

**The Foreign Direct Investment Behaviour of Chinese Firms:
Does the 'New Institutional Theory' Approach offer
Explanatory Power?**

Hinrich Voss

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The candidate confirms that the work submitted is his/her own and that appropriate credit has been given where reference has been made to the work of others.

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To my parents

Abstract

The People's Republic of China has become a major source country for foreign direct investment. The objectives of this research are to identify the determinants of this phenomenon, to identify the international investment strategies pursued by Chinese MNEs, and to evaluate the effect of the domestic and international institutional environments on the determinants, investment strategies and behaviour of Chinese MNEs. Particular emphasis is given to the role of cross-border business and social networks. To address these objectives a novel framework, termed the Chinese outward direct investment regime (or ODIR), is advanced and tested using methodological triangulation techniques. This is done using data obtained from several sources, namely interviews with managers at the headquarters of Chinese MNEs and Chinese government officials, a survey questionnaire distributed to Chinese affiliates in the UK and official FDI data obtained from SAFE and MOFCOM, which are used in two econometric models of global Chinese ODI.

The research makes a number of major contributions. First, the ODIR framework is found to have significant explanatory power in a number of key respects, especially in relation to the influence of domestic institutional factors on the internationalisation behaviour of Chinese MNEs. Second, the importance of domestic capital market imperfections as a driver of Chinese ODI is also confirmed. Capital market imperfections as a special application of the internalisation theory (Buckley and Casson, 1976) is argued to explain certain idiosyncratic investment behaviours observed among Chinese firms, especially in relation to host country risk. Third, a number of new proxies for international business research have been developed and applied successfully in models. Fourth, New Institutional Theory, the Stages Theory and the New International Venture theory have all been tested for the first time in relation to Chinese ODI. Of these, New Institutional Theory was found to have greatest explanatory power.

Table of Contents

Acknowledgements	II
Abstract	IV
Table of Contents	V
List of Tables	IXI
List of Figures	XI
Abbreviations	XII
1 Introduction	1
1.1 Rationale of the research	1
1.2 Research objectives and questions	6
1.3 Definitions and terminology	8
1.3.1 Foreign direct investment	8
1.3.1.1 Foreign direct investment flows	8
1.3.1.2 Foreign direct investment stock	9
1.3.2 Multinational corporation and its affiliates	9
1.3.3 Country classification	9
1.4 Structure of the thesis	10
2 Internationalisation through foreign direct investment – Some stylised facts and theoretical explanations	12
2.1 Global foreign direct investment pattern and development	12
2.1.1 The global development of foreign direct investment	12
2.1.2 Host country distribution of ODI flows	15
2.2 Theoretical foundations of foreign direct investment	16
2.2.1 The general theory of foreign direct investment – Internalisation theory	16
2.2.2 The Eclectic Paradigm	18
2.2.3 The investment strategies behind foreign direct investment	20
2.2.4 ‘Stages’ theory	23
2.2.5 International new ventures	26
2.2.6 International entrepreneurial networks – Network theory	27
2.2.7 Institutions and internationalisation	30
2.2.7.1 Institutions governing international economic activity	31
2.2.7.2 Institutions governing home country conditions	33
2.2.8 Specific theoretical considerations for foreign direct investment from	

developing countries	34
2.2.9 Further theories on foreign direct investment	37
2.3 Empirical studies on foreign direct investment determinants	38
2.4 Summary	47
3 Chinese outward foreign direct investments – patterns and explanations	48
3.1 China’s political economy between 1949 and 2005	48
3.2 The institutional environment for Chinese outward direct investment	50
3.2.1 Corporate actors in China	50
3.2.2 Political and administrative actors in China	53
3.3 Development of Chinese outward direct investment since 1979	56
3.3.1 Phase 1: Open-Door policy and first steps on international grounds (1979-1985)	57
3.3.2 Phase 2: Government encourages Chinese ODI (1986-1991)	60
3.3.3 Phase 3: The impact of Deng Xiaoping’s journey to the South (1992-1998)	63
3.3.4 Phase 4: Pre-WTO accession adjustments and the ‘Go Global’ policy (1999-2001)	66
3.3.5 Phase 5: Accession to WTO and ‘Go Global’ implementation (2002 and onwards)	68
3.3.6 Industry sector distribution	75
3.4 Explaining Chinese outward direct investment – A literature review	78
3.4.1 The eclectic paradigm applied to Chinese MNEs	78
3.4.2 International investment strategy of Chinese MNEs	79
3.4.3 Stages theory and the development of Chinese MNEs	86
3.4.4 China’s new international ventures	87
3.4.5 International entrepreneurial networks of Chinese MNEs	88
3.4.6 The institutional embeddedness of Chinese MNEs	90
3.4.7 Non-SOEs as international investors	92
3.5 Summary	93
4 An explanatory model of Chinese outward direct investments	94
4.1 Institutional theory	94
4.2 The Chinese outward direct investment regime	97
4.2.1 Endogenous institutional factors	97
4.2.2 Exogenous institutional factors	103
4.3 The Chinese ODIR and international business theory	109

4.4	Summary	110
5	Methodology	112
5.1	Mixed methods approach for Chinese business research	112
5.1.1	General issues	112
5.1.2	Challenges in cross-sectional research	113
5.1.3	Challenges in qualitative research	114
5.2	Primary data collection	116
5.2.1	Interviews in China	116
5.2.1.1	Interviewee identification	116
5.2.1.2	Interview organisation and structure	119
5.2.1.3	Limitations concerning interviews	120
5.2.2	Survey of Chinese affiliates in the United Kingdom	123
5.2.2.1	Identification of Chinese affiliates in the UK	123
5.2.2.2	Survey questionnaire organisation and distribution	123
5.2.2.3	Limitations to the survey questionnaire	124
5.3	Quantitative analysis and secondary data sources	124
5.3.1	Data sources and limitations of the dependent variable	124
5.3.2	Data sources and limitations of the independent variables	127
5.4	Summary and project overview	133
6	The determinants of Chinese outward direct investment – interpretations from primary data	134
6.1	Interviews of Chinese multinational companies	134
6.1.1	Rationale and outline of the fieldwork	134
6.1.2	Interview results and discussion	134
6.1.2.1	International investment strategy and locational choice	135
6.1.2.2	Networks facilitating internationalisation	139
6.1.2.3	Ambiguous impact of the institutional environment	142
6.1.3	Summary	144
6.2	A survey of Chinese affiliates in the UK	145
6.2.1	Rationale and outline of the fieldwork	145
6.2.2	Methodology	149
6.2.3	Research findings and discussion	150
6.2.3.1	Stylised facts of Chinese investors in the UK	150
6.2.3.2	Investment strategies of Chinese respondent firms	154

6.2.4	Summary	158
6.3	Comparison and discussion of the qualitative research	160
7	Cross-sectional data analysis of the determinants of Chinese outward direct investment	162
7.1	Model One: Domestic institutional factors and international network effects – An analysis of SAFE data	162
7.1.1	Operationalisation of Model One	162
7.1.2	Results and discussion	169
7.2	Model Two: International institutional factors and international network effects – An analysis of MOFCOM data	174
7.2.1	Operationalisation of Model Two	174
7.2.2	Results and discussion of Model Two	182
7.3	Comparison and discussion of the cross-sectional results	190
8	Conclusion	192
8.1	Main findings	192
8.2	Contributions of the research	200
8.3	Limitations and suggestions for further work	201
	References	203
	Appendices	235

List of Tables

Table 1.1: ODI stock of major developing economies, 1981 to 2005 (USD billion and % of developing economies total)	2
Table 2.1: ODI flows by region during, 1970-2005 (Five year annual average: USD billion and % of world total)	13
Table 2.2: FDI inflows by region, 1970-2005 (Five year average: total USD billion and % of world total)	15
Table 2.3: Factors that influence positively the choice of an international investment strategy	22
Table 2.4: Direct effects of government policies on ODI	33
Table 3.1: Key ODI regulations in Phase 1 (1979 to 1985)	59
Table 3.2: Key ODI regulations in Phase 2 (1986 to 1991)	62
Table 3.3: Geographical distribution of Chinese ODI: Accumulated stock for the period 1979 to 2005 (period average stock in USD bn and % of period average)	63
Table 3.4: Key ODI regulations in Phase 3 (1992 to 1998)	65
Table 3.5: Geographical distribution of Chinese ODI: Accumulated period average of investment projects 1979 to 2004 (total number and % of total)	66
Table 3.6: Key ODI regulations in Phase 5 (2001 onwards)	73
Table 3.7: Historic and emergent investment behaviour of Chinese MNEs	85
Table 5.1: Anonymised interview schedule	121
Table 5.2: Variable description and sources	131
Table 6.1: Descriptive analysis of Chinese firms interviewed	135
Table 6.2: Cumulative stock of Chinese ODI to Europe, 1990-2003 (three year average, USD million and %)	147
Table 6.3: Selected acquisitions of British companies by Chinese firms	148
Table 6.4: Years of establishment of parent company and FDI projects in the UK	150
Table 6.5: Ownership structure of the Chinese parent company	151
Table 6.6: Scope of internationalisation of respondent firms	152
Table 6.7: Type of UK operation of Chinese respondent firm	153
Table 6.8: Business operations by industry sector of respondent firms	153
Table 6.9: Offensive market-seeking investment drivers of Chinese respondent firms	154
Table 6.10: Defensive market-seeking investment driver of Chinese respondent firms	155
Table 6.11: Asset-seeking investment drivers of Chinese respondent firms	156
Table 6.12: Perceived firm-specific advantage respondent Chinese firm	157
Table 6.13: Evolving investment strategies and competitive advantage of Chinese firms in the UK as identified in the survey	159

Table 7.1: Descriptive analysis of Chinese ODI to OECD and non-OECD countries in Model One based on SAFE data, 1984 to 2001	167
Table 7.2: Correlation Matrix for Model One	168
Table 7.3: Results for determinants of Chinese ODI in Model One (SAFE data)	170
Table 7.4: Descriptive analysis of Chinese ODI flows to OECD and non-OECD countries in Model Two based on MOFCOM data, 1991 to 2003	180
Table 7.5: Correlation matrix of Model Two	181
Table 7.6: Results of determinants of Chinese ODI in Model Two (MOFCOM data)	184

List of Figures

Figure 1.1: Chinese outward direct investment stocks and flows in USD billion (1981 to 2005)	3
Figure 1.2: Chinese international acquisitions, total annual USD million and numbers	4
Figure 2.1: The Uppsala theory	24
Figure 3.1: China's approved outbound investment projects by industry sector and host region, 1979-2001 (% of total projects in the region)	76
Figure 3.2: China's approved ODI value by industry sector and host region, 1979-2001 (% of total to the region)	77
Figure 4.1: The Chinese outward direct investment regime	110
Figure 5.1: Spatial distribution of interviews in China	119
Figure 5.2: The research project	133
Figure 6.1: Number of employees worldwide of Chinese respondent firms	152
Figure 6.2: Number of employees in Chinese affiliates in the UK	152
Figure 7.1: Chinese ODIR – Domestic institutions (Model One)	166
Figure 7.2: Chinese ODIR – Supranational institutions (Model Two)	178

Abbreviations

ASEAN	Association of Southeast Asian Nations
BOP	Balance of payments
CCP	Chinese Communist Party or Communist Party of China (CPC)
CIS	Commonwealth of Independent States
CNOOC	China National Offshore Oil Corporation
CNPC	China National Petroleum Corporation
CPII	Columbia Program on International Investment
CSY	China Statistical Yearbook
GATT	General Agreement on Tariffs and Trade
GDP	Gross domestic product
EIU	Economist Intelligence Unit
FDI	Foreign direct investment
FT	Financial Times
FYP	Five Year Plan
IMF	International Monetary Fund
IPA	Investment promotion agency
JV	Joint venture
LM	Lagrangian multiplier
MNE	Multinational enterprise
MOFCOM	Ministry of Commerce (formerly MOFERT and MOFTEC) (PR China)
MOFERT	Ministry of Foreign Economic Relations and Trade (until 1993) (PR China)
MOFTEC	Ministry of Foreign Trade and Economic Cooperation (1993-2003) (PR China)
NBS	National Bureau of Statistics of China
NIE	Newly Industrialised Economy
NOC	National oil company
OECD	Organisation for Economic Coordination and Development
ODI	Outward foreign direct investment
OLI	Ownership-Location-Internalisation
PBC	People's Bank of China
POLS	Pooled ordinary least squares
PRC	People's Republic of China
pp	percentage point(s)
RE	Random effects estimator

REER	Real effective exchange rate
SAEC	State Administration for Exchange Control (until 1994) (PR China)
SAFE	State Administration for Foreign Exchange (formerly SAEC) (PR China)
SAIC	Shanghai Automotive Industry Corporation
SAR	Special Administrative Region
UKTI	UK Trade and Investment
UNCTAD	United Nations Conference on Trade and Development
US (U.S.)	United States
USD	U.S. dollar
WOS	Wholly-owned subsidiary
WTO	World Trade Organisation

1 Introduction

This thesis reports the findings of a thirty two month investigation of the character, distribution and determinants of outward foreign direct investment from the People's Republic of China. This introductory chapter to the thesis first sets out the rationale for the research, explaining that Chinese outward direct investment has accelerated dramatically since 2000, as a number of indicators reveal. Then, the objectives and questions that underpin the research are stated, along with an introduction to the methods used to answer them. The key thrust to the research is that existing work on Chinese outward direct investment underplays the effect that the institutional environment within and outside China has on the international decision-taking of Chinese multinational enterprises. This is followed by an outline of key terms and definitions used throughout this thesis. The chapter concludes with a review of the structure of the thesis, in order to help orientate the reader.

1.1 Rationale of the research

The People's Republic of China (henceforth: China) is well-known and well-researched as a host country for foreign direct investment (FDI) (e.g. Cross and Tan, 2004; Buckley *et al.*, 2002; Branstetter and Lardy, 2006; Clegg *et al.*, 1996).¹ Little is known and understood, however, about China's evolving role as a source country of FDI. Prior to 1979, outbound direct investment (ODI) from this autarkic economy was modest. But since then, ODI flows have steadily increased. A first peak was reached just after the former Chairman of the Chinese Communist Party (CCP), Deng Xiaoping, revived the economic liberalisation and reform process in 1992, after which outflows jumped to USD 4.4bn (see also Figure 1.1). Outflow levels remained at a relatively high level for a developing country and reached another peak of nearly USD 12bn in 2005. It is predicted that annual Chinese ODI flows will continue to rise to USD 37bn to 60bn by 2010 (EIU and CPII, 2006; Beebe, 2006). These projections are reinforced by repeated announcements by high-profile Chinese politicians and accompanying policy changes of the intention to create some fifty international competitive Chinese MNEs (Buckley *et al.*, 2006; Sauvant, 2005).

A number of other studies point to China's growing importance as a source country for FDI. Annual surveys by the United National Conference on Trade and Development (UNCTAD, 2005a, 2004a) about future FDI source countries reveal that China is predicted to become the

¹ In this study, the term China is used to refer to the People's Republic of China (PRC). For the purposes of this research, the PRC excludes the special autonomous regions (SAR) of Hong Kong (SAR) and Macau (SAR), unless specifically stated. The Republic of China (Taiwan) is treated as an independent country. Regions with disputed borders (for example the Spratly Islands and the Paracel Islands in the South China Sea) are excluded from the definition of the PRC, as are associated economic activities. All statistics and figures respect these distinctions.

second most important foreign investor in Africa and Asia for the years 2004 to 2008 (behind South Africa and the USA). Frost (2005) shows the increased significance of Chinese investment for Southeast Asia, listing and describing extensively Chinese investors in this region. A similar development is now taking place in Europe. Liu (2004), for example, asserts that Chinese firms had become one of the most important foreign investors in the United Kingdom. In 2005, China became one of the ten most important developing source countries for FDI in terms of absolute global flow and stock figures (UNCTAD, 2007a). UNCTAD reports that China's ODI stock was valued at nearly USD 46bn at the end of 2005. This places China behind the economically more advanced East Asian countries like Hong Kong Special Administrative Region (SAR), Singapore and Taiwan, Republic of China but ahead of developing countries in South America, West Asia and the European transition economies (see Table 1.1).

Table 1.1: ODI stock of major developing economies, 1981 to 2005 (USD billion and % of developing economies total)

	1981-84	1985-89	1990-94	1995-99	2000-05
Developing economies	77.33bn	103.57bn	200.06bn	513.52bn	988.65bn
China	0.16%	2.07%	4.87%	4.36%	3.61%
Argentina	7.57%	5.76%	3.67%	3.02%	2.17%
Brazil	50.61%	38.44%	21.13%	9.01%	5.93%
Hong Kong SAR	0.69%	5.44%	14.54%	37.38%	38.16%
Mexico	2.24%	2.21%	1.68%	1.08%	1.69%
Republic of Korea	0.37%	0.89%	2.30%	3.29%	3.04%
Singapore	1.14%	1.69%	6.74%	8.61%	8.79%
Taiwan, Rep. of China	16.97%	16.21%	17.37%	9.98%	8.21%

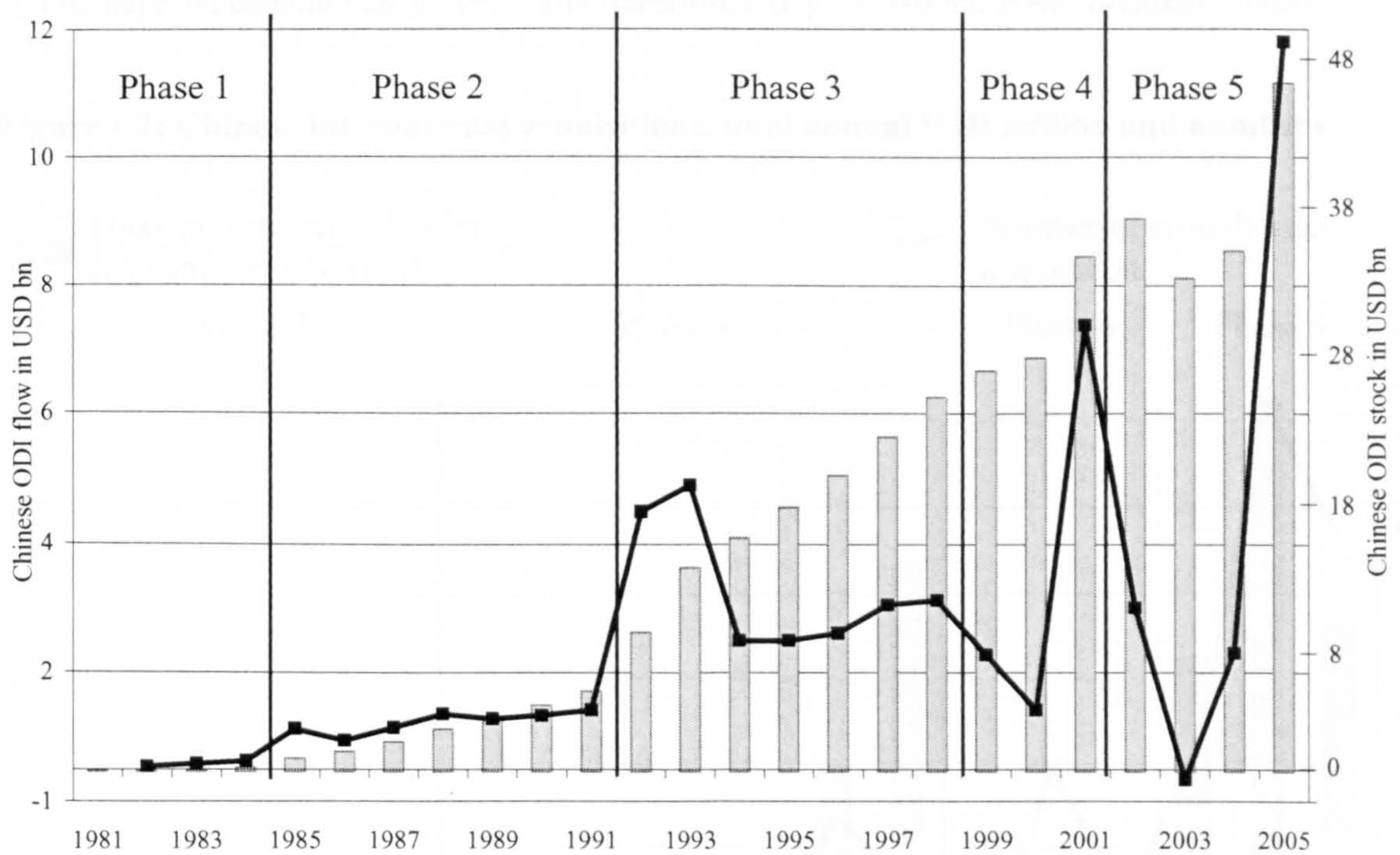
Notes: (1) The figures presented here are computed period averages in USD billion for all developing countries and respective share of each country.

(2) The British Virgin Islands and the Russian Federation rank higher than China for the period 2000-2005 in terms of ODI stock.

Source: UNCTAD (2007a).

Although Chinese ODI flows and stocks are generally modest compared to industrialised countries such as the USA or the UK, China's ODI growth since the end 1970s reflects a significant departure from the former autarkic and socialistic economic system and this is likely to have had important effects on the internationalisation of its firms.

Figure 1.1: Chinese outward direct investment stocks and flows in USD billion (1981 to 2005)



Notes: (1) Left scale (—■—) represents Chinese ODI flows;

Right scale (█) represents Chinese ODI stock.

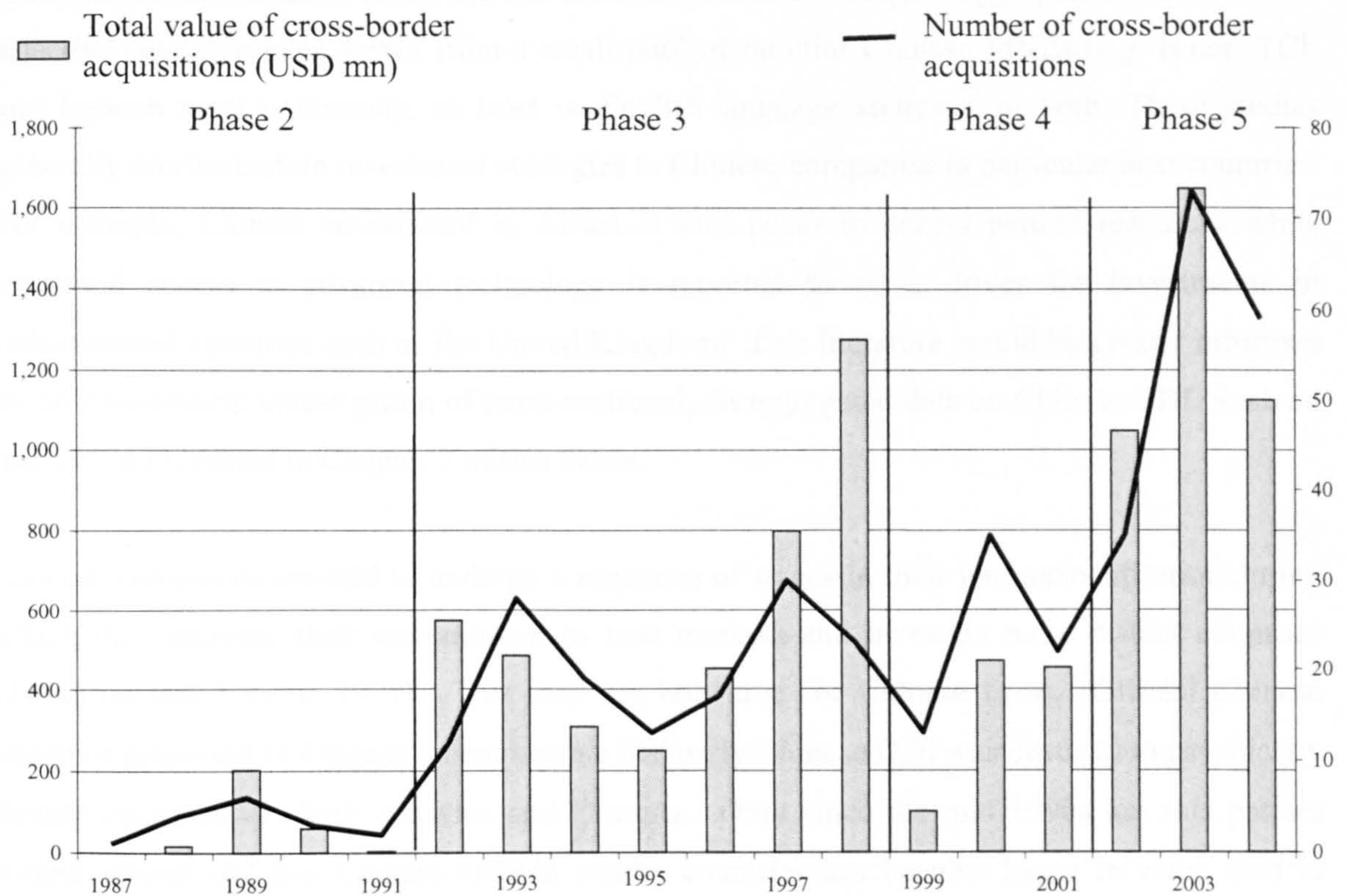
(2) See Section 3.2 for explanations of the phases.

Source: UNCTAD (2007a).

The growth of Chinese ODI is also evident in the area of cross-border mergers and acquisitions. Chinese firms are becoming increasingly internationally active by acquiring (often ailing) foreign firms. Not only has the number and total value of acquisitions risen (as Figure 1.2 illustrates) but so too has the prominence of the target companies. Well publicised purchases include the take-over of IBM's (USA) PC business by Lenovo in 2005 and Nanjing Automobile's successful bidding war with its domestic rival Shanghai Automotive Industry Corporation (SAIC) for MG Rover (UK) in 2004/05 (FT, 2005a). Today, Chinese companies are often mentioned among the first potential buyers when a company or parts of a company are for sale. A point in case is Daimler's divestment of Chrysler (2007). The three Chinese auto manufacturers Chery, First Auto Works and SAIC were all separately rumoured to have negotiated with Daimler to acquire the US-American subsidiary (FT, 2007a). The consideration of a Chinese firm as a potential buyer of a leading automobile manufacturer exemplifies the perceived change in the quality and potential of Chinese ODI. What this example fails to identify or to explain, however, are the drivers behind China's FDI outbound

surge. It also raises the question of why Chinese firms are deemed capable of acquiring and managing a large Western multinational enterprise (MNE) when their firm-specific advantages and managerial capabilities are generally questioned (e.g. by Nolan, 2002; Shenkar, 2005).

Figure 1.2: Chinese international acquisitions, total annual USD million and numbers



Notes: (1) Left scale: total value of cross-border acquisitions by Chinese firms;
 Right scale: number of cross-border acquisitions by Chinese firms.
 (2) Data for the years prior 1987 and post 2004 are not available.

Source: UNCTAD (2007a).

Given this background, the objectives of this research are: (i) to identify the determinants of Chinese ODI; (ii) to identify the international investment strategies pursued by Chinese MNEs, and (iii) to evaluate the effect of the domestic and international institutional environment on the determinants, investment strategies and behaviour of Chinese MNEs. As part of the third objective, the role of international business and social networks is given particular emphasis. In so doing, theories on FDI and on MNE investment behaviour which were developed from research that focuses on industrialised country MNEs are tested for their applicability to a developing country context such as China. A positive finding for the applicability of the theories is generally expected (UNCTAD, 2006).

There are four key strands to this research, each underpinned by a strong theoretical and empirical foundation. First, a thorough analysis of the international investment strategies of Chinese firms is undertaken with the aim of shedding light on the determinants of Chinese ODI, the drivers behind international acquisitions (such as the proposed acquisition of Chrysler), and the rise of Chinese ODI globally. Work on Chinese ODI by Deng (2003), Wong and Chan (2003) and others tends to scrutinise and draw inferences from highly aggregated data or rely on selective case examples drawn from a small pool of familiar Chinese MNEs (e.g. Haier, TCL and Lenovo most commonly, at least in English-language sources), or both. These studies generally ascribe certain investment strategies to Chinese companies in particular host countries. For example, Chinese investment in Africa is said occur to access natural resources while improved access to advanced technology is reported to be a driver for investments in industrialised countries such as the United Kingdom. This literature would be greatly informed by an econometric investigation of cross-sectional, disaggregated data on Chinese ODI. Such an analysis is presented in Chapter 7 of this thesis.

Second, companies are said to undergo a sequence of stages in their internationalisation during which they increase their commitment to host markets and invest in more distant countries (Johanson and Vahlne, 1977). This may not hold true for Chinese firms. Official Chinese statistics presented in Chapter 3 demonstrate that early Chinese ODI was destined to psychically distant countries in North America and Oceania. Only since the mid 1990s has this pattern turned around and that Chinese ODI in nearby countries has become larger in value than in more distant countries. It may therefore be that Chinese firms rather follow a pattern identified for international new ventures. Following this approach, firms invest in locations where there is a good business opportunity readily available (Oviatt and McDougall, 1994) regardless of geographic or psychic distance. This research investigates whether or not such behaviour can be observed for the internationalisation activity of Chinese MNEs.

