former CNOOC general manager Liucheng Wei used a soccer analogy to make that point, arguing that “China’s oil companies cannot just

47 Data is based on Edward Iwata, “Chinese takeover bid for Unocal up in air”, USA Today, July 14, 2005.
play in the domestic league. We should also compete in the World Cup."\textsuperscript{48}

Compared to purchasing oil assets in Africa or in the Middle East, acquiring American oil companies have the following advantages. First, China's oil companies can gain technical expertise. One objective of CNOOC's bid for Unocal was to gain deep-water exploration and production capacity. Likewise, its acquisition of a stake in Canada's MEG Energy was said to be targeted at securing advanced oil sands extraction technology.\textsuperscript{49} Second, China's oil companies can learn large project management skills from American oil companies. Compared to Western oil giants like ExxonMobil, BP, and Shell, China's oil companies are latecomers to the international oil business and have less experience in "executing complex projects that involve employing cutting-edge technology, arranging huge financing packages, managing environmental impacts, and finishing on time and on budget."\textsuperscript{50} Third, China was invaded by a group of Western countries in the 19th centuries, such as the two Opium Wars and Boxing Rebellion. Today, still many Chinese people feel that China is a victim of Western powers. They also feel sympathy for Africa which was colonized by Europeans for hundreds of years. Therefore, buying oil companies in America can make them feel more proud of China's rise than doing so in Africa. In the 1980s, when Japanese firms made purchases in America, nationalist sentiment also arose in Japan.

\textsuperscript{50} Ibid.
Barriers for Chinese State-owned Oil Companies to Enter the U.S. Market

A. The Committee on Foreign Investment in the United States (CFIUS)

When CFIUS was established in 1975, it chiefly targeted at Japanese companies, because Japan was then an economic threat to the U.S. Today, Chinese companies replaced Japanese companies and are easily subject to be investigated by CFIUS. Figure 4.2 shows that the numbers of CFIUS-covered transactions led by a Chinese buyer has been increased rapidly since 2006. In 2007, only 2% of transactions with Chinese buyers were investigated by CFIUS. In 2012, it rose up to 20%. In other words, one fifths of Chinese investments in the U.S. were challenged by CFIUS in 2012. In the meantime, CNN conducted a survey which argued that "most Americans want U.S. leaders to be tough with China on trade and economic issues."51 This is not a good signal for the long-term development of China-U.S. trade. With increasing economic conflicts between China and the U.S., CFIUS's status in international business has become much more important than ever before. Thus, in the section I will probe into CFIUS and several important regulations that CFIUS has used to block foreign Mergers & Acquisitions (M&A) in the U.S.

CFIUS is probably a little known government agency in the U.S. Reuters called it "the mysterious agency that can block a global merger." In the past few years, companies from China, Russia, Europe and Japan are snatching up U.S. firms which have exposed CFIUS more to media reports.52

Although U.S. Congress has the right to speak and suggest, CFIUS is still independent from Congress and answers directly to the President. On its official website, CFIUS defined itself as,

An inter-agency committee authorized to review transactions that could result in control of a U.S. business by a foreign person ("covered transactions"), in order to determine the effect of such transactions on the national security of the United States.\(^{53}\)

CFIUS has its origin back to the Cold War as the Executive Branch of the U.S. government's "economic kill-switch" for FDI.\(^{54}\) In 1975, it was established by President Gerald Ford under the Executive Order 11858. At the section 1 of the

\(^{53}\) http://www.treasury.gov/resource-center/international/Pages/Committee-on-Foreign-Investment-in-US.aspx

Executive Order 11858, it reads: "International investment in the U.S. promotes economic growth, productivity, competitiveness, and job creation. It is the policy of the U.S. to support unequivocally such investment, consistent with the protestation of the national security. . . . there is hereby established the committee on Foreign Investment in the U.S."  

In addition, the Executive Order 11858 also stated that CFIUS would have "primary continuing responsibility within the Executive Branch for monitoring the impact of foreign investment in the United States, both direct and portfolio, and for coordinating the implementation of United States policy on such investment." To implement this mandate, CFIUS was directed to:

1. Arrange for the preparation of analyses of trends and significant developments in foreign investments in the United States,
2. Provide guidance on arrangements with foreign governments for advance consultations on prospective major foreign governmental investments in the United States,
3. Review investments in the United States which, in the judgment of the Committee, might have major implications for United States national interests,
4. Consider proposals for new legislation or regulations relating to foreign investment as may appear necessary.

Apparently, when CFIUS was established in mid 1970s, its major target was not Chinese companies, because China was then a closed economy under Mao. Actually, the establishment of CFIUS was a response to the rising Japanese companies in the 1970s and 1980s. For instance, in 1983, a Japanese firm sought to acquire a U.S. specialty steel producer. The steel was used in making military

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55 Executive Order 11858, U.S. Treasury.
57 Ibid.
aircraft. So, the Department of Defense and CFIUS stepped in investigation and finally forced the Japanese firm to withdraw its offer.\(^{58}\)

Over the past decade, U.S. media reports have downplayed the competition and acquisitions from Japanese companies, and highlighted the case of Dubai Ports World in 2006 and several purchases by Chinese companies. There are several reasons for this shift. First, 9/11 changed U.S. foreign policies. The Dubai Ports World Controversy in 2006 is a good example to show how terrorism concerns during the Bush Administration determined the failure or success of foreign investment in the U.S. Second, Japan was once a threat to the U.S., but it has declined since the 1990s. Due to its stagnant economy; Japan has slowed down its speed in overseas merging and acquisition (M & A). Japan is even regarded as America’s “best ally in Asia.” Today, both American public and government no longer think Japan is a competitor to U.S. By contrast, they view China and the Middle East as major threats. The pivot of U.S. foreign policy was shifted to the Middle East during the Bush Administration and now is being shifted to the Asia-Pacific region.\(^{59}\) Third, China’s communist regime makes the U.S. public more afraid of Chinese companies than Japanese ones. Many Americans still hold a negative image toward China. A CNN Opinion Research Corporation Poll conducted in 2009 found that 71% of Americans considered China to be an economic threat; two-thirds saw China as a source of unfair competition, and 51% regarded it as a military threat.\(^{60}\)

\(^{58}\) James K. Jackson, "Congressional Research Service-The The Committee on Foreign Investment in the United States (CFIUS)", March 6, 2014.


B. Another Barrier to Market Entry: Anti-China Interest Groups in the U.S.

The case of Dubai Ports World showed that American interest groups have a great deal of leverage on U.S. politics. In October 2005, Dubai World, a company in United Arab Emirates, attempted to acquire the right of managing businesses in six U.S. seaports. Eller& Company, a U.S. firm, opposed this sale and thus hired semi-retired lobbyist Joe Muldoon to persuade Congress to block the deal. Muldoon got support from Democratic New York Senator Charles E. Schumer and an Associated Press reporter who put this deal in the national spotlight. Finally, Dubai Ports World failed to shrug off concern of terrorism and had to sell the operations to a U.S. entity. According to The Washington Times, "Intelligence and security officials opposed to the deal with Dubai Ports World said ports are vulnerable to the entry of terrorists or illicit weapons because of the large number of containers that enter U.S. territory, regardless of who manages them."

Unlike the case of Dubai Ports, American interest groups do not associate the purchases by Chinese investor with terrorism. Instead, they blame China for its communist regime, suppression, human rights, unfair trade and more. The anti-China interest groups in the U.S. are strong, including organizations (Labor Union, Human Rights Watch), social media, internet, blogosphere and celebrities. But, there are also pro-China interest groups in America like the US-China Business Council and lobbyists hired by Chinese companies. They compete to influence the Congressional decisions on China. For instance, table 4.2 shows that in 2005 when CNNOC attempted to purchase Unocal, it spent more than $2.2 million on lobbying.

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CNNOC hired Akin Gump Strauss Hauer & Feld, one lobbying firm in Texas, to assist its purchase. Immediately, Akin Gump Strauss Hauer & Feld drew criticism from anti-China politicians. On July 12, 2005, Rep. Frank Wolf, R-Va., a member of the Congressional China Caucus, sent a strongly worded letter to Akin Gump's lobbyists questioning their representation of CNOOC. "When I noted that CNOOC was one of your newest clients, I immediately thought, 'Is there no bright line to separate who the lobbyists in Washington will or will not represent?'"63

Table 4.2

Annual Lobbying by China National Offshore Oil Corporation64

An interest group has many names, such as “special interest”, “pressure group”, “advocacy group”, and “lobby group”. However, these are “negatively charged terms, each implying unsavory tactics or a lack of a concern for a broader

A neutral term should be interest group. According to opensecrets.org, there are 12,278 lobbyists in the U.S. by the end of 2013. Some of them are very influential and can affect America’s China policies by lobbying Congress, such as The American Federation of Labor and Congress of Industrial Organizations (AFL-CIO), International Brotherhood of Teamsters; and the National Textile Association all of which were against free trade with China and blamed the Chinese government for violating human rights.

Anti-China interest groups have actively attended congressional committee hearings. For example, in May 1993, there was a hearing held in the House of Representatives. The American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) expressed their opposition against the extended most-favored-nation treatment to China. AFL-CIO used the strategy of either-or choice. It pushed industry and commerce lobbyists to choose “either conscience or profit.” The AFL-CIO asked, “Aren’t democracy, justice and basic human rights more valuable than those profits gained by exploiting one billion Chinese people?”

Anti-China interest groups have carried out large-scale lobbying activities of members of U.S. Congress, especially those conservative congressmen from the eastern states with textile firms. They collaborated and proposed cancelling most-favored-nation treatment to China. They put forward separate Sino-US trade bills and demanded mandatory restrictions on Chinese exports to the United States. Under the support of anti-China groups, in April 1990, Massachusetts Democratic

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65 Ronald J. Hrebenar, Interest Group Politics in America (M.E. Sharpe, 1997).
66 "Number of Lobbyists", Lobbying Database, Center for Responsive Politics, 2014.
representative Barney Frank proposed a bill that cut half of China's textile and garment exports to America. In 1991, Congressman Holmes and Gilman (Republicans from New York) proposed a bill that stipulates: ban on U.S. citizens investing foreign penal facilities, and American companies and trade union have the right to sue penal importer and may ask for three times of compensation for loss.\(^6\)\(^8\) This bill includes additional terms against Chinese export. Under this bill, American companies must prove that the products they are imported from China are not made by Chinese prisoners. The amount of the punishment to offenders is high enough for all importers.

Anti-china interest groups continuously notified Congressmen and the Customs Administration of suspicious Chinese products made by prisoners, forcing the U.S. Customs officers to conduct compulsory examination on some Chinese products.\(^6\)\(^9\) In addition, anti-China interest groups communicated each other in information, mutually aided each other and coordinated in lobby actions. For instance, AFL-CIO provided Laogai Research Foundation in California a large amount of financial aid. Laogai Research Foundation helped AFL-CIO to collect relevant proof of Chinese exporting products made in forced labor camps. Besides, AFL-CIO aided some human rights organization to supervise China's human rights situation. AFL-CIO leaders also held positions in human rights organizations at the same time, and helped planning activities against most-favored-nation treatment to China.\(^7\)\(^0\)

\(^6\) Ibid.
\(^6\) Shujie Leng, “Made in China – But Was it Made in a Prison?” *NPR*, March 29, 2014
\(^7\) "International Trade Report", November 27, 1991.
Based on all, table 4.3 was created to summarize the strategies adopted by anti-China interest groups. Actually, anti-China sentiment and Anti-Americanism both exist in the U.S. and China, respectively. Nearly 130 years ago, the U.S. approved the 1882 Chinese Exclusion Act, which explicitly rejected Chinese immigrants for six decades because of their race. Until recently U.S. Senate did not apologize.\textsuperscript{71} In China, anti-American sentiments emerged in 1999 when the Chinese Embassy in Yugoslavia was bombed by U.S. Air Force. Thousands of Beijing residents and college students protested in front of the U.S. Embassy in Beijing. Some of them even threw stones to KFC and McDonald's.

