

# How Chinese MNCs control their subsidiaries: Evidence from Australia

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# Introduction

- China's outward foreign direct investment (OFDI) has rapidly grown to \$56.53 billion in 2009, accounted for over 5% of global FDI, and ranked fifth in the world after USA, France, Japan, and Germany.
- There were over 13,000 Chinese subsidiaries abroad by the end of 2009.
- China's FDI stock reached to \$245.75bn, but only accounted for 1.3% of the total global FDI stock.
- Australia is the 4<sup>th</sup> largest recipient of China's OFDI, only trailing after HK, Virgin Islands, and Cayman islands.

# Introduction (2/3)

- Control used by MNCs over their subsidiaries to align their interests with those of their headquarters has become increasingly important
  - Corporate control affects the MNCs' competitiveness, corporate performance, and sustainable development
  - MNC's subsidiaries have substantially contributed to their parent company revenue, profit, technology, and management know-how.

# Introduction (3/3)

- Chinese MNCs are a relatively new phenomenon
- China has many unique institutions
  - Many Chinese MNCs are State-owned enterprises (SOEs)
  - Corporate governance in China is still weak because of its inefficient legal framework
  - Chinese culture
  - China's administrative system inherited from its socialist planned economy
- Many Chinese MNCs lack resources and capabilities in international operations and management
  - Long isolated from the world before 1979
  - Chinese privately-owned enterprises (POEs) were only permitted officially to invest abroad since 2003
  - Heavily relied on large domestic market size

## Research questions

- What control mechanisms are used by Chinese MNCs over their subsidiaries in Australia?
- How do China's institutions and Chinese MNCs resources affect Chinese MNC's control over their foreign subsidiaries?

# Literature review on corporate control

- What is organisational control?
  - Control is widely regarded as a process (R. N. Anthony, 1965; Arrow, 1974) “whereby management and other groups are able to initiate and regulate the conduct and activities so that their results accord with the goals and expectation held by those groups” (Child, 1984, p)
- Several decisions have to be made in designing a corporate control system
  - Control style or strategy (Financial, strategic, or strategic planning)
  - Control areas (input, process, or output)
  - Control agent (bureaucratic, personal, social)
  - Control formality (formal vs informal)

# The control cube

	<b>Formal</b>	<b>Informal</b>
<b>Financial</b>	Formalised output control	<b>Output</b>
<b>Strategic</b>	Bureaucratic formalised control	<b>Input</b>
<b>Operational</b>	Personalised centralized control	<b>Behaviour</b>
	Socialization and network	
	<b>Bureaucratic</b>	<b>Personal and social</b>

## Other major issues in corporate control research

- Antecedents and moderators for the use of control mechanism
  - Environment at both home and host countries
    - Production factors, institutions, culture, etc
  - Industry and organisation
    - Industry structure, competition intensity, firm age and size, parent-subsidiary relationships, etc
- Control process
  - Feedback
  - Feedforward



# Hypothesis development

## China's national institutions and corporate control

- What is institution?

- Institutions are “the rules of the game in the society or more formally, are the humanly devised constraints that shape human interaction” (North, 1990, p.3)
- Scott (1995) refers to institutions as “cognitive, normative, and regulative structures and activities that provide stability and meaning to social behaviour”.

# China's institutions and corporate control

- The political and legal setting in China is characterized by government direct intervention, ambiguity in laws and regulations, arbitrary enforcement, and uncertainty.
- Based on transaction costs theory, hierarchy would be preferred over market, as it can reduce uncertainty and lower potential transaction costs.
- **H1: Controlling by ownership is strongly preferred by Chinese organisations and managers**

# Chinese culture and corporate control

- Hofstede's cultural dimensions
  - Long-term orientation: China (118), US (29), UK (25), and Australia (31)
    - Chinese MNCs emphasizes more on of learning from their foreign subsidiaries and long-term performance
    - **H2: Financial control is less preferred by Chinese MNCs than strategic control**
- Uncertainty avoidance: China (40), US (46) and Australia (51)
  - Chinese have a higher level of tolerance for ambiguity and uncertainty, and place less emphasis on law and rules compared with Westerners
    - **H3: Chinese MNCs preferred informal control rather than formal control**

# Guanxi and corporate control

- *Guanxi*

- Guanxi emphasises the level of trust placed on those key personnel connected. Trust is the primarily determinant of *guanxi* strength.
- Guanxi is highly valued by Chinese
- **H4: Chinese MNCs prefer using expatriates for controlling their foreign subsidiaries**

## Chinese MNC' s resources and competences

- Most Chinese MNCs lack experiences in operating and managing their international businesses
  - They have a relatively short history of international operations.
  - China had a long period of international isolation before 1979
- However, there are variations among Chinese SOEs in their experience of international operations and management.
  - Several Chinese SOEs were long-established specialised foreign trade corporations, such as Minmetals, SinoSteel;
  - Specially-created foreign business oriented corporations including CITIC Group and CNOOC;
  - These Chinese corporations are more competent in conducting international business.