Third, to account for China's heritage of economic planning (which is still visible in the government's involvement today [Scott, 2002]) and continuous changes to China's institutional environment since 1979, special emphasis is placed on institutional theory. In this thesis, a model is advanced which allows testing the extent to which institutional theory has the power to explain the recent evolution of Chinese ODI. As Figures 1.1 and 1.2 demonstrate, Chinese ODI is generally described as having evolved in five phases (see for example Ye, 1992; Wong and Chan, 2003, Wu and Chen, 2001). Each phase is defined by changes to the nature of Chinese ODI that are caused mainly by changes to the institutional environment and the administration and regulation concerning outbound FDI. This comprises changes to the outward investment approval regime and the capability of firms to pursue international business opportunities,

among other things. Capability may, in the Chinese context, not necessarily mean managerial capacity and technological advancement over competitors but privileged access to financial resources. The possibility to internalise access to abundant funding may help Chinese firms to overcome competitive weaknesses and invest abroad to pursue objectives other than purely profit-maximising ones. This is not to say that Chinese firms are not profit-maximisers. But there exists the likelihood that they may invest in one country to gain access to resources to be exploited in a third country. The institutional realm is also of importance from another perspective. Not all Chinese firms were allowed at all times to pursue investments abroad. Liberalisation of this policy and the consequential rise of a different breed of firms may be changing the nature of the determinants of Chinese ODI. The impact of the changes is probably best illustrated in Figure 1.2. This shows major ups and downs in the annual value of cross-border acquisitions by Chinese firms at the start of each phase. This hints at the possibility that the domestic institutional environment may affect the international investment strategies and behaviour of Chinese MNEs. To date, academic research has merely skirted around issues surrounding the institutional environment and it is generally considered separately from the investment behaviour of Chinese firms (e.g. Deng, 2003, 2004; Warner *et al.*, 2004; Wu and Chen, 2001). Chinese institutions are likely to be an important determinant of Chinese ODI. Better account of this in empirical work could help to explain the steady growth and the positive prospects of Chinese ODI evidenced in the UNCTAD and other surveys.

Fourth, a further aspect not fully accounted for in extant research is the influence of the Overseas Chinese Diaspora on firm investment decision-making. A large body of research has identified that the Overseas Chinese have played an important role in re-integrating China into the world economy (e.g. Naughton, 2007; Gao, 2003) and that the Chinese government actively tries to retain strong linkages with the Overseas Chinese, which generally have a strong affinity towards their ancestral home regions on the mainland (e.g. Liu, 2000). It is therefore pertinent to investigate whether or not the Overseas Chinese Diaspora has a moderating effect on the overseas investment strategies of Chinese MNEs.

1.2 Research objectives and questions

In this thesis, the four research objectives are pursued using a common and specific set of research questions. Although the research questions are developed more fully in Chapter 3, it is worthwhile to state them clearly at the outset and to link them to the research objectives. Each research question is now introduced, along with the Chapters in which they are addressed.

Identification of the determinants of Chinese ODI

The objective of identifying the drivers of Chinese ODI leads to the first and most straightforward research question: What are the determinants of Chinese ODI (*RQ1*)? Later the argument is developed that the determinants are not static but have changed over time along with changes to the domestic and institutional environment in which Chinese MNEs are embedded. Hence, it follows: Have the determinants of Chinese ODI changed over time (*RQ6*)? These two research questions are addressed in Section 6.2 and Chapter 7 of this thesis.

The international strategies of Chinese firms

This research objective aims to identify the strategies of Chinese MNEs following the classification of generic investment strategies proposed by Dunning (1993). Research questions underpinning this objective therefore ask to what extent Chinese ODI is driven by market-seeking (*RQ2*), resource-seeking (*RQ3*), technology seeking (*RQ4*), or strategic asset seeking (*RQ5*) motivations. It is again assumed that these strategies are not necessarily static but may have changed over time (*RQ6*). As is made clear in Chapter 3, China has made great strides in reforming and liberalising its economy. This has led to a variety of ownership forms being demonstrated by its MNEs. Consequently, this research explores whether or not the investment strategies of Chinese MNEs differ by ownership type (*RQ11*). Another aspect to corporate strategy concerns the extent of international commitment and the spatial distribution of Chinese ODI. These issues are addressed by *RQ7* and *RQ8* which ask whether the internationalisation of Chinese MNEs confirms to the 'stages' model or the theory of international new ventures. These research questions are all addressed in the two empirical Chapters 6 and 7 of this thesis.

Influence of domestic and international institutions

The influence of domestic and supranational institutions on ODI is central to modelling the international investment decisions of Chinese MNEs done in Chapter 4. This aspect is split into two research questions, the first concerning the role of domestic institutions (*RQ10a*) and the second, international institutions (*RQ10b*). This is done for reasons of simplification and to reduce the effect of noise in the data. Since the effect of these institutions may vary by ownership type of Chinese MNE, *RQ11* is linked to this research objective, too. The effect of the domestic institution is investigated in interviews with parent firms in China (Section 6.1) and evaluated together with a testing of the determinant effect of supranational institutions on patterns of Chinese ODI undertaken in the econometric modelling in Chapter 7.

Influence of international networks

There is evidence to suggest that the presence of Overseas Chinese in a target country may facilitate the internationalisation of Chinese firms, although, as is made clear in Section 3.3 of

this thesis, research findings on this issue are ambiguous. *RQ9* is designed to address this research objective. The influence of such international networks may vary by ownership type and this is tackled in *RQ11*. The question of the influence of international networks also plays a role in assessing whether Chinese firms invest in ways proposed in the Uppsala model (*RQ7*) or as asserted in the theory on international new ventures (*RQ8*). The influence of international networks is examined in interview (Section 6.1) and tested in the econometric modelling in Chapter 7. Based on the findings, inferences are drawn that answer *RQ7* and *RQ8*.

1.3 Definitions and terminology

It is important at the outset of this research that key terms and concepts used in this study are clearly delineated and defined.

1.3.1 Foreign direct investment

Foreign direct investment (FDI) is a substantial, long-term relationship which an enterprise undertakes in a country foreign to its residence (UNCTAD, 2006). It comprises at least one of the three following investment options: (i) equity capital (i.e. the purchase of, normally, 10% or more of the share of an enterprise in a country other than the home country of the acquirer);² (ii) reinvested earnings of the foreign affiliate (i.e. earnings of the affiliate which are not paid out as dividends or otherwise remitted to the parent company); and (iii) intra-company loans from the parent company to the foreign affiliate (UNCTAD, 2006). To distinguish it from portfolio investment it is normal to regard FDI as also involving investment that secures managerial control over the foreign operation. FDI is often synonymously used for the more precise term ‘inward/inbound foreign direct investment’. Investment originating from a source or home country is called ‘outward/outbound foreign direct investment’ (OFDI) or ‘outward/outbound direct investment’ (ODI). In this thesis the acronym ODI is preferred. Both inward and outward foreign direct investment can be described in terms of flows and stocks, as follows:

1.3.1.1 Foreign direct investment flows

FDI flow is the capital provided by the investing enterprise to the foreign invested companies, or capital provided by the foreign invested company to the investing enterprise (UNCTAD, 2006), over a given period of time (normally one calendar year in official statistics).

² The internationally recommended threshold figure for the classification of FDI to apply is higher in some countries, for example Germany where it is 20% (OECD, 1996).

1.3.1.2 Foreign direct investment stock

FDI stock is the accumulation of yearly foreign direct investment and divestment flows by home country companies. Hence, the “FDI stock is the value of the share of their capital and reserves (including retained profits) attributable to the parent enterprise, plus the net indebtedness of affiliates to the parent enterprise” (UNCTAD, 2006: 294), normally presented as the net aggregated figure for an economy for a calendar year. The term FDI stock therefore usually applies to the net value of foreign-owned assets in an economy in a given year.

1.3.2 Multinational corporation and its affiliates

A multinational enterprise (MNE) is defined as “an enterprise which owns and controls activities in different economies” (Buckley and Casson, 1976: 1). An affiliate is a company that is controlled directly or indirectly in another economy by a foreign investor firm. The term affiliate comprises (i) subsidiaries in which the investing firm holds 50% or more of the voting stock/equity capital, (ii) associate firms in which 10% to 50% of the voting stock/equity capital are held by a foreign investor and (iii) branches which are unincorporated and are wholly or jointly owned by a foreign investor (OECD, 2005a). In this study, the term affiliate is used to embrace each of these ownership forms.

1.3.3 Country classification

In international business theorising, when describing FDI flows and when explaining certain firm characteristics, it is useful to distinguish between different types of host and home country. Country-specific characteristics differ greatly and can exert a significant influence on the outward and inward investment behaviour of MNEs, as is revealed in this study.

To date, there exists no consensus among supranational agencies such as the United Nations bodies, the World Bank, the International Monetary Fund (IMF) and the Organisation for Economic Cooperation and Development (OECD) as to what defines a *developed* vs. *developing*, and *industrialised* vs. *emerging (transitional)* vs. *industrialising* country. This study therefore follows the classification of developed and developing countries as used by the United Nations Conference on Trade and Development (UNCTAD) in their annually published *World Investment Report*. In particular, the classification as presented in the latest version of UNCTAD’s internet-based FDI/TNC database is used (UNCTAD, 2007a). The list of country classifications and constituent countries used in this study is provided in Appendix A.1.

The terms *developed* and *industrialised* country are used synonymously in this study, as are the terms *developing*, *industrialising*, *emerging*, and *transitional* country. Having said that, it should be noted that there are differences between countries described by these terms. The

terms *transitional economy* and *emerging economy* are typically employed to describe countries that are changing their economic system towards to an open, market economy and have (almost) reached the level of economic development of developed countries, respectively. The former is normally applied to the countries of Central and Eastern Europe, the Baltic States and China. The latter is typically associated with the so-called 'newly industrialised economies' (NIEs) in Asia, namely Hong Kong SAR, Singapore, Republic of Korea (or South Korea) and Taiwan, Republic of China (Taiwan). Although the NIEs are called 'industrialised', they are officially not classified as industrialised Asian countries but rather as emerging or developing ones (UNCTAD, 2006).

A further country classification used in this study is the 'Triad economies'. This comprises North America (Canada and the USA), the European Union countries and Japan. Finally, in this research, countries are further classified depending on membership status in the OECD and in the WTO/GATT.

1.4 Structure of the thesis

The remainder of the thesis is structured as follows. In Chapter 2, Chinese ODI is placed in context of global FDI flows and the international distribution of MNEs. This is followed by a review of theories that explain FDI originating from developed countries, along with an overview of the research stream that argues that developing country ODI is distinctive from developed country FDI. The chapter concludes with a review of empirical studies on the determinants of FDI in general. A description of Chinese ODI is then given in Chapter 3. This chapter is divided into three sections. The first introduces the corporate and government actors in China. This is done to inform the model of the Chinese outward direct investment regime which is advanced later. This is followed by a review of the development of Chinese ODI with particular reference to political and administrative changes in China since 1979. Finally, extant literature on Chinese ODI is reviewed in this chapter and linked to the theories presented in Chapter 2 and the institutional environment presented in the earlier sections of this chapter. This final section also develops the specific research questions for this study. Based on the research questions, a model is then advanced in Chapter 4 that seeks to explain patterns of Chinese ODI. This model combines different theories into a holistic framework within which Chinese ODI can be analysed. The model draws heavily on the 'new institutional theory' approach, since it is argued in this research that the domestic and institutional environment shapes to a great degree international investment decision-making of Chinese MNEs. This model is tested in subsequent chapters. Chapter 5 describes the research methods used in this study and evaluates the merits of quantitative and qualitative business research in the context of

China. The primary and secondary data collection methods used in this study are introduced. In Chapter 6, the primary data collected in interviews with Chinese parent MNEs and in a survey of Chinese affiliates in the UK are analysed and discussed. In Chapter 7, two econometric models using two different sets of Chinese ODI data and two different time frames are specified in order to test the model of Chinese ODI as advanced in Chapter 4. In Chapter 8, the findings of the research are discussed and conclusions are drawn. The main contributions made by this study are also highlighted here. The thesis concludes with some suggestions for further research on Chinese ODI.

2 Internationalisation through foreign direct investment – Some stylised facts and theoretical explanations

This chapter provides the context and analytical frameworks for the investigation of Chinese outward direct investment (ODI) conducted later. First, an overview is presented of the global development of foreign direct investment (FDI) since the 1970s for both developed and developing countries to place Chinese ODI and the growth of Chinese multinational enterprises into context. Second, theoretical models that explain FDI from developed countries and MNE behaviour and strategies are introduced and critically evaluated (Section 2.2). These analytical tools are typically used in extant studies on Chinese ODI (see Section 3.4). They also partially inform the development of a model to explain Chinese ODI which is advanced in Chapter 4. Then, an overview is presented of empirical studies that investigate the determinants of FDI from developed and developing countries. In so doing, a foundation for testing the new model of Chinese ODI econometrically in Chapter 7 is laid out.

2.1 Global foreign direct investment pattern and development

This section reviews patterns of global ODI and the distribution of MNEs with regards to the growing position of ODI originating from, and MNEs headquartered in, developing countries. This is followed by a similar review of global FDI *inflows*. In both sections, the position of China and its MNEs are highlighted and put into perspective. A more detailed account of the development of Chinese ODI since 1979 is provided in Chapter 3.

2.1.1 The global development of foreign direct investment

Worldwide FDI flows have increased dramatically since the 1970s when the United Nations Conference on Trade and Development (UNCTAD) first published data on the subject. While the total amount of worldwide FDI outflow during the 1970s stood at an annual average of USD 28.26bn, it rose continuously during the 1980s to an annual average of USD 93.32bn and quadrupled to an annual average of USD 418.97bn in the 1990s (UNCTAD, 2007) (see also Table 2.1). Annual flows of outward FDI continued to increase in the new millennium and nearly doubled to USD 779.26bn over the period 2000 to 2005 compared with the 1990s (UNCTAD, 2007). This outbound FDI generally originates from the industrialised economies, notably North America, the European Union (EU15) and Japan. These industrialised economies accounted for 98% of world FDI outflows annually during the 1970s. Since then, the share has steadily declined, standing at a period average of 87% for the years 2000 to 2005 (UNCTAD, 2007). Because the industrialised economies are the main sources of FDI, it is not surprising

that they headquarter the majority of MNEs and the largest MNEs by foreign and total assets. Nearly three-quarters of all MNEs originate from the industrialised countries and 85% of the worlds' top 100 MNEs (by foreign assets) were headquartered in the Triad economies in 2004 (UNCTAD, 2006). Accordingly, theories of MNE behaviour, investment motivation and strategy mainly derive from observations of companies based in the industrialised countries, specifically the USA (see also Section 2.2).

By contrast, developing and emerging economies represent a much smaller but growing source of FDI. While only 1 to 2% of annual global FDI averages originated from the developing countries in the 1970s, this figure has risen to 12% in the most recent period, 2000 to 2005. This increase is remarkable percentage-wise but even more so in absolute value terms.

Table 2.1: ODI flows by region during, 1970-2005 (Five year annual average: USD billion and % of world total)

	1970-74	1975-79	1980-84	1985-89	1990-94	1995-99	2000-05
World	189.4	376.2	443.0	1,424.4	2,260.6	6,086.9	6,913.3
Developed economies	99%	98%	95%	93%	88%	89%	87%
Europe	46%	44%	49%	53%	49%	60%	60%
N. America	50%	48%	34%	20%	26%	24%	22%
Asia/Oceania	7%	7%	12%	20%	13%	5%	5%
Developing economies	1%	2%	5%	7%	12%	10%	12%
L. America	0%	1%	1%	1%	2%	3%	4%
Asia/Oceania	0%	0%	3%	5%	9%	7%	8%
Africa	0%	0%	1%	0%	1%	0%	0%
Transition economies	0%	0%	0%	0%	0%	0%	1%

Notes: (1) Some columns do not sum to one hundred due to rounding errors.

(2) A complete country list and classification is presented in Appendix A.1.

Source: UNCTAD (2007a).

World FDI flows increased more than thirty-six fold from 1970 to 2005 but flows from developing countries rose from USD 3.5bn to USD 802.6bn in the same period – a two hundred and twenty nine-fold increase. The distribution of developing country source countries was spread over all continents in the 1970s but since then has become more concentrated. Since the 1990s, the Asian Newly Industrialised Economies (NIEs) and, gradually, China have

increasingly contributed to developing country ODI and now dominate it with a share of more than 60% of the stock value and nearly 50% of the flow value in 2006 (UNCTAD, 2007a). Outward FDI from Hong Kong SAR increased significantly during the 1990s when it accounted on average for more than 35% of ODI originating from developing countries (see also Table 1.1). ODI originating from mainland China is reported by UNCTAD from 1982 onwards only. Annual ODI from China increased from USD 44mn in 1982 to an annual period average of more than USD 2bn from 1991 to 2003 (UNCTAD, 2007a). The stock of Chinese ODI was valued in 2005 at USD 46.31bn, the seventh highest amount among developing countries. Since 2000, China's position as an important source country has been strengthened by significantly growing annual ODI flows. Flow levels reached USD 5.50bn in 2004 and rose again to USD 12.26bn in 2005 (MOFCOM, 2006a).³

The growing importance of ODI originating from Asian developing countries is also reflected in several rankings of the largest MNEs such as the global 'Top 100' and 'Top 200' MNEs published by UNCTAD.⁴ These UNCTAD rankings present the largest MNEs from both developed and developing countries by total foreign assets. The ranking for 2004 includes five developing country companies in the Top 100, including China-based China International Trust and Investment Corporation (CITIC). A further ten developing country companies are represented in the Top 200, including an unnamed Chinese company (UNCTAD, 2006). The strength of Chinese and NIEs companies is also observable in another ranking by UNCTAD which lists the top 100 non-financial developing country MNEs with regard to total foreign assets. Seventy-seven of the top 100 companies were headquartered in Asian countries in 2004, of which ten are from China, namely, in descending order: China International Trust and Investment Company (CITIC), China Ocean Shipping (Group) Co., China State Construction Engineering Corporation, China National Petroleum Corporation (CNPC), Sinochem Corporation, TCL Corporation, China National Offshore Oil Corporation (CNOOC), China Minmetals Corp., Cofco International Corp., and BOE Technology Group Company Ltd. (UNCTAD, 2006). Of these ten Chinese companies, seven are ranked among the top 50 developing country MNEs in UNCTAD's 'Top 100' list. Compared to the first year of the publication of the ranking in 1993, the significant presence of Chinese companies in 2004 is

³ The data reported by MOFCOM is not necessarily congruent with UNCTAD data. UNCTAD reports lower ODI flows for 2004 and 2005 and has generally valued Chinese ODI stock differently than MOFCOM. An explanation for this divergence is presented in Chapter 5.

⁴ Further rankings exemplifying the growth of Chinese firms are the *Fortune Global 500* (15 Chinese firms in 2005 and 19 in 2006 [Fortune, 2007]), the *Forbes Global 2000* published in 2007 (44 firms [Forbes, 2007]), the *Business Week's Global 1000* (6 firms in 2006 [Business Week, 2006]), the *Top 200 Emerging Markets Companies* also published by Business Week from 2001 (10 firms [Business Week, 2001]), and the *Deloitte Technology Fast 500 Asia Pacific Ranking 2006* (60 firms [which also includes Hong Kong-based firms; Deloitte Touche Tohmatsu, 2006]).

striking. No Chinese company was listed in 1993 and even in 2000 the ranking included three Chinese firms only (UNCTAD, 1995, 2002). Given the growing importance of FDI from developing countries, and from China in particular, there is a need for scholars to systematically investigate the determinants and drivers of Chinese ODI. This research is concerned with the investment motivations of Chinese companies such as the top ranked ones mentioned here and their mainland peer companies.

2.1.2 Host country distribution of ODI flows

The distribution of worldwide inward FDI mirrors to some extent the development of global ODI. As with global ODI, the Triad economies are also the main recipients. These economies have attracted an average of about 70% of annual inflow since the 1970s (see Table 2.2). Overall, this share is considerably lower than the respective ODI share. European countries in particular received lower proportions of global inward FDI flow than they contribute to ODI. This is partly explained by the upsurge of inward FDI into North America and by the rise of the NIEs and China as main recipients of inward FDI flows.

Table 2.2: FDI inflows by region, 1970-2005 (Five year average: total USD billion and % of world total)

	1970-74	1975-79	1980-84	1985-89	1990-94	1995-99	2000-05
World	179.5	307.8	587.5	1,290.1	2,010.6	6,068.8	7,269.8
Developed economies	79%	74%	68%	83%	68%	70%	65%
Europe	45%	40%	26%	35%	41%	41%	45%
N. America	27%	28%	37%	43%	22%	27%	18%
Asia/Oceania	7%	6%	5%	5%	5%	3%	2%
Developing economies	21%	26%	32%	17%	31%	29%	31%
L. America	10%	12%	11%	5%	8%	11%	10%
Asia/Oceania	4%	10%	18%	10%	20%	16%	19%
Africa	6%	4%	3%	2%	2%	1%	3%
Transition economies	n/a	n/a	0%	0%	1%	1%	3%

Notes: (1) Some columns do not sum to one hundred due to rounding errors.

(2) A complete country list and classification is presented in Appendix A.1.

Source: UNCTAD (2007a).

The developing countries as a whole have received a large proportion of worldwide inward FDI flows annually since 1970 (around 25%) with a gradually increasing proportion being directed

towards China (Zhao, 2003; Zhou and Lall, 2005). China received around one-third of all FDI flows into developing countries during the mid-1990s and did so again in 2002 and 2003. Around forty per cent of all FDI flows to Asian countries were directed to China (UNCTAD, 2007a; Zhao, 2003). The majority of FDI flows into China originated from nearby Hong Kong SAR, Macau SAR and Taiwan (Naughton, 2007).⁵ The worldwide development of FDI inflows by region is summarised in Table 2.2.

2.2 Theoretical foundations of foreign direct investment

This section reviews and discusses theories that have the potential to explain the volume and distribution of Chinese ODI. Traditionally, theories on FDI derive from research on industrialised country MNEs, since these were among the first to internationalise on a large scale. Starting with what is regarded here as the core theory of FDI – the internalisation theory (Buckley and Casson, 1976) – this section presents and discusses theories and frameworks typically applied to analyse FDI from industrialised countries. In addition to internalisation theory, the following theories and frameworks are reviewed: (i) Dunning’s eclectic paradigm (also called the OLI paradigm), which stipulates that ownership and host country location advantages must be present for a firm to internalise transactions across borders; (ii) the international investment strategies of firms (Dunning, 1993); (iii) the Stages Theory (also called the ‘Uppsala’ approach), and (iv) the international new venture theory, which challenges the stages theory by stating that some firms conduct FDI very quickly after establishment. In addition, because the internationalisation process of a firm may be accelerated by access to social networks, (v) the international entrepreneurial network theory is presented. Implicit in all these theories is that institutions play an important role in the internationalisation of firms. Hence, (vi) new institutional theory is introduced. This section finishes with an assessment of the ability of these theories to explain FDI from developing countries. The theoretical insights from this section are used to develop a model of Chinese ODI which is presented in Chapter 4 and tested in Chapters 6 and 7.

2.2.1 The general theory of foreign direct investment – Internalisation theory

Buckley (1990) argues that the core (general) theory of FDI is the internalisation theory.⁶ The general principles of internalisation are twofold (Buckley and Casson 1976). Firms (i)

⁵ A significant but indeterminate share of FDI in China from Hong Kong is generally assumed to be ‘round-tripping’ FDI, i.e. funds that are legally and illegally channelled out of China to be reinvested in China through a foreign investment vehicle in order to take advantage of preferential treatment extended to foreign investors (see also Section 3.3 and Wall, 1997).

⁶ This section draws mainly upon Buckley *et al.* (2007a).

internalise missing or imperfect external markets across borders until the costs of further internalisation outweigh the benefits, and (ii) firms choose locations for their activities along the supply-chain that minimise the overall costs of their operations.⁷ Imperfect markets are distortions in the price system caused by structural or cognitive factors. Structural imperfections relate to government imposed or enforced formal constraints such as barriers to competition and poorly defined property rights which lead to rising transaction costs. Cognitive imperfections relate to uncertainties concerning, for example, future foreign exchange rate developments and business-related government policies (Dunning, 1995; Hennart, 2001). Expansion by internalisation of markets across borders means that firms use FDI to gain an advantage over (local) competitors in a host country by replacing imperfect external markets in intermediate products and services with their organisational, hierarchical corporate structure and by appropriating the returns that this may generate (Buckley and Casson, 1976; Buckley, 1988; Hymer, 1960). Through internalisation, companies may benefit from lower transaction costs (such as communication and contracting costs), improved protection of intangible assets, increased bargaining power, improved buyer/seller certainty and expanded transfer pricing possibilities (Agarwal, 1980). In so doing, companies perceive other arm's length modes of internationalisation, such as exporting or non-affiliate licensing, to be more costly.

Buckley (1993) comments that there may be justifications for special applications of the core theory. To illustrate, the most commonly used example of the exploitation of imperfect markets are companies in knowledge-intensive industries with valuable intangible assets (Buckley and Casson, 1976; Buckley, 1988; Buckley, 1993). Internalisation theory is not constrained to research-intensive industries, however. Rather, it is a special application of the core theory. It follows from this that special applications of the internalisation theory to accommodate firm, industry or country characteristics (such as the internationalisation of small firms and of developing country firms) are possible extensions (Buckley, 1988). This raises the possibility that developing country ODI, and, for the purposes of this study, specifically ODI originating from China, might be better explained by a special application to be nested in the core theory.

These general principles, as well as the following theories and frameworks, are derived from research on industrialised country MNEs. The internalisation of imperfect markets across borders argument remains relevant for non-industrialised country companies as it constitutes the core element of FDI theory. However, in the case of developing country MNEs, it is likely that

⁷ Market imperfections are created by, for example, government intervention while, in contrast, market failure is based on monopolistic power, unintended externalities and so forth (Boddewyn and Brewer, 1994).

a set of particular market imperfections exists which require special applications of the general theory. This argument is further developed in Chapters 4, 6 and 7.

2.2.2 The Eclectic Paradigm

Although internalisation theory is arguably the core theory to explain FDI, Dunning (2000) asserts that the internalisation of imperfect markets is a necessary, but not sufficient, condition for firms to conduct FDI. Dunning (1977) proposes that the investing firm needs to hold ownership advantages relative to local firms. Ownership and locational advantages are taken into consideration by a company if internalisation advantages cannot be utilised through a direct investment. In such instances, the firm would rather export or license. The importance of ownership and locational advantages and the ability to internalise these advantages as a precondition for FDI have been drawn together by Dunning (e.g. 1980, 1988, 2000, 2002) to form his so-called eclectic paradigm or OLI (Ownership-Location-Internalisation) paradigm.

The necessity of a firm having ownership advantages follows from the second aspect of the core theory. To be able to out-compete local firms in a foreign setting, the investing firm needs one or more ownership advantages. An ownership advantage is an asset that competitors cannot imitate, copy or otherwise access over the short-run, securing for the owner monopolistic rents (Penrose, 1995). The monopolistic rents which the company gains during this period have to be large enough to compensate for the risks associated with investing in a new and unfamiliar business, political and cultural environment (Hymer, 1960).

Dunning (2000) argues that ownership advantages have to be identified and fostered (O_i), accessed (O_t) and utilised (O_a) by a company. Ownership advantages based on specific assets (O_a) can be either endogenous or exogenous to the firm. Endogenous ownership advantages are of a technological, managerial or organisational nature and can be tangible, as in the case of technology, or intangible, in the case of management and organisational capabilities and brands. Exogenous advantages refer to privileged access to input factors such as (government) funding, raw materials and labour allocation which can be exploited to reduce costs. The ability to internalise and utilise these endogenous and exogenous assets is labelled O_t by Dunning. This notion of ownership advantages has been recently extended by Dunning with the addition of institutionally-related competitive advantages (O_i) (Dunning, 2006a). The ownership advantage O_i refers to company-specific incentives and motivation structures which enables it to either exploit existing ownership advantages or to access and gain new ones. It is generally assumed that companies develop their ownership advantages in their domestic markets over time before they internationalise (e.g. Dunning, 2000; Buckley and Casson, 1976; Hymer, 1960). As a

consequence, large enterprises with a dominating position in their home market are normally those that possess the capabilities to invest internationally (Hymer, 1960). However, firms from, for example, developing countries which are smaller and less well endowed with firm-specific advantages than their counterparts from developed countries are argued to undertake FDI in order to augment their asset stock and strengthen ownership advantages in order to close the capability gap (e.g. Bartlett and Ghosal, 2000; Fosfuri and Motta, 1999).

The second element of the eclectic paradigm relates to host country locational factors. Dunning argues that the selected host location needs to possess immobile factor endowments (L) which can be combined with the ownership advantages of a company so that it serves markets through FDI rather than through export. The locational factors comprise hard and soft factors. 'Hard' factors denote immobile and non-renewable factors, such as raw materials, which have to be excavated. Important hard factors are natural resources such as oil and mining products, timber and food resources for example. 'Soft' factors are highly influenced by the institutional environment of the host region (Meyer, 2004; Henisz, 2004; Delios and Henisz, 2003). Soft locational factors comprise, *inter alia*, political and business risk and commercial transparency, the level of education and skills of the workforce, the quality and enforcement of laws and regulations, the level of corruption and the freedom and support concerning research in sensitive areas such as biotechnology and genomes, for example (Andersen, 1997). Location advantages are combined with ownership and internalisation advantages, otherwise the MNE would produce locally through licensing and other contractual agreements.

The third pillar of the eclectic paradigm is the internalisation theory of Buckley and Casson (1976) as described above, which is incorporated by Dunning as I-factors.

The eclectic paradigm is not without criticism. Several gaps and inconsistencies have been identified over the decades. The paradigm has been argued to be just a toolbox to analyse FDI and not a theory in its own right (Dunning, 2006b). It is further criticised as being a static approach which presents a snapshot in time while business reality is dynamic and constantly changing and evolving. The paradigm therefore arguably fails to accommodate properly the consequences of globalisation and ease of communicating internationally for businesses, which may help firms to relocate production abroad (Li, 2003). The concept of ownership advantage is argued to be vaguely defined and too focused on the engineering-related advantages of a firm which are not necessarily reflected in other, perhaps more important, economic advantages a firm needs, such as developing a product tailored for a specific market and generating surplus rents as a consequence (Itaki, 1991). For example, the technical expertise of German firms may lead to over-engineering of products which are subsequently not price-competitive. Moreover,

the concept of three parallel advantages blurs the explanatory power of the framework because of double-counting of ownership advantages under internalisation and firm-specific advantages (Itaki, 1991; Andersen, 1997; Buckley, 1988).