Table 4.3
Tactics Used by U.S. Anti-China Interest Groups

<table>
<thead>
<tr>
<th>Anti-China Interest Groups</th>
<th>Tactics</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1. Provide broad media coverage of Tiananmen incident in 1989. They blame trade interest groups. &quot;Merely pursue money instead of human rights and conscience.&quot;</td>
</tr>
<tr>
<td></td>
<td>2. Carry out large-scale lobbying activities and cooperate with conservative congressmen from Eastern states harmed by textile imports.</td>
</tr>
<tr>
<td></td>
<td>3. Pressure US Customs to have mandatory inspection on certain Chinese products (e.g. made by prisoners).</td>
</tr>
<tr>
<td></td>
<td>4. Anti-China interest groups communicate with each other in the information, mutually support each other in funding, and coordinate in lobbying actions.</td>
</tr>
<tr>
<td></td>
<td>5. Influence public opinion on China, e.g. cyber-security, oil industry and U.S. national security, Shuanghui's purchase of Smithfield Foods and food safety.</td>
</tr>
<tr>
<td></td>
<td>6. Protect American labors (against exporting jobs to China) and win support from the U.S. general public.</td>
</tr>
</tbody>
</table>

Source: author's data

C. Chinese Oil Companies' Own Weaknesses

The causes of Chinese oil companies' failures in the U.S. are complex. We cannot solely blame U.S. Anti-China interest groups. Chinese oil companies' own weaknesses should also be examined. There are at least three major weaknesses of Chinese oil companies. First, Chinese national oil companies do not have mature business strategies for brand-building. For example, both Chinese auto and oil companies have tried entering the U.S. market for years. However, they still do not
have a clear guiding ideology on how to win support from American consumers. When it comes to foreign brands, average American consumers can easily name some Japanese or Korean brands, such as Nissan, Toyota, LG, and Samsung. They never heard of BYD (Build Your Dream), a Chinese auto firm that is attempting to pursue the American consumers. BYD had planned to sell its E6 electric hatchbacks in the U.S. by the end of 2010. But, it did not succeed. Stella Li, the senior vice-president in charge of the company’s US business, said: “Back then, we had passion, but we had no brand, no history, no capital and no competitive advantage.”\footnote{Bloomberg in Beijing and Shanghai, “BYD Plans to Launch into US Market Next Year”, \textit{South China Morning Post}, January 8, 2014.} Like BYD, the three major Chinese oil companies currently also lack long-term development plans in the U.S., and their negative images to the U.S. government and public will not be improved in a short time.

At the same time, the management of Chinese state-companies’ overseas branches is flawed. Some parent companies did not give overseas branches enough autonomy in operation, so they missed some good business opportunities. And, some parent companies just took laissez-faire attitudes toward their overseas subsidiaries, so the overseas subsidiaries were not well regulated and supervised. For example, recently, PetroChina’s former Indonesia chief Zhigang Wei was under investigation.\footnote{Charlie Zhu and Chen Aizhu, “PetroChina’s Former Indonesia Chief under Investigation”, \textit{Reuters}, October 16, 2013.} He was accused of buying poor-quality oil fields from Indonesia at unreasonable high prices. Undoubtedly, in the authoritarian regime, corruption is always a big disadvantage of Chinese national oil companies, which leads to non-
transparency of decisions and individual leaders' expropriation of the state-owned assets.

Second, Chinese national oil companies face great pressure from domestic energy demand and domestic criticism. Due to its huge population and moderate oil reserves, China's oil consumption per capita is much lower than the world average.74 With fast economic development, the Chinese are hungry for world oil, which has imposed great pressure on Chinese national oil companies. Because Chinese national oil companies are supported by the Chinese government and a large amount of their capital is from Chinese people's taxes. If they make any mistake overseas, they might face fierce criticism from both Chinese public and government.

Third, Chinese national oil companies have an incomplete understanding of non-Eastern Asian cultures. For example, George Feng and Xianzhong Mu's article meticulously exams what cultural challenges are Chinese oil companies facing in Africa and what strategies should they take. According to the authors, Chinese oil companies' overseas management was challenged by miscommunication, working habits, religions, orientation and coexistence.75 While the majority of Chinese people today are atheists, people in Africa, the Middle East and the U.S. have beliefs either in Islam, Judaism or Christianity. For example, in the U.S. many stores are closed and there is less traffic on Sunday, because people go to churches. In China, Sunday is probably the best day for business. In order to make more money, some

74 "Oil Consumption Per Capita", *Index Mundi*, January 1, 2012.
Chinese companies even require employees to work on Sunday, which is unacceptable to some Africans and Americans.

D. The U.S. Urged China to Reform Its State-Owned Enterprises

During the 1980s and 1990s, the Taiwan issue was probably the major concern between China and the U.S. However, since 2001 economic issues have topped the Taiwan issue in Sino-U.S. relations. The Obama Administration is continuously urging China to further reform itself, including the RMB exchange rate with the dollar, state-owned banks and enterprises, and trade barriers. The U.S. believes that China’s state-owned companies still compete with a range of unfair advantages in the Chinese and global markets. For example, China’s financial system is still dominated by state-owned banks, who favor lending to large state-owned companies like PetroChina and Sinopec. In addition, the state-owned companies’ implicit backing by the Chinese government discourages private firms’ entry and expansion. In a meeting at the Commonwealth Club of California, U.S. Treasury Secretary Timothy F. Geithner argued,

If China’s state enterprises want to be treated like commercial enterprises by the rest of the world, they need to act more like commercial enterprises, including by paying market-based dividends to their shareholders and making their corporate governance and finances less opaque.76

Geithner seems to favor China’s private companies more than the state-owned ones. When he visited Beijing in 2012, he said: “China must rely more on innovation by private companies rather than capacity expansion by state owned enterprise, with an economy more open to competition from foreign firms, and with a more

76 “Remarks by Secretary Geithner at the Commonwealth Club of California”, April 26, 2012.
modern financial system.” Indeed, the U.S. is more afraid of China’s state-owned companies which are often related to sensitive sectors like military, telecommunication, energy and banking.

During Geithner’s visit to Beijing in 2012, he also slammed the Chinese government’s subsidies to state-owned companies. To his surprise, the new China leadership seems to be more cooperative than previous ones. For the first time, according to senior American officials, Chinese negotiators said they would commit to removing advantageous financing and regulatory conditions to state-owned enterprises. The Chinese officials had also agreed to raise foreign firms’ stake in joint securities ventures. As a return of favor, in 2013 the U.S. and Canadian government approved the sale of Nexen to CNOOC, which failed in acquiring U.S. oil firm Unocal in 2005.

E. China’s Rising Military Makes It More Difficult for Chinese Companies to Obtain U.S. Oil Assets

In the spring of 2006, Chinese President Hu visited Washington and conducted a tough formal talk with his counterpart, George W. Bush. The talk covered many subjects and urgent issues, such as the rebuilding of Iraq; anti-terrorism; the global financial system; the U.S. debt and China-U.S. trade; human rights; and definitely the issue of oil. Hu felt uncomfortable with this visit as Chinese Falun Gong protestor heckled him for several minutes on the White House lawn and

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besides a White House announcer mixed up China's formal sovereign name (People's Republic of China) with the name preferred by the Nationalist government on Taiwan (Republic of China). By contrast, Hu immediately left for Saudi Arabia after his rash farewell to D.C. and had a greatly cozy atmosphere in Riyadh with the Saudi royal family. Later, it seems that Hu's Arabian sojourn piqued interest in the United States. Americans seem to be unhappy as the Chinese and Saudis signed new oil contracts. To some extent, the U.S., no matter its politicians or the general public, is getting more and more cautious of the closer relationship between China and the Middle East.

The increasing Chinese oil demand makes China much more nervous about the oil supply security as the U.S. power, particularly the American navy, is globally present and poses a potential threat to China's maritime oil transportation. Based on this rationale, the Chinese are speeding up their military strategy transformation - that is, from the land to the sea. According to Jon Alterman and John Garver, Sino-American conflict in the Middle East could cut China off from access to energy, since the U.S. controls the sea lanes on which oil to China travels.

Traditionally, China adopts the strategy of "watching the tigers fight", which comes from an old Chinese saying. This strategy fairly characterizes China's approach to U.S. policy in the Middle East. Partly this is because the Chinese tend to believe that the grandiose ambitions of the United States to control the Middle East
and its oil will not succeed in any case.\textsuperscript{81} In other words, China is not willing to join the fighting in this region. Instead China prefers to free-ride on the U.S. If America's efforts to stabilize the Middle East fail, China will probably not step in. Besides, since Deng Xiaoping, China has always kept in mind that economic development is the top national priority. The Chinese seems to be good at learning lessons from the ancient wisdom, such as "Gao Zhu Qiang, Guang Ji Niang, Huan Cheng Wang," which means "build tall walls, store grains, and claim the throne later." Therefore, the land-defensive strategy has dominated China's military strategy over the past several decades.

The problem is the conflict between the rising oil demand and unmatched navy power. How can China solve the problem? The Chinese media, general public and decision-makers in recent years seem to embrace Mahan's sea power theory warmly.\textsuperscript{82} They call for a transformation of China's military strategy, from land to sea. If we look at several indicators, we will find that China's increasing oil demand is unprecedented. First, China is the second in oil-importing nations, probably become the first in next one or two decades. Oil fuel the rapid economic growth. Once the engine of Chinese economy started, it is difficult to stop or slow it in recent years. Second, China's middle class is growing as more Chinese are getting richer. The young Chinese middle class are well educated and to some extent are also influenced by Western values and life styles. They are eager to buy nice cars with larger consumption. This is also rooted in Chinese culture, the culture of face.

\textsuperscript{81} Jon B. Alterman and John W. Garver, \textit{The Vital Triangle: China, The United States, And The Middle East}, (CSIS, 2008).

Owning a new car, particularly an American or German car, make them not lose face.

It is reported that China ranks the top by motor vehicle production in 2010. Third, China is said to be the second largest manufacturing country in terms of Nominal GDP and the first in terms of PPP GPD. These indicators all suggest that China’s economy is fueled and sustained largely by energy, particularly oil. If there is any emergency of oil security, China will suffer greatly, let alone face war with other major powers.

In order to secure China’s maritime oil security, in recent years China has diversified the oil sources. Table 4.4 shows that China has purchased oil assets in regions beyond the Middle East.

