WHY SINO IRON PROJECT FAILS? A PERSPECTIVE OF LIABILITY OF FOREIGNNESS

Xueli (Charlie) Huang
RMIT University, Australia
Charlie.huang@rmit.edu.au

Guangping Huang
RMIT University, Australia
Guangping.huang@rmit.edu.au

ABSTRACT

Purpose: This paper aims to explore the liability of foreignness (LOF) suffered by Chinese MNCs and examine the roots of such LOF from pluralistic theoretical perspectives. It also attempts to uncover and explain what mitigating mechanisms are employed by Chinese MNCs.

Design/methodology/approach: This paper employs a single case study method. Data were collected through multiple sources, including interviews with managers and information collection from the company's websites, media reports, and the Internet.

Findings: We found that Chinese MNCs suffered unfamiliarity, relational, and discriminatory hazards due to their lack of international operational experiences, being outsiders of global value networks, and national identity respectively. Home country institutions and the weak corporate governance have moderated the relationships between LOF and the mitigating strategies used.

Research limitation: The paper is based on a single case study. A multiple-case study or a survey can make the findings more generalizable.

Practical implications: For Chinese business managers, a solid preparation and analysis before making investment decision is indispensable to mitigate its liability of foreignness.

Keywords: China, Global, MNCs, Foreign Direct Investment (FDI), Liability of Foreignness (LOF)

On 11th November 2012, CITIC Pacific (CP), a Chinese controlled and publicly listed HK based company, announced that its wholly owned Australian subsidiary, CITIC Pacific Mining (CPM), has load-commissioned its first production line out of total six in its Sino Iron Project (SIP) in Western Australia. Although this can be regarded as a milestone for SIP, it was delayed nearly four-years as CP initially expected this in early 2009. The costs of SIP, partially owning to this four-year delay, have increased from the initially-designed US$2.5 billion to US$7.8 billion at the end of June 2012. The media have widely expected that the final costs of SIP may reach US$10 billion.

What contributed to this nearly four-year project delay and potentially 300% cost blow out for a major mining project in Australia? This has become a question asked by many academics, business executives, and government officials in Australia, and particularly in China. This paper attempts to address this question from the perspective of "liability of foreignness" (LOF) (Zaheer, 1995) using a pluralistic theoretical approach.

Such study is warranted for both theoretical and practical reasons. Theoretically, Chinese outward foreign direct investment (OFDI) is a relatively new phenomenon despite China has become the largest FDI home country among the developing countries (Sauvant & Chen, 2012). Although the concept of LOF has been long developed (Zaheer, 1995) to explain difficulties in conducting international business, most of studies have used this concept for explaining the behaviors of multinational corporations from developed countries doing business in developing or developed countries (Denk, Kaufmann, & Roesch, 2012). Chinese investors, particularly state-owned enterprises (SOEs), may incur liabilities and deploy

mitigating strategies different from those of developed countries due to their state ownership, lack of international experience, and national identity. It is not clear how their national identity, state ownership, and experience level may affect the extent of LOF, thus impacting on FDI decisions and management of Chinese subsidiaries in foreign countries. Practically, the findings from such study can help Chinese business executives understand the factors contributing to their LOF and influencing their FDI performance, thereby improving the quality of their FDI decision and management. For business executives in host countries, the findings can assist them to understand LOF suffered by Chinese investors and thus to be better prepared in competing or cooperating with Chinese investors, either as subcontractors, JV partners, or consultants.