2.2.3 The strategies driving foreign direct investment

Although in reality a particular overseas investment project is likely to be conducted by a firm for pluralistic reasons which may change over time, international business theorising generally recognises three generic motives, namely:

- Market seeking FDI;
- Efficiency seeking FDI; and
- Resource seeking FDI (Dunning, 1993, 2000).

Market seeking FDI is generally driven by the market size, growth and potential of a host country. It is undertaken by companies to strengthen or protect existing markets (defensive strategy) or to develop and explore new markets (offensive strategy). FDI motivated by defensive market seeking objectives tends to follow trade and occurs when a host country imposes or threatens to impose tariff or non-tariff barriers to imports. The response of firms is to invest behind the tariff wall. A defensive market seeking strategy is also said to occur as a firm sets up a foreign affiliate to be close to established customers to serve them better and strengthen their loyalty, particularly when this takes place as firms follow major customers into new markets. Offensive market seeking behaviour is said to take place when firms supply products and services to new markets. Proximity to local and third markets provides advantages in respect to transportation costs, information flow (to and from the market) and product adaptation. By investing locally, the firm also increases its control over brands, distribution channels and other intangible and tangible assets (Dunning, 1993).

Efficiency seeking FDI occurs when outward investors seek lower cost locations for their operations and production in order to reduce production, labour, communication and administrative costs. Hence, firms may centralise production in a key location in response to a reduction in trade barriers across regionally integrating countries. It also refers to investment that is driven by the need to reduce costs involved with the search and implementation of new technologies and designs, and to internalise supply chains to increase competitiveness through higher efficiency.

Resource seeking FDI can be decomposed into three subcomponents: (i) natural resource seeking, (ii) technology seeking, and (iii) strategic asset seeking FDI. The natural resource seeking motive refers to investments in the exploitation of natural factor endowments of countries such as oil, minerals and other raw materials. Such investments are undertaken for commercial purposes or with the intention to secure the supply of scarce raw materials for the national economy, i.e. to fulfil a national economic policy agenda. Technology seeking investments are conducted in areas such as research and development or in design facilities. Firms seek to tap into existing knowledge stocks and expertise locally or to become involved in the development of new technologies and standards when non-participation would diminish future competitiveness. Often, the investor intends to benefit from spill over and demonstration effects deriving from agglomerations of similar minded companies and from complementary industries.

The third resource seeking sub-group is strategic asset seeking FDI which is motivated to acquire tangible and intangible assets, skills and capabilities that cannot be delivered in house in a timely or cost effective way by the investing firm. This include investments to obtain (internationally) recognised brand names, better access to local distribution systems and access to managerial practise and expertise. Typically, firms try to obtain these hard-to-replicate assets through acquisition. While the eclectic paradigm generally assumes that companies would exploit ownership advantages in the host country, the strategic asset seeking motivation gives leeway to allow for asset-augmenting investments. Asset-augmenting ODI occurs when a company lacks critical assets itself that constitute an ownership advantage in a host country – that is, the company is a ‘multinational without advantage’ (Fosfuri and Motta, 1999) – and so invests abroad to access local resources to build and strengthen its ownership advantages.

Table 2.3 summarises some factors that influence the investment strategy. This demonstrates that some factors impact on several investment strategies at the same time and are not clearly distinguishable from each other.

Table 2.3: Factors that influence positively the choice of an international investment strategy

Market seeking	Efficiency seeking	Resource seeking
Large and growing markets in terms of, for example, per capita income ^{1,8}	Factor input costs, e.g. labour, materials, machinery, energy ^{1,2}	Availability, price and quality of natural resources ^{1,8}
Access to adjacent regional and global markets (e.g. EU) ^{1,8}	Membership of a regional economic integration agreement conducive to the establishment of regional corporate networks ⁸	Established (international) brands ³
Availability and price of skilled and professional labour ¹	Freedom to engage in trade in intermediate and final products ¹	Infrastructure to enable resources to be exploited, and products arising from them to be exported ¹
Presence and competitiveness of related firms, e.g. leading industrial suppliers ¹	Presence of agglomeration effects, e.g. export processing zones ¹	Access to different cultures, institutions and systems; and different consumer demands and preferences ¹
Quality of national and local infrastructure, and institutional competence ¹	Opening and liberalisation of markets ¹	Availability of local partners to jointly promote knowledge and/or capital-intensive resource exploitation ¹
Macroeconomic and macro-organisational policies as pursued by host governments ¹	Availability of specialised clusters, e.g. science and industrial parks, and of specialised factor inputs ¹	Local opportunities for upgrading quality of resources and the processing and transportation ¹
Existence of agglomerative spatial economies and local service support facilities ¹	Investment incentives, e.g. tax breaks, accelerated depreciation, grants, subsidised land ¹	Investment incentives, e.g. tax holidays ¹
Growing importance of promotional activities by regional or local development agencies ¹	Lower corporate tax rates than at home ²	Advanced technology to upgrade once ownership advantages is accessible ^{4,5}
Increased need for presence close to users in knowledge-intensive sectors ¹	Cost of input costs, e.g. natural resources and assets, transport and communication costs to/from and within host economy adjusted for productivity for labour resources ⁸	Technological, innovative and other created assets (e.g. brand names), as embodied in individuals, firms and clusters ⁸
Structure of markets ⁸	An entrepreneurial environment which encourages competitiveness enhancing cooperation within and between firms ¹	Access to a local business network is given ⁶
Tariff and non-tariff barriers ¹	Low-cost unskilled and skilled labour ⁸	Quality of local firms and their tangible and intangible asset stock ¹
Access to distribution channels ³		Opportunities offered for exchange of localised tacit knowledge, ideas and interactive learning
Country-specific consumer preferences ⁸		Access to marketing and management skills ⁷ Gaining reputation ⁹

Adapted from: ¹ Dunning (1998); ² Dunning (1980); ³ EIU and CII (2006); ⁴ Dunning *et al.* (1998); ⁵ Dunning (1996); ⁶ Oviatt and McDougall (1994, 2005);

⁷ Makino *et al.* (2002); ⁸ UNCTAD (1998); ⁹ Antkiewicz and Whalley (2006).

2.2.4 'Stages' theory

Based on case study research of four Swedish companies, Johanson and Wiedersheim-Paul (1975) proposed that companies conduct FDI after having gained international experience through less committed and less risky business activities. This proposition has been further developed by Johanson and Vahlne (1977) into the stages theory. This gradual and sequential view of internationalisation is also known as the Uppsala model and the 'internationalisation' approach.

The internationalisation of a company is argued to occur with an inward and an outward orientation (Welch and Luostarinen, 1988). The former is confined to the borders of the home country. The company engages with international business partners through importing, international strategic alliances in the home country and by undertaking original equipment manufacturing for foreign companies, for example. Having an outward orientation requires that the company actively operates across borders. Outward orientated business activities comprise exporting, non-affiliate licensing and FDI.

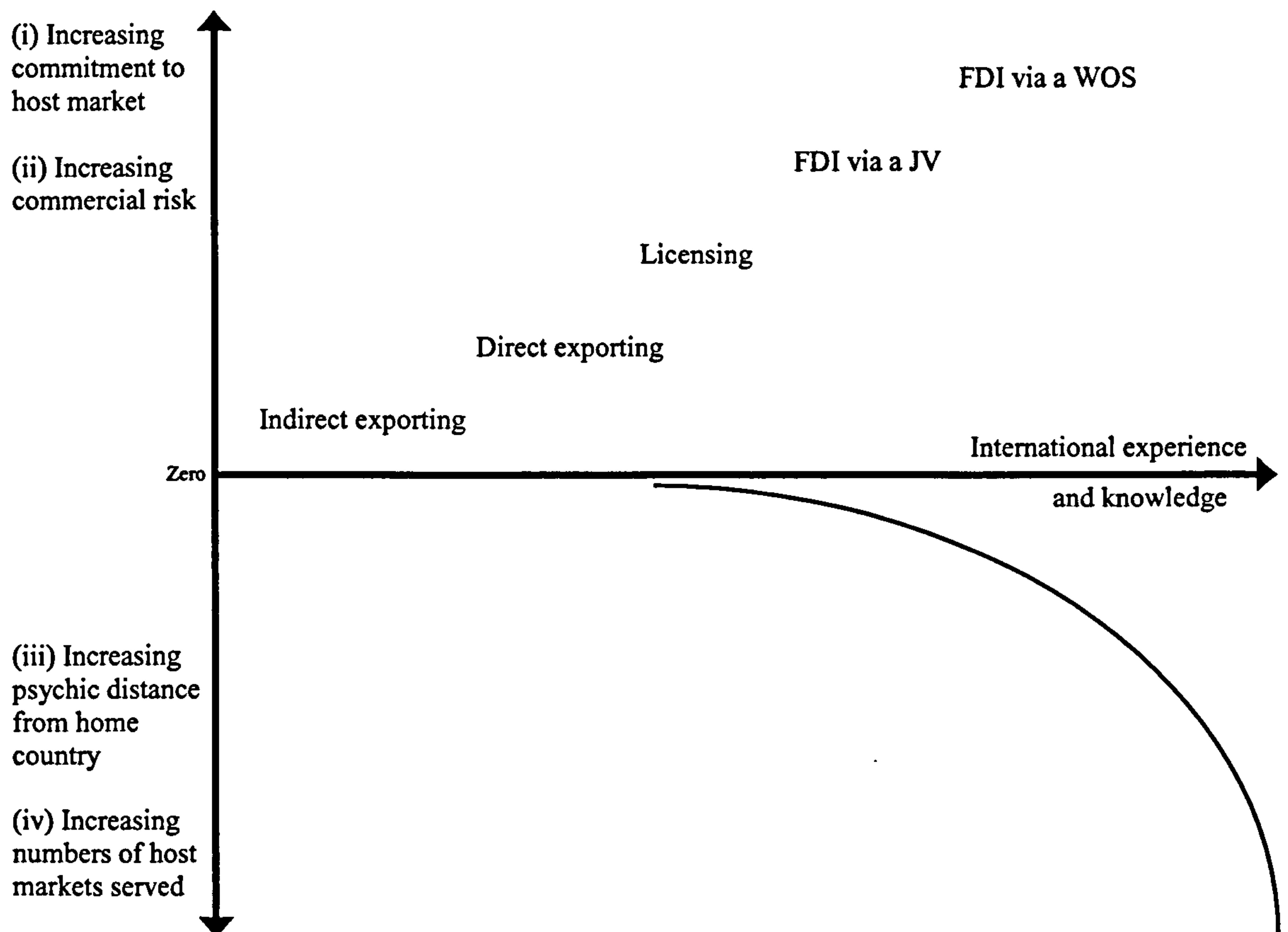
Under this approach, it is assumed that companies new to the internationalisation of their operations lack the experience of internalising markets in a new environment with respect to culture, business (culture), politics and so forth. Although these firms possess ownership advantages they may fail to grasp all the potential merits of an FDI because transaction costs vary in response to geographic and psychic distance. Psychic distance is the difference in culture, language and political and business environment between the home and host country as perceived by managers (Johanson and Wiedersheim-Paul, 1975). The broad definition of psychic distance makes it difficult to measure in a single proxy. Thus, there exists no proxy encapsulating these factors into a single psychic distance measurement but rather a set of different measurements (Dow and Karunaratna, 2006). Having said that, the most commonly used proxies are based on cultural distances between countries (Hofstede, 1980) and indexes or clusters based on Hofstede's work like the cultural distance index (Kogut and Singh, 1988) or the country clusters of similar cultures (Ronen and Shenkar, 1985).⁸

In the Uppsala model, it is argued that firms start slowly and stepwise to internalise international markets, starting with countries closest and most similar to the home country in terms of culture and the political and business environment. With greater international business experience firms feel more capable and prepared to invest in more psychic distant countries and

⁸ With respect to the difficulty of measuring and comparing culture see discussion between Earley (2006), Hofstede (2006) and Javidan *et al.* (2006) and between Hofstede (1996) and Hampden-Turner and Trompenaars (1997).

broaden their foreign market coverage (Johanson and Vahlne, 1977; Johanson and Wiedersheim-Paul, 1975). This incremental internationalisation process enables companies to identify and exploit business opportunities and to successively expand their scope of business into areas in which they were previously not competitive (Chang, 1995; Johanson and Vahlne, 2006). Besides increasing the distance from the home country, the operational scope is also argued to deepen over time. Low resource commitment and limited risk characterise the starting phase of internationalisation through indirect export and later direct export. Resource commitment is increased sequentially as the company concludes international licence agreements, opens representative and sales office abroad and, eventually, sets up production facilities. The sequential stages of internationalisation can be summarised as increasing resource commitment and enhanced risk-taking as a consequence of augmented business experience in increasingly geographical and psychically distant markets. With rising business experience in foreign markets, the firm gathers tacit skills and strengthens its ownership advantages. The two aspects to internationalisation: deepening the commitment in one market (i and ii) and broadening the coverage of foreign markets (iii and iv) are illustrated in Figure 2.3.

Figure 2.1: The Uppsala theory



Notes: WOS: Wholly-owned subsidiary; JV: Joint venture.

Source: The author

However, the psychic distance perceived by managers is not only reduced through direct experience following a direct investment in a foreign country but also through different mediators without the firm being physically present abroad. Mediating factors include, inter alia, being a supplier to an international company in the home country, forming a strategic alliance with an international firm in the home country and by purchasing from international suppliers (Karlsen *et al.*, 2003; Welch and Luostarinen, 1993). Continuous and intensive contact with foreign businesses sensitises the domestic company before it internationalises and provides it with some experiential knowledge about certain foreign companies and business behaviour. The increasing application of the internet as a means for international communication and interaction may have a similar effect. Companies can get into contact with worldwide customers through e-commerce functions which may increase their awareness of customer attitudes and behaviour without being physically present in a foreign market (Yamin and Sinkovics, 2006).

The Uppsala theory has been criticised. The focus of the theory is on a gradual internationalisation of marketing seeking companies without acknowledging that some companies remain at one stage, for example by only exporting to other countries although investing might be more cost efficient, apply different 'stages' simultaneously in different countries, and retreat from internationalisation and divest their foreign equity holdings. These shortcomings question the general applicability of the theory. It also fails to explain the considerable amount of FDI flows driven by resource seeking and efficiency seeking motives (Bell and Young, 1998; Andersen, 1997; Li, 2003). It can be argued that natural resource seeking FDI cannot be explained by the stages theory as the company has to invest where the immobile resources are present. It is also not clear what triggers the initial decision to internationalisation as well as how domestic and international external factors have an impact on the internationalisation process (Andersen, 1993). The model also does not address how the (international) personal experience and network of the management team affects a company (i.e. firms can recruit managers with the relevant international experience) (Johanson and Vahlne, 2003; Welch and Luostarinen, 1988). The above described different facets of international interaction may reduce the perceived psychic distance and internationalisation costs (Eriksson *et al.*, 1997), and help to accelerate the internationalisation of a company through FDI (Nachum and Zaheer, 2005) and enable it to leapfrog certain internationalisation stages, for example by conducting its first investment in a psychic distant country. Such leapfrog can be caused by an overestimation of knowledge about psychically proximate countries which can lead to the (misleading) assumption that business operations in the host country can be carried out in a similar way to the home market. Such behaviour would negate existing business and cultural differences which require adaptation to the local market and consequently would impede

business performance (O'Grady and Lane, 1996). A similar phenomenon can be observed when companies only use e-commerce to internationalise the business, regard locally experienced knowledge about foreign markets as unimportant and thus may not reap the full potential of the market (Yamin and Sinkovics, 2006). Finally, a lack of properly defined conditions and factors such as psychic distance makes it complicated to identify causal linkages between the stages (Andersen, 1993; Child *et al.*, 2003) which makes empirical testing difficult.

The criticism is reflected in ambiguous empirical results of the stages theory. Empirical studies have employed different key variables, research designs, and settings. Consequently, these studies have either confirmed (e.g. Erramilli *et al.*, 1999) or rejected (e.g. Lau, 2003) the theory. A case in point are 'international new ventures' or 'born-globals' which are considered below. Despite these conflicting results and the shortcomings described above, this theoretical approach may have some merits in explaining Chinese ODI. Chapter 3 illustrates that Chinese ODI in the early 1980s was mainly destined to developed countries in terms of investment value which is contrary to the Uppsala theory. The majority of investment projects are, however, found in countries proximate to China which confirms the theory. Chapter 6 and 7 therefore try to answer the question if the Uppsala theory is applicable to explain Chinese ODI.

2.2.5 International new ventures

A group of internationalised enterprises resides outside the realm of the stages theory. In contrast to the stages theory, some companies internationalise very soon after establishment and overcome the problems of psychic distance quickly and without major problems. As the Uppsala theory fails to accommodate this type of firms, a theory on 'international new ventures' has been suggested by Oviatt and McDougall (1994). 'International new ventures', also called 'born-globals' or 'international entrepreneurs', internationalise with, or shortly after, establishment "to derive significant competitive advantage from the use of resources and the sale of outputs in multiple countries" (Oviatt and McDougall, 1994: 49). Such companies gain and strengthen their ownership advantages by grasping perceived business opportunities internationally. Or, as defined by Oviatt and McDougall (2005: 540), "international entrepreneurship is the discovery, enactment, evaluation, and exploitation of opportunities - across national borders- to create future goods and services." Such firms internationalise markets in an early stage of their development and further develop through the experience and knowledge they gain internationally (Zahra *et al.*, 2000; Zahra, 2005). Although the internationalisation process for such firms differs from the one stipulated by Johanson and Vahlne (1977), they might still invest in psychically close countries first before internationalising further. Having said that, of crucial importance is the question of where international new ventures can find

markets that constitute business opportunities rather than considering the dimension and effect of psychic distance (Ibeh *et al.*, 2004).

International new ventures internationalise in a very short timeframe after being established, and are, typically, small-sized and lack a dominant position in their domestic market. Thus, they cannot rely on the size of their company or an established domestic market where they can generate scale economics that constitute an ownership advantage. Rather, the possession of, and access to, (generally) intangible assets provides them with an ownership advantage which facilitates their internationalisation (Oviatt and McDougall, 1994).

The theories on international new ventures and the internationalisation in stages are complementary and can be treated as two ends of a spectrum (Sapienza *et al.*, 2006; Oviatt and Douglas, 1994). The former describes fast moving firms who are risk-takers with high resource commitment. Such firms are knowledge-intensive or knowledge-based firms which seek to quickly exploit their gained ownership advantage internationally and to exploit their monopolistic advantage for as long as possible, since they operate in a fast-moving business environment (Oviatt and Douglas, 2005). The latter describes slow, risk-averse firms which, generally, operate in traditional, slowly advancing and mature industries. One factor which may support the internationalisation of international new ventures is their network embeddedness. This point is developed in the following section.

2.2.6 International entrepreneurial networks – Network theory

Regardless as to whether or not firms invest internationally soon after establishment or after a gradual learning process (see Sections 2.2.4 and 2.2.5), their investment decision-making may be influenced by access to a network. Firms following a ‘gradual’ stages approach to internationalisation and international new ventures can benefit from, and may even accelerate, their internationalisation by accessing international business and social networks (Oviatt and McDougall, 2005; Johanson and Vahlne, 2003). Networks are a “set of high-trust relationships which either directly or indirectly link together everyone in a social group” for the recursive exchange of information (Casson, 1997: 813). Business and social networks are informal institutions which can therefore enable companies to internationalise or foster their internationalisation process as they disseminate information between actors previously unknown to each other and can lower the actors’ transaction costs (Johanson and Vahlne, 2003, 2006; Aharoni, 1999; Standifird and Marshall, 2000). Another perspective is to consider such networks as intangible assets of a company (Coviello, 2006). To date, the importance of networks has been especially stressed for entrepreneurial firms (e.g. Oviatt and McDougall,

2005; Casson, 1997) and for small firms which are part of an international production network (e.g. Chen and Chen, 1998; Chen, 2003). This type of company seeks business opportunities regardless of where there are to be found. Access to a network can be a source of privileged knowledge about business opportunities in potential target countries (Johanson and Vahlne, 2006). A large, sparse network is therefore crucial for them as it will disseminate more information than would a dense network. However, networks can also be of significance to companies with weak ownership advantages; for example, mature companies from developing countries with limited resources and capabilities to rely on to internationalise. The label 'international entrepreneurial network' comprises both business and social networks (Zhang and van den Bulcke, 1996).

Networks can be differentiated using three distinguished characteristics: (a) strong vs. weak ties, (b) the size of the network, and (c) dense vs. sparse network (Oviatt and McDougall, 2005). Both strong and weak ties (that is, linkages and relationships with other actors), share the feature that they constitute two-way flows of information between people (Casson, 1997). Ties are strong when they constitute a durable and reliable relationship built upon emotional investment and trust. Due to the high and constant investment required for such a relationship, these ties are normally small in number and thus not ideal for fostering the internationalisation of companies (Oviatt and McDougall, 2005). But because of the relationship, strong ties are generally easily accessible and responsive to any request (Nebus, 2006). Weak ties are more common. The larger a weakly tied network a company is embedded in is, the more likely it is to receive information about possible international business opportunities as each actor is imbedded in its specific context with access to information non-members lack (Granovetter, 1973, 1983). Relationships with customers and suppliers can be regarded as weak ties based on mutual business interests. Of interest for the internationalisation of a company are linkages to international customers established through, for example, trade relationships or international joint ventures in the home country (Welch and Luostarinen, 1993). Additionally, contacts to representatives of a potential host country resident in the home country are also a significant ties (such as to investment promotion agencies, international chamber of commerce and other economic exchange supporting bodies). A special set of weak ties are indirect ties, that is, ties through a so-called broker (or bridges or middle-man). Brokers connect formerly loose actors with each other and can thus facilitate exchange of information and business interaction (Oviatt and McDougall, 2005; Casson, 1997). Brokers are generally regarded as constituting weak ties, while not every weak tie is automatically a broker (Granovetter, 1973). Brokers can be existing suppliers and customers as well as other social contacts in the home or host country.

There is another set of ties that can neither be clearly categorised as being strong nor weak: these are social ethnic ties. Social ethnic ties derive from some commonalities between individuals, such as same ethnicity or being part of a widely spread family, or a common history or background like studying at the same school or university. These ties are therefore not necessarily business-related. Social ethnic ties across national borders may be regarded as strong since they are social ties and therefore involve high personal investment and commitment. However, loose and brief social contacts to third parties can also be regarded as social ethnic ties although they are weak. Social ethnic ties can stretch internationally through travel and migration as, for example, can be seen in the Chinese, Greece, Indian, Irish, and Mexican linkages to the USA, the presence Overseas Chinese in Asia or the Japanese ties with South America (e.g. Rauch and Trindade, 2002; Liu, 2000; Yoshino, 1974).

The size of the direct and indirect network measured in terms of number of actors or nodes a company is linked with or tied to, may influence the potential internationalisation speed of a company. Generally, with increasing network size, the internationalisation speed accelerates as information about business opportunities are easily exchanged collected and exploited (Oviatt and McDougall, 2005). This is enhanced by the fact that increasing network size goes in hand with increasing linkage weakness as it becomes too resource-intensive for the firm to maintain strong ties with every actor (node) and it becomes progressively more difficult for every actor to be linked to everyone else.

A sparse network describes a network where the ties of one company are not or rarely interlinked with others; it is therefore normally a weak tie network. On the other hand, in a dense network all nodes are tied with every other node. Each type of network has its advantages and shortcomings. Sparse networks provide more information from disperse markets to a company, increasing the likelihood of it finding new business opportunities. Dense networks are characterised by redundant linkages and a higher inherent trust level. Such networks can be regarded as clubs based on trust and reputation. Information about misbehaviour is disseminated within the network and the specific actor warned or excluded. This form of supervision and control is lacking in a sparse network (Oviatt and McDougall, 2005).

Companies that use actors and brokers in their network to internationalise do not necessarily invest in a psychically close location. Rather, they follow business opportunities either identified by themselves or suggested by their network wherever they become visible. The building and utilisation of networks differs from country to country and is shaped by the country specific institutional arrangements which sheds especial importance on cross-cultural networking (Parkhe *et al.*, 2006). The influential sphere of institutions extends to other

(business) areas as well and makes it pertinent to incorporate it in a theoretical framework on Chinese ODI. It has been alluded to the wide-spread Overseas Chinese community which helped the Chinese economy to re-integrate to the world economy after 1979 (Chapter 1). Such Overseas Chinese networks constitute informal institutions which may also facilitate the internationalisation of Chinese firms.

It is argued that the unit of analysis in discussion of this type should be the network itself (Lavie, 2006). However, the scope of this research necessitates deviating from this view as it is restricted to the utilisation of network connections to gain information about markets, business opportunities and, ultimately, the foreign direct investment by Chinese companies.⁹

2.2.7 Institutions and internationalisation

The theories and frameworks reviewed so far, consider the institution environment as being one factor of influence on the decision-taking of firms. The degree of relevance attributed to institutions varies, however. The institutional framework considered by this work is more often than not limited to the host country or region (e.g. Dunning, 2000). The institutional environment of the home country is typically left aside. The term 'institution' comprises a wide range of elements including customs and beliefs, religious and other norms, judiciary and bureaucracy, government structures and market mechanisms (North, 2005; Williamson, 2000). The eclectic paradigm explicitly refers to the host country with the idea of locational advantages. The concept of psychic distance in the stages theory acknowledges implicitly home and host country institutions by considering the perceived "distance" between them. Network theory refers to institutions indirectly by asserting that networks can be used to lower transaction costs in an unfavourable environment. Probably the most explicit consideration of the role of institutions in international business is made by the internalisation theory. The exploitation of market imperfections across borders necessitates some actions by institutions to create the market imperfections in the first place. This somewhat arbitrary acknowledgement of home country institutions in international business validates a review of institutions and the proposition of stronger consideration in research on developing country ODI in particular. Developing countries have typically a restrictive institutional environment towards ODI in order to minimise the outflow of capital. ODI is often perceived by the local government as detrimental to the economic development of the country (UNCTAD, 1996).

⁹ The network approach in this research does not attempt to model an extensive mathematical network analysis assessing the effects of ties, nodes and black holes (e.g. Wasserman and Faust, 1994). First, data availability limits the feasibility of this approach for Chinese MNEs currently. Second, the network approach is utilised in an informative way to support the research only.

The internationalisation of companies is not only triggered by their aspiration to internalise imperfect markets across borders but it is also influenced by the domestic and host country institutional framework. The host country's institutional setting has been incorporated in the eclectic paradigm as a locational factor (e.g. Dunning, 1988). It has been scrutinised and tested for host countries (e.g. Meyer, 2004), as well as for the impact on investing firms (e.g. Delios and Henisz, 2003a, 2003b). Moreover, the impact of the domestic institutional framework has been acknowledged in research in terms of push-factors triggering the internationalisation of companies (such as foreign exchange fluctuation and restrictive industry policy and in terms of promotion activities [e.g. Duran and Ubeda, 2001; Bulatov, 2001; Sim and Pandian, 2002; Lall, 1986; Pradhan, 2004]). However, institutional theory has not been formally incorporated into theories such as the eclectic paradigm, stages theory or network analysis (Parkhe *et al.*, 2006; Grosse and Behrman, 1992). This is an important omission. Institutions provide the formal and informal economic playing field for companies and they determine the incentive mechanisms and schemes deriving from this (North, 1990; Peng, 2002; Wright *et al.*, 2005). The institutional setting of a country thus determines greatly the pace and scope of the domestic economic development due to the constraints and resources it provides and the herefrom evolving path dependencies (North, 1990, 2005). The institutions of interest and relevance here are the government and its adjacent structures, namely legislature, judiciary and bureaucracy. Although these are formal institutions, their sphere of action may reach into informal areas when laws and regulations are interpreted and applied in a discretionary way. The influence of the institutional framework is not restricted to the domestic realm but can also play a crucial role (both positively and negatively) in the internationalisation of domestic companies, as discussed below. More specifically, the behaviour and decisions of domestic institutions may lead to domestic market imperfections which are then exploited by inward investing MNEs or constrain the evolution of domestic firms which could be competitive internationally.

2.2.7.1 Institutions governing international economic activity

Take, for example, a closed, state-controlled economy, in which state-owned enterprises are key economic actors as an institutional setting. Such a setting not only discourages companies from internationalising but may effectively prohibit it. This is because such a state may implement various means to control the agglomeration and utilisation of foreign exchange which could be used to internationalise (for example, balance of payments controls). The control mechanisms are directed against the international economic engagement of domestic enterprises. Such policies lead to strict control of the national capital account to prevent foreign exchange from being transferred abroad, the discretionary selection of state-owned companies to engage in international trade and the requirement to go through a rigorous approval process if a state-owned company wants to invest internationally. The stimulation of exports through an

(artificially) undervalued currency, subsidies and other preferential treatment that aims to establish export-led growth can be a further discouragement for ODI as it may become more costly to internalise across borders. This institutional framework restricts companies from conducting FDI even if they see an opportunity or are willing to face the risks involved with international business activities and possess ownership advantages to run successfully an international affiliate. As a consequence, domestic enterprises are hampered in strengthening and upgrading their knowledge and technology stock and, subsequently, their competitive position in the domestic and international market is undermined (e.g. Dunning *et al.*, 1998; Young *et al.*, 1996; Ozawa, 1992). So long as the economy remains tightly state-controlled such policies are accomplishable; leaving aside the merits of such a policy.