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83 Data is based on CIA Fact book and Wikipedia.
### Table 4.4

Large Merger and Acquisition Deals by China’s State-owned Oil Firms§

<table>
<thead>
<tr>
<th>Company</th>
<th>Date</th>
<th>Country</th>
<th>Assets</th>
<th>Price (US$ millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sinopec</td>
<td>Dec 08</td>
<td>Syria</td>
<td>Tanganyika Oil</td>
<td>2,000</td>
</tr>
<tr>
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<td>Nov 08</td>
<td>Iraq</td>
<td>al-Ahdab field</td>
<td>2,900</td>
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<td>Australia</td>
<td>AED Oil</td>
<td>561</td>
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<tr>
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<td>Blocks 17 and 18</td>
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<td>Oct 05</td>
<td>Kazakhstan</td>
<td>PetroKazakhstan</td>
<td>4,000</td>
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</tbody>
</table>

Source: Author's database

Also, China speeds up transforming itself from a land power to a sea power. China’s first aircraft carrier was launched in 2012 and it was reported that China is planning to build four more in coming years.§§ China also sent military cruises to the Indian Ocean and the Eastern African shore to protect its oil tanker ships. China’s strengthening military power is a double-edged sword however. On one hand, it protects Chinese oil companies’ overseas assets. But, on the other hand, it may foster the ‘China Threat’ theory in the U.S. and make it more difficult for Chinese companies to obtain U.S. oil assets. Below is the logic that explains the

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connection between China's rising military and the failures of China's oil companies in the U.S.:

China's rising market demands;
→
China started to diversify its oil sources, including buying oil assets from oil-rich countries
→
With more overseas oil assets purchased, China started to worry about its oil security (because the U.S. controls the international maritime transportation line);
→
In order to protect overseas oil assets and transportation, China started to strengthen its military power;
→
However, China's rising military power makes the U.S. more nervous, which fosters the "China Threat Theory" in the U.S.
→
Oppositions to China's purchase of American oil assets by the U.S. public and Congress. China's state-owned companies are easily subject to the CFIUS investigation.

Summary

In summary, this chapter covers at least five major sections: 1. an overview of Chinese state-owned oil companies; 2. a detailed discussion of the big three Chinese oil companies in the U.S., 3. the barriers to market entry, including CFIUS, Anti-China interest groups, U.S. Congress and the rule-based society; 4. Chinese oil companies' own weaknesses; and 5. The impact of China's rising military power on its companies' overseas purchases.

In the overview section, I find that China's state-owned oil companies have grown very fast over the past two decades. Today, they are top ranked in the Global 500. Their fast development is a result of the state-led development. First, compared
to those private Western oil companies, the Chinese state-owned oil companies are less worried about their revenues and profits. Their financial condition is relatively stable because of the capital back-up by the Chinese government and central bank. For this matter, African politicians and businessmen have confidence in the Chinese investment, which is one of many reasons that explain China's energy expansion in Africa. In addition, Chinese state-owned companies are the hotbed for corruption either in the domestic market or in international markets. PetroChina's bribery in Africa enabled it to obtain good oil assets. By contrast, in the U.S. PetroChina received lawsuits against corruption and non-transparent decision.

Second, unlike private Western oil companies, the leaders of Chinese oil companies are usually appointed, promoted or dismissed by the Chinese government. Some top government officials were general managers or chairmen of Chinese oil companies before they were promoted to government positions. Therefore, there is a great intersection of public and private interest in China. Jiemin Jiang's downfall showed this.

In the second section, I outlined three major cases of the failures of China's oil companies in the U.S. PetroChina faced lawsuits. Sinopec's agreements in Wyoming were terminated. And, CNOOC failed to purchase Unocal. Following the description of the process and failures of their attempted purchases, the third and fourth section answer why they have failed in the U.S. market. To sum up, there are at least three barriers to entry in the U.S.

The first barrier is CFIUS, as an executive branch committee under the President rather than a Congressional entity. The study shows that CFIUS has
shifted its target from Japanese companies to Chinese companies. In recent years, there are an increasing number of purchases by Chinese investors that have been blocked by CFIUS, including the cases of CNOOC, Huawei, and Sany Heavy (Huawei and Sany Heavy will be examined in chapter 5, because they are private Chinese companies).

The second barrier is the interaction between U.S. Congress and anti-China interest groups, which makes it more difficult for Chinese companies to trade or invest in the U.S. The anti-China interest groups often cite China's problems (e.g., human rights issues, the Tibetan issue, shortage of freedom of speech and more) to affect Congressional decisions on the China-U.S. trade.

Third, the U.S. is a rule-based society which is starkly different from the environment where Chinese oil companies grew up. In the U.S., dispute resolution is heavily based on public regulations and laws, whereas in China many disputes are settled privately (Called "私了 Si Liao" in Chinese). Therefore, when Chinese companies faced lawsuits in the U.S., they felt unconformable, incompetent and passive.

In addition to these barriers to entry in the U.S market, Chinese companies have some weaknesses in common. There is much room for them to improve management skills as well as understanding of Non-East Asian cultures. For instance, in China, friends and colleagues compete to pay dinners. In the U.S., most prefer to "Go Dutch". In China, Sunday is probably the busiest day for department stores and street vendors. But, in the U.S., many people go to Church and take a rest on Sunday. Admittedly, understanding foreign cultures is a slow learning process,
which cannot be done overnight. In the following years, Chinese companies should
“put themselves into Americans’ shoes” and gradually change their negative images
in the eyes of many American consumers. The last but not least is China’s military
building and its impact on China’s purchases of overseas oil assets. China’s rising
military may strengthen China’s oil security in the Middle East and Africa. In return,
the U.S. may view it as a growing threat, which makes it more difficult for Chinese
companies (no matter state-owned or private) to obtain American assets. In the next
chapter, I will examine two private Chinese companies (Huawei and Sany Heavy)
which have close ties to the Chinese military and failed in acquiring American assets.
CHAPTER V

CASE STUDY 4: PRIVATE CHINESE COMPANIES IN THE U.S.

Introduction

In the previous chapter, three Chinese state-owned enterprises are examined. The empirical studies show that those SOEs investing in strategic resources like oil will trigger CFIUS reviews. How about private Chinese firms? Will they enjoy more successes than SOEs in the U.S.? My case studies show that FDI of private investors in the U.S. has overtaken that of SOEs. This trend gives us at least two signals. First, ownership matters. Most private Chinese firms are independent from the control of home government and are not viewed as potential threats by the U.S. government and public. Second, sector matters. Most private Chinese firms are in sectors of consumer goods and are also smaller than SOEs in terms of company size. As a part of American cultures, private entrepreneurship is praised for its innovation. However, the success of some private Chinese firms in the U.S. does not mean that all private Chinese firms should be worry-free from a CFIUS review. This chapter will divide private firms into two kinds. One is those with close ties to home government. The other is those without. By comparison, my case studies show that for private Chinese firms, the key to CFIUS approval is to clearly clarify their purposes of purchases of American assets as well their relationships with home government.
Recent Trends of Chinese FDI in the U.S.: Private Firms Have Overtaken the State-Owned

For a long time, China’s foreign direct investment (FDI) was dominated by State-owned enterprises (SOEs). SOEs are officially described “Guo Jia Jing Ji Ming Mai” (the economic artery of the country). The status of SOEs in the national economy was unchallengeable because they control banking, communication, transportation and energy industries. In recent years, China’s private companies have grown bigger and more sophisticated and are thus getting more comfortable in considering overseas acquisitions. For example, in 2012, Dalian Wanda Group Co., Ltd., a Chinese private conglomerate and China’s largest investor in cultural and entertainment activities, successfully acquired AMC Entertainment Holdings, Inc., a leading U.S. film exhibitor. In 2013, Shuanghui, China’s largest pork producer purchased Virginia-based firm Smithfield Foods.¹

According to Rhodium Group, a New York-based research firm, 16 out of the 17 deals closed in the first quarter of 2013 by Chinese companies were done by privately-owned enterprises.² Figure 5.1 by Rhodium clearly shows that China’s private firms have outperformed China’s state-owned firms in the U.S. market since 2012.

The increase of investment by China’s private companies is now the new trend of China’s FDI in the U.S. Why did China’s FDI trend shift from dominance-by-SOEs to dominance-by-private firms? Akin Gump Strauss Hauer & Feld LLP, a U.S. lobbying firm for Chinese companies, argues that:

The areas of FDI expansion are broadening from the focus on resources and high tech to brand building, distribution in industries where private firms may have a stronger representation. In addition, provincial governments have been encouraging privately owned firms in their regions to ‘go out’.\(^3\)

Indeed, compared to China’s private firms, SOEs have at least four drawbacks. First, SOEs are a hotbed of corruption. In previous chapters, I have discussed the interaction between government officials and SOEs. Some SOEs leaders were

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appointed by their government supervisors or later they were promoted to higher-level government positions. For example, Jiemin Jiang was the general manager of PetroChina before being appointed the director of the State-owned Assets Supervision and Administration Commission in 2013. This movement between firms and government invites corruption.

Second, compared to most private firms, SOEs are less efficient in economic activities. In China, SOEs jobs are called "Tie Fan Wan" (literally, iron rice bowl), which means a permanent job a person would never lose whether he works hard or not. Although the wages offered by SOEs might be lower than some private companies, still many Chinese graduates compete for SOEs jobs. In order to get a stable job in SOEs, a Chinese graduate may use connections and make deals behind the scenes, which is called "Zou Hou Men" in Chinese (literally, going through the back door). For this reason, SOEs employees are not necessarily talented or competent. In addition, they are much less motivated to work hard compared to private employees because of their permanent positions and fewer incentives. Some Chinese SOEs have serious debt problems. For instance, in the 1990s, China was plagued by "triangular debts (when a manufacturer that has not been paid for its product is unable to pay its suppliers, which in turn struggle to pay their suppliers).” Later that decade, financial institutions were burdened by bad debts generated by state-owned enterprises.4

Third, private companies are more creative and can also create more jobs than SOEs. The number of "Tie Fan Wan" (permanent stable jobs in state-owned

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companies) is very limited and cannot meet the rising population of college graduates every year. In 2004, there were 2.8 million Chinese college graduates. In 2013, it rose up to more than 7 million.\(^5\) The Chinese government is facing intense pressure over unemployment because a higher rate of unemployment seems to have a positive causal relation with social instability, which is not wanted by the Chinese government. The Chinese government is not willing to see another Tiananmen protest organized by college students and workers together.

To respond to the rising population of young Chinese graduates and migrant farm workers, the Chinese government has encouraged private-sector investment through various policies over the past decade. For example, as a communist regime, China basically copied the Soviet Union’s healthcare model in the 1950s. Hence, China’s healthcare sector had been dominated by public hospitals and was not opened to private organizations for a long time. In 2014, Chinese authorities unveiled a package of healthcare measures which allow private sector firms to build health institutions.\(^6\) Admittedly, China’s health care industry is less developed than the U.S. In the U.S., healthcare is a large mature industry. According to the latest data by U.S. Census Bureau, there are 784,626 health care companies in the U.S., which hire almost 17 million people.\(^7\) China has a long way to go in terms of private healthcare sector. However, there is great potential for China’s private companies, and the government’s recent move will create more business opportunities and jobs for Chinese college students. I expect that in the near future we will see more and

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\(^5\) "2001-2013 Population of Chinese College Graduates", Career.eol.cn

\(^6\) "China moves to encourage development of private healthcare", Xinhua, April 9, 2014.

\(^7\) "Health Care Industry Statistics", US Census Bureau, July 2013.
more Chinese private firms cooperate with U.S. healthcare firms and sell products together in the Chinese market.