REVIEWING LITERATURE ON LIABILITY OF FOREIGNNESS

MNCs competing in foreign countries will incur additional costs that are not, or to a lesser degree, suffered by indigenous firms in the host countries (Mezias, 2002; Zaheer, 1995). Conceptually, LOF is defined as "all additional costs a firm operating in a market overseas incurs that a local firm would not incur" (Zaheer, 1995, p. 343). More specifically, Mezias (2002, p. 266) refer to LOF as "phenomena that cause foreign firms to incur costs domestic firms do not, incur costs to a greater extent than domestic firms do, or be denied benefits only domestic firms are eligible to receive". The original idea of LoF can be traced back to Hymer (1976) who argued that MNCs need to have monopolistic advantage to overcome its disadvantages in foreign countries in order to compete successfully. Based on the LOF definition, it has two important characteristics. First, it is *dyadic* as it involves both the home and host country (Luo & Mezias, 2002) and second, it is *relative* due to its essential reference to indigenous firms (Sethi & Guisinger, 2002). Eden and Miller (2001) used a metaphor of ''stranger in a strange land'' (p. c4) for describing these two characteristics. This also implies that the degree of LOF a MNC suffers varies with the context, such as firm, industry, home country and host country (Zaheer, 1995).

What are the sources of LOF? Zaheer (1995) pointed out four broad sources of LOF: (1) costs related to spatial distance (e.g., travel, transportation, and coordination over distance and across time zones); (2) firm-specific costs stemming from the firm's unfamiliarity with the environment and lack of roots in the host country; (3) costs arising from the host country environment, such as the lack of legitimacy of foreign firms, administrative barriers, and economic nationalism; and (4) costs caused by regulations in the home country, such as the restrictions on high-technology sales to certain countries imposed on some Western multinationals. Eden and Miller (2001, 2004) considered relative production cost is not part of LOF and grouped the sources of LOF into three categories: unfamiliarity hazard, relational hazard, and discrimination hazard. Therefore, LOF is the combined consequence of special distance, MNCs' resources, international experience, identity, and also the effect of external environment of both host and home countries on their international operations. Thus, it is distance-related, resources-based, and institution- and society-embedded.

Several theories have been used in extant literature to explain why MNCs suffer LOF, including Resource Based View (RBV), institutional theory, learning theory, social networking, and international expansion (Denk, et al., 2012). However, these theories focus on different aspect of LOF. While RBV and institutional theory attempt to explain the root of

LOF, organizational learning and social networking theories concentrate on how to mitigate LOF, and international expansion theory focuses on the context and dynamics of LOF.

Another central issue in the study of LOF is to identify effective mechanisms, or strategies, to mitigate LOF. To do so, foreign firms can use two broad approaches (Zaheer, 1995): bringing in their firm-specific advantages, such as technologies, brand names or managerial know-how, to its foreign subsidiaries, or mimic the successful practice of local firms in the host country. It can be defensive or offensive (Luo, Shenkar, & Nyaw, 2002). The former refers to strategies that reduce the cost of hazards from the host country, including contract protection, parental control, parental service, and output standardization while the latter refers to strategies that improve relations between the host country and the firm, covering local networking, resource commitment, legitimacy improvement, and input localization.

Other LOF-mitigating mechanisms include entry mode selection (export, JV or acquisition) (Eden & Miller, 2001), first mover (Eden & Molot, 2002), and boundary spanning (Elango, 2009). For example, Eden and Miller (2001) argued wholly-owned subsidiary should be used as entry mode for countries where institutional distance and ethnocentrism are low, and by those MNCs with good reputation and high levels of legitimacy and prior experience in international operations.

A number of recent articles have focused on the LOF suffered by MNCs from emerging market. For example, Miller et al. (2008) argued that MNCs from emerging market entering developed countries have to "compete from a position of double disadvantage: The firms incur additional costs of doing business abroad, and in addition they are often resource poor compared to domestic firms in developed market" (p. 646). However, MNC from emerging countries can draw on their ethnic identity and cooperation with ethnically similar firms to compete in the host developed country. Klossek, Linke and Nippa (2012) studied how Chinese subsidiaries in Germany mitigated their LOF and found that they employed several mechanisms, including due diligence, sharing responsibilities, reputation building, and prior experience in international operations. However, they didn't elaborate on how Chinese MNCs employed such mechanisms to mitigate their LOF in Germany.