If this is one side of the institutional spectrum concerning the 'support' of domestic company internationalisation, an open, market-led economy with private enterprises being the dominate actors is at the other end of the spectrum. Such an economy has liberalised its capital account controls and foreign exchange utilisation restrictions, and the decision to invest internationally rests solely in the hands of the domestic companies without government interference. Government rather tries to support domestic companies by establishing a (positive) framework constituting of, for example, subsidies for ODI and other preferential treatments such as domestic tax concessions and cheap access to capital. In such an institutional framework, domestic companies are able to take the chance to internalise international markets when they identify an opportunity and possess the relevant ownership advantages to carry out the investment (as predicted by the eclectic paradigm). This development might be further supported by protective measure towards infant or pillar industries as identified by the government and its agencies. Obviously, there is a wide range of institutional arrangements between these two poles which influences domestic companies to varying degrees. Policies with potential direct effects on ODI are summarised in Table 2.4.

Table 2.4: Direct effects of government policies on ODI

		Market imperfections	
		Increase	Decrease
ODI	Increase	<ul style="list-style-type: none"> • Overvalued currency¹ • Subsidies for ODI¹ • Export controls¹ • Price controls¹ • Government protectionism² • Particularistic economic goals³ 	<ul style="list-style-type: none"> • Liberalisation of capital controls on ODI¹
	Decrease	<ul style="list-style-type: none"> • Undervalued currency¹ • Wage controls¹ • Export subsidies¹ • Restrictive ODI approval processes 	<ul style="list-style-type: none"> • Privatisation of SOEs¹ • Vigorous enforcement of arm's length transfer pricing¹ • Lack of support from government⁴

Adapted from: Brewer (1993).

Sources: ¹ Brewer (1993), ² Dicken (2003) and Hennan and Keegan (1979), ³ Warner *et al.* (2004), ⁴ Villela (1983).

2.2.7.2 Institutions governing home country conditions

There are also institutional influences which indirectly effect the internationalisation of companies. These include further push-factors such as domestic protectionism, industry and capital market imperfections. Domestic protectionism is normally enforced by local political entities to protect (or nurture) local companies. However justified such policies might be, they constrain the business and growth opportunities of non-local companies. Similarly, an unbalanced industry policy and credit allocation may impede the development of competitive local firms. An industry policy in favour of selected industrial sectors may neglect and oversee potentially important developments in other industry sectors. The lack of support and recognition can hamper the domestic development of companies in such a sector. Equally, a government-induced credit allocation that focuses on specific industry sectors, on company size or on ownership forms is not beneficial for the overall economic development as it impedes the growth of potential companies (Boyreau-Debray and Wei, 2005). Companies outside the credit allocation scheme have to explore new funding sources, such as their personal funding and social (international) networks (Buckley *et al.*, 2007a). In such cases, companies might seek to invest abroad to ensure sound growth and to keep up with developments in their specific industry. Some evidence for such policy behaviour can be found in China, for example. Credit allocation in China is argued to be biased towards state-owned enterprises for most of the time since 1978 (Lardy, 1998) and the Chinese government has initiated different scheme to bolster the development of large, competitive domestic enterprises (Nolan, 2002; Naughton, 2007). These factors could have been beneficial for the development in China, while the provincial

market protection has somewhat impeded the creation of nation-wide enterprises until the mid-1990s at least (OECD, 2002).

2.2.8 Specific theoretical considerations for foreign direct investment from developing countries

As outlined in the beginning of this chapter (see Section 2.1), FDI flows and the number and size of MNEs originating from developing countries have reached considerable proportions. It is generally acknowledged today that MNEs from developing countries are driven by the same generic investment strategies as their counterparts from industrialised countries. Nevertheless, adjustments and extension of FDI theory and on the behaviour of MNEs from these countries may be necessary to account for country specificities (UNCTAD, 2006; Buckley and Mirza, 1999; Yeung, 1994a; Pradhan, 2004). This is because, extensions and amendments of common theory to accommodate the specific conditions of the MNEs from developing countries may increase the explanatory power for this new breed of MNEs (Child and Rodrigues, 2005; Yeung, 1994a; Giddy and Young, 1982). The reasoning for this is based on the notion that ownership advantages of developing country MNEs and their motivations to invest abroad may deviate from the patterns known for industrialised country MNEs. This point is now developed below in the context of the key contributions to international business theory previously described in this chapter.

Eclectic paradigm

Monopolistic advantages through state-of-the-art technology, intangible assets and firm size are generally less in evidence for developing country MNEs when compared with industrialised country ones. When these advantages are present they are normally smaller as these firms are less research-intensive (Lall, 1983a). These firms therefore have to secure their ownership advantages differently. Such advantages may derive from the adaptation of purchased, imported or licensed technologies to local conditions (i.e. factor prices, input characteristics and demand conditions). This experience can then be extended to host countries with similar market conditions to their home country (Lall, 1983a; Monkiewicz, 1986; Lecraw, 1977, 1993; Kumar and Kim, 1984). Hence, such firms are argued to compete on low-quality and low-priced products (Lecraw, 1993) and focus on labour-extensive production because of abundant cheap labour in the domestic market (Ghymn, 1980). This means that the home country experience may constitute a key source of competitive advantage for these firms. It is argued that a firm is sensitised by the institutional and business environment it confronts at home which helps it to better and more quickly adapt to the specific needs of a host country with respect to matters such as the necessary R&D efforts and spending, labour-intensity of production, marketing and

sales strategies and so forth (Lecraw, 1977; Kumar, 1982; Lall, 1983a; Monkiewicz, 1986). This sensitivity may also explain investments by developing country firms in host countries deemed too risky and unstable by MNEs from an industrialised country. Hence, the identified firm-specific advantages increase the likelihood of South-South ODI; that is, investments by MNEs from one developing country into another, instead of ODI in an industrialised country.

Nevertheless, developing country ODI in an advanced country may still occur. The investment strategy into advanced countries is argued to be in line with a point made earlier: that MNEs from developing countries are generally considered to lack ownership advantages in comparison to industrialised country MNEs (Bartlett and Ghosal, 2000; Dunning *et al.*, 1998; Dunning, 2001; Makino *et al.*, 2002). Recent research therefore posits that the lack of ownership advantages may push developing country MNEs to invest in more developed countries in order to obtain knowledge and built-up a competitive advantage (e.g. Bartlett and Ghosal, 2000). This can be considered asset-seeking FDI. It has thus been argued that developing country MNEs invest in developed countries to extend or built-up firm-specific advantages which they combine with the advantages mentioned above and exploit then other developing countries (Erramilli *et al.*, 1999). Indonesian companies, for example, are argued to acquire companies in industrialised countries to access knowledge, technology and expertise and, also, to use the foreign affiliate to expand the export operations from Indonesia (Lecraw, 1993). Other investments in industrialised countries are asserted to support domestic exports to these countries and tend to be rather service- than manufacturing-oriented (Kumar, 1982). Resource seeking investments may be undertaken by developing country firms in industrialised countries as well depending of the global distribution of the resources and the ease to access such resources in a host country.

The location (L) element of the eclectic paradigm is constrained to the host country and does not account for the domestic institutional framework of an MNE. This might have been justified in times where the home country institutional backgrounds of MNEs were fairly homogenous, i.e. all being well-developed, transparent market economies with a democratic, pluralistic system and relatively similar cultural backgrounds. It has been shown in Section 2.1, however, that since the mid-1990s companies from developing countries are increasingly investing overseas. These firms differ substantially in respect of their home country institutional frameworks from industrialised country firms and amongst each other. This phenomenon necessitates considering the accommodation into FDI theory of domestic locational factors, in particular domestic institutions, and an assessment of how these influence ODI behaviour of local companies. This may help to explain ODI by developing country MNEs because, as previous research suggests (e.g. Dunning *et al.*, 1998) companies from developing countries internationalise despite a lack

of tangible ownership advantages vis-à-vis their industrialised country counterparts. In fact, besides asset specific advantages, O_i and O_t and access to resources are of importance as well. Hence, conducting FDI *because* of a perceived lack of ownership advantages and the aspiration to catch-up can be a major investment motive for developing country firms.

Uppsala approach

MNEs from developing countries are argued to generally follow the stages theory by investing first in countries psychically close to the home country (e.g. Giddy and Young, 1982; Yoshino, 1974). Examples can be found in research on firms from Argentina (Ferrantino, 1992), Brazil (Villela, 1983), Hong Kong (Lau, 1992, 2003), India (Pradhan, 2003; Lall, 1983b), Republic of Korea (Erramilli *et al.*, 1999; Kumar and Kim, 1984), and Malaysia (Zin, 1999). To further attenuate investment risk, developing country MNEs [in the 1970s and 1980s] were found to often hold a minority stake in joint ventures with local firms (Yeung, 1994b; Lecraw, 1977, 1993; Tallman and Shenkar, 1990; Pradhan, 2004). The minority-stake phenomenon seems to disappear successively as developing country companies gain international experience, skills and funds which makes it more feasible for them to establish majority owned and wholly-owned affiliates (Pradhan, 2003, 2004; Lee, 2002; Lecraw, 1993). An exception seems to be South Korean MNEs, which have generally relied on majority owned affiliates from an early stage of internationalisation (see O'Brien, 1980).

Institutional environment

The institutional environment of developing countries has been taken into consideration by the body of literature to describe the development of developing country ODI. Domestic institutions affect the internationalisation of domestic companies four ways. First, as described above, familiarity with the institutional environment of the home country may give MNEs an advantage over other (industrialised country) firms when they invest in a host market with similar characteristics. Second, firms may suffer from unfavourable business development conditions at home which pushes the companies abroad. Commonly mentioned institution-related push factors include an unstable or unpredictable monetary, fiscal and judicial policy, domestic political risk (e.g. Bulatov, 2002; Villela, 1983), and the difficulty of earning hard currency through means other than ODI (Buckley and Mirza, 1999), for example. Third, and in contrast to the second point, home governments may encourage domestic companies to internationalise and change the institutional framework accordingly. This may happen for different reasons. Some governments may seek to create MNEs to help to achieve national economic development goals or foreign policy objectives. MNEs created for these purposes often seek to secure raw materials abroad or be an executor of foreign policy directives which may, be designed to support official development aid, for example (Mazzolini, 1980; Warner *et*

al., 2004). In this respect, governments may encourage domestic companies to invest in a particular host country for a specific purpose (World Bank, 2006b). Consequently, government-controlled or government-owned firms might place less attention to host country risk level and psychic distance considerations because it fulfils national policies and is thus supported by the government (financially and politically). This also raises issues around the (necessary) size of the company and the (necessary) stage of economic development of the home economy as well as issues concerning the firm's position in an (international) value chain and industry and firm-specific characteristics (Bell and Young, 1998; Lee and Chen, 2003). Cases in point are the Asian MNEs. The Chinese government undertakes activities to encourage ODI in raw material exploration to meet growing demand at home (e.g. Dhume and Lawrence, 2002). Similarly, the Singaporean, South Korean and Malayan governments have built their MNEs (Yeung, 1998; Dicken, 2003; Hennan and Keegan, 1979).

This review of developing country MNE context shows that common international business theory is applicable to this type of firm. However, it also shows that some refinement is necessary to the general theory because a stronger acknowledgement of the home country institution effects is arguably required.

2.2.9 Further theories on foreign direct investment

A number of other theories have been put forward to explain the *raison d'être* of the MNE. These theories are considered to be outside the scope of the present study for a number of reasons. The theories are mentioned here briefly for completeness.

The investment development path (e.g. Dunning and Narula, 1996; Duran and Ubeda, 2001) has some merits if it can be applied to the provincial or sub-provincial level and by industry. Country level analysis does not reveal much about the destination of ODI and the theory does not account for intra-/inter-industry agglomeration effects and location specificities (e.g. institutional fabric). The product-life cycle theory by Vernon (1966) assumes maturing products in a mature market – China is a developing country market with hardly mature markets. Aliber (1971) considered foreign exchange differentials as a determinant of FDI. This approach lacks explanatory power as a stand-alone theory especially as the Chinese Yuan is pegged to the US dollar. It is used here as general support to theories. Knickerbocker (1973) suggested that FDI is a reaction to oligopolistic pressure. Following this approach, oligopolies in the Chinese market or the international market push Chinese companies to conduct ODI. Again, this approach lacks explanatory power as a stand-alone theory.

2.3 Empirical studies on foreign direct investment determinants

Having set out the theoretical background for FDI with emphasis on the applicability to developing country ODI, the purpose of this section is to provide a rationale for the inclusion of particular independent variables that are used in this study to test the model of Chinese ODI which has been developed. To the best of our knowledge, the empirical investigation of Chinese ODI patterns has not been analysed in this way before. Therefore, justification for the inclusion of particular independent variables in the equations has to be based on their use in studies that model FDI that originate from other countries. Where possible, research that concentrates on ODI from developing countries is discussed separately. This is now done below.

Market-seeking FDI

In econometric work market seeking FDI is generally found to be strongly induced by the absolute current market size (Gross Domestic Product or GDP), relative current market size (Gross Domestic Product per capita or GDP per capita) and future market potential, as is reflected in the current and past growth of annual GDP (Agarwal, 1980). Theory predicts that these market-related determinants have a positive effect on inward FDI from industrialised countries and this is supported by several studies. For example, Clegg and Scott-Green (1998) find a positive association between Japanese investment and GDP for six EU countries. A number of studies of the ODI position of the USA find a positive correlation between its (flows or stocks) and host country market size of a number of developed and developing countries in the 1970s (Loree and Guisinger, 1995), of Mexico in the 1990s (Love and Lage-Hidalgo, 2000) and of European countries (Lunn, 1980, 1983), so do the studies by Scaperlanda and Balough (1983), and Scaperlanda and Mauer (1969, 1972). In a more recent study, Sethi *et al.* (2003) find that US FDI is generally directed towards countries with high gross national product (GNP) but that it shifts to lower GNP and GNP per capita countries over time. These findings on developed country ODI are generally confirmed by studies focusing on ODI from developing countries. With respect to developing country ODI, Erramilli *et al.* (1999) find that South Korean ODI was directed to relatively wealthier, higher-income countries in the 1980s but shifted to lower-income countries around the year 1990. Rammal and Zurbruegg (2006) tested the importance of the host country's GDP per capita and annual GDP growth as a driver of intra-ASEAN ODI. They found that, while a host country's GDP per capita is a determinant for FDI from Thailand, the future market potential (measured as GDP growth rate) is significant and positive for ODI from Indonesia, Malaysia, Singapore and Thailand but not for that from the Philippines.

There is, however, a large body of empirical work in which a positive correlation between FDI inflows and market size is not found. For example, Clegg and Scott-Green (1998) find that Japanese ODI into the EU-9 is negatively associated with host country GDP. Similarly, Culem (1988) and Goldberger (1972) cannot find any significant association between inflows and market size for US investment into Europe. Loree and Guisinger (1995) find no significant association between US ODI and host country GDP per capita for the year 1982 while Clegg and Scott-Green (1998) do not find a significance effect for GDP growth.

The mixed results for market size leave it unclear when and why one of the market-related variables provides stronger explanatory power than the others (Chakrabarti, 2001).

Natural resource-seeking

A number of studies examine the effect of natural resource endowments of a country on levels of inbound FDI. These studies use four different measurements to proxy natural resource-seeking investments. The varying results of the natural resource variable as a determinant of inbound FDI may be a result of the employment of different proxies.

Asiedu (2006) uses the share of fuel and minerals in total exports (%) as a proxy for natural resources. Her results show that FDI as percentage of GDP is positively associated with a larger share of fuel and minerals exports. A proxy with a similar industry focus is employed by Onyeiwu and Shrestha (2004). They measure natural resources in fuel exports as a percentage of total exports. Similarly Johnson (2006) employs a dummy variable for oil abundance and additionally measures natural resources endowment in the form of production of crude oil in thousand barrels per day. The study by Onyeiwu and Shrestha (2004) supports the findings of Asiedu (2006) for a different set of African countries (that is resources endowments have a positive effect on inbound FDI flows) while Johnson (2006) reports mixed results. Johnson finds a negative effect of oil production on inward FDI to Central and Eastern European countries when tested with a set of traditional FDI determinants but no significance when a set of transition-specific variables are included in the model. However, he does find a positive effect on oil abundance for Commonwealth of Independent States (CIS).¹⁰ Energy resource abundance has been employed by Campos and Kinoshita (2003) as a dummy variable based on country characteristics defined by De Melo *et al.* (1997). Campos and Kinoshita (2003) find that abundant natural resource endowment is positively associated with FDI to CIS countries.

¹⁰ It should be noted that Johnson (2006) uses a dummy to proxy oil and gas abundance. The four CIS countries Azerbaijan, Kazakhstan, Russia and Turkmenistan score one and the remaining twenty one countries score zero.

However, the coefficient they report is not significant for the less well resource endowed Eastern Europe and Baltic host countries. For developing countries, Chen (1992) finds that larger, raw-material dependent Taiwanese firms demonstrate more of a propensity to invest abroad than do small resources dependent and small and large resource independent firms.

The problem with the proxies used in this research is that they focus very much on one industry sector and are thus very much country, region or industry specific. The problem of using single proxies becomes especially evident when analysing FDI inflows to a larger set of countries that do not have the same set of natural endowments. Two conflicting trends may be observed. First, the importance of natural resource-seeking investment to total FDI may not be captured because of the minor importance of the resources proxied in the majority of countries. Second, the importance of natural resource seeking FDI may be overstated in some years and for some countries as such investments tends to be smaller in numbers, large scale, capital-intensive projects (that is, low in number but high in value). These investments may therefore overshadow other investments, especially in other natural-resources, in particular years in time series data.

Strategic asset seeking-investment

FDI in R&D is argued to be an efficient way to source knowledge in a host country. Besides the typical behaviour of adapting products to local market needs, such investment might also indicate capability-augmenting FDI (Kuemmerle, 1999; Iwasa and Odagiri, 2004). Empirical studies on strategic asset seeking-investments that use R&D related proxies provide mixed evidence. Love (2003) analyses USA investments in major industrialised countries and reverse investments. While he finds a positive relationship between R&D intensity and US ODI, he finds no such relationship or a negative one for inward FDI to the USA. Similarly, he finds a zero or a negative effect on FDI flows for R&D-intensity differences between host and home country. Anand and Delios (2002) use a R&D intensity difference variable and find that it is generally positively associated with FDI from Germany, Japan and the United Kingdom to the USA. Splitting the sample into sub-samples, they find that asset-augmenting FDI is attracted by total R&D in the host country, but that this variable is not significant for asset-exploiting investment. Love (2003) tests whether asset-seeking or asset-exploiting motives drive FDI between the USA and major OECD countries and employs a model using relative technological advantages. He finds that inward FDI to the USA is mainly in R&D intensive industries, as firms seek to exploit domestic technological capabilities. He also finds that the technology exploitation motive is also significant for US ODI (Love, 2003). A different way to measure

knowledge sourcing FDI is purported by Griliches (1990) and further provided by Al-Laham and Amburgey (2005), Iwasa and Odagiri (2004) and Sun *et al.* (2002). They assert that the number of patents applied for or granted in a host country is a proxy for the stock of local knowledge that promotes strategic asset seeking FDI. A higher number of granted patents indicates a stronger research and knowledge base in the host country which the investing firm may then seek to tap into or acquire through spillover, demonstration and other effects. This notion is supported by Cantwell *et al.* (2004) who state that patent activities are a good indicator of technological activity and the technology base in the host country. Al-Laham and Amburgey (2005) use the number of patents granted to U.S. American biotechnology firms as a determinant for foreign equity investment in such companies. However, they find no significance for this variable. Co and List (2004) examine the impact of granted patent in a specific geographic area in the USA on new inward FDI inflows and find a positive relationship. Filippaios *et al.* (2003) suggest that US American ODI is triggered by the number of patent applications made in the target country. However, this variable was dropped from their final estimation without explanation.

In the context of developing country ODI, Pradhan (2004) identifies the extent of in-house R&D to be an important driver of Indian ODI. This finding contrasts with the general assumption that developing country firms lack ownership advantages but rather indicates that some Indian firms have developed firm-specific advantages. Makino *et al.* (2002) investigate FDI by Taiwanese firms, and find that they tend to invest in developed countries for asset-augmenting reasons.

Efficiency-seeking

As explained in Section 2.2.3, efficiency investments are generally undertaken by firms to decrease overall business costs. Empirical studies generally proxy business costs via a wage variable on the basis that (relatively) lower wages is a determinant of FDI (home/host country wage differentials). This is generally supported (Agarwal, 1980). While Love and Lage-Hidalgo (2000) find support for the proposition, Loree and Guisinger (1995) find no significant association between host country wage rates and FDI.

Foreign exchange

Exchange rate differentials between home and host country currencies are general assumed to affect FDI. This is because an overvalued home country currency encourages ODI by lowering the relative cost of buying foreign assets while an undervalued host country currency encourages inward FDI by reducing the relative costs of domestic assets. Thus, a home country

facing an appreciation of its currency should observe an increase in ODI and decrease in inward FDI while a host country experiencing a depreciation of its currency should experience the converse (Froot and Stein, 1991; Cushman, 1985; Agarwal, 1980; Kohlhagen, 1977; Love and Lage-Hidalgo, 2000). Exchange rate effects have been tested using bilateral exchange rate levels and exchange rate volatility (Blonigen, 2005). A number of studies confirm the determinant effects of the foreign exchange rate on FDI (e.g. Chang, 1995; Clegg and Scott-Green, 1998). However, Agarwal (1980) finds no such relationship while Blonigen (2005), for example, finds that some studies report contradicting effects using the same data. The research is briefly reviewed below.

Chang (1995) shows that Japanese ODI to the USA has been driven by the appreciation of the Japanese Yen against the US dollar. Clegg and Scott-Green (1998) find support that the real effective exchange rate (REER) between home and host country currencies positively affects FDI but that a change in the REER has a negative effect. Differences in results may be due to the difficulty of measuring REER accurately (Chinn, 2005, 2002). Cushman (1985) finds some positive effects of host country currency depreciation on inward FDI – though, not for all of his models. With regards to exchange rate expectations Cushman (1985) also finds a strong negative association between host country's currency appreciation and inward FDI.

A number of studies have examined the effects of exchange rate differences on Asian ODI. For example, Chen *et al.* (2006) find that market seeking motivated Taiwanese firm investment is positively associated with changes in the host country's foreign exchange (relative to Taiwan) and level of foreign exchange. FDI by efficiency-seeking firms is negatively associated with these factors, however. Bae and Hwang (1997) also find mixed results for Korean ODI, which they find is driven by an appreciation of the Korean Won relative to the US dollar and a depreciation relative to the Japanese Yen. The former is explained by the decreasing export competitiveness while the latter is argued to occur as Korean companies seek to secure access to Japanese technology which becomes too costly to import.

Trade

Trade-related factors may affect FDI in three distinctive ways. First, trade is often a precursor of FDI (Buckley and Casson, 1981). A company serves a foreign market through exports until the foreign market is sufficiently large and FDI becomes more cost-effective than supplying the market from a distance. Second, barriers to trade may encourage companies to invest and produce locally in order to circumvent the market entry barrier (that is tariff jumping FDI) (Blonigen, 2005; Buckley and Casson, 1981). Trade-barrier variables have been employed

widely in research on FDI determinants and are mainly found to effect FDI positively (e.g. Bajo-Rubio and Sosvilla-Rivero, 1994; Clegg and Scott-Green, 1998; Culem, 1988; Love, 2003; Lunn, 1983; Wezel, 2003). Blonigen (2005) argues that tariff-barriers differ across industries and are therefore difficult to measure. He argues that anti-dumping measures are a better proxy for trade barriers and a better indicator for trade barrier induced FDI from developed countries. Third, in order to reduce supplier uncertainty, companies may integrate backward up the supply chain (Buckley, 1988).

For these reasons, a number of studies on FDI determinants have included a measure or measures of trade intensity. A positive relationship between total home country exports and ODI is generally found for Asian developing country ODI. For example, Bae and Hwang (1997) find that South Korean FDI is associated with host countries with which South Korea has a greater trade balance, while Kimura and Lee (1998) find that South Korean FDI is positively associated with Korean exports to Asia, Europe and the world in total but not with exports to North America. Lim and Moon (2001) find partial support for Kimura and Lee's study (1998) but positive effects on Korean ODI are only found for developing countries and mature industries. Lim and Moon (2001) find that this effect decreases over time. For Taiwanese firms, Chen (1992) finds a positive association between ODI and the export-ratio of Taiwan. Ferrantino (1992) finds positive correlations for India and Argentina. Seo and Suh (2006) find that South Korean FDI to ASEAN-4 countries, i.e. Indonesia, Malaysia, Philippines and Thailand, is rather export-creating than substituting and tends to be export platform investments for exporting to third countries. However, some of their findings lack statistical significance. Finally, Kwon (2002) shows that horizontal FDI by South Korean firms is more sensitive to trade-barriers than is vertical FDI.

Geographic distance

Geographic distance between home and host country is likely to affect the internationalisation of firms because it moderates transport and communication costs, among other things. However, studies on the relationship between geographical distance and FDI yield ambiguous findings. On the one hand, the incentive to substitute FDI for export increases with geographical distance (Buckley and Casson, 1976). However, Grosse and Trevino (1996) propose that access to market information becomes more burdensome and expensive with increasing geographic distance and this favours exports to FDI. Using distance between the home country's capital to the closest US city, Grosse and Trevino (1996) find the geographic distance is negatively associated with levels of inward FDI to the USA; with the notable exception of FDI from Japan. Terpstra and Yu (1988) employ the same proxy but find no significant effect on the investment

activities of US advertising firms. The negative finding of Grosse and Trevino (1996) is supported by Buch *et al.* (2005) for German FDI and Ferrantino (1992) for Argentinean and Indian FDI which they find to decrease with increasing distance from the home country. Ferrantino (1992) measures geographic distance as shipping distance and finds it to be negatively correlated with ODI. This indicates that firms from Argentina and India tend to invest in nearby countries. Geographic distance is not only used as a supplementary measurement with trade in extant studies but also to analyse FDI sequences. For example, Erramilli *et al.* (1999) find that early South Korean FDI was directed to proximate countries later FDI to more distant countries. Arguably, this supports the Uppsala theory of incrementally expanding the geographical scope for South Korean firms investigated.

Openness

Along with trade and inward FDI, the openness of a country to international business is often taken as a proxy in studies of FDI determinants for attractiveness to foreign companies. Openness is measured in different ways and empirical work therefore reveals mixed results. For example, Yeaple (2003) in his study employs a dummy for inward FDI openness calculated from the World Competitiveness Report with no significant result while Billington (1999) in a study of FDI to the United Kingdom calculates openness to trade based on tax revenue figures. In his survey, Chakrabarti (2001) reports that other studies have reported both positive and insignificant effects of openness on FDI citing Kravis and Lipsey (1982), Culem (1988), Edwards (1990) and Pistorresi (2000) as supportive studies and Schmitz and Bieri (1972) and Wheeler and Mody (1992) with insignificant findings.

Host country risk

As was argued in section 2.2, the institutional setting of a host country is an important determinant in the investment decision of a firm (Delios and Henisz, 2003a). The institutional setting impacts on a range of variables ranging from political and business risk to the enforcement of laws, corruption and bureaucratic predictability. Delios and Henisz (2003a, 2003b) analyse the impact of host country policy uncertainty on the market entry form and sequence for Japanese firms. They find that host country policy uncertainty negatively effects the entry of Japanese firms, while less Japanese companies will invest in such an environment and the companies which do invest tend to choose the less risky and committing entry form.

A widely used measurement for country risk – comprising business and political risk – is the International Country Risk Guide (ICRG) composite index. A number of other proxies used in

empirical investigations of FDI determinants are, for example, Business Environmental Risk Intelligence (employed by Gaba *et al.*, 2002 and Globerman and Shapiro, 2003), Freedom House (used in the work of Dow and Karunaratna, 2006; Pourmarakis and Varsakelis, 2004), and Transparency International (used by Habib and Zurawicki, 2002; Voyer and Beamish, 2004; Robertson and Watson, 2004, for example). While Blonigen (2005) agrees that institutions are important determinants, he questions the reliability of the available indices because they are often based on subjective expert opinion. Biswas (2002) employs the ICRG and finds a positive association between increased FDI levels and lower host country risk. A study by Bénassy-Quéré *et al.* (2007), using different country indices and a proxy for host country institution, reveals that good institutions and low risk are important determinants of inbound FDI.

Although the propensity of developing country MNEs to invest for risk diversification and minimisation reasons has been theorised and inferred from descriptive analysis of secondary and anecdotal data (e.g. Cross *et al.*, 2007; O'Brien, 1980), to date, no empirical study testing this hypothesis could be identified in the extant literature. The only indication that Asian MNEs might be inclined to invest in a safe and predictable environment is provided by Rammal and Zurbruegg (2006), who find that the host country regulatory quality is an important driver for intra-ASEAN FDI.

Cultural distance

One of the most often used proxies for cultural distance are the measures defined by Hofstede (1980), which were subsequently collapsed into a single measure by Kogut and Singh (1988).¹¹ Using a composite measure for cultural distance based on the four dimensions of Hofstede (1980), Sethi *et al.* (2003) find that US FDI historically has been directed towards culturally proximate countries but has recently shifted to culturally more distance countries (that is, from Europe to Asia). Delios and Henisz (2003a) group countries with similar cultural backgrounds as suggested by Ronen and Shenkar (1985) and rank these culture-based groups against Japan. They find that Japanese firms are less likely to serve markets in country groupings that are less culturally similar to Japan.