Fourth, China's SOEs are more likely to receive reviews by CFIUS. David Riedel, president of New York-based Riedel Research Group, said: “External investments by private companies are less politically sensitive than investments from State-owned companies, which is critical to investment success in the U.S.” The success rate of China's private firms in the U.S. might be higher than that of China's state-owned firms. However, this does not mean that China's private firms did not receive any investigations from CFIUS. Actually, CFIUS has also investigated those Chinese private firms with strong government background. For example, Huawei, a private Chinese telecommunication company, failed to acquire California-based cloud computing company 3Leaf in 2010 and 2011. For this reason, in the next section, I will probe three major regulations relevant to CFIUS.

How does CFIUS work? CFIUS's procedures and legitimacy are based on three major U.S. regulations relevant to foreign investment. From earliest to latest, they are The Exon Florio Amendment (1988), The Byrd Amendment (1993), and Foreign Investment and National Security Act (2007).

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Major U.S. Regulations Regarding Foreign Investment

A. Omnibus Foreign Trade and Competitiveness Act - The Exon Florio Amendment

(provision)

The Exon Florio Amendment was passed in 1988, as a part of the Omnibus Foreign Trade and Competitiveness Act. This event was triggered by the attempted acquisition of Fairchild Semiconductor Corporation, an American company, by the Fujitsu Corporation, a Japanese company.9 Then U.S. President Reagan was surprised to find out that at that time there were no regulations that he could use to block the acquisition. So, Senator J. James Exon and Representative James J. Florio immediately sponsored the amendment, which granted the President the authority to block proposed or pending foreign “mergers, acquisitions, or takeovers” of “persons engaged in interstate commerce in the United States” that threaten to impair national security.10 Although Fujitsu Corporation finally withdrew the acquisition under political pressure, Congress took the opportunity to pass the legislation that would block similar transactions in the future.11

The Exon Florio Amendment has fundamentally transformed CFIUS, because President Reagan delegated his authority to administer the Exon Florio provision to CFIUS, particularly to conduct reviews, to undertake investigations and to make

recommendations. In 1989, when China National Aero-Technology Import and Export Corporation (CATIC), a state-owned military aircraft producer, attempted to purchase MAMCO Manufacturing, a U.S. firm machining and fabricating metal parts for aircraft, President George H.W. Bush ordered CFIUS to conduct the investigation. CFIUS then started to collect information from various sources to research the background of CATIC. After several months' investigation, on February 2, 1990 President Bush, on the basis of unanimous recommendation from CFIUS, ordered CATIC to divest all its interest in MAMCO. In addition to the power of undertaking investigations, CFIUS has gained de facto legislative authority to negotiate and enforce agreements over FDI because of its ability to cause any foreign firm to divest. Thus, after the Exon Florio amendment, CFIUS truly became an empowered governmental body.


The Byrd Amendment is an upgrade of the Exon Florio Amendment. In 1992, Congress passed it through Section 837(a) of the National Defense Authorization Act for Fiscal Year 1993 (P.L. 102-484). According to James Jackson, a specialist in International Trade and Finance, the Byrd Amendment requires CFIUS to investigate foreign investment in cases where two criteria are met:

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15 James K. Jackson, Congressional Research Service - The Committee on Foreign Investment in the United States (CFIUS), March 6, 2014.
1. The acquirer is controlled by or acting on behalf of a foreign government;

2. The acquisition results in control of a person engaged in interstate commerce in the U.S. that could affect the national security of the United States.\(^{16}\)

The mandatory investigation for foreign investments that meet the two criteria is at least 45 days. Moreover, CFIUS could reopen a review of an acquisition in question and overturn its approval at any time.\(^{17}\) Under the Amendment, an acquisition by a foreign government-controlled entity is more likely to be subject to CFIUS reviews than an acquisition by a foreign non-government entity.\(^{18}\) This may explain why state-owned firms are more likely than private firms to receive CFIUS review. In addition, this Amendment also requires CFIUS to file a report to Congress at the conclusion of any investigation, which "adds to the process an opportunity for Congress to exert political pressure for more vigorous, stricter enforcement."\(^{19}\) The Byrd Amendment increases Congress's involvement in foreign investment, which can stir up popular opposition and thus makes it more difficult for China's state-owned firms to acquire American assets.

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\(^{16}\) James K. Jackson, Congressional Research Service-The Committee on Foreign Investment in the United States (CFIUS), March 6, 2014.


\(^{19}\) Ibid.
C. Foreign Investment and National Security Act

The most recent regulation that strengthens CFIUS's power is the Foreign Investment and National Security Act (FINSA) which was passed during the George W. Bush Administration. First, under FINSA, CFIUS established its membership by statute. There are nine permanent members. Some active members are the Departments of Defense, Commerce, Homeland Security, and Justice. The CFIUS investigation committee is chaired by the Secretary of the Treasury. Other government agencies may also serve as lead agency with respect to particular investigations, depending on the nature of the acquisition.

Second, FINSA fixes the holes of pre-existing regulations including the Exon Florio Amendment and Byrd Amendment, because FINSA pays particular attention to the acquisitions of America's critical infrastructure assets by foreign companies. FINSA states that "Among the additional factors CFIUS must now consider in its review are the impact of the transaction on critical infrastructure, broadly defined, as well as energy assets and critical technologies." To some extent, FINSA is viewed as a response to the controversies surrounding China National Offshore Oil Corporation's unsolicited bid for Unocal in 2005 and Dubai Ports World's (DPW) attempt to acquire port facilities in 2006.

Third, FINSA applies to all foreign investments in U.S. defense and critical infrastructure businesses regardless of whether they are state-owned companies or

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22 Ibid.
private ones. For example, in 2007 when Huawei, a private Chinese telecommunication firm, attempted to buy an American firm, Senator John Kyl, together with thirteen other Senators, sent a letter to the Treasury Department urging that the transaction be closely reviewed under FINSA. Telecommunication was treated as a specific form of critical infrastructures. The next section addresses the Huawei case in more detail.

Huawei

A. Who Is Huawei?

In 1987, the same year when KFC entered China, Huawei was established by ex-military officer Zhengfei Ren in Shenzhen of Southern China. Shenzhen is a fishing town situated just across the border from Hong Kong, so in early years Huawei was just a small sale agent for a Hong Kong company producing Private Branch Exchange (PBX) switches, an in-house telephone switching system that interconnects telephone extensions to each other as well as to the outside telephone network. After three years' learning experience from Hong Kong. In 1990, Huawei embarked on its own independent research and commercialization of PBX technologies targeting hotels and small enterprises. In the early 1990s, Huawei chiefly targeted at the rural Chinese market. For example, in 1992, Huawei

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26 This part draws on Huawei's official website.
developed rural digital switching solution. In 1995, Huawei generated sales of RMB 1.6 billion, mainly derived from rural markets in China.

Huawei shifted its major market from rural China to urban China in the late 1990s. In 1998, Huawei expanded into metropolitan areas of China and launched wireless GSM-based solutions. GSM is Global System for Mobile Communications, a standard to describe protocols for cellular networks used by mobile phones.28 In the 1990s, China started a series of economic reforms including the reform of state-owned enterprise and the housing system by then-Premier Zhu.29 At that time the government attempted to liberate China’s economy further through labor mobility. Thus, millions of Chinese farm workers started to migrate from rural China to urban China. Most farm workers left their parents and children at home in Western China while they were working in the cities of Eastern China. Due to the far distance and busy work, many of them could only return home for reunion once a year. This created demand for inexpensive personal communications. Since then, the demand for mobile phones has increased every year in China, which spurred Huawei’s rapid growth.

Soon after Huawei’s expansion into urban China, Huawei started to explore international markets. In 1999, Huawei set up its first overseas R&D center in Bangalore, India. There are two reasons why Huawei chose to launch its first overseas R&D center in Bangalore. First, India is geographically close to China and is also a developing country, so the labor and transportation costs are very low.

Second, Bangalore is known as the “Silicon Valley of India” which is the hub of India’s leading IT and telecommunication companies. Thus, Huawei could get enough technical support from partners in Bangalore. In 2000, Huawei’s sales of $100 million were generated from international markets. Only two years later, the sales of international markets skyrocketed to $552 million. With China’s “going-out” policy and admission into the WTO, Huawei speeded up its overseas expansion during President Hu’s administration. So, instead of establishing R&D centers, Huawei started to build joint ventures with foreign companies after 2003. From 2003 to 2007, Huawei had established several joint ventures with Siemens, Global Marine, Motorola and Symantec.

After twenty years’ rapid development, Huawei has transformed from a small private company to a giant multinational networking and telecommunications equipment company. Some praise Huawei because it is an outstanding example of China’s economic reform and success. Others criticize Huawei because it had a military origin and its success could not be copied by other Chinese private companies.

B. Huawei’s Close Tie to Home Government

Huawei’s military origin is the major source of mistrust for Western governments including the U.S., Britain and Australia. Many believe the founder of Huawei, Ren Zhengfei, was a director of the People’s Liberation Army (PLA)
Information Engineering Academy.³⁰ Huawei argued that U.S. government exaggerated Mr. Ren's military background. According to Huawei officials, Mr. Ren was just a Deputy Regimental Chief without military rank. When he joined PLA in 1974, he was just a soldier tasked to establish the Liao Yang Chemical Fiber Factory.³¹ In 1983, Mr. Ren retired from the army and joined Shenzhen South Sea Oil Corporation (SSSOC), a state-owned company.³² However, he was not satisfied with the low wage offered by the company, so he decided to found his own business.

In 2010, Huawei's new board of directors and supervisory board were elected by representatives of Huawei employees. In the same year, Huawei also revealed board members in its annual report and official website to boost transparency. It was the first time Huawei exposed its leaders' information to the public. When Huawei attempted to purchase U.S. firm 3Leaf in 2010 and 2011, the U.S. government requested more information about Mr. Ren's military background. However, Huawei refused to answer it.³³ On January 19, 2011 an article on Xinjin Bao asserted that Mr. Ren has not granted any media interviews since becoming the company's CEO in 1988.³⁴

In addition to Mr. Ren, Yafang Sun, Chairwoman of Huawei, was also believed to be affiliated with the Chinese government and military. Both Chinese and

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³¹ Ibid.
³² "Huawei Annual Report Details Directors, Supervisory Board for First Time", Open Source Center, October 5, 2011.
³⁴ "Huawei Annual Report Details Directors, Supervisory Board for First Time", Open Source Center, October 5, 2011.
Western news media reported that she worked for the Communications Department of the Ministry of State Security for an unspecified period of time before joining Huawei. In early years, Sun used her connections at the Ministry of State Security to help Huawei through financial hardship.35

C. Doomed to Fail in the U.S. Market

Huawei attempted twice to buy American companies. In 2008, Huawei made efforts to purchase a stake in 3Com, an American maker of Internet router and networking equipment. Along with Bain Capital, a private equity firm in Boston, Huawei proposed a $2.2 billion deal, which was very attractive to 3Com. Then, CFIUS established a committee which consists of representatives of twelve U.S. government agencies to review the 3Com deal. In the process of review, U.S. Congress pressed CFIUS and cited a study by the Rand Corporation to support the argument that Huawei had close ties to the Chinese military.36 In the end, CFIUS blocked this sale because 3Com makes anti-hacking computer software for the U.S. military and Huawei's background is suspicious. Eventually, 3Com was acquired by HP in 2009.