RESEARCH METHOD

Case selection

This study aims to explore the LOF suffered by Chinese MNCs, particularly those state-owned, in the Australian mining industry. As Chinese investment is a contemporary phenomenon, case study is appropriate for such a study (Yin, 2003). SIP was selected for several reasons: (1) it is by far the largest Chinese Greenfield investment in the Australian mining industry. It was also the first international venture by CP and the first international mining project by CITIC Group (CG) after it became the majority shareholder of CP in Dec 2008. The project was established in 2006 and one of the earliest major Chinese Greenfield investments in the Australia. As the first production line was load commissioned in Nov 2012, the degree of LOF and effect of CP's strategies and actions to mitigate its LOF during its entire developmental stage have played out and thus can be studied in details. (2) Using Greenfield to enter international market incurs a higher level of LOF than acquisitions. Coupled with the large scale and complexity of the project, SIP is a good case study on LOF as it can provide a comprehensive coverage of the sources of LOF and their effect on

Greenfield investment in the Australian mining industry. (3) Australia is the six largest destination of Chinese OFDI by the end of 2011, and over 80 per cent of Chinese investment in Australia was in the mining industry (Ministry of Commerce, 2012). Thus, this study can help other Chinese investors understand the LOF for investing in the Australian mining industry and develop their strategies for mitigating these liabilities.

As part of a large research project on Chinese OFDI in Australia, this paper focused on the causes of SIP's poor performance from the perspective of LOF. We had conducted five interviews with five senior and middle managers, a focus-group of 13 middle managers at CPM, and undertaken a content analysis using the publicly-available information from three sources: (1) *Factiva*, an e-database containing the Australian major newspapers, including *The Australian*, *The Australian Financial Review*, and *Western Australia Business News* since the start of 2006 when CP started investing in Australia. A total of 142 newspaper reports were collected; (2) CP's company reports and announcements in its company's website (www.citicpacific.com) since 2006; and (3) using Baidu, the most popular Chinese Internet search engine for Chinese media reports on the Internet. In addition, we also used Internet search for collecting supplementary information where necessary.

Case Description

CPM was established in 2006 and is a wholly-owned subsidiary of CP, with CITIC Group (CG) holding 28.78 per cent of its share before 2009.

The purpose for setting up CPM was to manage SIP. In April 2006, CP acquired the right to mine one billion tons of iron ore (magnetite) at Cape Preston, which is located 100 kilometers south of Karratha (1,535 kilometers north of Perth, Western Australia). SIP was designed to be the biggest magnetite ore producer in Australia with an annual production capacity of 24 million tons of iron ore concentrate. The original expected cost of the project was estimated to be US$2.5 billion with the first production line in operation in early 2009 (CITIC Pacific, 2006).

The Project consists of mining operations, an ore beneficiary plant (crushing, grinding, and concentrating), a dewatering plant, a 30-kilometer slurry pipeline, a 450 megawatts gas-fired power plant, a 51 million-kiloliter desalination plant, port and transshipment facilities, and other infrastructure. This was the first international project for CP, and first mining project for CG.

However, the project has suffered a severe cost blowout, with the estimated costs of close to US$10 billion. The timeline of the major events of the Project is outlined in Table 1.

In identifying LOF, we followed the definition of LOF and the procedure suggested by Mezias (2002), focusing on those additional costs either suffered by CPM but not local firms, or a larger extent to CPM than the local firms.