A different approach is used by Ferrantino (1992) for developing country ODI. Based on the idea that migrant flows establish social networks across borders which may help to reduce transaction costs (see also Section 2.2.6), Ferrantino employs proxies for the number of host country immigrants in Argentina (source country) and Indian emigrants in a host country to

¹¹ Shenkar (2001) provides a thorough criticism of the single cultural distance index suggested by Kogut and Singh (1988).

measure transaction cost reduction effects. Both proxies show a positive relationship between migration and ODI. Gao (2003) also uses ethnic groups as a proxy for international networks. Gao computes the ratio of Overseas Chinese in a home country to assess their influence on accumulated FDI to China from that home country. He finds that the Chinese inward FDI stock from a host country rises with ratio of Overseas Chinese in that country.

Interest rates

A number of studies reveal that FDI is generally sensitive to interest rates and tends to increase with rising interest rates in the home market (e.g. Barrell and Pain, 1996; Reinhart and Reinhart, 2001). Increasing interest rates in the home country raise debt-serving costs which can push firms to invest abroad. Grosse and Trevino (1996) and Bajo-Rubin and Sosvilla-Rivero (1994), however, find no significant effect of US and Spanish interest rates on inward FDI, respectively. Results for ODI from Asian countries are mixed. Bae and Hwang (1997) use two proxies to measure Korean interest rates which, they propose may push Korean companies to invest abroad. The proxies are not significant though. In contrast, Rammal and Zurbruegg (2006) find the interest rate of ASEAN host countries has a significant effect on ODI originating from Indonesia, Malaysia and Singapore but not for ODI from the Philippines or Thailand.

Inflation rates

Volatile and unstable inflation rates in a host country discourage market seeking FDI by creating long-term commercial uncertainty which impedes strategic corporate planning, especially in respect of price-setting and profit expectations (Buckley *et al.*, 2007a). Rammal and Zurbruegg (2006) test to what extent the host country's annual inflation rate (consumer price index) accounts for variation in intra-ASEAN ODI patterns. The inflation rate is found to have a significant discouraging effect on Malaysian ODI but no measurable effect on ODI from Indonesia, the Philippines, Singapore, and Thailand.

Summary

The above overview of empirical studies on the determinants of FDI reveals mixed results for the significance of all variables presented. This indicates that probably not just one factor is sufficient to explain patterns of FDI but rather that a wider range of economic, institutional and social infrastructure factors interact dynamically to influence observable variables in the investment behaviour of MNEs (Agarwal, 1980). The diverging empirical results are not due to

home country bias, i.e. whether or not the home country is industrialised, but rather depend on the model specification and the source and treatment of the employed variables.

2.4 Summary

This chapter has set the context within which Chinese ODI will be analysed. First, some stylised facts on the global development of FDI since 1970 and the spatial spread of MNEs have been presented in order to provide context for this research. China ranks steadily higher in both categories over this time period. Chinese ODI flows increased from forty-four million US dollars in 1982 to early four and a half billion US dollars in 1993 and were valued at about twelve billion US dollars in 2005. At the same time, the number of Chinese MNEs represented in rankings of major MNEs has increased significantly. A more detailed account on the evolution of Chinese ODI is presented in Chapter 3. To analyse and discuss this phenomenon, a well developed theoretical framework is essential. This chapter therefore reviews theories on FDI and MNE behaviour which have been developed and extensively tested for industrialised country firms. Of the presented theories, the eclectic paradigm and international investment strategies are most commonly employed in the analysis of Chinese ODI (see Section 3.3). Reference to these theories is made throughout the remainder of this thesis. In the last section of this chapter a number of determinants of FDI as identified in empirical studies for developed and developing countries are presented. The selection of the variables has been based on the theories presented in the previous section. The influence of the variables is often empirically ambiguous because of the model specifications and data treatment. This occurrence is true for studies on developed and developing countries. Chapter 7 will build on this body of literature in cross-sectional analyses with a view to identify the determinants of Chinese ODI.

3 Chinese outward foreign direct investments – patterns and explanations

Since the instigation of the ‘Open-Door’ policies (*gaige kaifang*) in 1978, China has evolved from a position of marginal relevance for ODI to become an important source country among developing countries (see Section 2.1). This development is generally argued to have evolved in five distinctive phases, which reflect changes in China’s political and regulatory framework and its business environment (Buckley *et al.*, 2006; Wu and Chen, 2001; Sauvart, 2005). Before these phases are described, it is useful to take a step back and to consider the history of China: the effect of this on firm internationalisation, the types of firms that become MNEs and prior research on Chinese ODI. The following section provides a brief review of China’s economic development between 1948 and 1978 and the reform measures implemented after 1978 to put Chinese ODI in context. This is followed by a description of political actors that have actual and potential influence on Chinese ODI and with a classification of enterprise ownership types in the Chinese corporate system. The knowledge of the political actors and forms of firm ownership will help the reader to understand the impact of ODI policies and regulations when these are discussed in connection with the five phases of Chinese ODI development. The concluding section of this chapter critically assesses the explanatory strength of the academic literature on the development of Chinese ODI as described in the Chapter 2. Based on the identified explanatory gaps and with reference to the theories and frameworks introduced in Chapter 2, the chapter also sets forth the research questions that guide this research.

3.1 China’s political economy between 1949 and 2005

To understand the recent growth of Chinese ODI and some ‘Chinese characteristics’, it is necessary to go back in time to provide a background to the development of the modern Chinese economy and the institutions that govern it.¹² The Chinese economy between 1949 and 1979 leaned heavily towards a Soviet-styled centrally planned economy with an internal focus on heavy industry and closure to international economic relations. This was exemplified in a trade to GDP ratio of up to around 10% for China until 1978 which increased to 65% in 2005 (Naughton, 2007).¹³ Although China followed the Soviet model, the Chinese economy was never as rigorously planned as the Russian one, with only up to six hundred commodities being

¹² Obviously, this review is superficial. In-depth analysis of these issues can be found in, for example, Naughton (1995), Steinfeld (1998), Child (1994), Hsu (1991), Holz (2003), and Huang and Ma (2001) on economic and business issues and Zhang (1998), Goldstein (1991), and Weatherly (2006) on internal and external political issues.

¹³ This section draws much upon the excellent account of China’s economy by Naughton (2007) and is extended and supported by additional sources as indicated.

allocated within the Chinese system compared with sixty thousand in the Soviet Union (Naughton, 2007). Despite the lower degree of control, the Chinese government nevertheless nationalised the economy until 1956. This government-guided industrialisation neglected the development of both a domestic service sector and household consumption and this impeded the development of balanced economic structure and economic growth. Indeed, concentration on heavy industry and misinformation were responsible for a major economic shock in China – the Great Leap Forward (1958 to 1960). In an attempt to accelerate industrialisation, resources were diverted from the primary sector and rural areas in general to industries in urban areas with fatal consequences. A further economic drawback was the dispersed resettlement of industrial structures to the Chinese hinterland in response to potential foreign aggression during the period of the so-called Third Front (1964 to 1966) (Naughton, 1988). This political initiative was undertaken without considering the impact on economic efficiency and competitiveness. While the impact of the Cultural Revolution (1967 to 1969) was felt heavily in the political and social realm, it left the economy fairly untouched. The years between the Revolution and the Open-Door policy are characterised by attempts to consolidate and improve the economic situation. Despite all the drawbacks, the Chinese economy grew between 1952 and 1978 at an average rate of 6% per annum (Naughton, 2007).

In 1978, the Chinese government instigated the ‘Open-Door’ policy with effect from 1979. The ‘Open-Door’ policy was first of all a reaction to the economic situation in China and was ‘designed’ to improve it. Gradualistic economic reform was therefore instigated instead of a planned reform project with a determined end goal such as, for example, an open market economy. This led to a process of ‘tit-for-tat’ and numerous economic reform and adjustments trials and experiments. The advantage of a gradual trial-and-error approach was that China could test which economic reform measure best suited the domestic economy and institutions at a particular point in time without leading to any disruption of the economic system. The opening of special economic zones (SEZs) for foreign enterprises, the introduction of a dual price system and the pursuing of a dual exchange rate are examples of this experimentation. SEZs were created in secluded areas of China with virtually no contact between foreign and domestic firms. But it provided Chinese firms and institutions with an opportunity to learn from foreign MNEs. The dual price system led to a ‘growing-out of the plan’ (Naughton, 1995) by allowing domestic firms to sell production that exceeded the directed quantity at market prices. Likewise, state-owned companies (SOEs) were selectively and partially released into more managerial-led governance through the introduction of a system of greater managerial responsibility and autonomy (Broadman, 2001; Child, 1994). In many cases, this preceded careful privatisation (OECD, 2002). Non-state owned corporate forms were slowly accepted into the Chinese economy and the economic leeway provided by the reform measures is

evidenced in the exceptional growth of township and village enterprises (TVEs) and private firms during the 1980s and 1990s. The young firms established themselves a market place despite political and financial constraints and put competitive pressure on state-owned firms (IFC, 2000; OECD, 2002). In 1992, China adopted a 'socialist market economy with Chinese characteristics' and this continues to the present day. Put into practice, this means that the government allows some economic freedom but also maintains an active role by keeping public ownership over selected 'key' companies and industries (OECD, 2002; Scott, 2002). In the 1990s, continuing and discretionary implementation of reforms at sub-national level caused an unpredictable economic environment in which the institutional environment remained uncertain over the long-run. As a reaction, Chinese companies diversified quickly into newly identified business opportunities to secure short-term strategic advantages and profits (Guthrie, 1997) which led to highly diversified Chinese conglomerates. The process of market openness to foreign business, liberalisation, deregulation and corporatisation of SOEs arguably culminated with China's accession to the World Trade Organisation (WTO) in 2001. This ended a process of nearly sixteen years of international negotiations and domestic economic alignments but also strengthened future reform measures by increasing external pressure to maintain policy direction through its WTO accession commitments (OECD, 2002).

3.2 The institutional environment for Chinese outward direct investment

As was indicated in the previous section, an analysis of Chinese ODI would be incomplete without acknowledging the institutional fabric within which Chinese companies are embedded, as this is likely to influence their investment behaviour (Child and Tse, 2001; Granovetter, 1985). For most of China's recent history, business transactions and government supervision of state-owned enterprises have been based on personal networks and small 'fiefs' rather than the codified and impersonal procedures as typically found in a market economy (Boisot and Child, 1988, 1996; Ralston *et al.*, 2006). Corporate actors just recently turned to be more market-oriented conducting business (Ralston *et al.*, 2006) which is partly a reaction to the competitive pressure from non-state owned firms. For this reason, this section describes key actors in Chinese ODI; first by describing the corporate actors and then the political and administrative actors.

3.2.1 Corporate actors in China

The descriptive analysis of Chinese ODI above and the theoretical explanations that follow later in this chapter are mainly based on the international investment behaviour of state-owned enterprises (SOEs). The internationalisation of firms other than SOEs is seldom taken into

account in extant research on Chinese ODI (exceptions are Warner *et al.*, 2004; Liu and Li, 2002). This chapter therefore provides a description of the different corporate forms in China and their economic position in the Chinese economy. One way of defining corporate actors in China is by their ownership form and their mode of coordination. Thus, three main enterprise forms can be distinguished, namely (i) SOEs, (ii) non-private enterprises and (iii) private enterprises (adapted from Boisot and Child, 1996). In turn, each of these three classes embraces several forms of ownership types. This classification constitutes a workable classification because in fact the official ownership statuses of Chinese firms are manifold, overlapping and often not meaningfully distinctive, because their status depends on the manner of their registration rather than on the nature of the shareholders (OECD, 2005b).

State-owned enterprises

The term 'state-owned enterprise' (SOE) comprises all companies which are directly or indirectly owned by the Chinese government and its ministries. Thus, under this category fall SOEs such as CNOOC and Shougang which are both partially owned by the State Asset Supervision and Administration Commission (SASAC), as well as enterprises that are controlled directly or indirectly by a ministry, provincial or municipal governments. It also includes firms which have been converted to a new company form and are registered today as joint-ownership enterprises or limited liability corporations because a government authority is a significant shareholder (Kanamori and Zhang, 2004; Clarke, 2003). Likewise, SOEs listed on the Chinese stock exchanges in Shanghai or Shenzhen have typically floated only a limited number of shares, the remainder of which rest with government authorities and are not tradeable (Kanamori and Zhang, 2004; Zhang, 2004). Some of the most prominent Chinese MNEs are to a significant degree state-owned but have also considerable numbers of shares owned by (foreign) strategic investors, as in the cases of Lenovo and TCL (Zeng and Williamson, 2003). SOEs are, despite all reforms, often subject to conflicting – political and ideological – demands from multiple national and sub-national government authorities which each exert direct and indirect influence to a greater or lesser extent (Hassard *et al.*, 2002; Clarke, 2003).

Collective enterprises

The term 'collective enterprise' comprises both collectively-owned enterprises (COEs) and township-village enterprises (TVEs). While COEs are normally found in urban areas, TVEs resemble the same company form in rural districts. Both company forms commonly belong to its employees or the local community. But, because of the typically strong ties between firms and local government, they are, by virtue of involvement, owned by the local government or other local authorities (Boisot and Child, 1996; Gibb and Li, 2003). Consequently, they sit somewhat between SOEs and private enterprises in terms of government support and market

responsiveness (Peng *et al.*, 2004). A case in point is Haier, the Chinese white goods manufacturer, which is partly owned by the city government of Qingdao, Shandong province (Yeung and DeWoskin, 1998).¹⁴ Collectively-owned enterprises such as Haier are often labelled as SOEs while TVEs constitute hybrid forms which lean more towards being privately-owned firms.

Private enterprises

To date, it remains somewhat unclear which enterprise forms are captured by the phrase 'private sector'. Following Heberer (2003), the private sector comprises individual companies (*geti hu*), private companies (*siren qiye*), foreign-invested companies and companies which have been classified as SOEs above, namely joint stock companies and limited liability companies. Besides these entities, a large number of private firms are said to have a 'red hat', i.e. they are officially registered as collectively-owned firms or TVEs to circumvent any potential state repression (Heberer, 2003; IFC, 2000). Privately-owned firms are therefore affected by local policies and governments which often act as business facilitator for and protector of the entrepreneur and manager (Boisot and Child, 1996; Gibb and Li, 2003). The most prominent privately-owned Chinese MNEs are Wanxiang, the automotive component producer, and Huawei, the telecommunication equipment manufacturer. It is pertinent to point out that wholly foreign-invested firms and Sino-foreign international joint ventures in China are also regarded as private enterprises but are excluded from this research.

Although the above discussion distinguishes between different ownership forms, the classification scheme is not without ambiguity. Property rights are not as well defined and clear-cut in China as they are in industrialised countries. Rather they have steadily evolved and they are established and revisited (Boisot and Child, 1996). This poses difficulties in specifying definitive ownership forms. Moreover, some enterprise forms exist in China without any statutory basis but are rather tolerated by administrative discretion (Clarke, 2005). We note, though, that legal changes in China since the end 1990s have strengthened the position of non-state owned enterprises and that property rights became better defined in 2004 (Kanamori and Zhao, 2004; Heberer, 2003). This indicates that a more specifiable distinction of corporate forms towards the end of the period under investigation may be feasible. However, for the period under study it is assumed that the here presented classification is appropriate.

¹⁴ White goods are household appliances such as kitchen and laundry equipment. This is to differentiate from brown goods (electronic entertainment goods such as TVs and stereo equipment) and grey goods (computer peripherals) (Stremersch and Tellis, 2004).

3.2.2 Political and administrative actors in China

There are a number of key political and administrative actors in China that impinge upon Chinese ODI. These include the State Council, State Administration for Foreign Exchange, the Ministry of Commerce, the People's Bank of China, National Development and Reform Commission and SASAC. The following descriptions of these administrative actors also reflect the numerous and on-going restructurings of the Chinese government system (Pearson, 2005).

State Council (国务院)

The State Council is China's executive organ (or cabinet). It is headed by the Premier and supervises ministries, special organisations, offices, and other administrations such as the ones discussed below. The State Council drafts and develops law and regulations which have to be approved by the National People's Congress and the Standing Committee. As the executive and administrative organ of China, the State Council also coordinates the national economic development, manages foreign affairs and concludes bilateral treaties. The State Council decides upon major economic policies and liberalisation measures, although the policy initiatives for these steps may come from its subordinate ministries, administrations and commissions (Zhao, 2006).

State Administration for Foreign Exchange (欢迎访问国家外汇管理局)

The State Administration of Foreign Exchange (SAFE) was established and equipped with administrative tasks concerning the usage and flow of foreign exchange in 1979 (Zhang, 2004; Lin and Schramm, 2003; Shan, 1989). SAFE consolidated the activities and responsibilities formerly distributed over several ministries in relation to the supervision of China's foreign exchange control (Lin and Schramm, 2004). Although the authority over SAFE moved in 1982 from the Bank of China to the newly created central bank, the People's Bank of China, the administration arguable remained relatively independent until a subsequent government restructuring in 1998 (Lin and Schramm, 2003; Shi and Gelb, 1998). This led to SAFE strengthening its mandate in following ODI-related functions: (i) the reporting of the balance of payments (BOP) data to the State Council and the International Monetary Fund (IMF), (ii) recommending foreign exchange policies to the People's Bank of China, (iii) overseeing the transfer of foreign exchange out of and into China under the capital account, and (iv) managing China's foreign exchange reserves (Zhang, 2004). Despite its apparent wide range of responsibilities, the influence of SAFE on Chinese ODI has been described by some researchers as minimal (Zhang, 2003; Wang, 2002).

Ministry of Commerce (中华人民共和国商务部)

The Ministry of Commerce (MOFCOM) was established in 2003. It resulted from a merger of the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) with selected responsibilities of the State Economic Trade Commission and the State Development and Planning Commission, namely domestic trade, foreign economic coordination and the coordination of international trade of industrial products, raw material and semi-finished products (Munro and Yan, 2003). The major responsibilities of MOFCOM with regard to Chinese ODI cover: (i) the supervision of Chinese ODI by drafting and implementing policies and regulations and considering non-financial ODI projects for approval; (ii) bilateral and multilateral negotiations on investment and trade treaties and representing China at the WTO and other international economic organisations; (iii) ensuring the alignment of China's economic and trade laws with international treaties and agreements; and (iv) coordinating China's foreign aid policy and relevant funding and loan schemes (Munro and Yan, 2003). These functions provide MOFCOM with direct and indirect opportunities to guide and influence the scope and direction of Chinese ODI. Indeed, MOFCOM issued the first regulations on Chinese ODI in 1984 and 1985, namely the *Provisional regulations governing the control and the approval procedure for opening non-trade enterprises overseas* (July 1985) and the *Circular concerning the approval authorities and principles for opening non-trade joint venture overseas as well as in Hong Kong and Macao* (May 1984) (Zhang, 2003).

People's Bank of China (中国人民银行)

The People's Bank of China (PBC) was established as China's central bank in 1983 and is currently directly supervised by the State Council (Zhang, 2004). The PBC is responsible for the overall financial policies and rules and dealings with international financial organisations such as the World Bank. It also supervises and manages the foreign exchange reserves of China (Chang, 1989). With respect to the latter function, the PBC imposed significant changes to China's foreign exchange regime in 1994 and this provided the PBC with tighter foreign exchange control (Barale and Jones, 1994). The combined powers over domestic monetary and financial policies and foreign exchange control give the PBC the possibility to levy one function against another. Careful management of China's foreign exchange reserves used in international investment projects by Chinese companies has helped the PBC to fulfil domestic monetary objectives such as a stable and low inflation rate because domestic enterprises could be encouraged to spend Yuan and reduce pressure on the monetary supply side (Pettis, 2005). The PBC also regulated the financial service sector and hence ODI by financial institutions prior to 1992. In 1992, securities, insurance and banking services were spun-off into separate

regulatory authorities among whom the China Banking Regulatory Commission today approves ODI projects by Chinese banks (Pearson, 2005).

National Development and Reform Commission (中华人民共和国国家发展和改革委员会)

The National Development and Reform Commission (NDRC), sometime referred to by its old name the State Development and Reform Commission, emerged from the institutional structure of the State Planning Commission (Munro and Yan, 2003). The NDRC is the main government body that designs, regulates and coordinates the economic development and industrial policy of China. As part of this function it regulates government investments into domestic industries (Pearson, 2005). One key function of the NRDC is to develop “strategies, goals and policies to balance and optimise [...] China’s overseas investments.” (Munro and Yan, 2003: 4). As part of this role, the NDRC has issued guidelines concerning access of domestic firms to soft loans to finance their internationalisation (Schwartz, 2005). In a similar vein, the NDRC, in cooperation with MOFCOM, has published a host country catalogue that lists the countries for which the Chinese government will provide subsidies for a FDI project (Zweig and Bi, 2005). The NDRC is also involved in the approval process of Chinese ODI. Large-scale Chinese ODI projects in industry sectors such as natural resources and other projects involving larger sums of foreign exchange need prior investment approval from the NDRC. The threshold has changed over the years and stands currently at USD 30 million. The latter is part of NDRC’s functions to maintain equilibrium in balance of payments (Munro and Yan, 2003).

State Asset Supervision and Administration Commission (国务院国有资产监督管理委员会)

A relatively new governmental authority is the State Asset Supervision and Administration Commission (SASAC). The SASAC was established by the State Council in 2003 to represent the Chinese government as owner of and investor in non-financial SOEs. SASAC has wide-reaching responsibilities and powers (Naughton, 2007; Pearson, 2005). Prior to its establishment, its functions were divided among the State Economic Trade Commission and several ministries and other government authorities that controlled and supervised ‘their’ companies independently from each other. Sometimes this created competing SOEs (Munro and Yan, 2003; Mueller and Lovelock, 2000; Pearson, 2005). In this respect, it is the objective of the SASAC to ensure that the SOEs under its supervision remain competitive and even increase profitability and the value of the assets involved (Pearson, 2005). It remains questionable if such an institution can fulfil this type of objective (Clarke, 2003). In SASAC supervision is split: The national SASAC directly controls nearly 170 national SOEs while sub-national SASACs take up this role for provincial SOEs (Naughton, 2006, 2007). Both levels of SASAC exercise their power through the appointment of senior managers to SOEs and the

involvement in major decision-making of firms under its control (Naughton, 2007). A considerable number of senior management positions are actually appointed directly by the CCP (Naughton, 2007). This structure and the strong influence of the party do not necessarily lead to the appointment of the most suitable, but rather the most rewarded, managerial candidates with questionable consequences for the company's domestic and international operations. ODI projects by SOEs under the supervision of SASAC are unlikely to be decided without the explicit approval of SASAC. The decision to invest overseas either through a greenfield investment or an acquisition can be regarded as a major decision that impacts on the company's profitability and the value of the involved assets. Any ODI project therefore touches upon the key objectives of SASAC. Examples of overseas invested Chinese firms under the direct control of SASAC include the following which rank among the Top 100 developing country MNEs as published by UNCTAD (2006), namely, CNOOC, CNPC, Sinochem Corporation, China State Construction Engineering Corporation, China Minmetals Corp, COFCO, and TCL (through SASACs' holdings in Huizhou Municipal Investment Holdings) (see also Section 2.1). SASAC also controls smaller SOEs such as China Aviation Oil, which has operations in Singapore, and the international trading company, Sinosteel.

The division of responsibility between the state actors described above is not always clear and has changed during the institutional reforms since 1979. Overlapping duties, conflicting interests between and within bureaucracies and multiple government authorities that a company has to approach illustrates the potential of the institutional framework to hamper the development of Chinese ODI. Smaller SOEs and privately-owned companies without well established relations (*'guanxi'*) with the administrations, in particular, may be discouraged especially by such an institutional environment.

Having set the background and introduced the corporate and political actors, it is now time to turn to data on Chinese ODI. The next section reviews the development of Chinese ODI since 1979. This section makes reference to the political actors outlined here and provides information about the changes and their responses to the regulatory framework which may be partly responsible for changes in the spatial distribution, amount, and number of ODI projects undertaken by Chinese MNEs since 1979.

3.3 Development of Chinese outward direct investment since 1979

Before 1979, Chinese ODI was modest because up to then China had followed an autarkic, import-substitution led economy model, under which only selected state-owned trading companies gained the right to establish foreign affiliates (Zhang, 2003). Data on ODI prior to

1979 are therefore sketchy but values are likely to have been miniscule. This research therefore focuses on the years 1979 to 2005. Since 1979 and the implementation of China's 'Open-Door' policy, Chinese ODI has increased steadily, especially after 2000 (see Section 1.1). Chinese ODI is generally described as having developed in five distinctive phases (Wong and Chan, 2003; Wu and Chen, 2001; Ye, 1992; Tseng and Mark, 1996). The classification follows changes to its geographical scope and adjustments to China's political and regulatory environment towards ODI, namely concerning the formal approval process. This section presents the development of Chinese ODI with respect to policy changes which have the potential to have impacted on Chinese ODI. These policy areas are foreign exchange control, foreign trade, and foreign affairs. The five phases embrace the years 1979 to 1985, 1986 to 1991, 1992 to 1998, 1999 to 2001, and 2002 and onwards.¹⁵ The key regulations issued during each of the five phases concerning ODI are listed for each period.

3.3.1 Phase 1: The Open-Door policy and first steps on international grounds (1979-1985)

From the outset of the 'Open-Door' policy, the Chinese government not only endeavoured to create an institutional environment to attract foreign MNEs to China but also to encourage Chinese companies to expand internationally through FDI (Zhang, 2003). China authorised selected state-owned trading companies under the auspices of the Ministry of Commerce (MOFCOM)¹⁶ and sub-national economic and technology cooperation enterprises to establish their first foreign affiliates (Zhang, 2003; Ye, 1992; Taylor, 2002; Tan, 1999). The objective of allowing controlled Chinese ODI was to ensure that it became an integral part of the Chinese economy and contributed to the social welfare of China and certain political goals. Moreover, the Chinese macroeconomic policy since the 1970s has focused on the accumulation of foreign exchange earnings. Only regulated ODI could help to avoid 'unnecessary' outflow of hard

¹⁵ Although there is a general agreement that Chinese ODI developed in distinctive phases disagreement exists between the authors: Ye (1992) argues there were two phases prior to 1992, namely 1978 to 1985 and from 1985 onwards. Tseng and Mark (1996) and Wong and Chan (2003) agree with Phase One being 1978 to 1985. The latter, however, defines the second Phase differently, namely from 1986 to 1991. Wong and Chan further distinguish Phase Three (1992-98) and Four (1999 to 2001). Tseng and Mark's Phase Three covers the years 1991 to 1996. Somewhat different is the classification by Wu and Chen (2001), who delineate their four phases as follows: 1979 to 83, 1984 to 85, 1986 to 92 and 1993 to 2001. Note that these models commonly have a closed last phase overlapping with the publication of the article.

¹⁶ The Ministry of Commerce evolved from the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) in 2003. MOFTEC was the successor organisation to the Ministry of Foreign Economic Relations and Trade (MOFERT) following a reorganisation in 1993. For simplification purposes, this study uses the term MOFCOM throughout while acknowledging that specific responsibilities and scope of function vary between the three organisations.

currency.¹⁷ The extent to which ODI benefited the Chinese economy and signalled a departure from socialistic ideology was heavily discussed during the 1980s and this debate partially impeded its development (Zhang, 2003). Each outbound investment project had to pass a thorough approval process in which several institutions were involved. The key political actors in the two stage process were the State Council, MOFCOM, SAFE¹⁸ and the NDRC (Ye, 1992; Tseng and Mak, 1996).¹⁹ Although the process has been modified several times since, the basic procedure remains unchanged to date. A firm applies, first, to SAFE to use foreign exchange earnings abroad and, second, to MOFCOM or the NDRC for the approval of the investment project business case (Deschandol and Luckock, 2005; Yin *et al.*, 2003; Horsley, 1990). The first step was necessary because SAFE is responsible for the administration of sourcing, conversion, remittance and monitoring of the repatriation of foreign exchange and of investment profits (Yin *et al.*, 2003; Lin and Schramm, 2003). Only companies which had been granted an export license had the right to retain a share of foreign exchange earnings under the suspicion of the retention scheme (Lardy, 1992; Shan, 1989). Under this retention scheme, exporting firms were allowed to hold a certain amount of foreign exchange earnings while the remainder had to be turned over to the Chinese government (Guo and Han, 2004). The retention scheme favoured firms in the costal provinces and certain industrial sectors, especially the light industry, over others. Firms in these areas could accumulate considerable amounts of foreign currency entitlements (Lardy, 1992). The retention scheme only entitled a company to use the amount of foreign exchange earned, with the prior approval from the relevant government authority - SAFE. The company therefore did not possess foreign exchange as such (Lardy, 1992). Hence, retained foreign exchange earnings could not be used freely for ODI but had to be approved by SAFE first. An application for an outward investment which included the usage of hard currency was therefore not possible for every Chinese company. To circumvent this policy, Shan (1989) asserts that trading companies established foreign affiliates to keep (illegally) hard currency earnings outside the Chinese system but within their international network of affiliates to draw on them when appropriate.

¹⁷ See Liew (2004) and Hall (2004) for an extensive survey on China's convoluted foreign exchange rate policy making.

¹⁸ SAFE evolved from the State Administration Exchange Control (SAEC) in 1994 which itself succeeded the State General Administration of Exchange Control (SGEC) (Shan, 1989; Bumgarner and Prime, 2000). For simplification purposes, this study uses the term SAFE throughout, while acknowledging that responsibilities and scope have varied between the three organisations.

¹⁹ The involvement and responsibilities of the government authorities have varied since 1978 in accordance with a gradual liberalisation and decentralisation of the approval process. This process mirrors the general pattern of economic reform in China which is generally associated with decentralisation and a careful introduction of market forces (Child and Tse, 2001; Boisot and Child, 1996).