Two years later, in 2010 Huawei attempted again to buy 3Leaf. 3Leaf is a small little-known American company, but it has some advanced technologies including cloud computing. Huawei thought the Obama Administration might be friendlier toward its purchase than the last one in 2008. However, the Obama

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35 “Huawei Annual Report Details Directors, Supervisory Board for First Time”, Open Source Center, October 5, 2011.
Administration did not show any favor toward or support for this purchase. Under pressure from CFIUS, Huawei finally dropped its bid for 3Leaf. In a brief statement, Huawei said,

This was a difficult decision; however we have decided to accept the recommendation of CFIUS to withdraw our application to acquire specific assets of 3Leaf.37

Huawei is doomed to fail in the U.S. because in recent years, cybersecurity or digital warfare has become a hot topic frequently addressed by U.S. news reports, government official reports and academic papers. The U.S. and China pointed fingers at each other. The U.S. complained about hacking and cyber-attacks from China’s PLA, Chinese companies and institutes. When Obama met Xi in May 2013, Obama urged Xi to investigate and curb cyber intrusions from China.38 In the meantime, the Chinese government also complained about hacking activities from the U.S. Particularly, after the Edward Snowden incident, Huawei was said to be hacked by the NSA, because for a long time the NSA had allegedly been looking for communications between Huawei and the Chinese military.39 In June 2013, China’s news agency China Daily reported: “U.S. should explain its hacking activities on China.”40

Following Huawei’s attempted acquisition, Sany Heavy Industry Co., Ltd, another Chinese private company, also failed to get four Oregon wind-farm projects in 2012. However, Huawei and Sany Heavy Industry treated their failures

differently. Huawei dropped its bid for 3Leaf voluntarily amid opposition. Basically, Huawei settled the case peacefully with the U.S. government. In a statement, Huawei said: "The significant impact and attention that this transaction has caused were not what we intended." In 2013, several news reports revealed that Huawei decided to give up on the U.S. market after several failures. The *Financial Times* quotes Huawei's executive vice president as saying, "We are not interested in the U.S. market anymore." Unlike Huawei's attitude of acceptance, Sany fought back against the U.S. government after its purchased was blocked. As the next section shows, in 2013 Sany even sued U.S. President Barack Obama.

Sany Heavy

*A. Who Is Sany?*

Sany is China's biggest construction equipment manufacturer and the fifth-largest in the world. It was founded by Wengen Liang and three of his partners in 1989. Successful Chinese businessmen have some similarities in their early years. Many were born to poor families. They worked in China's state-owned enterprises, but later quit. There are many examples (e.g. Huawei, Haier, Lenovo and Sany). Mr. Liang was born to a poor peasant family in Hunan, central China and also the hometown of Chairman Mao. In 1983, he joined a state arms plant after his

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graduation from China Central South University. He worked there for three years and was also promoted as a top director. In 1986, he quit his job in the state firm and started to trade ships and make wine but eventually failed. In 1989, Mr. Liang found his right goal - that is, to establish a factory making heavy industry equipment.

B. The Major Impetus for Sany’s Fast Development in China

In less than two decades, Sany has transformed from a small local firm to a large multinational company. What factors can explain this success? There are many, including Sany’s corporate culture, leaders’ Guanxi, adoption of new technologies, support from the local government and more. I argue the major impetus or factor for Sany’s success is China’s state support for real estate over the past decade. Sany is not a house or bridge builder, but it provides equipment for those builders. It reminds one of a similar case in the U.S. In the Gold Rush, some dig for gold, and some just sold tools like shovels. Interestingly, shovel sellers finally became rich while some gold diggers found nothing. Sany, as an equipment maker for heavy industry and construction, has benefited a lot from China’s large construction projects from the mid-1990s to today. For instance, in 2012, Sany signed a contract with China State Construction Engineering Corporation (CSCEC) to provide a super-high-rise concrete pump for the construction of Guangzhou East Tower, which will be the highest building in Guangzhou city.45

45 “SANY Participates in Construction of Guangzhou East Tower”, Sany’s official website, October 8, 2012
Sany, as a successful representative of Chinese private firms, has been welcomed by top Chinese leaders many times. In 2003, Former President Hu inspected Sany and commented: "You have made splendid achievements in the past. Hope you unite as one to create a better future!" Former Premier Wen visited Sany in 2005 and 2010, respectively. Premier Wen also witnessed Sany’s contract-signing ceremony in 2009 when Sany invested EUR 100 million to build a R&D center and machinery manufacturing base in Bedburg, Germany. Other top leaders who also visited Sany include Jia Qinglin, Political Bureau of CPC and Chairman of China National Consultation Committee of the CPPCC; Zeng Qinghong, Political Bureau of CPC and Vice President of the PRC; Huang Ju, Vice Premier and Standing Committee Member of the Political Bureau of the CPC Central Committee and Zhou Yongkang, Member of Standing Committee of the Political Bureau of CPC Central Committee, to name a few. There are rumors on the Internet that new Chinese President Xi’s only daughter is dating Sany founder’s only son. Due to Sany’s close ties to the Chinese government, its attempted investment in Oregon wind farms drew attention from the U.S. government, which resulted in its failure in 2012.

C. Sany Failed in Oregon Wind Farm Projects and Sued Obama

On February 28, 2012, through its affiliated company, Ralls Corp, Sany purchased wind farm projects in Oregon. Just three months later, the U.S. Navy contacted Ralls and complained that the wind farms might affect their training

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46 “About Sany”, Sany’s official website.
47 Ibid.
48 Ibid.
because the projects consist of four locations, all of which are near or within restricted Navy airspace. Then, CIFIUS stepped into the investigation. In July, Ralls received the first interim order from CFIUS demanding a halt to the project on grounds of national security. In addition, no one is allowed to enter the wind farms except for authorized American citizens. Sany was shocked. To reduce the loss, Sany had to transfer the wind farms to American companies because the Chinese were not allowed to enter the sites. In August, Sany received a second interim order from CFIUS, which prohibited Sany transferring any projects to American companies.

In the end, Sany had to give up all ongoing wind farm projects in Oregon. Sany requested for compensation for the loss. CFIUS turned it down saying that “there was no compensatory mechanism for banned projects.” The major explanation that CFIUS gave to Sany was that Sany’s wind farm projects were close to U.S. military facilities. Sany argued that “10 Germany-made Repower wind turbines and 27 Denmark-made Vestas wind turbines were working in the same area.” Then, Sany wrote letters to President Obama and Secretary Clinton, but received no answers. Sany was disappointed and angry. So, Sany decided to accuse Obama of discriminating against Chinese firms in the U.S.

The Sany case was famous for two reasons. First, it was the first time that a U.S. President stepped in to block such a foreign business deal since 1990, when President George H.W. Bush blocked the sale of a manufacturer to a Chinese agency.

51 Ibid.
Second, it is also the first time a Chinese firm used legal means to sue a U.S. president.52 Sany can file the case at several levels of U.S. courts, though the likelihood of success is slim. Junpo Hao, an expert in cross-border litigation, said: “Should the company fail, the losses are minimal, but should the case win, it would become a milestone.”53 Moreover, Sany set an example to other Chinese firms, thus I expect that in coming years there will be more Chinese firms using legal means to fight their cases against the U.S. government.

The Shuanghui - Smithfield Acquisition

A. ShuangHui

The Shuanghui - Smithfield Acquisition was the most famous case of China’s acquisition in the U.S., because the purchase represents the largest purchase of a U.S. firm by a Chinese company to a date. Shuanghui offered $4.7 billion for Smithfield, a purchase worth more than $7 billion including Smithfield’s debt.54

Probably, most Americans know about Smithfield Foods, the largest pork producer and processor in the U.S. Smithfield Foods products are sold in major American grocery stores such as Walmart, Food Lion and Farm Fresh. However, average Americans are not familiar with Shuanghui, the largest meat producer in China. Shuanghui’s ham sausage is one of the most famous products throughout China. It also was my favorite when I was a teenager. Although my mother told me

that it might have some preservatives, I still could not resist buying packets of Shuanghui ham sausages. They were cheap and ready-to-eat. At the very beginning, Shuanghui sold only pork sausages. Later, Shuanghui diversified its products by making chicken, beef and fish sausages with various flavors. There are some Muslim groups in Northwestern China, so Shuanghui's chicken sausages are labeled as “Qing Zhen Shi Wu” (Islamic food).

Shuanghui was founded in 1958 by the local Luohe city government and was not a private company at the beginning. In 1984, Wang Long, known as “China's butcher-in-chief”, was appointed head of Shuanghui. Since then, Shuanghui has gradually transformed itself into a private firm. During the 1970s and 1980s, China's domestic consumption was weak. China was even an oil and meat exporter. The Soviet Union was Shuanghui's largest foreign market. When the Soviet Union collapsed, Shuanghui's managers were very upset as Shuanghui lost its major oversea market. But a train trip by Wang Long changed Shuanghui's fate. Ready-to-eat ham sausage originated from Japan and the U.S. In the early 1990s, ready-to-eat ham sausage was a new thing to the majority of Chinese people. Once on a train, Wang Long saw a passenger next to him eat ham sausage. An idea came into his mind that Shuanghui should produce ready-to-eat ham sausages instead of selling raw meats. So, Wang Long immediately returned to his factory and drafted a plan including buying ham sausage making machines from Japan.

56 Wan Long, Baidu, 2014.
57 Baike, Baidu.
In 1992, Shuanghui produced its first branded sausage. After two decades' growth, Shuanghui has already become a meat importer instead of meat exporter. Today, Shuanghui buys tons of raw meats overseas and then processes them in world factories, and finally sells them to the growing number of Chinese consumers. According to Chairman Wan Long, "Chinese traditionally like to eat pork, and China doesn't have the resources to raise cattle on a large scale. If there isn't a lot of beef, you'll have to eat pork if you like to eat meat." It is reported that in 2012 China imported more than 1.3 million tons of pork and its byproducts, including more than 500,000 tons from the U.S.

B. Smithfield Foods

Smithfield Foods is a Virginia-based pork producer, headquartered in Smithfield, Virginia. The company was founded in 1936 by Joseph Luter. Its prime time was in the 1980s when it purchased Eckrich, Farmland Foods of Kansas, Gwaltney of Smithfield, John Morrell, and Premium Standard Farms. However, since the 1990s Smithfield Foods has continuously received criticism for environmental, animal rights and labor violations. In 1997, the company was fined $12.6 million by the Environmental Protection Agency (EPA) for violations of the Clean Water Act. It was then the largest Clean Water Act Fine ever. In 2005, Human Rights Watch (HRW) issued a report criticizing Smithfield Foods for unsafe work conditions. In 2010, the

59 Ibid.
Humane Society of the United States (HSUS) released an undercover video which showed that Smithfield Foods tortured animals. At the time when Shuanghui attempted to buy it, Smithfield Foods has a debt outstanding of $3 billion. By contrast, China’s enforcement of regulations regarding environment and labor rights was not strict. In 2011, there was an article on the Internet, documenting that Shuanghui had polluted a local river. However, so far Shuanghui has not been warned or punished by local government.