Table 1 The timeline of the Sino Iron Project

Date	Event
31/03/2006	CP invested US$215 million to acquire right to mine 1 billion ton of iron ore (magnetite),
2006	Barry Fitzgerald was appointed as CEO and Chief Engineer of CPM
24/01/2007	CPM has entered into the contract with MCC for US$1.106 bn, announced the total costs of SIP was expected to be **US$2.5 bn** with the first production line completed in **early 2009**.
20/08/2007	CP entered into the Supplemental Agreements with MCC in relation to the adjustment to the scope of the Works as set out in the Original Contract and the revision of the Contract Sum to US$1.75 bn, and sold 20% interest of SIP to MCC for US$448 mn.
2007	CP acquired further right to mine 1 bn ton of iron ore for US$200 mn.
17/04/2008	CP announced more than US$1 bn blowout in costs to **US$4.2 bn**
24/12/2008	CITIC Group paid HK$11.625 bn (US$1.5 bn) to CP to become the majority shareholder of CP, increasing its shareholding from 28.78% to 57.56%.
6/01/2009	CPM signed an agreement for seven years with Apache and Santos for supplying LNG to CPM's power plant at the highest gas price for the region.
8/04/2009	Mr Larry Yung Chi Kin resigned as Director and Chairman of the Company due to the foreign currency exchange hedging. So did the managing director Mr Henry Fan Hung Ling
10/05/2009	Dr Dongyi Hua was appointed as the Chairman of CPM with other four senior executives from CITIC Construction, and arrived in Australia in September 2009
04/05/2010	CP signed a supplemental agreement under which it agreed to pay an additional amount of US$835 million to MCC, and announced cost blow out **to US$5.2 bn**
21/05/2010	Barry Fitzgerald resigned as the Managing Director and Chief Engineer of CPM.
18/08/2010	CP stated it expected the first production line should be ready for operational testing by **the end of 2010**, and the first concentrate shipment in the first half of 2011
19/01/2011	CP updated to the market that all components needed for the operation of the first production line should be ready for commissioning as an integrated system by **the end of July, 2011**, and export of iron ore is expected to be in the latter part of 2011
18/07/2011	CP announced that it expected that the production and export of iron ore concentrate **in the first half of 2012**.
30/12/2011	CP paid an additional US$822.1 million to MCC for the completion of the first two production lines and the common facilities, increasing the contract sum from US$2.585 bn to US$3.407 bn. It also announced that the first production line is expected to be completed by **the end of August, 2012.** The Project costs was expected to be over **US$6.0 bn**
13/04/2012	Acquiring further right to mine one bn ton of iron ore, totalling to 3 bn of iron ore (magnetite). The Project expenditure reached **US$7.1** bn by the end of 2011
19/11/2012	CP announced that the load commissioning of the first production line and the common facilities of SIP has been achieved and the concentrator plant has begun to produce iron ore concentrate. It also announced the total costs for the Project would be less than **US$10 bn** and the full operation was expected **in 2014**.

Finding and discussion

Many factors have contributed to the massive cost blowout and dramatic project delay of SIP. In this study, we primarily aim to identify the LOF suffered by CP using Eden and Miller (2004)'s three types of sources of LOF and describe key mitigating strategies used by CP.

Poor Preparation for Entering the Australian Mining Industry

CP's entry into the Australian mining industry was not well planned. Clive Palmer, who bought the right to mine the magnate resources at Cape Preston in 1986, had been attempting to sell the right to mine the magnetite discovered since, but couldn't get any buyer before 2006. The main reason for this is that magnetite is lower in iron content and higher in production costs compared with hematite (another type of iron ore, usually called "direct shipping ore") as it required processing into concentrate before it can be economically used as raw materials by steel mills.

The time spent on project selection by CP was very short. The project was first introduced to another Chinese SOE early last decade. The former vice president of this Chinese SOE then introduced it to CP in late 2005 after he retired from that SOE. The agreement to buy mining right of one billion was signed at the end of March 2006 only several months after this project was introduced to CP, and "coincidently" one day before Chinese Premier Wen Jiabao visited Australia. Given the complexity and scale of this project, and more importantly, the fact CP had little experience in mining operations and in Australia, it seems that CP rushed into the project without appropriate preparation and analysis, possibly due to the political pressure from the Chinese government to sign the agreement before its Premier visited Australia.

The entry mode used by CP was also inappropriate. CP selected Greenfield as the entry strategy into the Australian mining industry, particularly into magnetite mining. Greenfield mode incurs a higher level of LOF than acquisitions or joint ventures as it involves greater uncertainty and a higher level of risk (Eden & Miller, 2001). In other words, the decision to use Greenfield to enter magnetite was very risky. Unfamiliarity hazard in this case has contributed to the decision in selecting this project and using Greenfield as entry mode.