Once the application had been accepted by SAFE, a further application had to be made to MOFCOM or the NDRC. Only projects of an investment value less than USD 10mn could be approved by MOFCOM. All other investment projects had to receive NDRC approval (see also Table 3.1). The application involved the submission of the following documentation: a feasibility study, a certificate from SAFE, a statement from the Chinese embassy in the target country, an investment recovery plan and documentation on the legal environment of the target country (Horsley, 1990). To pass the approval successfully, early overseas projects had to fall into one of the following four categories: (i) securing access of domestically scarce natural resources, (ii) accessing and transferring technology to China, (iii) enhancing export possibilities for Chinese companies, and (iv) augmenting managerial skills through ‘on-the-job training’ (Guo, 1984). To support the transfer of technology and managerial knowledge and to attenuate business risk, the establishment of a foreign joint venture abroad was promoted by the Chinese government.

These restrictive measures partly explain the slow growth of Chinese ODI despite an overvalued Chinese Yuan. At the beginning of the Open-Door policy, the Chinese Yuan was inconvertible under neither the current nor the capital account. Rather, the exchange rate was perceived as an administrative accounting tool of minor priority for the autarkic Chinese economy (Lardy, 1992; Lin and Schramm, 2004). The lack of any market forces to determine the value of the exchange rate was reflected in an overvalued Chinese Yuan during the pre-reform era, which continued to the mid-1980s.

Table 3.1: Key ODI regulations in Phase 1 (1979 to 1985)

Regulation	Issued	Comments	Enunciator
Circular on the approval procedures for international economic and technical cooperation corporation to set up overseas subsidiaries	July 1985	A core document for laying out the principal for the regulation and control of ODI. Opened ODI to all economic entities with financial resources, foreign joint venture partner and relevant capabilities ^{1,2}	MOFCOM
Provisional regulations governing the control and the approval procedure for opening non-trade enterprises overseas	July 1985	Ceiling for investments to be evaluated by MOFCOM and NDRC stands at USD 10mn ¹	MOFCOM
Circular concerning the approval authorities and principles for opening non-trade joint venture overseas as well as in Hong Kong and Macao	May 1984	The first regulation on Chinese ODI ¹	MOFCOM

Sources: ¹ Zhang (2003), ² Cai (1999).

Though overvalued, the neglect of involvement in the global economy, the inward-looking development strategy and tight foreign exchange control meant that Chinese firms were not encouraged to establish foreign affiliates during this period.

Nevertheless, the very small number of foreign affiliates established by trading companies prior to 1979 increased rapidly with the instigation of the Open-Door policy. The number of foreign affiliates increased to more than 100 ventures by 1983, covering a wide range of businesses. These operations were mainly established in industrialised countries (Guo, 1984). International joint ventures were, for example, established in the service sector such as in banking and technical consultancy, and in trade-related activities (for example, manufacturing and resource development). Early investments abroad were conducted by companies such as CITIC, one of today's major Chinese MNEs. CITIC was established by the State Council in 1979 with the explicit goal of investing and diversifying internationally. Sinotrans, the Chinese logistics company, established an affiliate in the USA in 1980 and China National Metals and Minerals Import and Export Corp. (Minmetals), the specialised trading company, opened offices in Hong Kong and the United Kingdom (Zhang, 2003). By the end of 1985, Chinese companies had invested around USD 900 million abroad, signifying a strong growth on the USD 44 million of FDI stock owned by Chinese MNEs three years earlier (UNCTAD, 2007a).

3.3.2 Phase 2: The Government encourages Chinese ODI (1986-1991)

With the issuance of new regulations by the MOFCOM in 1985, restrictive policies on ODI were eased in Phase 2. The approval process was opened to SOEs other than trading companies (Zhang, 2003) and, as Tan (1999) argues, to private enterprises.²⁰ Companies still had to undergo the formal administrative approval process, including the evaluation of sufficient financial and managerial capacity of the investing firm and evaluation of the foreign joint venture partner (Wong and Chan, 2003; Tseng and Mak, 1996). Advances in the technological and managerial standards of Chinese enterprises promoted the outward investment drive of the Chinese firms and of Chinese authorities at all levels. At the same time, international activities in more mature industries were encouraged by the Chinese government with the aim of profit

²⁰ The explicit inclusion of privately-owned firms in the MOFCOM directive is questionable. Private firms were for the first time recognised in 1982 as supplementing entities to SOEs. However, this ownership form was only properly defined in 1988, in 1997 it was acknowledged to be an integral part of the Chinese economy and its legal status strengthened in 1999 (Heberer, 2004; Kanamori and Zhao, 2004). The political debate on the usefulness of Chinese ODI, on the one hand, and the debate and gradual legitimisation of privately-owned firms on the other suggests that the 1985 directive only affected SOEs. Moreover, it was a directive by SAFE, NDRC and MOFCOM issued as late as 2003 that arguably legalised ODI by private firms for the first time (Yin *et al.*, 2003; Norton Rose, 2005).

maximisation (Wu and Chen, 2001). During Phase 2, SAFE and MOFCOM issued refined regulations on ODI, on the usage of retained foreign exchange earnings. They also increased the transparency of the documentations needed during the ODI approval process (see Table 3.2). Following these policy changes, the numbers of Chinese international investment projects grew quickly from the 185 seen at the end of Phase 1 to 801 by the end of 1990 and 904 by the end of 1992 (Table 3.3 and Tan, 1999).

The growth of Chinese ODI was also supported by another development. Official Chinese development strategy shifted from an import-substitution to export-led growth. The overvalued Yuan had become a constraint because it artificially increased the price of Chinese products on international markets. Around the mid-1980s, the Chinese government began to devalue the Yuan to support Chinese exporters and to promote hard currency earnings (Lardy, 1992). To further support Chinese exporters and accumulate foreign exchange, the Chinese government favoured 'in kind' ODI projects. Such projects involved the export of physical equipment, know-how, and raw materials, for example, instead of foreign currency earnings.

Overseas projects considered to be of national strategic importance, however, have traditionally enjoyed foreign exchange-related privileges. Qualifying Chinese firms have been able to readily purchase foreign exchange and receive loans denominated in foreign currency from domestic financial institutions, even during periods of tight foreign exchange control (Cross *et al.*, 2007).

The *Almanac of China's Foreign Economic Relation and Trade* reports the total accumulated current value and number of approved ODI projects since 1990 (Table 3.3 and Table 3.5). Before the end of Phase 2, Chinese companies largely invested in developed countries. About 70 per cent of Chinese investment was destined to these countries while only 30 per cent was hosted by developing countries (measured in average USD billion ODI stock). Within the group of developed countries, the North American countries of Bermuda, Canada and the USA received the lion's share, accounting for 41 per cent of total Chinese ODI stock at the end of 1992. Investments to the USA were mainly attributable to the acquisition of Mesta Engineering Corporation by Shougang, the Beijing-based steel company, in 1988. This acquisition was actually Shougang's first ODI project (Zhang, 2003).

Table 3.2: Key ODI regulations in Phase 2 (1986 to 1991)

Regulation	Issued	Comments	Enunciator
Regulations on the drafting and approval of project proposals and feasibility study reports of overseas investment projects	August 1991 (effective by)	A core document throughout the 1990s on the requirements for an ODI project approval ⁴	NDRC
Opinion of the State Planning Commission on the strengthening of the administration of overseas investment projects	March 1991 (effective by)	A core document throughout the 1990s ⁴	NDRC
Rule for the implementation of administrative measures for the investment of foreign exchange overseas	June 1990	Detailed regulation on what was required to apply for an overseas investment ¹	SAFE
Administrative measures on overseas financial institutions	April 1990	Primary rules concerning ODI in the financial sector ⁶	PBC
Measures for foreign exchange control relating to overseas investment	March 1989	First regulation on the use of foreign exchange; examination of self-owned foreign exchange funds ^{1,2,3}	SAFE
Regulations governing the approval of setting up of trade-related enterprises overseas	July 1988	5% of the ODI sum had to be deposited in a special account. All foreign profits to be remitted to the Chinese state. The firm could retain 100% foreign exchange quota ^{1,2,5}	MOFCOM

Sources: ¹ Zhang (2003), ² Cai (1999), ³ Huang (2005), ⁴ Tong and Groffman (2000), ⁵ Zhao (2006); ⁶ Yu *et al.* (2005).

It is relevant to note, however, that the data presented here may underreport the extent of the international activities of Chinese firms at the time because they regularly secured international loans to complement the foreign exchange remitted from China (Ye, 1992). In contrast to the investment value, the number of investment projects was higher in developing and transitional countries than in developed economies (61% vs. 39%) during this phase. This indicates that Chinese ODI was of large-scale in North America while investments in Asia/Oceania were generally dominated by a large number of small-scale projects. At the end of Phase 2, Chinese investments were registered in hundred and one countries (see Table 3.5).

Table 3.3: Geographical distribution of Chinese ODI: Accumulated stock for the period 1979 to 2005 (period average stock in USD billion and % of period average)

	Phase 1 and 2 1979-92 ^(a)	Phase 3 1992-98	Phase 4 1999-01	Phase 5 2002-05 ^(b)
World (USD bn)	1.21 bn	1.99 bn	3.78 bn	14.50 bn
Developed economies	70 %	59 %	37 %	23 %
Europe	3 %	3 %	2 %	5 %
North America	41 %	37 %	24 %	13 %
Asia/Oceania	27 %	20 %	10 %	6 %
Developing economies	27 %	35 %	57 %	71 %
Latin America	5 %	7 %	14 %	9 %
Asia/Oceania	18 %	21 %	26 %	54 %
Africa	4 %	7 %	16 %	8 %
Transition economies	3 %	5 %	5 %	6 %

Notes: (1) The MOFCOM publication reports Chinese ODI from 1990 onwards only. The figures in this column refer to Phases 1 and 2 by inference as they represent accumulated figures; (2) The latest available data are for the year 2005.

Sources: MOFCOM (1991-2002) *Almanac of China's Foreign Economic Relations and Trade* and MOFCOM (2004-2006) *China Commerce Yearbook*.

3.3.3 Phase 3: The impact of Deng Xiaoping's journey to the South (1992-1998)

In early 1992, Deng Xiaoping, *de facto* leader of China from the late 1970s to early 1990s (Yahuda, 1993; Naughton, 1993), travelled to Southern China in an effort to express his support to economic reforms and market opening. This landmark journey strengthened the liberal politicians in the CCP and bureaucrats in the government agencies and marked a departure from the restrictive and containing policies that characterised the aftermath of the Tiananmen Square incident in 1989.²¹ As a consequence of this newly gained liberalisation momentum, Chinese ODI officially became part of China's national economic development plan and was publicly endorsed by the then chairman of the CCP and, later, president of China Jiang Zemin (Zhang, 2003). Encouraged by these measures, local and provincial government authorities increasingly engaged in overseas businesses and allowed companies under their supervision to establish affiliates abroad. The government officials were also driven by the conviction that the

²¹ Steadily rising inflation (to an annual rate of nearly 30%) and political tensions led to a week-long set of demonstrations on the Tiananmen Square, Beijing, in 1989. These demonstrations were eventually broken up by military force. This was followed by a tightening and partial withdrawal of economic reforms which decreased significantly the confidence of foreign observers and investors (Naughton, 2007). For a good account of the Tiananmen Square incident see Zhang *et al.* (2001).

internationalisation will help Chinese firms to increase their competitiveness and to circumvent trade discrimination by host countries (Tan, 1999). This came to a halt, however, when MOFCOM became suspicious of defalcation of state-assets through the establishment of questionable international ventures (that gave rise to illegal privatisation) and in the wake of the Asian financial crisis in 1997 (Ding, 2000a; see also Section 3.3). This crisis forced MOFCOM to tighten the approval procedure and to better screen and monitor each outward investment project (Wong and Chan, 2003). This policy was supported by SAFE and its local offices in 1998 when it stopped approving foreign exchange for ODI projects (Lin and Schramm, 2003, 2004). The precise effect of the approval ban, however, is not clear. Official MOFCOM data published in the *Almanac of China's Foreign Economic Relations and Trade* and undisclosed SAFE data (SAFE, 2005) record approvals for outward investment projects for the years 1997 to 2000. This discrepancy may indicate deviating *de jure* and *de facto* realities in China.

At the beginning of Phase 3, the thresholds that defined which government organisation was responsible for approving Chinese ODI were adjusted (see Table 3.4). MOFCOM and NDRC became responsible for investments of up to USD 30 million while the State Council had to approve any ODI project valued above USD 30 million (Zhan, 1995). Likewise, in 1995, the investment value threshold for the approval of foreign exchange in an outbound investment project was adjusted upwards. Formerly, applications for an investment project under USD 1mn were dealt with by SAFE's regional offices and only projects above USD 1mn by the national SAFE. Following a SAFE Circular in 1995, SAFE branches in 14 selected provinces and municipality were given the right to approve investments projects of up to USD 3million in value.

Further reform measures implemented were concerned with the Chinese currency and foreign exchange earnings. First, from 1994 to 2005 the Yuan was pegged to the US Dollar at a nominally fixed rate. Since 2005, the Chinese government has eased this peg and has devalued the Yuan against the US Dollar. Second, the foreign exchange retention scheme and swap markets were abolished in January 1994. A buyer-seller market was introduced instead (Guo and Han, 2004). Prior to 1994, only Chinese companies which had been granted international trading rights could earn foreign currencies and use this to fund their ODI projects. Companies without trading rights were thus restricted in their international investment activities (Zhang, 2003; Zhang, 1999). The number of potential Chinese international investors was thus 'artificially' limited to a small 'club' of (successful) international trading firms. With the liberalisation of 1994, the Chinese government moved from an 'earn-to-use' to a 'buy-to-use' foreign exchange policy regime. This is arguably a crucial development in the evolution of Chinese ODI, since the approval procedure generally began with an investigation of the foreign

currency involved. From 1994 onwards, foreign exchange entitlements could be bought from SAFE to finance ODI projects regardless of whether or not the applicant had previously generated foreign exchange earnings through trade. It is likely that this liberalisation step enabled more Chinese companies to finance their international investments by converting domestically earned Yuan into foreign currency.

The largest recipient of Chinese ODI between 1992 and 1998 (in terms of average USD investment stock per period) was again North America with a share of 37% of total Chinese ODI stock (see Table 3.3). Canada received the largest share with 18.3% of total Chinese ODI followed by the USA (17.5%). The third place was held by Australia (16.3%). This pattern is manifested in the high ratio of Chinese investment in industrialised countries in general (59%) of total stock versus investments in developing countries (41%). This investment pattern is probably a reflection of resource-seeking investments in Canada and Australia where the majority of the approved investment value was directed towards the extraction of petroleum and natural gas and in diversified investment (SAFE, 2005). During this period, Chinese companies began to conduct large-scale acquisitions abroad, exemplified by the purchases by CITIC of the Australian firms Metro Meat (1994) and Portland Aluminium Smelter (1998) (CIBUL, 2007).

Table 3.4: Key ODI regulations in Phase 3 (1992 to 1998)

Regulation	Issued	Comments	Enunciator
Notice on supplemental provisions to the administration measures on foreign exchange for overseas investment	Sept. 1995	Chinese investors are allowed to purchase foreign exchange for an ODI project; prior to this, a Chinese investor had to earn the foreign exchange ²	SAFE
Examination and approval standards on foreign exchange risk and fund source examinations for outbound investments	Sept. 1993	The source of ODI funding has to be assessed prior other approvals. This contradicts NDRC regulations which prohibits SAFE to issue the certification before NDRC approval ^{2,3,4}	SAFE
Regulations of MOFCOM on the administration of the approval and examination of non-trading overseas enterprises (trial draft)	March 1992 (effective)	Implementation of a USD 30mn investment value ceiling for projects to be evaluated by NDRC and national MOFCOM instead of the State Council ^{1,5}	MOFCOM

Sources: ¹ Zhang (2003), ² Yu *et al.* (2005), ³ Yu and Hwang (2005), ⁴ Cai (1999), ⁵ Tong and Groffman (2000).

The investment project pattern of Phase 3 is very similar to Phase 2. Developing and transitional countries dominate with a share of 67%. The increase by 6 percentage points on the previous period was caused by proportionally more investments in the transitional economies.

Table 3.5: Geographical distribution of Chinese ODI: Accumulated period average of investment projects 1979 to 2004 (total number and % of total)

	Phase 1 and 2 1979-92 ^(a)	Phase 3 1992-98	Phase 4 1999-01	Phase 5 2002-04 ^(b)
World (total number)	904	1881	2855	7574
Developed economies	39 %	33 %	28 %	27 %
Europe	9 %	7 %	6 %	7 %
North America	18 %	16 %	14 %	13 %
Asia/Oceania	11 %	9 %	7 %	7 %
Developing economies	54 %	53 %	58 %	63 %
Latin America	7 %	7 %	7 %	5 %
Asia/Oceania	36 %	36 %	37 %	49 %
Africa	11 %	11 %	14 %	9 %
Transition Economies	7 %	14 %	14 %	11 %
Average number of host countries	101	137	149	159

Notes: (1) The MOFCOM publication reports data on Chinese ODI from 1990 onwards only. The figures in this column therefore refer to the years 1990 and 1991 but infer to the complete Phases One and Two as they represent accumulated figures;
(2) The latest available data are for the year 2004.

Sources: MOFCOM (1991-2002) *Almanac of China's Foreign Economic Relations and Trade* and MOFCOM (2004-2006) *China Commerce Yearbook*.

3.3.4 Phase 4: Pre-WTO accession adjustments and the 'Go Global' policy (1999-2001)

Phase 4 was characterised by contradictory policies toward ODI. On the one hand, the Chinese government tried to consolidate excessive and poorly administered ODI projects by strengthening the outward investment approval process and capital controls. On the other, firms in the light industry sector (textiles, machinery, and electrical equipment) were encouraged to internationalise (Wong and Chan, 2003; Wu and Chen, 2001). In 1999, MOFCOM tried to encourage Chinese firms to establish assembly plants overseas to support the export activities of Chinese firms. The same objective was followed when MOFCOM selected thirty-three

experimental SOEs in the main export sectors to receive priority state assistance to invest abroad – of which thirteen firms were in consumer electronics (Wu and Sia, 2002). Additionally, and most importantly, the Chinese government instigated in 1999 ‘Go Global’ or ‘zou chu qu’ (走出去) policy which was a strong, public commitment to adopt an institutional environment to foster outbound investment.²² The policy was officially supported by the former Chinese President Jiang Zemin and the former Chinese Premier Zhu Rongji (Zhu, 2001) and became formal policy with the incorporation in the 10th Five Year Plan (FYP) in 2001 (Child and Rodrigues, 2005). The ‘Go Global’ policy was issued to encourage and support (financially and administratively) Chinese firms to internationalise with the aim to strengthen their competitive advantage and, recursively, the economic restructuring and development of China. This policy was also a reflection of the Chinese perception that China had by now become sufficiently developed to take its appropriate place in the global economy, as symbolised by the international strength and scope of its MNEs (Zhao, 2007). A key initiative of the 10th FYP was to push SOEs to ‘Go Global’. Five hundred-and-twelve companies have been identified to be of key importance to China’s international business aspirations and have received preferential attention (Wu and Sia, 2002).

During Phase 4 the spatial distribution of Chinese ODI started to change considerably compared to the previous period in terms of investment value (Table 3.3). The developing countries received on average a 22 percentage point larger FDI stock from China per year than in the previous period. This growth took place mainly in Africa (+ 9 percentage points), Latin America and the Caribbean (+ 7pp), and South, East and Southeast Asia (+ 5pp). Accordingly, Chinese ODI in the developed countries declined relatively. Most significant were the drops in share of Chinese ODI located in North America (- 13pp) and Asia/Oceania (-10pp). Considering that these figures reflect the stock of China’s outward foreign direct investment, the actual flows to developing countries were clearly significantly higher than to developed countries over this period.

The distribution of investment projects by number at this time supports this shift. The investment numbers in developing and transitional countries rose by 5 percentage points and accounted for a share of 72% of total number of Chinese ODI projects. The number of projects

²² The starting year of the ‘Go Global’ policy is ambiguous. Cai (2006) states that Premier Jiang Zemin announced the policy in 1998 while Child and Rodrigues (2005) refer to the year as being 1999. Sauvart (2005) and Zhang (2005) take the year 2000 as the starting point. A fourth group of researchers refers to the year 2001 in connection with the FYP (e.g. CAITEC and WDA, 2005). The most recent date is proposed by Kaartemo (2007) who refers to 2003. The discrepancies probably derive from (i) access to original sources in Chinese and (ii) reference to either the first mentioning or the public implementation of the policy.

in Africa rose along with the investment value. By the end of 2001, Chinese companies had invested in 149 countries.

3.3.5 Phase 5: Accession to WTO and 'Go Global' implementation (2002 onwards)

Since China's accession to the World Trade Organisation (WTO) in 2001 the business environment for Chinese enterprises has changed dramatically. WTO accession necessitates the gradual opening of once locally protected domestic markets to comply with its accession protocols and the WTO's 'most favoured nation' rule. Domestic enterprises thus face increasing competition from Chinese and foreign invested enterprises as well as from foreign importers. Growing domestic competition is likely to force many Chinese companies, especially private-owned enterprises which lack political support, to find new markets both in China and abroad, and this is likely to provide fresh stimulus to Chinese ODI flows (von Keller and Zhou, 2003; Taylor, 2002).

Against this backdrop, the Chinese government has undertaken several initiatives to facilitate Chinese ODI (see Table 3.6). First, the investment approval process has been decentralised to sub-national government authorities while investment in seven selected countries only require approval at a national level (revealingly, the relevant countries are not mentioned in any reference referring to this policy however). Second, the government has simplified and abolished the feasibility study as part of the application documentation but now stresses market forces and the managerial capabilities of the investing enterprise instead. Third, control on international capital movement will be eased which should promote Chinese outward FDI (FT, 2004). Finally, enterprises are no longer required to deposit security at SAFE and are allowed to raise money on international finance markets to help fund ODI activity (Wong and Chan, 2003).

A further liberalisation step involved the foreign exchange approval process which changed significantly in 2002. First, some twenty-six approval requirements were repealed by SAFE in 2002 and 2003. This was followed by abolition of a foreign exchange risk assessment and the foreign exchange deposit and exchange rate risk analysis (Zhang, 2006; Yin *et al.*, 2003; EIU ViewsWire, 2004). Third, SAFE also allowed Chinese firms to use foreign exchange of up to fifteen per cent of the total investment sum to cover set-up cost prior to its final decision (Deschandol and Luckock, 2005). Fourth, throughout previous years, SAFE capped the amount of foreign exchange available to domestic enterprises for outbound investment. This artificial limit was abolished in 2006 (Stender *et al.*, 2006). Fifth, further liberalisation concerns whether or not the national or sub-national SAFE office is responsible for approving foreign exchange.

Following China's typical proven trial-and-error economic reform, six coastal provinces were selected in October 2002 to trial the decentralisation of foreign exchange purchase for ODI by domestic firms. After the successful trial period and successive geographical extension, this policy came in force nationwide in 2005 (Zhao, 2006). This gives local SAFE branches more leeway and should shorten the approval process considerably.

A similar measure was undertaken by MOFCOM. The national MOFCOM office is now only involved in approving investments by companies under the supervision of the central government (for example, under supervision of SASAC)²³ and investments by any company in seven selected target countries (including Iraq, Japan, and the USA). Investments in other regions still need to be evaluated by provincial MOFCOM offices (MOFCOM, 2004a; FT, 2004). Resource-seeking FDI exceeding an investment value of USD 30 million and non-resource seeking FDI exceeding USD 10 million have to receive approval from the NDRC (Norton Rose, 2005; Deschandol and Luckock, 2005). Resource-seeking investments above USD 200 million and non-resource seeking investment above USD 50 million have to be approved by the State Council (Yu *et al.*, 2005). Regardless of the size of investment, the State Council and the NDRC are also responsible for any investment in Taiwan and countries that have no official diplomatic relationship with China (Yu *et al.*, 2005). The number of government authorities involved in the approval process has been increased. The key authorities remain SAFE, MOFCOM, NDRC and, to a lesser degree, the State Council and the Ministries of Finance and Foreign Affairs. Newly involved are the specialised supervisory bodies of financial institutions such as the Chinese Insurance Regulatory Commission which approves ODI by Chinese insurance companies (Wang, 2002; Tong and Groffman, 2000; Wong and Chan, 2003; Norton Rose, 2005). It has been indicated that the formal approval process is likely to evolve further over time into a pure registration and monitoring process, easing overseas investment further. The liberalisation from a system of micro-control to macro-control mechanisms have *de-jure* significantly eased the internationalisation of Chinese firms via ODI.

In a recent statement on existing regulations concerning the ODI approval process, MOFCOM (2005) stated that Chinese firms are guided via the approval process to invest in a feasible project in an economically and politically stable host country that has concluded a bilateral treaty with China on investment and taxation. The investment should also carry benefits for the firm and for China's economy by: (i) promoting China's exports of goods and services, (ii)

²³ In contrast, Yu and Hwang (2005) state that companies under the central government can decide independently whether to invest or not. These firms only have to make a post-investment filing with the NDRC.

enhancing the firms' technological capacity and R&D activities, (iii) enabling the firm to create and establish an international brand.

Despite these liberalisation and decentralisation measures and political assurances, criticisms of the current regime persist. China continues to maintain tight control on the capital account of ODI (Lin and Schramm, 2003). The investing company has to have foreign trading rights to be able to generate foreign exchange. Although trading rights are now awarded more widely to private and state-owned firms since the late 1990s (Saich, 2004), applications for trade licenses can be rejected or, once awarded, they can be withdrawn. This impedes the earning of hard currency and the development of overseas businesses. Moreover, the division of approval responsibilities between the NDRC and MOFCOM is often unclear for potential Chinese investors and local government agencies (CAITEC and WDA, 2005). This might be more relevant for large-scale natural resource investments by state-owned enterprises. Long (2002) characterises the approval process as being very time-consuming, resource intensive and not designed to encourage firms to invest overseas. By contrast, discretionary local politics often contradict national law and investment procedure. Local institutions occasionally allow ODI without any formal procedure in favour of a well-connected *nomenklatura* (Ding, 2000a). Arguably, a large part of Chinese ODI has not been formally approved (and registered) by the Chinese government but rather has been channelled out of the country using, for example, private channels and transfer pricing methods (Deng, 2004). This applies to ODI by both SOE and privately-owned firms and may be a reaction to a restrictive approval regime. The Chinese government established current account convertibility in 1996. Although the government has slowly adjusted policies and frameworks for capital account convertibility, this was not achieved until 2007 (Roberts and Tyers, 2003). The achievements with regards to the capital account concentrate on inward FDI and export facilitation,²⁴ whereas similar action to support Chinese ODI remain underdeveloped to an extent that it is perceived as a very restrictive system (Lin and Schramm, 2004; Guo and Han, 2004). This stand in stark contrast to the acknowledgement by the Chinese government that a freer regime towards outward investment will help domestic enterprises to diversify business risks more effectively and is an essential element of the 'Go Global' policy (Groombridge, 2001; Guo and Han, 2004).²⁵

²⁴ Zhang (2006) notes that the Chinese definition of currency convertibility may deviate from the Western one. In particular, he asserts that China is likely to define it as full convertibility on the current account and liberalisation of long-term transactions only on the capital account.

²⁵ In contrast, it is argued by some observers that a restrictive stance towards ODI is beneficial to the Chinese economy as it eases pressure of capital flight and thus on wider economic implications with respect to inflation, non-performing loans and unemployment (Schwartz, 2005). Both perspectives seem to be outdated, as Zhang (2006) reports extensive reforms between 2001 and 2004.

Moreover, the Chinese government involvement does not remain on a macro-level. The provision of an 'acquisition fund' and cheap loans also shape the investment decision of Chinese MNEs and constitutes an invaluable source of competitive advantage (Antkiewicz and Whalley, 2006; Child and Rodrigues, 2005).²⁶ Micro-control is evident in the annual appraisals by MOFCOM and SAFE to assess the performance of overseas affiliates (MOFCOM, 2004a; People's Daily, 2002). Based on the outcome of the evaluation, future approvals of outbound investment and expatriation of staff is granted or not. Such types of 'parental' involvement by the Chinese authorities in the decision-making of state-run *and* non-state-run enterprises is said to be common practice (Ring *et al.*, 2005; Child and Tse, 2001). The macro-control of Chinese ODI is likely to be facilitated by the so-called 'Outbound Catalogue' issued by MOFCOM and NDRC in 2004 for the first time. This catalogue lists the governments' preferred host countries and industries and tries to attract Chinese firms to them by offering preferential access to finance and tax concessions and other incentives (Deschandol and Luckock, 2005). It is possible that the role of the catalogue will be extended to the foreign investment catalogue which regulates inward investment to China. Finally, there seems to be some evidence that the Chinese government's approach towards outbound investment is shaped greatly by the level of surplus on the capital account (Zhao, 2006). The reform and liberalisation measures could be reversed if the growth of China's foreign exchange reserve slows down and falls below a politically unacceptable threshold.

The observed changing pattern of outward FDI for the period 1999 to 2001 has continued in Phase 5 (see Table 3.3). The proportion of ODI stock of Chinese investments to developing countries rose to 77% and for industrialised countries it continued to decline to 23% compared to Phase 4. However, this time most developing countries experienced a relative decrease as well. The share of Asia/Oceania more than doubled to 54% while Africa (-8 percentage points) and Latin America (-5pp) saw their relative share decline. Similarly, project numbers in Asia/Oceania increased by 12pp but declined in Africa and Latin America by 5 and 2 percentage points respectively. The number of Chinese investment projects in developed countries has remained stable.