C. Why Was Shuanghui Interested in Purchasing Smithfield Foods?

Today, farming lands and water resources are very precious in China because they are decreasing in recent years with China’s fast urbanization and industrialization. In order to meet the huge domestic demand, Chinese companies are actively seeking lands, resources, forests and energy around the globe. “The U.S. has sufficient farming land and water resources. Buying Smithfield is to secure the supply of feed and water to pigs for Shuanghui”, said by James Feng, general manager of Soozhu.com, China’s biggest independent hog researcher. Indeed, when I took a train crossing the U.S. from the East Coast to the West, I was so amazed by the diversity and richness of natural resources in the U.S. In Chinese, the world “America” means “beautiful country.” As a new country, not many big wars or devastating destruction happened in U.S. territory. Overall, lands, water resources and forests are well protected in the U.S. By contrast, in its long history, China

63 http://bbs.tiexue.net/post_5566622_1.html
64 Ibid.
experienced many devastating wars and peasant revolutions, particularly, Mao's Great Leap Forward Movement, which caused damage to China's natural resources. Today, it is rare that one can see old trees in China.

In addition to rich farming lands and water resources, better technologies are another factor that motivated Shuanghui to purchase Smithfield. For a long time China's farming has been heavily dependent on labor, whereas American farming utilized tools, equipment and new technologies. Through many TV programs or movies, the Chinese people have developed stereotypes toward American agriculture industry - that is, they generally think that an American farm is so large, on which American farmers fly airplanes and drive big tractors. By contrast, China's agriculture is far behind. The Chinese peasants work very hard in the fields using simple tools. To feed China's huge population, Chinese agriculture agencies are sending agriculture technicians to Europe and the U.S. every year. Li Qiang, chairman of Shanghai JC Intelligence Co., an agricultural research company, said: "China spends tens of millions of dollars every year importing U.S. piglets or breeding swines because the U.S. has much better technology in that field."  

D. Food Safety Concerns

When Shuanghui attempted to buy Smithfield Foods, Shuanghui was accused of using chicken in ham to save cost, because chicken meat was cheaper than pork. Average Chinese consumers nowadays are very concerned about meat quality.

66 "Shuanghui Accused of Using Chicken in Ham to Save Cost: Paper", Caijing, October 12, 2013.
In recent years, both Chinese and Western media exposed several scandals regarding China’s food safety, including fake milk powder, bad fried chicken and illicit cooking oil recycled from gutters. The Chinese generally think that food imported from Europe, Australia, New Zealand, and the U.S. is much safer and cleaner. However, some Chinese consumers could not travel to the U.S. or Europe frequently due to the far distance and visa restrictions. Therefore, Hong Kong becomes their top destination to buy baby milk powder. Since 2008, a huge population of Chinese have flooded to Hong Kong and caused shortage of milk powder in Hong Kong. So, in 2013 the Hong Kong government lifted restrictions on buying milk powder - that is, no more than 1.8 kilos of milk powder could be taken out of Hong Kong per person per trip.67

With the purchase of Smithfield Foods, Shuanghui was eager to tell the Chinese public that Shuanghui products are safe because they import better and safer meat directly from the U.S. Wan Long, head of Shuanghui, said: “Europe and America have excellent skills and equipment. If we go and purchase businesses from America and Europe, develop China’s meat industry, we will raise the level and standard of our food safety.”68

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E. Keys to CFIUS Approval

According to Alston & Bird LLP, the largest law firm in Atlanta, Shuanghui and Smithfield managed the political and regulatory process surrounding the proposed acquisition exceptionally well. First, Shuanghui and Smithfield submitted documents to CFIUS voluntarily even before CFIUS started the investigation. By doing so, Shuanghui provided a high degree of transparency and confidence to U.S. government agencies and political leaders. Second, Shuanghui made a definitive commitment to maintain Smithfield’s structure, independence and headquarters in the U.S. Shuanghui also guaranteed that there will be no closures at Smithfield’s existing facilities and locations, and that Smithfield’s existing management team will remain in place. Third, Shuanghui also pledged to maintain Smithfield Foods’s headquarter in Smithfield, Virginia, and to continue Smithfield’s philanthropic support of community initiatives and investments in sustainability. In the past several years, Smithfield Foods has donated a large amount of money to University of Virginia, Virginia Tech and some programs in Richmond. I believe with Shuanghui’s backup, Smithfield will continue or even expand its philanthropic work in the future. In a word, Shuanghui respected Smithfield’s corporate culture and heritage, and the role Smithfield plays in its home communities.

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CHAPTER VI

CONCLUSION

Summary of Major Findings

This dissertation respects the importance of cultural factors in determining an MNC’s success. However, the most original parts of the dissertation are the statist intervention and market entry. For instance, in the statist section, I have examined some U.S. regulations on foreign investments (e.g. The Exon Florio Amendment, The Byrd Amendment, and FINSA) which are helpful for those Chinese MNCs as new comers to the U.S. market.

Second, this dissertation acknowledges the interaction between market factors and statist factors. Given that cultural dissimilarities between China and the U.S. are constant and controlled, the degree of importance of statist and market factors may vary by different conditions. For example, for Chinese state-owned enterprises which had invested in the U.S., statist interventions were probably the most important determinants for their successes or failures. In contrast, market factors served as the most influential factors in the case of American consumer producers investing in China.

Third, empirical studies show that my two statist hypotheses are more valid and persuasive (1. MNCs with close ties to their home government, and 2. MNCs investing in sensitive sectors) than the cultural hypothesis. The cases of Google, Huawei, CNOOC, PetroChina and Sinopec all support the fundamental argument that state-
supported MNCs investing in sensitive sectors are more likely to receive political resistance from the host country, which cause them to fail. In addition, the cases of KFC, McDonald’s, General Motors and Ford in China show that market factors and statist factors sometimes are overlapped with each other.

Fourth, one of the difficulties I encountered in writing this dissertation is finding some government reports and data. Neither CFIUS reports nor Chinese reports by the Ministry of Commerce of China have been fully disclosed to the general public. However, I have obtained enough relevant information and evidence from various sources to support my cases. These sources are U.S. Chamber of Commerce, KPMG, Rhodium Group, mainstream American and Chinese news reports, and academic journal databases. Below is a summary of the key findings:

A. With Distrustful Bilateral Relationships and Cultural Dissimilarities, Domestic Firms with Statist Support Will Erect Obstacles for Foreign MNCs to Succeed.

American media often attribute the failures of American internet companies in China to China’s strict censorship and government intervention. Likewise, Chinese media often blame the U.S. government for treating Chinese companies unfairly and setting up barriers to their market entry. Both the Chinese public and American public often point fingers at each other and think that the failures of their companies in the counterpart’s market is largely due to distrustful Sino-U.S. relations.

Sino-U.S. relations are like a pendulum, swinging back and forth. In Mao’s China, Sino-U.S. relations were at the lowest point. When Deng came into power
after Mao's death, Sino-U.S. relations started to improve quickly. China and the U.S. even experienced a short honeymoon period in the 1980s. Then, the bilateral relations started to fall after a series of incidents in the 1990s including the Taiwan Strait Missile Crisis and U.S. bombing of the Chinese embassy in Belgrade. After 2002, the bilateral relationship improved again because the U.S. needed to cooperate with China on terrorism, and in the meantime China's new President Hu had a mild-mannered character. Admittedly, bilateral relationships or governmental intervention can explain international business or trade in some ways. For instance, when China and the U.S. were on their honeymoon from the early 1980s to the mid-1980s, the U.S. even exported weapons and high technologies to China, which is unlikely today.

However, in the field of international studies we cannot merely use bilateral relationships to explain everything. Likewise, we cannot use only culture to explain everything in humanity studies or in social science. Through my case studies, I find that the failures of Chinese MNCs and American MNCs in each other's markets are caused by a combination of cultural, statist and market factors. For instance, while Google insisted that its failure in China was largely due to statist intervention and hacking activities, the results of my studies find that market competition also matters. Many Chinese internet users agreed on the fact that Baidu was doing better than Google in terms of search relevancy in Chinese words. Baidu had occupied the largest market share even before Google entered China. In addition, Baidu's fast development benefited from China's loose enforcement of intellectual property laws through the 1990s to the mid-2000s. During that period, Baidu was able to provide
free online music and videos without risk of punishment. By contrast, Google was not able to do the same because it is an American company and might easily be sued by other American companies. Therefore, in its early years of development, Baidu was more attractive to Chinese internet users than Google was.

Similarly, eBay also faced a strong Chinese rival in China: Taobao. Yun Ma, founder of Taobao, travelled to America and later introduced the e-commercial platform to China. Both Taobao and Baidu did not simply copy their American counterparts. Instead, they made many changes and improvements in advertisement, website layouts, online tools and services. In addition, Taobao and Baidu, as local Chinese firms, know the psychology and demand of Chinese consumers better than eBay and Google, respectively. The study clearly shows that with a distrustful bilateral relationship, domestic Chinese firms with statist support (e.g. Baidu, Taobao) can erect great obstacles to their foreign counterparts (e.g. Google, eBay).

Likewise, we cannot simply attribute the failures of Chinese state-owned enterprises in America to the discrimination and unfairness of the U.S. government. Cultural dissimilarities and market competition matter. When Chinese companies' purchases were blocked by CFIUS, the Chinese media criticized the U.S. government for trade protectionism and discrimination. Actually, there are both cultural and market factors that resulted in failures of Chinese companies in the U.S. For instance, Chinese state-owned oil companies grew in a relation-based culture, where disputes are usually resolved out of the court and thus they seldom face lawsuits from private companies or individuals. In general, Chinese public and
private firms are more submissive to the state authorities than their American counterparts. And, they are less likely to sue state-owned enterprise or government agencies if their interest were damaged. Therefore, Chinese state-owned enterprises have a sense of superiority over Chinese private firms.

However, when they enter the U.S. market, a rule-based society, Chinese state-owned enterprises lose the sense of superiority and lack incompetence in dealing with various issues they never encounter in China, such as interest group politics, strict environmental inspection and large penalties, lawsuits from American investors, and complicated regulations regarding foreign investment and hiring employees in the U.S. Indeed, with distrustful bilateral relationships and cultural dissimilarities, both American MNCs and Chinese MNCs have experienced certain barriers to enter and penetrate each other’s market.

B. Sectors Really Matter.

Admittedly, type of sector is an important factor that affects foreign MNCs’ successes or failures in host countries. In general, those American companies making consumer goods and having transparent relations with its home government are more likely to succeed in China, so do Chinese firms in the U.S.1 For instance, American fast food (e.g. KFC, Hooters, Subway, and Pizza Hut), auto (e.g. General Motors and Ford) and clothing firms (e.g. Calvin Klein, GAP, and Ralph Lauren) have gained popularity and successes in the Chinese market. In previous chapters, I have explained why these American companies are more welcomed by

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1 There are four basic needs in China: Yi, Shi, Zhu, and Xing (Clothing, Food, Housing, and Transportation).
the Chinese people. To sum up, there are at least three reasons. First, they provided
more jobs, built large plants and opened physical chain stores, whereas most
internet and media companies did not. So, the local Chinese officials and business
leaders prefer job-creating American firms. Second, they set up businesses in China
much earlier than American internet and media companies (e.g. KFC entered China
in the 1980s, almost twenty years earlier than eBay and Google). For this reason,
they are more experienced in localizing their products than internet companies.
Third, as they are not investing in sensitive sectors or buying strategic resources,
they are encouraged by local Chinese officials and are also allowed to build
partnerships with local Chinese firms.