Using Chinese Standards in Project Design and Costing

The LOF contributed by the unfamiliarity hazard is also reflected in the project design and feasibility study. Project design and costing are widely regarded as an important step for investing in a mining project. Pre-feasibility and feasibility studies are two crucial studies to help decide if the project is economically viable. While the quality of its pre-feasibility and feasibility studies reports are not available for inspection, the time spent on them was less than 6 month, much shorter compared with another Australian miner that took more than one year to complete a feasibility study in a similar, but less complex, magnetite project. The mining agreement was approved by the Australian Foreign Investment Review Board (FIRB) in June 2006. CP had already selected its lead contractor and started its construction as reported in its 2006 Annual Report:

> "We have signed a general construction contract with China Metallurgical Group Corporation ('MCC') (in January 2007). Work on the development of mining,

> beneficiation plant, pellet plant, desalination plant, power station and material handling system has begun. First shipment of product is expected to be in 2009". (CITIC Pacific, 2006, p.5)

The pre-feasibility and feasibility were conducted by a Chinese-lead consortium. The costing and standards were primarily based on those in China. As expressed by a veteran Chinese manager, the feasibility study in China is "often very simple, with the purpose for getting approvals from the superior organization or government". Consequently, many designs and specifications had to be modified to conform to Australian standards in the construction stage, which has caused project delay and increased costs (CITIC Pacific, 2010).

Difficulties and Costs in Managing Major Contractors

The LOF caused by relational hazard for the project is vividly reflected in the contract management. Used properly, contract is an effective approach to mitigating LOF (Luo, et al., 2002) as contract protection can reduce the complexity and bureaucratic costs of inter-firm coordination (Al Najjar, 1995), and alleviate conflict derived from heterogeneous goals, culture, and strategies (Geringer & Hebert, 1989).

Dealing with the project's lead contractor, MCC, however, has become a major problem and incurred much extra cost for CPM. MCC was selected as the lead contractor in Jan 2007 for US$1.1 billion. It is responsible for the project's infrastructure, including "the design, construction and installation of the primary crushing plant, concentrator, pellet plant, material handling system, camp and other auxiliary infrastructure facilities. It also includes procurement of certain mining equipment" (CITIC Pacific, 2006, p. 14). Although MCC was regarded as having "extensive experience and expertise" in the design and construction of similar minerals processing plants in China and some developing countries, such as Brazil and Iran (CITIC Pacific, 2006), it had little experience in undertaking a large scale of construction project in developed countries, like Australia. The contract price for MCC were increased three times from the original US$1.1 billion in 2006, to US$1.75 billion in 2007, US$2.58 billion in May 2010, and US$3.407 billion at the end of 2011, even the design and construction of the pellet plant was shelved from the original MCC's contact. MCC has been blamed for the increases in the contract price due to its unfamiliarity with the relevant Australian policies (CITIC Pacific, 2011, 2012). "MCC told us [CP] that they underestimated the complexity and the amount of work involved in constructing and commissioning a project in Australia" (CITIC Pacific, 2011, p.5). These policies include the immigration policy, environmental protection, and occupational health and safety in the workplace.

Two major reasons for MCC to incur severe cost blowouts are that it was banking on the cheap Chinese skilled labor in costing the Project and took for granted that Australian workforce is as flexible as Chinese in working hours – a major method used in China to beat the project deadline. However, with the special permission from Australia's Department of Immigration, it was only allowed to bring 400 Chinese skilled labor, rather than over 3000 at its original design. Moreover, strict industry regulations had made the flexible use of workforce uneconomical. Both have contributed substantially to the project delay and cost blowout.

Consequently, CPM had spent much effort to deal with MCC, including the revision of the contract and signing a new penalty agreement at the end of 2011 for further project delay after 31st August 2012 for the load commission of the first production line. The massive extra cost in dealing with MCC demonstrated how new context can contribute to LOF. Although CP knew MCC well before 2006 when the contract was signed, dealing with MCC in the new international context was a loss-loss to both parties involved. It is like to put "new wine into old bottles" – the bottles break and the wine runs out!