The increase in Chinese ODI to the developing countries can be partially explained from a foreign policy perspective. China has long seen itself as the advocate and supporter of developing countries and as a strong regional player building upon its legacy (Wang, 2006a; Broadman, 2007; Cornelissen and Taylor, 2000; Bailey, 1975; Chai, 1979). After a period of

²⁶ Xiao and Sun (2005), for example, report that CNOOC received for its failed take-over bid to Unocal a preferential USD 7bn loan from the Chinese government. USD 2.5bn of the loan was interest-free and the remainder enjoyed with 3.5% interest over thirty years.

inward orientation, China is progressively building upon this perception. It uses its foreign policy and punctuated official development aid to support its objectives in international relations and international business. As a consequence, China's foreign policy and foreign aid are successively brought in line with the overseas investment ambitions of Chinese companies and political goals of the national government. The regions where this is most pronounced are Africa and ASEAN. This strategy is manifested in mainly three facets: (i) state visits, (ii) official development aid, and (iii) specialised regional committees and organisations:

State visits

The most visible features of China's alignment of the 'Go Global' and foreign policy are the numerous high-profile state visits of China's leaders to developing countries which are often intended to smoothen the way for Chinese companies into the host country (Liu, 2001). Among the most prolific state visits have been the tours by President Hu Jintao through Latin America (2004) and Africa (February 2004, April 2006, and January 2007), Premier Wen Jiabao's visit to Africa in June 2006 and Foreign Minister's Li Zhaoxing Africa tour in January 2006. Both regions have not received such an intensive political recognition by any other major industrialised economy or developing country. During each state visit, China has signed a number of wide-ranging economic co-operations agreements, foreign aid schemes and Chinese investment, such as an agreement on exploration rights for CNOOC in Kenya.

Official development aid

China's official development aid is generally allocated to transportation and telecommunication infrastructure projects, but it also includes the construction of new sports facilities, parliaments and other real estate (Pheng and Hongbin, 2003). The interesting aspect of China's aid scheme is that it often supports the receiving country by offering it significant loans at often lower-than-market rates. Loans of this type are often conditional on the receiving country awarding a Chinese company with investment opportunities has been evident in Cambodia, Ethiopia, Laos and Sierra Leone for example (Zhan, 1995; Frost, 2005; FT, 2005b; FT, 2006a; FT, 2006b). China's official development aid strategy therefore not only helps her to increase its political stance on and influence in the host country. It also supplies Chinese companies with international contracts which helps them establishing an overseas market and setting up affiliates in a government-backed, hence low-risk manner.

Specialised regional committees and organisations

To further support its international stance, China supports the South-South Cooperation initiative by the United Nations Development Programme (UNDP) by participating in the Technical Cooperation among Developing Countries (TCDC) and Economic Cooperation

among Developing Countries (ECDC) programmes. One of China's explicit objectives in its cooperation strategy is to foster the 'Go Global' agenda and, in particular, to support and encourage privately-owned Chinese enterprises to invest in Africa (Zhao, 2007). As a mean to increase private Chinese ODI, China has established the China African Business Chamber for private businesses only and seeks to conclude double taxation treaties and bilateral investments treaties with the African Nations (TCDC Update, 2005, 2006). These points were further articulated in "China's African Policy" paper issued in January 2006 (TCDC Update, 2006). Further, China has set up the Forum on China-Africa Co-operation which has been held thrice since 2000. The Forum is a high-profile gathering of African and Chinese head of states and ministers designed to strengthen the partnership and to discuss political and economical issues of mutual benefit. It also helps to promote and conclude economic cooperation and assistance with Africa. A similar forum does not exist between China and any other region.

Table 3.6: Key ODI regulations in Phase 5 (2001 onwards)

Regulation	Issued	Comments	Enunciator
Notice on the statistical system of direct overseas investment	Jan. 2007	Amendment of the 2004 version to incorporate quarterly information on the signing of overseas investment projects and round-tripping investments via tax havens and to better track and account for investments by private enterprise ¹¹	MOFCOM, NBS
Circular on revision of certain foreign control policies relating to overseas investments <i>(alternate translation: Notice on the adjustment of certain foreign exchange control policies for overseas investment)</i>	June 2006	Lifts SAFE restrictions on the amount of foreign exchange available annually to domestic investors' outbound investments. Domestic investors are now able to undertake offshore investments using self-owned foreign exchange, foreign exchange purchased with Yuan and/or domestic loans ^{1,4}	SAFE
Detailed rules for the examination and approval of investments to open and operate enterprises abroad	Oct. 2005	Specifies and clarifies the 2004 regulation on requirements, risk avoidance, and project feasibility ¹⁰	MOFCOM
Circular on the issues on offering more financing support to key overseas investment projects	Sept. 2005	Annual finance plan with preferential treatment of investment projects in (i) natural resource exploitation, (ii) export enhancing infrastructure, (iii) R&D, and (iv) M&A ¹⁰	NDRC, China Exim Bank
Circular on expanding the trial regions for the pilot program concerning overseas investment	May 2005	Reform of the exchange approval regime is extended to the whole country: Further decentralisation, i.e. local SAFE offices decide	SAFE

(<i>alternate translation</i> : Circular on Issues Relating to Enlarging Pilot Reform of Foreign Exchange Administration Concerning Overseas investment)		about a higher threshold; total foreign exchange available for all investor has been increased to USD 5bn per annum; Remit out of China <u>prior</u> to obtaining approval as required, e.g. preparation and start-up period ⁶	
Notice concerning the policy on providing credit and loan support for overseas projects encouraged by the State	Oct. 2004	A loan will be provided if the FDI projects fulfils at least one of the following requirements: <ul style="list-style-type: none"> - Natural resource-seeking in which China is short; - Promote Chinese export; - R&D in advanced international technology; - M&A to increase international competitiveness and market exploration of the Chinese firm² 	NDRC, China Exim Bank
The interim measures for the administration of examination and approval of the overseas investment projects	Oct. 2004 (effective)	All kinds of companies are allowed to invest abroad; sets out the threshold values for examination at national level and clarifies the approval process ¹⁷	NDRC
Provisions on the Examination and Approval of Investment to Run Enterprises Abroad	Oct. 2004 (effective)	National approval for seven countries/regions required, remaining countries are approved at sub-national level; No feasibility study is required anymore ¹⁶	MOFCOM
Decision on Reforming Investment System	July 2004	Major reform of the ODI approval and departure of former practice which initiated subsequent reforms ⁶	State Council
Countries and Industries for Overseas Investment Guidance Catalogue (<i>alternate translation</i> : Investment in Foreign Countries Industry Sector Guidance Catalogue)	July 2004	Companies complying with requirements and having received the investment approval have preferential treatment concerning funding, tax collection, foreign exchange, customs and others; Lists more than seven supported industry sectors and 67 approved countries ^{8, 18}	MOFCOM, Ministry of Foreign Affairs
Tentative administrative rules on approval of offshore investments projects	April 2004	Rules concerning international M&As: No international M&A agreement can be signed by a Chinese investor without the approval by NDRC ¹³	NDRC
Issues relevant to further intensifying the reform of foreign exchange administration on external investment circular	Oct. 2003	Simplification of approval procedures; establishment of pilot areas for eased and extended local approval ^{5, 8, 10}	SAFE
Circular of the issues related	May 2003	No further information provided ¹⁰	NDRC

to granting financing support to key overseas projects encouraged by the state			
Notice on certain issues relating to simplify foreign exchange fund source examination for overseas investment	March 2003	SAFE is <u>only</u> investigating domestic foreign exchange sources. Foreign exchange obtained from a source outside of mainland China no longer examined ²	SAFE
Statistic system of overseas investments	Dec. 2002	Agreement to jointly publish annually a bulletin on Chinese ODI development ¹⁵	MOFCOM and NBS
Comprehensive external investment results evaluation procedures	Oct. 2002	Clarification of standards and procedures for evaluating ODI applications ⁵	MOFCOM
Joint annual inspection of overseas investment tentative procedure	Oct. 2002	Post-investment regulation ^{5,10}	SAFE MOFCOM

Sources: ¹ Stender *et al.* (2006), ² Yu *et al.* (2005), ³ Zhang (2003), ⁴ Freshfields Bruckhaus Deringer (2006), ⁵ Yin *et al.* (2003), ⁶ Yu and Hwang (2005), ⁷ Tong and Groffman, 2000; ⁸ Norton Rose (2005); ⁹ Zhao (2006); ¹⁰ UNCTAD (2007b); ¹¹ MOFCOM (2007); ¹² Huang (2005); ¹³ Xiao and Sun (2005); ¹⁴ Cai (1999); ¹⁵ MOFCOM and NBS (2002); ¹⁶ MOFCOM (2004a); ¹⁷ NDRC (2004); ¹⁸ China Law and Practise (2005).

3.3.6 Industry sector distribution

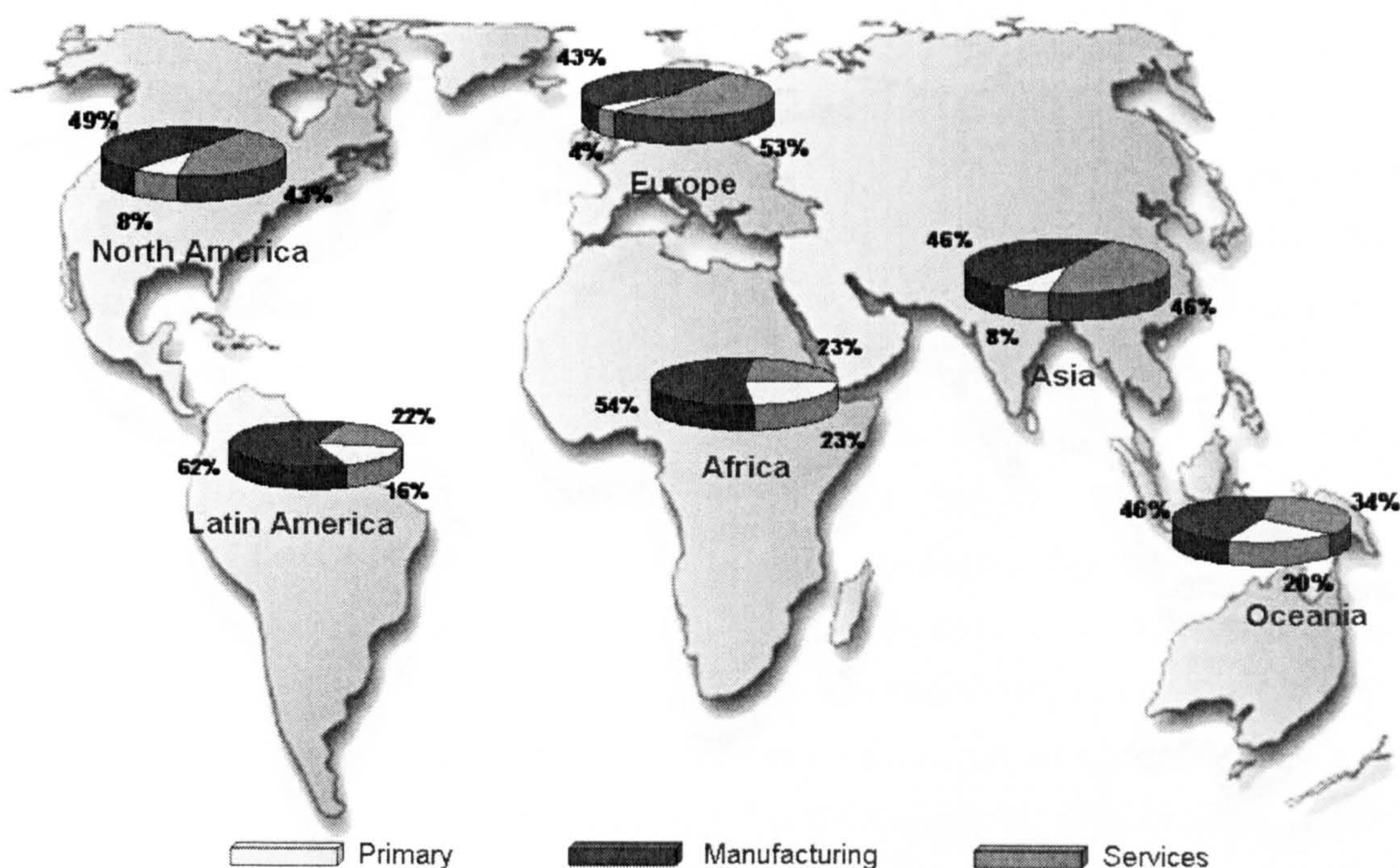
An analysis of Chinese ODI would be incomplete without an overview of industry sector distribution. Chinese ODI by industry sector may reflect areas of government support and competitiveness of Chinese firms. In this section, a different dataset is used to the previous section. While the previous section mainly relies on MOFCOM data, this section is informed by data collected by SAFE.

Figures 3.1 and 3.2 depict the aggregated industrial distribution of SAFE-approved Chinese ODI by (i) investment project and region and by (ii) investment value and region for the period 1979 to 2001 (SAFE, 2005). The regions are as follows: North America (USA and Canada only), Latin America, Europe, Africa, Asia and Oceania. With regard to the number of investment projects, some interesting observations can be reported. First, the ratio of primary, manufacturing and service projects are similar for North America, Europe and Asia with 4 to 8% of projects in the primary sector, 43% to 49% in manufacturing and 43 to 53% in services. Although the ratios are similar, it has to be borne in mind that absolute figures differ across these three regions. Asia registers the majority of approved Chinese investments (1583 projects)

whereas North America (612) and Europe (358) score fewer. Considering the different economic development stages and thus different factor prices in North America and Europe on the one hand and in Asia on the other, a stronger concentration of manufacturing investments in Asia is assumed. Thus, the high number projects in the manufacturing sector for Latin America and Africa is not surprising.

The service sector receives relatively small numbers of investment projects. Only in Africa and Oceania does it reach a share of more than 20%. Chinese ODI in this sector has been (and this argument will be developed later) devoted to support the trade functions of Chinese firms and, to some extent, secure hard currency from abroad and keep it within the organisation.

Chinese investments in the primary sector predominantly occur in Latin America, Africa and Oceania. This reflects probably the investments in fishery, timber and other agricultural products in these countries as reported by Frost (2005), Wu and Sia (2002), Cai (1999) and others.



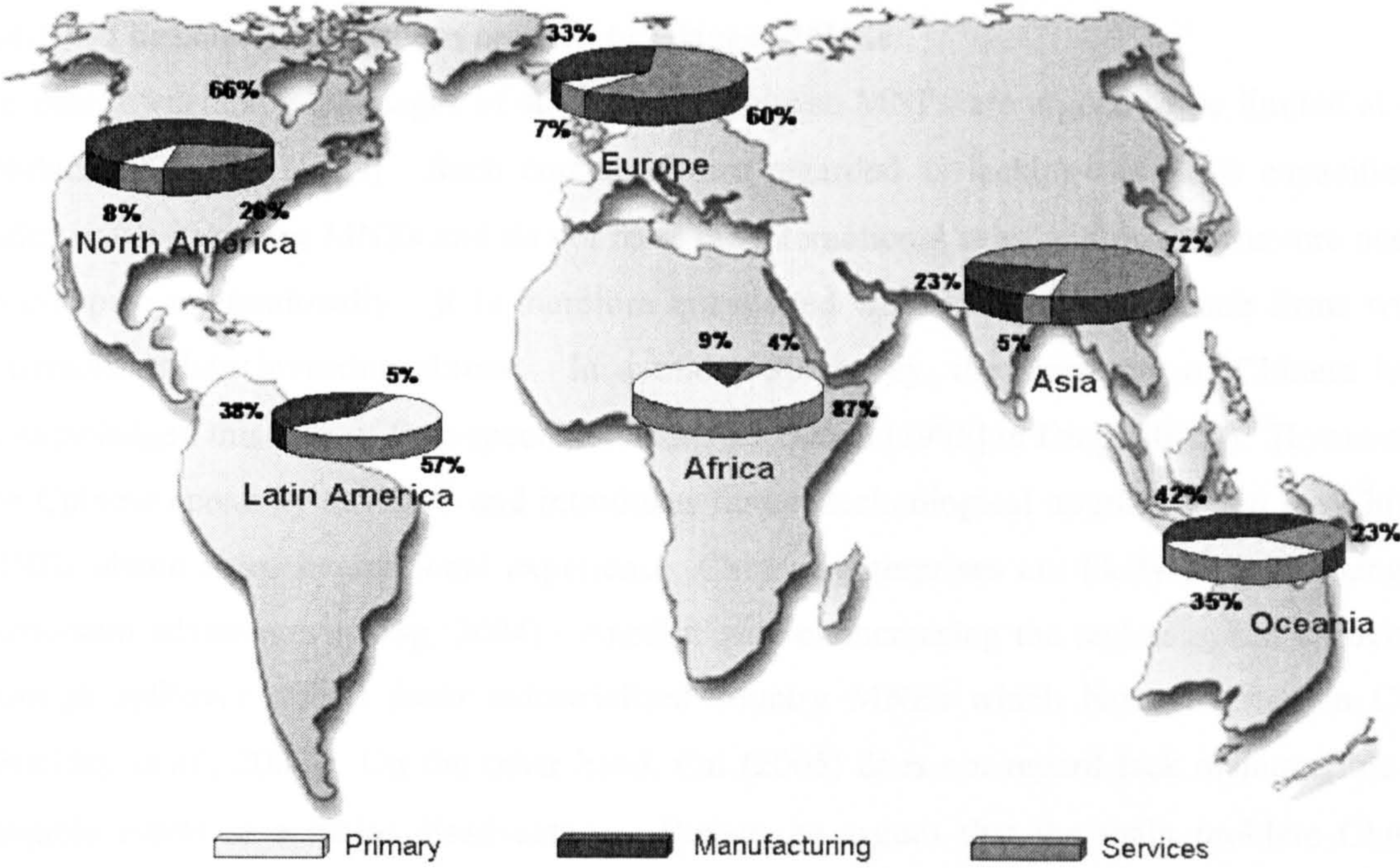
Source: Author's calculation based on SAFE (2005).

Figure 3.1: China's approved outbound investment projects by industry sector and host region, 1979-2001 (% of total project numbers in the region)

The above observations no longer apply when the approved investment values are examined. Investment in the service sector is the most important contributor to Chinese ODI in Asia (72%

of total investment value) and Europe (60%) but it plays only a marginal role in Latin America and Africa. These figures compare well to the above 60% share reported by Zhan (1995), based on MOFCOM data, and the share of around 60% stated elsewhere (e.g. Wong and Chan, 2003; Taylor, 2002). Service-related investments in Europe, North America (26%) and Asia may be at least partially trade supporting investments. Such investments are typically of small scale and this would explain some of the difference observed between investment value and project numbers.

The strong position of investments in the manufacturing sector in North America becomes more pronounced when investment values are examined. More than 60% of Chinese ODI occurs in this sector in this region; a share no other region achieves. Investments in Europe and Latin America comprise about a third of the total in the manufacturing sector while in Africa manufacturing FDI is much less pronounced with 9% of the total (SAFE, 2005). The overall share of the manufacturing sector updates Zhan’s (1995) observations who asserts that it accounts for a relatively small share of total Chinese ODI.



Source: Author’s calculation based on SAFE (2005).

Figure 3.2: China's approved ODI value by industry sector and host region, 1979-2001
(% of total to the region)

Zhan (1995) suggests that about 25% of total Chinese ODI occurs in the primary sector. This is partially reflected in the data by SAFE (2005) as well. Investments into Latin America, Oceania

and, especially, Africa have been dominated by large-scale investments in primary resources. North America, Europe and Asia are for the period under investigation not host to major Chinese investments in this sector (1979 to 2001).

3.4 Explaining Chinese outward direct investment – A literature review

The analyses in the literature of the evolution of Chinese outward FDI has focused, to date, on SOEs using established international business theories. The eclectic paradigm (Dunning, 1999) and the international investment strategies of FDI (market-, resource-, and efficiency-seeking) (Dunning, 1993) are the most frequently applied. The sequential and ad-hoc internationalisation have also been touched upon in research papers on the subject, as has the importance of international networks to Chinese firms. The literature is now reviewed with the aim of identifying key determinants and to highlight shortcomings in extant work. This section commences with a discussion of the research results of the theoretical approaches applied and identifies explanatory gaps. Based on these, the research questions for this study are developed.

3.4.1 The eclectic paradigm applied to Chinese MNEs

To date, ownership advantages of state-owned Chinese MNEs are argued to be limited at best (Nolan, 2002; Cai, 1999). Such companies are regarded as lacking the R&D capacities of industrialised country MNEs and do not have the international sales and profit structure needed to compete internationally. It is therefore questioned what kind of assets such firms would internalise when investing abroad. In a mid-1990 survey, the managers of Chinese MNE acknowledged this lack of firm-specific advantages (Duan [1995] in Ding, 2000a). However, as the Chinese economy develops and introduces further technological upgrading and the Chinese MNEs obtain more international experience, Chinese enterprises are likely to gain intangible ownership advantages (Deng, 2004). Another way of increasing the technological capacity is through spillover effects from industrialised country MNEs which have invested in China (Buckley *et al.*, 2002). On the other hand, Cai (2006) does not regard lack of intangible and tangible assets as a major disadvantage. Rather, he argues that the main problem Chinese companies face internationally is the lack of sound financial resources. Obviously, considering this crucial inconsistency with neoclassical theory, this observation suggests that supplementary explanations might have to be found to explain the internationalisation of Chinese firms. One could argue that state-ownership of most Chinese MNEs of itself constitutes a firm-specific advantage that industrialised countries MNEs do not possess (Child and Rodrigues, 2005; Ding, 2000a). The political, financial and material support provided by the Chinese government could yield a significant advantage over those MNEs that have to achieve profitability to raise the

shareholder value and report business plans to their shareholders. At least some state-run Chinese MNEs have set up foreign affiliates to support either domestic development goals or China's international diplomacy goals. The importance of operation costs seems to be minor in these cases. In contrast, financial support by the government has been argued to be limited or absent by a number of Chinese senior managers such as Ms Ma, Senior Vice President and Chief Financial Officer of Lenovo, the computer company (Balfour, 2005). Although Lenovo is 50 per cent owned by Chinese authorities, Ms Ma stresses that Lenovo's internationalisation strategies and operations are based solely on commercial considerations. Child and Rodrigues (2005) contradict this statement, however, and make the case that Lenovo has expanded through privileged access to financial, scientific and other human capital support prior to its first international investment and has received government backing when pursuing international acquisitions. This simple overview points to the fact that there is little consensus regarding what drives Chinese ODI, even for the same case-study firms. The determinants are not satisfactorily delineated or proven. Hence, the first research question of this study is:

RQ1 – What are the determinants of Chinese ODI?

3.4.2 International investment strategies of Chinese MNEs

Market-seeking FDI

During the 1980s and early 1990s, market-seeking motivation is argued to be related mainly to providing a support function for Chinese domestic enterprises. In this view, outward FDI is seen as being designed to help Chinese firms to familiarise with international market behaviour and requirements, to collect market information for subsequent investments and to facilitate exports of Chinese domestic firms to increase their hard currency earnings. This view is acknowledged in the work of Buckley *et al.* (2006), Wu and Sia (2002), Zhang (2003), and Wu and Chen (2001), among others. Examples of FDI driven by these motivations include the investments by a Chinese pharmaceutical company in Thailand with the ultimate objective of supplying the region of Thailand-Myanmar-Cambodia and the investment of another Chinese firm in the African fish industry to subsequently export fishing vessels from China to Africa (Tan, 1999). Export-supporting FDI has been of interest to the Chinese government for many years as well (see Section 3.3) as a way to generate income in foreign currency and to increase China's foreign exchange reserves (Wall, 1999). Two types of FDI that Chinese firms use to circumvent trade barriers have been observed: they either invest behind the trade barrier or they establish an export-platform in a third country which faces less or no trade restrictions for the specific products produced (Wall, 1999). During the 1990s, the prime objective of market-

seeking FDI is said to have changed. Buckley *et al.* (2006) propose that the main purpose is gradually switching to more defensive and offensive measures to either defend existing markets or develop new one, respectively. To illustrate, Tan (1999) states that the investments by China Southern Glass in the USA and Australia were designed to increase its control over distribution in important export markets. Moreover, Chinese companies have invested internationally in order to access and develop new markets as domestic markets have become increasingly more competitive and saturated, especially after 2001 and China's WTO accession. The international diversification of business interests by Chinese firms is supported by the Chinese government to spur their growth and competitiveness (Wall, 1999). One reason is the on-going economic integration of China into the world economy and heightened domestic competition following China's WTO accession in 2001 (UNCTAD, 2006; Sauvant, 2005; Beebe, 2006). Moreover, the domestic growth of Chinese firms has often been constrained by inadequate distribution and logistics networks, market saturation and regional market protection across a range of industry sectors (Zeng and Williamson, 2003). Market-seeking investment behaviour has also seen Chinese firms re-orientate their FDI strategy towards developing countries in Asia and Africa. The Chinese investments in these countries are argued to be small-scale and labour-intensive projects producing low-value added products for the local market (Deng, 2004). This investment behaviour mirrors the international strategies identified for other developing country MNEs (e.g. Lecraw, 1993; Wells, 1983).

RQ2 – To what extent is Chinese ODI driven by market-seeking motivations?

Resource-seeking FDI

Natural resources-seeking FDI are argued to be mainly stimulated by the Chinese government to ensure sustainable supply of natural resources where China has domestic shortfalls, in order to satisfy the high domestic demand and to maintain high economic growth rates (Buckley *et al.*, 2007a; Buckley *et al.*, 2006). The internalisation of key raw material inputs such as minerals, petroleum, timber, fishery and agricultural products (Wu and Sia, 2002; Cai, 1999; Wall, 1999) is driven with a view to obtaining stable and relatively cheap access to these products compared to oscillating prices on world markets (Tan, 1999). These investments are undertaken to fulfil certain political imperatives which may cushion any commercial risk for the investing company (see Section 3.3).

Resource-seeking FDI has been historically directed towards developed countries such as the USA, Canada and Australia (Buckley *et al.*, 2006; Wu and Sia, 2002; Zhan, 1995; Guo, 1984). This is exemplified by the acquisition of stakes in Australian mineral and food companies by

China Metallurgical Import and Export Corporation and by CITIC, both in the 1990s, and by the acquisition of Canada-based PetroKaz by CNPC in 2005, amongst others (Wu and Sia, 2002; Wall Street Journal, 2005). Not all acquisition attempts have been welcomed and concluded successfully, however. CNOOC failed in 2005 to acquire Unocal, the California-based oil company, mainly because of political concerns in the USA about issues of national security and domestic energy supply (Marchick *et al.*, 2005; Graham and Marchick, 2006). China Minmetals aborted the purchase of Noranda (Canada) after exclusive negotiations over some two years (FT, 2005b). More recently, a qualitative shift observed which is accompanied by investments in developing countries. Chinese companies are increasingly leveraging national foreign policy and official development aid agreements with developing countries and are adjusting their location strategies accordingly (Ma and Andrew-Speed, 2006; Deutsche Bank Research, 2006). Hence, since the late 1990s resource-seeking investments have occurred more frequently in developing countries, for example, in Sudan, Angola, Kyrgyzstan (all in oil), and South America (in minerals especially).

RQ3 – To what extent is Chinese ODI driven by resource-seeking motivations?

Technology-seeking FDI

International technology-seeking FDI by Chinese MNEs is argued to be special in a number respects (von Zedtwitz, 2005). Such investment occurs predominantly in advanced industrialised countries, such as Europe and the USA with the objective of obtaining technologies either through the acquisition of a company (or its sub-units) or the establishment of a affiliate in a cluster region (Warner *et al.*, 2004; Wall, 1997). Although this is reasonable, extant research underplays the significance of developing country firms investing offensively in advanced countries to close the technology-gap with industrial leaders (von Zedtwitz, 2005). The most common entry mode used by Chinese MNEs in this respect is the acquisition of a host country company to quickly secure access to advanced technology, management practice and other assets (Warner *et al.*, 2004; Deng, 2004). To illustrate, Haier used both approaches to gain access to new, advanced technology by establishing a de novo refrigerator factory in the USA in 1999 and by purchasing a refrigerator factory from a leading European manufacturer in Italy in 2001 (Wu and Sia, 2002; von Keller and Wei, 2003). Chinese companies which access foreign technology through acquisition tend to transfer technology and other tangible assets back to China to strengthen their production facilities; foreign markets are subsequently serviced through exports with products made to higher specifications (Wall, 1999). One of the most prominent examples of this is the acquisition of MG Rover by Nanjing Automobile Corporation (NAC). Although NAC has retained some production facilities in the UK, major

parts of the production line have now been transferred to Nanjing where production commenced in 2007 and will serve as a blueprint for a subsequent third production line which the company plans to open in the USA in 2008 (FT, 2006c, 2007b).

With the increase of international technology sourcing, Chinese companies are also adapting their research and development (R&D) facilities and structures to better internalise internationally-acquired know-how (von Zedtwitz, 2005). For example, Huawei, the privately-owned telecommunication equipment company, set up five international R&D units by 2003 which were established together with manufacturing and marketing units in order to rapidly catch up with international leading telecommunication equipment companies (Chen and Jiang, 2003). The approach by Huawei runs counter to common experience observed among industrialised country MNEs which tend to internationalise their R&D units *after* having successfully established their customer-oriented units in the host markets (Chen and Jiang, 2003; Cantwell, 1995).

RQ4 – To what extent is Chinese ODI driven by the objective of accessing advanced technology?