## Chinese MNC' s resources and corporate control

- **H5a: The quality of strategic control by Chinese MNCs over their Australian subsidiaries is moderated by their human resources as indicated by the MNC' s experience in international operations and management.**
- **H5b: The quality of strategic control by Chinese MNCs over their Australian subsidiaries is moderated by the strong desire of ownership control.**
- **H6: The use of expatriates in corporate control by Chinese MNCs are moderated by their human resources as indicated by the MNC' s experience in international operations and management.**

# Research Methods

- 10 Chinese subsidiaries operating in the Australian mining industry from four Chinese MNCs were selected
  - Chinese ownership in these companies is more than 50 per cent.
  - These subsidiaries or their parent companies are publicly listed, either in the Australian or Hong Kong Stock Exchange
- Five senior managers from four Chinese subsidiaries were interviewed

Subsidiary	Parent company	Major operations	Chinese Ownership (%)	Operation, stage and size of subsidiary (investment)
CPM S1	A very large SOE with more than 30 years of international operations	Conglomerate, including international trade, construction, and steelmaking (diversification)	100	Iron ore mining, development (US\$4 bn)
YCA S2	A very large SOE with a long history in coal mining	Coal mining (Synergy)	100	Coal mining, production (A\$3.4 bn)
MMR S3	A very large SOE with over 30 years of international trade.	Conglomerate (vertical integration in non-ferrous metals, mining, processing and trading) (Diversification)	100	Base metals mining, production (US\$1.3 bn)
SMW S4	A very large SOEs with over 30 years of international trade.	Conglomerate (vertical integration in steel industry: mining, processing and trading)	100	Iron ore mining, exploration (A\$1.4 bn)
AM S5	A provincial SOE, then acquired by S3's parent company. (D)	Conglomerate (vertical integration in non-ferrous metals)	76	Base metal, exploration (A\$70 mn)
EM S6	A large Chinese SOE in nuclear power industry (Diversification)	Conglomerate (vertical integration in nuclear power)	70	Uranium mining, exploration, (A\$81.4 mn)
MoMS7	A large Chinese POE (Diversification)	Privately-owned enterprise, Conglomerate	55	Base metals, development (US\$140 mn)
ZJ S8	A large Chinese SOE (Diversification)	Conglomerate (vertical integration in non-ferrous metals)	50.1	Base metals, development (\$45.5 mn)
W S9	A very large Chinese steel mill (Synergy)	A very large integrated still mill (Mining, processing and trading)	60 (JV)	Iron ore mining, exploration (A\$186 mn)
A S10	A very large Chinese steel mill (Synergy)	A very large integrated still mill (Mining, processing and trading)	50 (JV)	Iron ore mining, development (A\$1.4 bn)



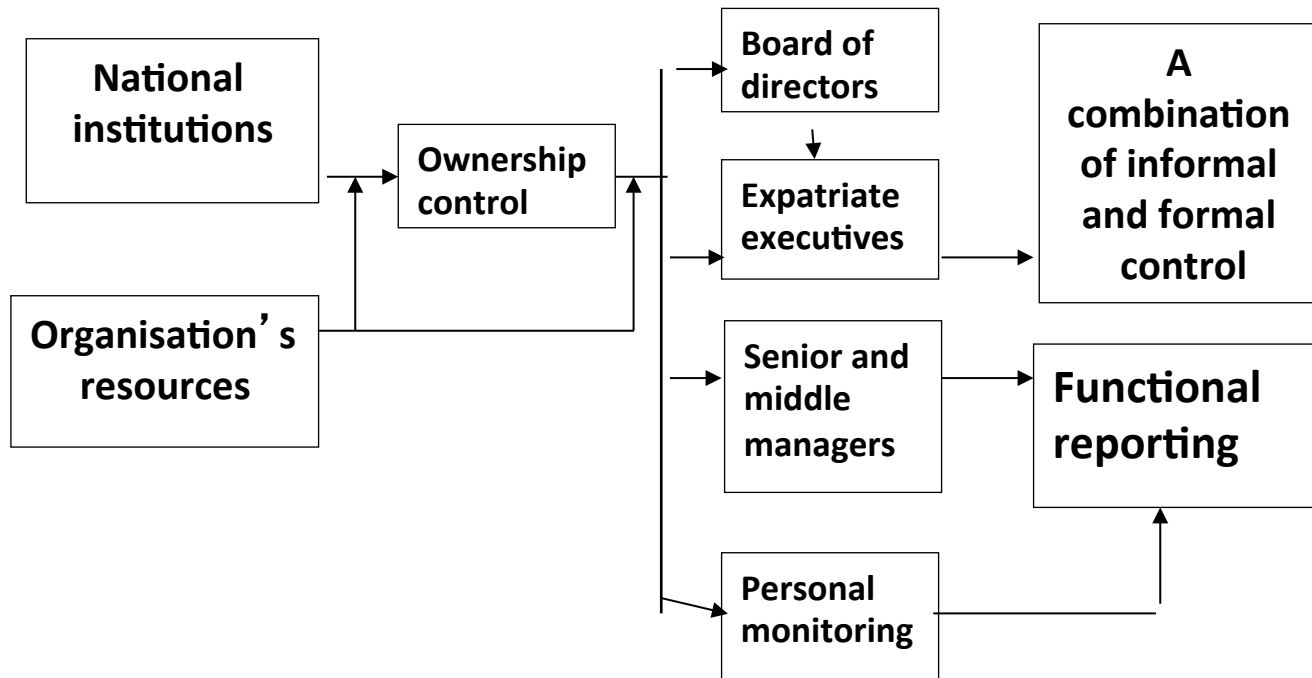
## Findings and discussion - The appointment of the board of directors in the subsidiaries of Chinese MNCs