Other major components of the project, except mining which is under the direct management of CPM, were contracted out to several Australian and international firms, such as IDE Technologies for the desalination plant, AE&E for the power plant, JV between NRW Holding and VDM group for Port Breakwater. These contracts protected the project costs as the expenditure was specified in the contracts. However, the mining component under the direct responsibility of CPM has also exposed it to the rising costs of labor and mining equipment.

Additional Costs in Corporate Management

Internal organization cost is another form of relational hazard (Eden & Miller, 2004). The LOF caused by this form of relational hazard have been mainly reflected in the areas of trust and organizational culture.

Regarding trust, an Australian-led management team was recruited immediately after the acquisition of the Project. Barry Fitzgerald, who had more than 30-year experience in the mining industry, was appointed as the CEO and Chief Engineer of CPM in 2006. This local appointment was to "mimic" the successful practice of local firms (Zaheer, 1995) as it can be very effective to reduce LOF caused by CP's unfamiliarity with the mining operations in Australia. As mentioned above, all major components (except mining operations) of the Project were contracted out to Australian and international firms under Fitzgerald's leadership. Nevertheless, early sign of project delay and cost pressure emerged even since 2007. This has caused the trust problem as CP was concerned about the management's competence and conflict of interest in managing this project.

Shortly after CITIC Group took the control of CP in April 2009, five senior managers were sent from CITIC Construction to CPM. They took several key positions at CPM, including the Executive Chairman of the Board. The main purpose of this was to transfer their project management experience to CPM to speed up the project progress in addition to the trust problem. This is another commonly used approach to mitigating LOF (Zaheer, 1995). These five senior managers had gained their project management experience in both China and some developing countries, particularly in Africa.

Fitzgerald resigned and left CPM in May 2010, less than eight months after the arrival of five Chinese senior managers and two weeks after CPM announced that it agreed to pay additional US$8.35 billion to MCC and the project budget was lifted to US$5.2 billion. The media widely tipped that he was a scapegoat and jumped before being pushed.

The Chinese management team attempted to use the Chinese approach in managing its organizational culture and human resources at the beginning of their appointment. For example, the CITIC Group's slogan in both Chinese and English was displayed at the

reception of CPM office. Managers and employees were asked to learn Chinese culture. However, this had caused a strong resistance, particularly from the Australian middle managers as one middle manager complained during the focus group: "We have our own corporate culture before, but suddenly it's all gone. Why we are asked to learn Chinese culture, not Chinese to learn our culture?" Workforce turnover was high in 2010. This prompted to the shift of management approach back to local practice.

Having said this, CPM has employed local managers in several key positions on which Chinese managers lack experience and knowledge, such as HR, environmental protection, safely and occupational health, external affairs, and legal services.

Discriminatory Government Regulations and Administrative Procedures

The third major source of LOF suggested by Eden and Miller (2004) is discriminatory hazards, caused by "the discriminatory treatment inflicted on the foreign firm relative to local firms in the host country".

Like any other FDI, CP's investment in Australia is generally welcomed and foreign firms are not discriminated by the Australian government at the federal and state levels. However, there were still discriminatory hazards from both relative and dyadic perspectives. From a relative perspective, for example, the Australian government permitted MCC to hire 400 foreign workers out of the 4000 workers it required (10% of all workers). However, it approved Hancock Prospecting (an Australian miner) in May 2012 to hire up to 1715 foreign workers for their 8000-worker project (about 20% of all workers) (Bowen, 2012). This can be regarded as a discriminatory hazard as the government has allowed a local miner to hire a higher percentage of foreign workers than MCC giving Hancock Prospecting a competitive advantage in costs due to cheaper labor. From a dyadic perspective, some government regulations in Australia, the English Proficiency Test for importing skilled labor for example, have also substantially contributed to the project delay and consequently cost blowout. This has become the biggest road block for Chinese MNCs, but not for English-speaking countries, such as India, South Africa, and Philippine. Moreover, some regulations are not explicitly codified or have socially-embedded components, particularly in the environmental protection, community engagement, and industry regulations. Administratively, visa processing is another liability for Chinese MNCs. All these liabilities can be illustrated in the statement of CP's Chairman:

> "[T]here are strict commissioning requirements, ranging from the certification of construction completion documents by *licensed Australian engineers* to meeting stringent safety regulation standards… commissioning of control systems… must be done by *qualified Australian electricians*. … commissioning also requires the assistance of equipment service providers, of which there are hundreds, and the on-going need to *process the visas of these workers* has continued to be complicated and time consuming" (CITIC Pacific, 2012, p.8 emphasis added).