Within the same sector, some American companies are more successful than
others in China. My empirical studies show that KFC is doing better than McDonald’s
in China. General Motors is doing better than Ford. Calvin Klein is more popular
than Ralph Lauren. Indeed, there are other explanatory factors beyond the type of
industry. For instance, market entry and choice of location matter. KFC entered
China earlier than McDonald’s. KFC established its first China restaurant near
Tiananmen Square, which is more influential and attractive than McDonald’s first
one in Shenzhen city. General Motors also entered China much earlier than Ford.
General Motors chose to build a joint venture with a strong Chinese automaker in
Shanghai, which is more successful than Ford’s joint venture in Chongqing.
C. Statist Interventions and Changing Perceptions of Foreign MNCs from the Host Country

In the 19th century, Lord Palmerston said: "Britain has no permanent friends, nor permanent enemies. She has only permanent interests." According to constructivism of IR, state's behaviors are often dependent on their perceptions of each other. Arguably, their perceptions of others do not always stay constant. The establishment of CFIUS was a statist response to Japanese companies in the 1970s. During that time, the U.S. viewed Japan as an economic competitor. Today, the U.S. widely views China as a competitor to the U.S. In recent years, the U.S. government became more cautious on mergers and acquisitions by Chinese state-owned firms or Chinese state-supported firms, including the cases of CNOOC, Huawei, and Sany Heavy.

In the 1960s, American children were told not to waste food at school because Chinese children were starving. With the success of China's economic reform, some of those poor Chinese children are now extremely rich. Their bold overseas investment and luxurious lives may change Americans' perception of Chinese investors. Currently, the American media still embraces the notion that Chinese money directed at the U.S. is harmful. However, some scholars argued that it might be just as false as it was in the 1980s when Japanese firms were said to flood the US market with money.3

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2 David Brown, Palmerston and the Politics of Foreign Policy, 1846-1855 (Manchester University Press, 2002), p. 82.
Statist intervention can affect public attitudes toward foreign MNCs (e.g. Chinese nationalism), which may hurt or help foreign MNCs. For instance, in the 1989 Tiananmen Square Incident, Chinese college students embraced America’s democracy and praised KFC’s Beijing restaurant as a gathering place. In contrast, during the 1999 Anti-American Movement, angry Chinese college students protested against the U.S. government and damaged KFC restaurants in several Chinese cities. Another example is Chinese people’s hatred toward Japan stirred up by statist intervention. Previous studies showed that under tense diplomatic relations, China’s state media and newspapers repeatedly lashed Japan for its invasion, which helped foment radical nationalism in China. During a series of anti-Japanese protests in 2012 and 2013, some Chinese consumers were so worried about buying Japanese cars, because a number of Japanese cars were damaged and the owners were beat severely by Chinese radicals. Also, on China’s most popular social network website, Weibo, there are numerous messages claiming that boycotting Japanese products is a patriotic deed. Finally, it turned out that China’s popular hatred toward Japan had, to some extent, benefited some American companies, particularly, American automakers.

Chinese people’s perception of the basic necessities of daily life is evolving. Bikes were once a basic necessity in China. Due to the mobilization of labor, urbanization and rapid economic development, cars are nowadays widely viewed as a necessity by average Chinese people. Unlike the U.S., the auto industry is a relatively new industry in China and the market potential is great. Today, there are more Buicks being sold in China every year than in the U.S. With the decline of
Detroit, some American automakers have changed their perception of the world’s car capital in recent years. Admittedly, cultural dissimilarity is a great challenge for American automakers. However, it did not stop American automakers move their research centers to China. Today, global automakers race to Shanghai and they believe that China is fast becoming the car capital.\(^4\) There are great market demands for new cars and internet services in China. Nevertheless, foreign automakers and internet companies have two different fates in China. One of the major reasons is statist intervention. In an authoritarian regime, social stability is a great concern for the ruling class. However, social stability is heavily dependent on economic development. One the one hand, China’s state authorities continue to attract foreign investments which are impetus for fast economic development. On the other hand, they filter out those foreign investments which might cause social instability.

\(\text{D. Ownership: China’s FDI Trend in the U.S.: Private Firms Overtook the State-owned} \)

For a long time, China’s FDI was dominated by state-owned enterprises. China’s private firms were weak and lacked enough capital or government support to invest overseas. But, the trend has gradually shifted in recent years. In 2013, China’s investment in the U.S. doubled and the majority was contributed by private Chinese investors. Chinese private firms are actively involved in a wave of overseas mergers and acquisitions. Some examples are Fosun International’s buyout of One

\(^4\) Robyn Meredith, “From China, the World’s New Car Capital”, \textit{Forbes}, April 22, 2009.
Chase Manhattan Plaza, Shuanghui’s acquisition of Smithfield Foods, and Yashili’s dairy investment in New Zealand.⁵

The rapid growth of investments from China’s private firms is due to several reasons. First, the U.S., as a rule-base society, has strong legal protections that foster innovation while China lacks market incentives and mature regulations. Second, many private Chinese firms are pushed out of the market by large, heavily subsidized state-owned enterprises in China.⁶ However, in the U.S. the Chinese state-owned firms do not have a sense of superiority over Chinese private firms. Third, the appreciation of RMB since 2005 has further encouraged Chinese private firms to invest in the U.S. Fourth, many private Chinese investors can get green cards through investing at least half a million dollars in the U.S. Canada also has similar immigration policies. In recent years, there have been an increasing number of rich Chinese businessmen and government officials fleeing to North America. In 2013, about 80 percent of the recipients of the U.S. investment green cards were from China.⁷

Food and real estate are the two major sectors that interest Chinese private investors. These two sectors are relatively less related to national security and the success rate of purchases is high. For example, Shuanghui successfully purchased Smithfield Foods in 2013. China Vanke, China’s largest residential real estate developer, broke ground on a 61-story residential skyscraper in Manhattan earlier.

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This year. These successful cases do not imply that all Chinese private firms had a pleasant experience in the U.S. market. Like China did to American companies, the U.S. does not fully open its telecommunication market to private Chinese companies including Huawei and ZTE. While Huawei have succeeded in many other countries, it lags much behind Samsung and Apple and still seeks a foothold in the U.S. market. In 2010, Huawei and ZTE both failed to win a Sprint contract due to strong opposition from the U.S. authorities. Instead, Samsung got the offer. Today, Huawei still lacks a deal with a major U.S. carrier (e.g. T-Mobile, Sprint, AT&T and Verizon) to sell its high-end models.

E. Barriers to Market Entry - “U.S. and China, Which Is Harder to Enter?”

China is the largest developing country while the U.S. is the largest developed country in terms of GDP and population. A survey of 1,004 global business leaders conducted by law firm Allen & Overy in 2011 showed that China and the U.S. are ranked first and second among nine major countries in terms of “hardest markets to enter.” For Chinese companies, the strict regulatory environment in the U.S. is probably the main deterrent to entry. According to the survey, 38% of Chinese business leaders chose the U.S. as the hardest to enter. A series of U.S. regulations regarding taxes, intellectual property rights, environment protection, labor rights and safety are strange and new to Chinese investors who grew up in a relation-based society. By contrast, only 4% of German business leaders and 2% of Canadian ones think the U.S. market is the hardest to enter.

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8 ibid.
9 Allen & Overy: Opportunities and Challenges, 2011.
For American companies, building Guanxi with the state government and local
governments and thus reducing statist interventions is probably the main barrier to
entry. My studies show that some American firms have overcome this barrier. To
win state support from the host country, leaders of General Motors personally
captured every opportunity to meet with Deng Xiaoping in the 1980s and expressed
their willingness to cooperate with the Chinese government and respect China’s
political regime. Today, General Motors is one of the largest foreign automakers in
China by sales. GM’s success in China is inseparable to its Guanxi with China’s state
government and the Shanghai city government. However, building Guanxi in China
is not easy for most other American companies. They need to search right persons
or local Chinese companies that can connect them efficiently with the state
government or local governments. In order to do so, some American companies
have risked bribing the Chinese intermediaries and thus violating *U.S. Foreign
Corrupt Practices Act*. For example, in order to access lucrative business in China,
some American companies had to hire children of senior Chinese leaders. Morgan
Stanley and Citigroup are recently exposed by the U.S. media and are being
investigated by the U.S. Department of Justice. Based on these findings, the next
section will discuss implications for both Chinese MNCs and American MNCs.
Implications for American MNCs in China

A. Localization

The localization strategy does not only include localizing products, but also includes localizing top managers. According to Judge and Li, when foreign subsidiaries operate in relation-based environments, managing directors who are parent-country nationals with host country origins will generally be most effective, all else being equal.\(^{10}\)

In fact, some American companies are good at localizing their managers in the Chinese market while others are not. General Motors set up a good example for other American companies in terms of selecting local managers. Early this year, General Motors announced that Chongwei Xie, a native Chinese, will be in charge of GM's public policy and Government Relations in China-related affairs.\(^{11}\) GM's official website says that Mr. Xie leads an experienced team that is building and maintaining a strong relationship with key government agencies and interpreting China's political environment to support management decisions.\(^{12}\) Mr. Xie, with degrees from both Chinese and American universities, can serve as a good bridge between GM and the Chinese market. Also, KFC did a good job in localizing managers in China. Lucy Wu, deputy head of the Chinese China Store and Franchise Association, said: "Yum [parent company of KFC] has the right boss in China. Su is Chinese and knows

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the Chinese market much better than foreigners. His localization strategy is the secret of success.”

In contrast, eBay was doing a poor job in localizing top managers in China. In 2004, eBay just entered China with ambitions to conquer the Chinese market within three months. EBay was then too optimistic because it was one of the world’s most well-known E-commerce firms compared to its Chinese competitor. EBay had succeeded in many other places of the world before it entered China. However, after three years, eBay was pushed out of China by Taobao, a local Chinese company which was little known to most Westerners. In Helen H. Wang’s recent book, *The Chinese Dream*, she pointed out that eBay committed several mistakes. The biggest mistake is that eBay sent a German manager to lead the China operation and brought in a chief technology officer from the U.S. Neither one spoke Chinese or understood the local market. EBay basically replicated its global platform to China and advertised on the internet in a country where small businesses did not use the internet much.

Similar to eBay, other American internet companies like Google, Amazon, and Yahoo all failed in China. Shaun Rein, founder and managing director of the China Market Research Group, said: “the reality is that many American companies will end up failing there, or missing expectations, because they do not localize their business models and management teams enough to compete with fast emerging domestic players.”

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B. Reducing Corporate Hierarchy between U.S. Headquarters and Chinese Subsidiaries

Beyond localizing top managers, reducing the corporate hierarchy is another important implication for American companies in China. Judge and Li proposed that when foreign subsidiaries operate in relation-based governance environments, organizational structures that imitate successful local competitors will generally be most effective, all else being equal.16 Today, MNCs are becoming bigger and look like a kingdom in terms of organizational structure. The term "hierarchy" is often used in either a social system (e.g. caste in India) or a political system (e.g. dynasty and feudalism in China). Investopedia defines corporate hierarchy as:

Corporate hierarchy is the arrangement of individuals within a corporation according to power, status and job function. In a public company, usually the board of directors will be at the top, followed by the CEO, who may also be the chairman of the board of directors as well as the president. Below the CEO will be other C-level executives, such as the CFO, CIO and COO, followed by upper management (vice-presidents/managers/directors), then the employees in each department who are further broken down into levels of experience and authority.