Sub'ry	Chinese Dir/total	Chairman	Chinese Insiders	Background (Chinese Dirs)	Background (non-Chinese D)
s1	6/8	C	All	Sci, Eng	OHS, Risk mgt
s2	4/7	C	All	Eng (3) Acc (1)	Mining operat' ns, Fin, Inv
s3	5/7	C	All	Finance and Acc	Eng, Operations
s4	7/8	C	All	N/A	Law
s5	6/8	C	All	Sci, Int trade, Fin	N/A
s6	5/7	C	All	As above	Geology, Eng
s7	3/8	A	4 yes, 1 unsure	Investment, Fin	Law, Inv, Geo
s8	3/6	C	All	Mgt, Eng	Inv, Consulting
s9	3.5/6	C	All	Int bus, geologists	Geo, Proj mgt
s10	2/4	A	All	Int bus, Eng	Inv, Operations

## Findings and discussion - The appointment of CEO and senior managers

Sub' ry	CEO	Other Sen mgr	Stage at May 2010	Investment	Chinese Parent Corp exp	Est
s1	Cr	7 (C)/11	Devel't, near prod'n	>5.0	Very experienced in Int project mgt (H)	06G
s2	A	1(A), 3(C)	Production	bn3.4	Experienced in coal mining (H)	09P
s3	A	5 (A)	Production	bn1.3 bn	Estab' d trading co (M)	08P
s4	Ch	11 (A)	Development	\$1.4 bn	Estab' d trading co (M)	07D
s5	Cr	2 (A)	Exploration	A\$70mn	Estab' d trading co (M)	07E
s6	Cr	3 (C)	Exploration	A \$81.4mn	Large power Co (L)	09E
s7	A	7 (A) 1 (C)	Devel't and early Prod' n	\$140mn	POE conglomerate (L)	09D
s8	A	2 (A)	Devel't and early Prod' n	\$45.5mn	Trading Co (L)	09D
s9	C	3 (C), 4A	Exploration	A\$186	Large steel mill (H)	10G
s10	A	2(A)	Devel't and early Prod' n	US\$1.4 bn	Large steel mill (H)	06G

# The antecedents and major control mechanisms used by Chinese MNCs



# Conclusions

- An overwhelming proportion of Chinese directors appointed by their headquarters are insiders.
  - Chinese MNCs appointed directors largely according to the proportion of ownership for exercising their ownership.
  - Most of them are with qualifications in science, engineering, accounting and finance.
- Chinese MNCs acquire Australian firms, top management positions at the subsidiary are more likely to be filled by local managers
  - However, some have been replaced by Chinese expatriates shortly after the acquisition, particularly for those subsidiaries at the early stages of resource development and small in size.
- The lack of experienced executives and middle managers, coupled with problem of English proficiency, has limited the number of expatriates sent from Chinese MNC headquarters to their Australian subsidiaries.

## Conclusions (cont' d)

- Most Chinese MNCs under this study use strategic control style in their subsidiaries in Australia
- Chinese MNCs extend their approach to controlling their domestic subsidiaries to the control of those in Australia, which heavily relies on ownership and personal control and is largely informal.

# Implications

- **HR development and remuneration is of strategic importance for enhancing MNCs' control over foreign subsidiaries.**
- **Chinese MNCs should use corporate governance more effectively and efficiently in aligning the interest of its subsidiaries to that of the corporate headquarters.**
- **A better balance in the use of control mechanisms may be needed moving away from the currently-dominated personal control and financial monitoring to a more system-based and culture-oriented approach.**
- **More effort needs to be devoted to the learning and knowledge transfer between the corporate headquarters and their Australian subsidiaries.**

**Questions**

Thank you

and

welcome your questions