Discussion

CP's venturing into the Australian mining industry with Greenfield entry mode has typified the LOF suffered by an inexperienced firm from an emerging country to a developed country. It was a typical example of "stranger in the strange land" (Eden & Miller, 2001) in terms of

CP's identity as seen by its key Australian stakeholders (Australian business communities, media, public and governments), and its unfamiliarity about the Australian business environment and contexts. Consequently, it has incurred four-year project delay and 300% cost blow outs. Although project delay and cost blow out are not uncommon in developing major mining or oil and gas industries in Australia, they are much longer and more costly at CPM than other local firms. Beasides several other factors, such as the rising costs of labor, equipment and materials, LOF has been a major factor contributing to the project delay and cost blowout.

Both RBV and institutional perspective can be used to explain a high level of LOF suffered by CP. For CP, it had no experience in mining operations before it invested in Australia. Thus, it was unfamiliar with the mining operations, and business environment in Australia. It started this project with "knee deep in the Big Muddy" (Miller, et al., 2008, p. 646) and competed from "a position of double disadvantage" (p.646). The poor quality of preparation and feasibility study partly reflected such CP's unfamiliarity caused by its lack of experience.

CP also incurred additional costs from a relational hazard standpoint as it was an outsider of global business network of mining project construction, including engineering, procurement and construction. According to the revised Uppsala model (Johanson & Vahlne, 2009), firms operating outside the local business networks will incur a "liability of outsidership" due to the fact they are not privy to information from inside the business circle.

The institutional perspective also shed much light into the LOF suffered by CPM. Although CP is listed in HK, it was still regarded as a Chinese firm. The legitimacy of Chinese investors, or "country of origin effects" (Vernon, 1977) in the Australian mining industry has been challenged by the Australian media and public (Huang 2011). There was a strong negative sentiment among the Australian media and publics about Chinese investment in 2009 (Huang 2011), partly due to their lack of understanding of Chinese SOEs, the cognitive pillar of institution. From a regulative pillar view, the Australian governments were reluctant to bend their administrative procedures and policies to CPM's requests, particularly in importing Chinese skilled labor to speed up the project even there was a big labor shortage in Australia.

To mitigate its LOF, CPM had primarily used defensive strategies (Luo, et al., 2002) including contract protection and use of parental expertise to reduce its vulnerabilities in Australia, in particular against conflicts of interests when dealing with foreign entities and also unexpected changes in Australia. This is appropriate according to the Importance-Liability-Matrix developed by Sofka and Zimmermann (2008), as the Australian market is of low importance to CPM, coupled with the great need to protect its multi-billion dollar project from cost increases. There is evidence that CPM has effectively used contract protection to protect itself against unexpected changes in construction, such as AE&E failing to build the power plant on schedule. However, a major problem in employing its strategies was to deal with the lead contractor, MCC.

The home country institutions have substantially influenced how CP responds to its LOF in this project. The intuitional forces include political pressure, trust, and taken-for-granted assumptions. First, the acquisition agreement was signed one day before Chinese Premier Wen Jiabao visited Australia. From the perspective of Chinese culture, this was regarded as a sign of good faith placed by the Chinese government onto Australia. This may reduce the necessary time required for CP to deliberate and select this project. Trust was a key reason

behind the appointment of senior Chinese management team to CPM in 2009. The case also shows that the trust between the parent company and senior foreign managers at its foreign subsidiary may more likely become problematic as the subsidiary performance deteriorates.