Each company's hierarchy will vary from this general structure. Corporate hierarchy affects the employees' ability to advance within the company and also impacts corporate culture. Corporations can have hierarchies that are considered more vertical, where the power comes from the top down, or a more horizontal hierarchy, where power and responsibility are more evenly spread across the firm.17

While eBay and Google’s Chinese mangers had less decision-making power, James McGregor, author of One Billion Customers, said: "Yum [parent company of KFC] has become the most successful foreign company in China ......They got in early, they adapted the product, they expanded aggressively and they gave their

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Chinese managers real decision-making power."\textsuperscript{18} So, one suggestion for American companies is that they cannot simply apply its global standardization strategy to China, a relation-based society. Instead, they should customize a new organizational structure that can decentralize decision-making and reduce corporate power hierarchies.

\textit{C. Partnering with Local Firms and Listen to Their Opinions}

Local cultures cannot be purchased or transplanted. Therefore, the most important investment for a foreign subsidiary entering a relation-based country is to cultivate close relationship with powerful locals.\textsuperscript{19} For example, Groupon had a strong Chinese local partner, Tencent. Tencent QQ is the most popular social network software in China. However, even with Tencent as a partner, Groupon still ignored suggestions from Tencent and relied on hiring foreigners to lead its business. Duncan Clark, chairman of Beijing-based technology consultancy BDA, said: "Why the heck didn't Tencent do more?" he said. "The whole structure was quite bizarre."\textsuperscript{20} Groupon was even lambasted by a Baidu executive at the Global Mobile Internet Conference for bringing in a gaggle of foreign directors who do not even speak good Chinese.\textsuperscript{21} Groupon committed the same mistake that eBay did before. Their failures sent a warning to other American companies that partnering

\textsuperscript{20} Michale Kan, "Groupon's Struggle in China No Surprise, Say Analysts", \textit{PCWORLD}, August 25, 2011
\textsuperscript{21} Ibid.
with local firms is not enough, American companies should also listen to their local partners and respect their decisions.

Partnering with a local Chinese firm can help American companies understand business culture and reduce risks. However, in the meantime the Chinese partner company might easily take American companies' intellectual property or learn advanced technology. This is a double-edged sword. When GM and Ford entered China, they knew this dilemma. But, they were ready to share some technologies with their Chinese partners while they were continuing developing new technologies in the U.S. To enter the Chinese market, sometimes American companies have to make some sacrifices.

D. Depoliticizing Your Products and Services

Why is talking Chinese politics a bad idea for American companies in China? The Chinese government is very concerned about its legitimacy (the popular acceptance of an authority) and social stability. The ruling class might see some new ideas and thoughts brought by American companies as threats. For example, some recent online Chinese news reported that a professor of Peking University replied to Chinese President Xi, saying that “If Peking University becomes a second Harvard University; it will be very dangerous to China.” Indeed, many Chinese leaders stress the point that China should keep its own political system (socialism with Chinese characteristics led by the Communist party) rather than the democracy model represented by the U.S. The Chinese government encourages Chinese companies to learn technologies and management skills from American companies, but does not
encourage them to go deep into the discussion of politics. Therefore, in order to build good company-government relations and company-company relations (American companies with China's state-owned enterprise), American companies should be cautious of exporting American democracy to China. Google's and Facebook's failures in China show that the depoliticization of your products and services is a precondition for success in China.

Implications for Chinese MNCs in America

A. Adapting to the Rule-Based Society

Some Chinese internet users criticize corrupted Chinese officials sarcastically, saying that "Even our village chief is more powerful than U.S. President Barack Obama." Power is like a lion while regulations are like a cage. The U.S. is a rule-based society, where power is within the cage of regulations. Obama's power and decisions are balanced by Congress and other entities like the U.S. media and public. By contrast, in China where hidden personal connections are more important than regulations, state-owned Chinese enterprises intersect considerably with government officials' personal interests. Chinese companies grew up in a relation-based society. Therefore, adapting to a rule-base society is a great challenge for them. Currently, many Chinese companies are willing to invest in the U.S. market, but they are not familiar with U.S. investment laws. Gary Locke said: "the United States is a mature, stable economy with a commitment to the rule of law......Whenever I talk to Chinese companies about opportunities in the U.S., I
always advise them to engage American lawyers, accountants and public relations professionals."^{22}

B. Understanding the U.S. Market

Chinese companies need to improve their management skills and understanding of the U.S. market. To understand the U.S. market, Chinese companies first need to cope with obstacles. In short, the barriers to market entry can be divided into three categories: political, social and environmental. The political barriers include distrustful bilateral relationships, anti-China interest groups, and U.S. government agencies like CFIUS. The social barriers include American public’s negative attitudes toward China and the difference between rule-base society and relation-based society. The environmental barriers are not limited to the strict environment laws and high standard of environment protection in the U.S. In the broader sense, it may also include the set of structural factors that influence all business, such as the pending mid-term election (which may stoke nationalist sentiments and xenophobia; the American business environment and the state of the economy (unemployment, inflation, and insufficient demand).^{23}

In previous chapters, I suggest that American internet companies should invest in China through partnering with Hong Kong or Taiwanese companies and thus reduce risks. Likewise, Chinese state-owned enterprises may also invest in the U.S. through Hong Kong companies. First, compared to Chinese companies, Hong


^{23} My understanding of environmental barriers is improved by Dr. Earnest (Shift from merely environmental regulations to a set of structural factors that influence all businesses).
Kong companies are better at understanding the Western markets and cultures. Second, Europe and the U.S. generally trust companies from Hong Kong more than Chinese companies. For instance, in 2010, China National Gold Group Corporation, a centrally state-owned Chinese gold producer, purchased three mining assets in Southern California through Hong Kong-listed Jackin International Holdings Limited. “It is very difficult for Chinese state-owned enterprises to buy US mines - this may be due to political reasons - so we decided to go through a Hong Kong-listed company,” said Yusheng Zhou, who was then-executive director of Jackin.

C. Improving Images through Investing in U.S. Social Media

Several surveys showed that the U.S. public still holds a negative view of China. Gary Locke, former U.S. ambassador to China, said: “Many Americans don’t understand China. And they sometimes don’t distinguish between the Chinese government and individual Chinese companies. For that reason, occasional friction between the U.S. and Chinese governments may cause people to think more negatively about Chinese companies whose only goal is to succeed commercially.” Indeed, building a positive image is very essential for Chinese companies entering the U.S. market. As the Chinese people are getting rich, advertising in U.S. major media agencies is no longer a dream. In recent years, the Chinese government and Chinese firms are making efforts to burnish the country’s image through advisements in U.S. social media. For example, Xinhua, China’s state-run news agency, leases a “60-foot

high (18-meter) by 40-foot (12-meter) wide sign on the north end of Times Square, hoping to reach the estimated half a million people that pass through the area every day.”

Chen Guangbiao, a Chinese entrepreneur and CEO of Jiangsu Huangpu Renewable Resources Recycling Company, did a survey of over a thousand ordinary Americans in cities like New York, Boston, and San Francisco and found out that only 20 some of them know about the Diaoyu Islands (a series of disputed Islands called “Senkaku Islands” by the Japanese). Later, he decided to publish a half-page advertisement in The New York Times, “solemnly declares to the U.S. Government and the American people”, that the Diaoyu Islands have been the territory of China since antiquity. Earlier this year, Mr. Chen even attempted to acquire The New York Times. His mission in buying the paper was “presenting an authentic China” and “promising better China coverage” to the outside world. It was reported that Mr. Chen flew to New York City and had dinner with a middle-level leader from The New York Times. However, the Times denied that the newspaper was up for sale.

D. No Fears for CFIUS: Do Your Lessons

Chinese companies should do the lessons before purchases. First, select areas for investment carefully --- Chinese companies should avoid sensitive areas including telecommunication, energy, aerospace, and information security.

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Second, Chinese investments may attract additional scrutiny. However, Chinese investors should be more self-confident and straightforward when dealing with CFIUS. Chinese companies should not attempt to circumvent CFIUS review at the beginning, because CFIUS is increasingly initiating post-closing reviews and has the power to force the investor to divest assets. Instead, Chinese firms should voluntarily submit their information to CFIUS before the closing of deals. For example, the parties in the Smithfield deal may have learned their lesson from previous experiences as the parties filed a voluntary notice with CFIUS prior to closing the transaction. Indeed, the more you fear, the more likely you are to fail.

Third, Chinese companies are in the learning process of hiring U.S. professionals to aid its purchase. In 2005, China’s Lenovo, the world’s largest personal-computer producer, successfully acquired IBM’s PC-making business arm with help from Jeffrey Carlisle, then-chief of Lenovo’s government relations. Today, Lenovo is attempting to buy Google-owned Motorola Mobility. Early this year, Lenovo chose to hire attorneys at Steptoe & Johnson LLP who held positions at the Central Intelligence Agency and the Homeland Security Department to guide its Motorola review through CFIUS. Lenovo set good examples for other Chinese companies. I expect that in the future more and more Chinese MNCs will research U.S. regulations regarding foreign investments and hire American interest groups, trade experts and attorneys to assist their purchases.

30 Ibid.
Finally, for Chinese companies doing business in the U.S., they look forward to seeing improved public images of China as well as a more transparent CFIUS review process. For American companies in China, they look forward to seeing accelerated investment liberalization and improved Guanxi with the Chinese government. With these changes, Chinese MNCs and American MNCs are expected to enjoy more successes in each other's markets, and in return their successes will reduce friction in the bilateral relationships.

Future Studies

The study suggests that it is very important for private Chinese firms to voluntarily clarify the purposes of purchases and their relationships with the home government. Although some Chinese companies like Huawei did so, they still failed to shrug off suspicions.

Future studies are needed in order to answer this question: how to make Chinese MNCs' words credible when it comes to CFIUS reviews? Future scholars of Chinese and American MNCs studies might look at several possible solutions:

1. Increasing mutual trust between China and the U.S. and reducing their geopolitical rivalries through strengthening bilateral relationships,

2. Improving corporate images through investing in American social media and mainstream news media,

3. Engaging American lawyers and getting more familiar with CFIUS regulations,

Second, numerous cases in this study show that statist and market factors sometimes interact with each other in confounding ways. To take this step further, future researchers can think over the quantification of statist and market factors.

Third, Chinese MNCs are relatively new to the U.S. market. They are eager to learn about the CFIUS review process. In the meantime, American MNCs in China are hoping that the Chinese government could further open more sectors for foreign investments. Therefore, future studies can be devoted to transparent CFIUS review process in the U.S. and investment liberalization in China.
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VITA

Shiwei Jiang
Graduate Program in International Studies
Batten Arts and Letters Bldg., Room 7002
Old Dominion University
Norfolk, VA 23529

Shiwei Jiang is a research analyst at Old Dominion University (ODU). He is also a recipient of the Linda Hyatt Wilson Scholarship in China Studies, and awarded with individual First Place medal for winning the World Quest by World Affairs Council.

In July 2009, he graduated from China’s key university Beijing Normal University with best thesis award. Since August 2009, he has been a graduate student in the Graduate Program of International Studies at Old Dominion University. From 2006 to 2014, Shiwei Jiang has published and presented a number of papers in China, Japan and the U.S. He is also a SAS Certified Advanced Programmer and a SAS Certified Statistical Business Analyst.

During his Ph.D. study in the U.S., Shiwei Jiang became a member of International Studies Association and American Economic Association and a reviewer of Asian Social Science. In addition, he is an active servant of the international student community at ODU. In 2012, he was one of six Global Ambassadors and also a member of International Student Advisory Board at ODU. As a native of Chongqing, China, he likes spicy food and traveling.