Taken-for-granted assumptions also played a part on how CPM and MCC behaved to reduce its LOF. Chinese MNCs have relied on the Chinese government in many occasions of OFDI, particularly in developing countries, to gain favorable treatments, such as importing labors, custom clearance, and visa issuing. However, the Australian governments were very reluctant to bend their administrative procedures and policies in response to CPM requests. "In Australia, no one listens to our requests; or they [the Australian government officials] politely listen to us, but in fact strictly follow the procedures" expressed by the Executive Chairman of CPM (Chen, 2010). Therefore, much effort had been spent on meeting with the Australian government officials, but with little effect on getting favourable treatment from the Australian governments.

The massive cost blow out and dramatic project delay have also raised a question of corporate governance at CP. Besides the loss of HK$15.5 billion (about US$2.0 billion) in its foreign currency hedging in 2008, the selection of the Project and Greenfield entry mode have reflected the weakness in corporate decision-making. The moving target of project cost and production schedule, particularly over the past two years, is another example of weak corporate governance in terms of transparency and information disclosure. The interaction between poor corporate governance and unfamiliarity has worsened the project outcome.

CONCLUSION AND IMPLICATION

This paper explored the LOF suffered by Chinese MNCs in the Australian mining industry. Using the Sino Iron Project as a case, we attempted to identify the specific LOF suffered by CPM in developing the project so far and the main strategies used by CPM in mitigating its LOF, and explain why such additional costs incurred to the Project and certain mitigating strategies were used by CPM. Several conclusions can be drawn based on the findings of this paper.

The unfamiliarity with the Australian business environment and contexts, and particularly its mining industry, has been a major source of LOF suffered by CPM. Consequently, CP had made uninformed decisions in its project selection and entry mode. The root of this unfamiliarity is contributed by the lack of international experience, both in Australia and in the mining industry, by CP and its leader contractor, MCC. Coupled with its unfamiliarity, the weak corporate governance at CP is another important cause why SIP failed.

CP also suffered LOF contributed by the relational hazards generated from its inter-firms and intra-firm relationship. From the inter-firm perspective, both CP and MCC were outsiders of the Australian mining industry viewed by most firms operating in this industry. Although both CG, the majority shareholder of CP, and MCC are Chinese SOEs, the cost involved in dealing with MCC has contributed substantially to the cost blowout. As this was CPM and MCC's first project together, there is no previous relationship between the two companies, thereby lacking the understanding and trust to what should be expected from both parties. This is the relational cost generated by the new international context. From the intra-firm perspective, the trust on management team and cultural clashes are the sources for additional costs.

SIP has also experienced discriminatory hazards. A major way demonstrated this was in MCC's attempt to recruit Chinese workers for its project. Compared with the permit given to the local mining firm for hiring 20 per cent of overseas workers, MCC was only permitted to import about 10 per cent. MCC was discriminated for this. From a dyadic perspective, the English Proficiency Test for imported workers is another example in this regard.

CP has used both mimicking local practice and bringing in corporate competences in mitigating its LOF suffered in the project. Nevertheless, the use of such mitigating mechanisms was influenced by the home country's institutions, such as culture, and organizational resources at the parent company.

Several implications can be suggested based on the findings of this paper for both Chinese managers and business executives in host countries. For Chinese business managers, a solid preparation and analysis before making investment decision is indispensable. From a LOF perspective, these preparations and analyses should examine relevant factors in both home and host countries at three levels: national, industry, the target organization and/or project because LOF is dyadic and relative. For investment in the mining industry, moreover, a process view of the mining cycle (exploration, construction, production, de-commissioning) needs to be adopted to fully examine the economic benefits of an investment in the project life cycle. Such preparation and analyses can help make decisions on the investment, entry mode, and strategies for mitigating LOF.

For business executives in host countries, understanding what LOF suffered by Chinese MNCs and its sources can better prepare them to cooperate with Chinese MNCs in their foreign operations, or to work within a Chinese MNC in terms of assisting Chinese MNCs to lower their LOF, thus improving their organizational performance.

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