Strategic asset-seeking FDI

Strategic asset-seeking motives are often a driving force behind Chinese investments in the USA and Europe, although it is not necessarily confined to these regions. The acquisition of (often) insolvent or underperforming European and US firms is done to acquire established brands, advanced technologies and management know-how, and to access distribution channels and foreign customers. Such behaviour is playing an ever increasing role in investment behaviour of Chinese firms and is done for asset augmenting reasons (Buckley *et al.*, 2006; Child and Rodrigues, 2005). In recent years, the strategic focus of Chinese consumer product manufacturers is argued to rest on the acquisition of brands that are more visible in international markets (Deng, 2004). Amongst the most high-profile examples are the acquisition of IBM's PC business (USA) by Lenovo, the purchase of MG Rover (UK) by Nanjing Automobile Corporation in 2005, and the purchases of Thomson's cathode ray tube television and DVD businesses (France) and Schneider Technology (Germany) by TCL in 2002 and 2003 respectively. While all examples have a technology component, the Chinese company also often buys into a regionally or even internationally well-established brand: in these cases *Think*

(IBM)²⁷, *Rover*, *Schneider*, and the Thomson brands *RCA* and *Thomson*. Actually, Germany arguably is a particularly attractive target country for this type of Chinese investment because a lot of small- and medium-sized companies are in difficulty but are well known (in China) for their technology, quality and well established brands (Reinert and Altrichter, 2004). Brand acquisition by Chinese MNEs is not universal, however. For example, Haier relied on its own brand when it started to invest first in Asia and then in the USA. The brand and the technological capabilities were, however, underdeveloped at the time of market entry and this suggests that Haier sought to build brand-related capacities and competencies while developing a new market (Child and Rodrigues, 2005).

RQ5 – To what extent is Chinese ODI driven by the objective of accessing strategic assets?

Efficiency-seeking FDI

Efficiency-seeking FDI is said to be of minor importance to MNEs from developing countries in general (Lall, 1982; Lecraw, 1977) and Chinese firms too (e.g. Buckley *et al.*, 2006; Deng, 2003, 2004; Zhan, 1995). There are two explanations for the lack of importance of this FDI motive. First, Chinese MNEs generally do not coordinate and re-organise international supply chains to benefit from different factor input costs because many are young and have not yet established geographically disperse operations that would benefit from reorganisation and rationalisation. Second, China possesses abundant low-cost labour and cheap land itself so many Chinese MNEs may prefer to relocate their labour-intensive production within China than shifting it abroad (Zhan, 1995). Nevertheless, Wu and Sia (2002) claim to have identified some emergent trends in this area. In particular, they state that Chinese companies seek to benefit from lower transportation costs and to avoid trade restrictions and barriers by establishing production facilities in developing countries. As they do so, these companies also outsource low-technology intensive production and establish regional production networks (as supply chains) in which the Chinese parent company is the kernel. It can be argued, however, that this investment behaviour identified by Wu and Sia (2002) is less efficiency-seeking and more market-seeking behaviour. Another example of efficiency-seeking behaviour is provided by Lenovo which as early as 2003, outsourced the majority of its laptop and component production to subcontractors in Taiwan (Naughton, 2007). Notwithstanding these observations, efficiency seeking FDI is not investigated further in this study. As Chinese firms continue to expand their geographic reach and range of international production, however, it is likely that efficiency

²⁷ In addition, Lenovo secured the trademark rights for *IBM* in connection with *Think* products for five years (FT, 2005c).

seeking FDI will become more commonplace, a factor that should be properly taken into account in future research on Chinese ODI.

Historic and Emergent investment behaviour framework

A step towards formalising the evolution of international investment behaviour by Chinese firms has been undertaken by Buckley *et al.* (2006). Using secondary data, Buckley *et al.* (2006) advance a framework that describes historic and emergent investment behaviour of Chinese firms abroad (see Table 3.7). This is based upon the strategic investment drivers for ODI of Dunning (1993) as applied in other studies on Chinese ODI (e.g. Deng, 2004). However, instead of taking a static stance to investment behaviour typical of research on Chinese ODI, Buckley *et al.* (2006) instead acknowledge that investment strategies of Chinese MNEs have changed in a dynamic institutional and business environment. Hence, they identify historic and emergent characteristics for each investment strategy: Natural resource-seeking investment was early confined to a small number of developed countries but is increasingly becoming more globally spread and covers more commodities; early market seeking investments sought to support Chinese exporters but is latterly more fine-grained, following defensive and offensive strategies; while early asset seeking investments were driven by the need to collect primary market information and knowledge but occurs latterly more to secure access to brands, distribution channels, and other tangible and intangible assets, for example. The shift in strategies Buckley *et al.* (2006) observe is supported by the changing attitude of the Chinese government towards ODI. While the government formerly pursued a strongly regulated and controlled or 'hands on' approach, it advocates today a 'hands off' approach. This is articulated clearly in the deregulation and liberalisation of Chinese ODI approvals describes in the five phases of Chinese ODI as presented in Section 3.3. It is also confirmed by the work of Hong and Sun (2006) who state that the international investment decisions of Chinese MNEs has been relocated from the central government to local government and are today taken mainly by the Chinese firm itself. Buckley *et al.* (2006) also consider changes to the industry sector distribution and foreign market entry mode choice of Chinese MNEs in their framework: Chinese ODI has shifted from being service-oriented to be manufacturing dominated, while wholly-owned affiliates substitute for joint ventures as the favoured entry mode. Cross and Voss (2007) update this framework and assert that the year 2000 is the watershed year in the changing investment behaviour of Chinese firms. It was then that discussions about the 'Go Global' policy began and this was formally acknowledged in the 10th five year plan, constituting major triggers for the qualitative shift in Chinese ODI observed by Cross and Voss (2007).

Table 3.7: Historic and emergent investment behaviour of Chinese MNEs

	Historic: pre-2000	Emergent: 2000 and after
Market seeking-strategy	To support the export function of the parent company	Defensive (import-substituting and quota-hopping FDI) and offensive (to develop new markets)
Natural resource-seeking strategy	Raw materials extraction mainly in developed countries	Raw materials and other commodities, more widely distributed
Strategic asset-seeking strategy	To obtain foreign market information and knowledge	To obtain foreign technology and brands and to access foreign distribution channels, managerial know-how and capital markets
Efficiency seeking-strategy	Of limited importance due to abundant pool of low-cost labour in China	Of limited importance due to increased agglomeration effects and abundant pool of low-cost labour
Sectoral distribution	Services-oriented (mainly trade-related)	Manufacturing-oriented
Entry mode	Joint venture	Wholly-owned affiliate

Source: Adapted from Buckley *et al.* (2006), see Cross and Voss (2007).

All of the literature reviewed in this section examine FDI motives of Chinese firms but fall short at identifying these relationships between the spatial distribution and investment motivation of Chinese ODI. Preliminarily, however, it seems to be apparent that resource-seeking investments are concentrated in African countries such as Sudan and in Central Asia (in terms of oil and gas). Likewise, technology-seeking FDI tend to occur more often in the industrialised rather than developing countries. To gain stronger support and evidence for these relationships cross-sectional analyses covering longer time periods are necessary. This is undertaken for the first time in this study.

RQ6 – Have the determinants of Chinese ODI changed over time?

Additional FDI motives

Besides the familiar investment strategies, two further objectives are argued to have driven Chinese ODI since the 1980s. These are, first, political concerns and, second, an array of motivations based on poorly defined and enforced property-rights in China (Ding, 2000a).²⁸ The former is especially related to the union of China with Hong Kong SAR in 1997. It is

²⁸ This discussion of political motives and (semi-)illegal practises is based on Ding (2000a).

argued that prior to 1997, mainland Chinese firms and (sub-national) government authorities intended to show political support and commitment to Hong Kong and to reintegrate it quickly into the mainland by establishing overseas affiliates or purchasing local firms there. These early Chinese investments in Hong Kong are argued to have been ultimately designed to show the mainland's power over Hong Kong, and its dependence on it (Wall, 1999). The property rights issue refers to different instruments used to gain private access to public assets with the intention of rent-seeking. Ding (2000a) illustrates this with several examples from the late 1980s and early 1990s where the internationalisation of Chinese firms was essentially a catalyst to abuse public assets. The most obvious outcome was the quasi-privatisation of overseas Chinese affiliates by the managers running them (Naughton, 2003; Broadman, 2001). Such asset-stripping occurred typically in the form of registration of the affiliate under the name of the managers (which deprived the Chinese parent company from access to and control of the foreign assets), or by the channelling of the affiliate's funds to a newly founded but unofficial firm in China (Ding, 2000b). While the former often received the blessing from the parent company, the latter was outright illegal. In most cases, little attention was given to these incidences because high-ranking Chinese cadres and their relatives were often involved. A further shadowy motivation was related to the 'round-tripping' phenomenon. Round-tripping denotes inward FDI which originates in the host country but was subsequently channelled outside the country and returned to benefit from tax holidays, subsidies, and other benefits, offered only to foreign investors. Thus, round-tripping is a form of rent-seeking. Concerning the Chinese outward investments to Hong Kong, a significant but indeterminate amount is argued to have happened for round-tripping purposes (e.g. Prasad and Wei, 2005; Weiss, 2004; Li, 2004). Asset-stripping and rent-seeking investment behaviour by Chinese firms are discussed for completeness here but do not inform a research question in this study because the 'official' data used here do not capture these types of activities.

3.4.3 Stages theory and the development of Chinese MNEs

The applicability of the internationalising approach (Johanson and Vahlne, 1977) to Chinese MNEs has yet to be tested thoroughly. So far, industry studies conclude that the theory is not supported by the internationalisation of Chinese enterprises. The largest Chinese construction companies by annual revenues develop their international presence without any sufficient and sustainable position in their domestic market. Rather, they seem to be China headquartered enterprises that rely on their international markets for business development, often supported by government authorities that have concluded infrastructure development agreements with developing countries in Asia and Africa (Frost, 2005; Pheng and Jiang, 2003). Similarly, high-technology intensive companies like Huawei have internationalised quickly with considerable

resource commitment as they established manufacturing, service and R&D units in industrialised countries and manufacturing and service units in developing countries. In so doing, it has leapfrogged the process of incremental spatial and resource expansion (Chen and Jiang, 2003). Contrary to this assertion, Li (2006) states that Huawei – and its Chinese competitor ZTE – in fact internationalise sequentially by establishing overseas affiliates in geographically and institutionally proximate countries first and by keeping its initial resource commitment low each time. Only with the international experience gained in developing countries did Huawei start to set up affiliates in developed countries Li argues. Du (2003a) asserts that the internationalisation of Haier also challenges the stages theory because Haier exported first to developed countries which are, arguably, geographically and culturally distant from China. However, earlier in her study, she mentions that Haier exported for some six years prior to seeking developed country markets. The evidence presented in her study is not persuasive, therefore. It is further contradicted by Du (2003b) who lists Haier's overseas investments since 1996 – the first investments occurring in nearby Asian countries which are still host to the majority of Haier's international investment projects. There is little other research on the applicability of a sequential internationalisation strategy of Chinese firms. This lack of research and evidence is probably due to lack of corporate access which is essential in pinpointing the development of internationalisation of a firm. Another explanation could be the neglect of the access of Chinese firms to international social networks. Such firms could benefit from the mediating role such networks play with respect to psychic distance which may support the internationalisation of such firms. This point is of importance and requires some further attention. It is hence discussed in a section further below.

RQ7 – Do Chinese firms follow a gradualistic approach to internationalisation?

3.4.4 China's new international ventures

Empirical and anecdotal evidence on Chinese new international ventures or 'born globals' is limited. The best account of such an internationalisation process is provided by Zhang (2003) who discusses the establishment and subsequent growth of CITIC. CITIC expanded quickly internationally and invested in a diverse range of unrelated industry sectors very soon after its formation in 1979. As early as two years after its establishment, it opened an office in Hong Kong and within seven years founded resource-seeking affiliates in Australia, Canada and the USA. This expansion was possible by the strong financial and political support of China's State Council which founded CITIC. Other examples and concomitant research, to our knowledge, do not exist. Chinese firms may, however, profit from their international networks when

seeking to invest internationally and this may allow them to expand rapidly into psychic distant markets (as is elaborated on below). Thus:

RQ8 – Do Chinese firms conduct FDI shortly after establishment?

3.4.5 International entrepreneurial networks and Chinese MNEs

Li (2003) argues that international latecomers establish business relations with firms in the host country to compensate for their late entrance into international markets. Access to an international network may help them to reduce investment costs and risks by facilitating the collection and evaluation of first-hand and trustworthy market information on the host market. Thus, it is not necessarily the most proximate country with a similar cultural fabric to China that Chinese firms invest in, but the location with the most pronounced ethnic Chinese business or entrepreneurial network (Zhang and van den Bulcke, 2000).

One strand of reasoning relates to the ‘ethnicity’ and firm-specific advantage argument. Liu (2000) states that the importance of international business networks in facilitating the internationalisation of ethnic Chinese firms has been generally acknowledged. Sung (1996) extends this perspective by identifying exogenous firm-specific advantages of Chinese MNEs in the form of ethnic and family connections with the Overseas Chinese which supports the investing firm and helps it to mitigate its business risk by disseminating business and market information.²⁹ Similarly, Tong (2003) and Bräutigam (2003) conclude that networks between the Overseas Chinese and China have played a significant role in the international investment decisions-making of Chinese firms. For example, the investment of Chinese firms in Africa has been found to have been significantly advanced by established personal connections with the host country (e.g. Bräutigam, 2003). Thus, cultural proximity only rather than the umbrella concept of psychic proximity may be the crucial factor initialising overseas investment by Chinese firms (Zhan, 1995). The Overseas Chinese Diaspora is especially widespread in Asia and was a crucial source of inward FDI to China from Singapore, Taiwan and Hong Kong during the 1980s and 1990s (Liu, 2000; Henley *et al.*, 1999; Ng and Tuan, 2002; Yeung, 1999; Sikorski and Menkhoff, 2000). Further research supports the importance of international social networks in business facilitation by concluding that international immigration networks are an important factor in the extension of trade relations with the respective native home country (Gould, 1994; Rauch and Trinidad, 2002). The size of the Overseas Chinese Diaspora is largest

²⁹ Overseas Chinese are defined by Poston *et al.* (1994: 633) as ‘all Chinese living outside mainland China and Taiwan, including *Huaqiao* (Chinese citizens residing abroad), *Huaren* (naturalized citizens of Chinese descent) and *Huayi* (the descendents of Chinese parents).’

in Asia but their associations are represented globally. By 1990, about 37 million Chinese lived outside mainland China, with the majority 66 per cent found in the four Asian countries of Indonesia (20%), Thailand (16%), Hong Kong and Malaysia (15% each) at this time. Asia comprised in total 88 per cent of all Overseas Chinese people. A further 8 per cent lived in North and South American countries, 2 per cent in European countries and 1 per cent in Oceania. The remainder lived on the African continent (Poston *et al.*, 1994). In countries such as Hong Kong, Macau, Singapore the percentage of Overseas Chinese of the total population was over 70 per cent. The Overseas Chinese people in these three countries, along with Malaysia (about 30% of total population) and Indonesia (about 5%), played a crucial role in the local economy as they often controlled the leading firms (Yeung, 1999; Poston *et al.*, 1994). Although these data are dated, it is unlikely that the distribution of Chinese people abroad have changed much since. The Overseas Chinese, though relying on personal contact, have established Overseas Chinese associations worldwide and these provide a platform to meet during the regularly occurring conventions of like-minded entrepreneurs from China and other countries to evaluate and assess business opportunities and to spin personal networks (Liu, 2000). A further function of these associations is arguably to represent mainland Chinese firms abroad (Liu, 2000); most probably in the decades prior to significant Chinese ODI. Based on these observations, the argument can be made that Chinese firms are likely to invest primarily in Asian countries where established international connections with the Chinese Diaspora can act as facilitator for their internationalisation. This is as proposed by Li (2003), among others.

By contrast, however, Gomez (2004) asserts that the role of the Overseas Chinese in the internationalisation process of Chinese firms is exaggerated. By analysing investments by the Overseas Chinese in the UK, Gomez concludes that little or no contact had been established between the investor firm and the ethnic Chinese living the UK prior a firm's investment. One explanation may be that Gomez' firm sample might represent mature and experienced firms who do not seek or need the support of other (local) firms. It should be noted, however, that the importance of international networks may differ depending on the ownership form of the Chinese firm. In particular, SOEs which enjoy the financial support of the domestic government authority supervising them may assign a minor role to the access to international networks than more independent Chinese MNEs. Similarly, this way of risk attenuation might play a more prominent role in the international investment decision-making of small- or medium-sized privately-owned Chinese firms, for example (Yang, 2005).

To date, research on the importance of networks for Chinese businesses has tended to rely on inferences drawn mainly from anecdotal evidence on Overseas Chinese business or has made

assertions without empirical evidence (e.g. Yang, 2005). To inform the above discussion, cross-sectional analyses are required. Thus:

RQ9 – To what extent do the Overseas Chinese people influence the international investment behaviour of Chinese firms?

3.4.6 The institutional embeddedness of Chinese MNEs

The discussion in Section 3.3 has shown that China's institutional environment has the potential to bear greatly upon the investment behaviour of Chinese MNEs. To some extent, this reflected in the literature on Chinese ODI.

Zhan (1995) describes the political stance towards ODI in China as being cautious, and this is reflected in the regulatory framework, which was more restrictive in the 1980s and much of the 1990s (see Section 3.3). This constraining environment provided Chinese firms and government authorities the time to gradually gain experience in international business. At the same time, the Chinese government has supported Chinese firms with financial aid to encourage them to internationalise and mitigate business risk. One measure has been to link China's official development aid to ODI (Zhan, 1995). A good example is the unconditional loan by Chinese government provided to Angola in 2005 which helped Sinopec to oust Total, the French oil company, from extending drilling rights and to secure prestigious offshore oil-drilling rights (Meidan, 2006; Frynas and Paulo, 2006). Such Chinese government behaviour may be most fruitful where the Chinese government and Chinese firms have a good bargaining position vis-à-vis host country governments that attract only modest amounts of investment from the industrialised nations. This may be countries generally avoided by industrialised country firms as a reaction to pressure from civil society on ethical (e.g. human rights) or political (e.g. international embargo) grounds such as Sudan and Myanmar. The Chinese government has also provided other institutional support, in form of, for example, easy access to external finance and privileged access to the domestic education market, to selected firms to help them to build the necessary capabilities and strength to internationalise (Child and Rodrigues, 2005; Antkiewicz and Whalley, 2006). The government has assisted by gathering host market information (Taylor, 2002) and instigated the 'Go Global' policy in 1999 and formally incorporated in national policy with the 10th and 11th five year plans. The Chinese government has over the years encouraged Chinese ODI in specific sectors, namely manufacturing, resource exploitation and resource augmentation (Cai, 1999). All these initiatives and policies are described at length in Section 3.3.

It should be noted, however, that these policies are often opaque and poorly publicised and hence not fully known to Chinese firms. The current regime is not fully supportive of Chinese ODI (Wong and Chan, 2003). For example, the approval of each investment project makes it difficult for Chinese firms to bid for a foreign company. A take-over offer with governmental approval of the project may breach existing regulations while waiting for the approval often cause unnecessary delays (Xiao and Sun, 2005). Despite all this, Liu *et al.* (2005) argue that China's domestic institutions have had little *direct* effect on Chinese ODI but instead *indirectly* support Chinese firms by providing a sound institutional environment for economic growth which helps domestic firms to develop and build-up competitive capabilities. Such capabilities may then be used to extend the firms activities across borders.

What is clear is that Chinese MNEs are embedded in a particular economic order at home which leads to strong interrelations, and sometimes collusion, with government authorities. This then impacts on the international investment behaviour (Cai, 1999; Child and Rodrigues, 2005). The knowledge of Chinese firms of operating in a dynamic developing country environment characterised by discretionary and burdensome bureaucracies may have actually provided these firms with firm-specific advantages and the development of certain core competences these firms could exploit in similar characterised countries – that is advantages deriving from home country embeddedness (Costin and Herken, 2006). On the other hand, Taylor (2002) states that the provision of a sound macro-economic framework within China including the further marketisation of SOEs and strengthening of monetary and fiscal policy, has benefited the development of Chinese MNEs greatly. Such measures have decreased the extent of discretionary implementation and enforcement of ODI regulations on the sub-national level and this has sometimes led to contradictions between national regulations and the official approval procedure (Ding, 2000a). However, this leeway may actually have enabled private Chinese firms to internationalise prior to 2004 as constraining laws and regulations have been circumvented.

This discussion shows that the incorporation of the domestic institution in an analysis of Chinese ODI is of crucial importance (Taylor, 2002; Child and Rodrigues, 2005). Although the institutional framework is generally acknowledged and its potential influence appreciated in extant research, it is not consistently and rigorously addressed nor empirically measured. Based on these discussions:

RQ10a – To what extent does the domestic institutional framework in China support the international investment strategies of Chinese firms?

As discussed in Section 3.3, China is increasingly involved with supranational organisations and international agreements (e.g. WTO accession) and seeks to conclude multilateral and bilateral agreements and treaties to promote international cooperation and, directly or indirectly support the internationalisation of domestic firms. These activities may at least in part be interpreted as an attempt by the Chinese government to establish a level-playing field for international investing Chinese firms. With regard to the international investment behaviour of Chinese firms, the following question arises:

RQ10b – To what extent does the international institutional framework support the international investment strategies of Chinese firms?

3.4.7 Non-SOEs as international investors

Non-state owned and, eventually, privately-owned Chinese enterprises are thought to have invested internationally since the mid-1980s. Ye (1992) mentions that out of thirty-seven Chinese MNEs interviewed in 1988 and 1989, only six were state-owned. Ding (2000a) mentions private Chinese MNEs briefly, arguing they are investing overseas to secure their wealth outside an uncertain Chinese political environment and because of hyperinflation in China amongst several other reasons. Further evidence on the internationalisation of private Chinese firms is patchy. Deng (2004) mentions that of the top 500 Chinese MNEs one is privately owned but, like Ding (2000a), fails to name the company. Recent political measures seem to have eased ODI by private-owned Chinese firms. Zhang (2006) mentions that the Chinese government issued a directive in 2004 allowing private firms to invest abroad legally and MOFCOM (2006b) reports the provision of greater financial support by the Export-Import Bank of China (China Eximbank) towards private enterprises. The China Development Gateway (2005) comments on a lifting of trade restrictions on private firms (from January 2001). This allows private firms to own a foreign exchange bank account and earn foreign exchange entitlements (both are preconditions to be eligible for ODI). Furthermore, Qin (2004) states that the Chinese government encourages private firms to increase their direct investments in Africa in particular to fulfil China's compliance to UNDP's South-South cooperation agreement. Newspaper articles increasingly report on private Chinese MNEs such as D'Long and Wanxiang investing in Europe and the USA and, finally, regional investment promotion agencies have published information about privately-owned Chinese outward investors (CAITEC and WDA, 2005; GfW, 2005). Judging from this sketchy account, private Chinese MNEs are growing in number and justify attention.

RQ11 – Do the determinants of Chinese ODI vary by ownership type?

3.5 Summary

This chapter presents a holistic review of the development of Chinese ODI and identifies a number of gaps in the body of literature on this phenomenon. In Section 3.2 the corporate actors investing abroad are introduced as are the political actors that impinge on them through their interventions. It is essential to have a clear understanding of these actors to follow the evolution of Chinese ODI and the twists and turns it has undergone (Section 3.3). Chinese ODI has not developed smoothly nor has the institutional framework in which it takes place. The identification of outward investment drivers and the rational underpinning the investment decision-making process in Chinese firms is therefore difficult to evaluate with any accuracy and this is mirrored in the extant body of research on Chinese ODI. Moreover, the bulk of this work is descriptive. There are therefore unanswered questions around the international investment strategy, use of networks and the speed of internationalisation of Chinese MNEs. These preliminary observations, the research questions and the theories presented in Section 2.2 are used in Chapter 4 to advance a model that, it is argued here, more completely presents the framework within which Chinese ODI happens than is available in prior research on the subject. In this, special attention is paid to the institutional realm that companies operate in. This model is then tested using qualitative and quantitative research methods and the findings are presented in Chapter 6 and 7.

4 An explanatory model of Chinese outward direct investment

In the previous chapter the assertion is made that research on Chinese ODI fails to explain fully the phenomenon. Research to date generally offers inconclusive accounts based on crude analysis of secondary data and lengthy case studies of a small number of high profile Chinese MNEs (e.g. Liu and Li, 2002). In Chapter 3, the case is made that the institutional environment in China is an important factor in the development of Chinese ODI, and that this cannot be disregarded. This chapter therefore follows a novel approach.³⁰ A new model is introduced with the aim of explaining Chinese ODI patterns and the international investment behaviour of Chinese companies. The model is rooted in the theories reviewed in Section 2.2, with special emphasis given to institutional theory. It is proposed in the model that institutions on the sub-national, national, and international levels play a key role in shaping Chinese ODI. In this thesis, this new explanatory model of Chinese ODI is termed the ‘Chinese outward direct investment regime’ or, in short, the ‘Chinese ODIR’. Parts of the model are tested in Chapter 6 using primary data and cross-sectional econometric modelling, the findings for which are presented in Chapter 7.

4.1 Institutional theory

Given the clear importance of institutions to Chinese ODI (as indicated in Sections 3.1, 3.2, and 3.3 of this thesis), it is pertinent to make reference to ‘new institutional theory’ in order to justify aspects of the Chinese ODIR model advanced later in this chapter. Institutional theory suggests that the domestic institutional configuration determines the pace and scope of a country’s macro- and micro-level economic development as a consequence of the constraints and resources provided by government to local and foreign firms (North, 1990; Redding, 2002). The institutional setting is generally stable and path dependent and therefore unlikely to change in the short-run – though exceptions exist like the European transitional countries, the unification of Germany in 1990 and in China in recent history (North, 2005).

An ‘institution’, by its nature, is a broad and fuzzy concept (Markusen, 2003). It therefore has to be clarified what kind of institutions are of interest in this research. The concept of institution generally encompasses a wide range of elements, including customs and beliefs, religious and other norms, the legislature, judiciary and bureaucracy, government structures and market mechanisms, amongst other things, many of which are difficult to measure. All of them are ultimately interlinked and influence each other (Williamson, 2000). However, this research

³⁰ This chapter builds upon and extends Buckley *et al.* (2007a, 2007b).

is neither concerned with institutions as long-lasting and 'difficult to change' belief systems and tradition nor does it use institutional theory to explain organisations and their operationalisation (e.g. North, 2005; Scott, 1987). The term 'institution' is applied here to delineate aspects of those institutions that coordinate aspects of an economy and which are partially codified and contain an element of enforcement. It is therefore constrained to the realm of formal elements (namely legislature, judiciary and bureaucracy, government structures, market mechanisms) and informal elements (mainly social relations). The formal rules are implemented and policed mainly by governments and their agencies. The domestic and international investment decision-making of an MNE is constrained by conditions set by the home institutional environment, i.e. the market imperfections created by the institutional fabric or, more colloquially, the 'rules of the game' and 'how the game is played' (Williamson, 2000; Buckley *et al.*, 2006; North, 1990; Peng, 2002; Wright *et al.*, 2005). Hence, institutional change occurs when rules change the incentive structure and payoff expectations of the actors 'playing the game' (Eggertsson, 1997). Given this background, institutional theory is often used to investigate the effect of the institutional environment on domestic firms and economic growth, for example, on the effects of monetary and anti-trust policies. The constraints given by an institutional environment affect the decision-making of a firm (Aharoni, 1999) by contributing to, or underpinning, a firm's capabilities (Murtha and Lenway, 1994). In this respect, Murtha and Lenway (1994) argue that the institutional environment of a command economy has typically government fixed trade plans which leave home firms with little or no strategic flexibility: some firms are government supported and thus have increased capabilities, while the remainder are deprived of the trading potential due to administrative restrictions. The transition to a market economy is not necessarily combined with the establishment of firm-specific advantages, which would enable local firms to invest abroad (Murtha and Lenway, 1994) because of path dependencies associated with the former institutional environment that did not favour competition and the building of core competences amongst domestic firms. Only when the economy has transformed sufficiently towards a market- and private-firm based economy will firms develop internationally enduring firm-specific advantages. Although this view relates very well to ODI from former state planned economies like China, it leaves aside the fact that outward investment from these countries may be driven by other factors as well. First, changes in the institutional fabric (a) towards a more accountable, credible and less bureaucratic burdensome regime in general (Globerman and Shapiro, 2002; Brewer, 1993) or (b) designed to foster the internationalisation of domestic firms in particular may give rise to ODI as economic transition progresses. Second, ODI of a country may still be dominated by a government driven internationalisation of state-owned or state-influenced firms even as the economy becomes more market related. This would constitute an artefact of state planning different to the administrative fiat describes above. While the state planning is a constraint, the new

institutional arrangement may constitute an ownership advantage enjoyed by beneficiary firms. These examples show that progression to a market-based economy may account for an upsurge in outward investment from any given country. Adjustments to the institutional fabric to allow for international business exchange and the evolution of competitive companies can be regarded as a source of market imperfections generated by the government which effect domestic firms (Boddewyn and Brewer, 1994).

The theory of internalising market imperfections across borders of Buckley and Casson (1976) contains an implicit acknowledgement of the importance of home country institutional elements on ODI (see Section 2.2). However, Buckley and Casson (1976) do not elaborate upon or develop this dimension fully. Market imperfections are often not accidental but are created and promoted by home country institutions and the constraints are imposed with intent (North, 1990). This is certainly the case for China, as evidenced in Section 3.3 and by the following quotation from Scott (2002: 65) “[...], the Chinese state is constituted to act [...] as an active player, promoting and controlling economic development. The norms governing state actors and citizens clearly differ: Chinese officials are more likely to presume that they, rather than any subordinate constituency, are obliged to decide and act for the common good.” Plenty of examples can be found in relation to Chinese ODI despite the fact that the Chinese government has withdrawn much of its presence with the institutional reforms in 1999 and thereafter. The establishment of CITIC by the State Council in 1979 and the favourable loan scheme extended to CNOOC to bid for Unocal in 2005, are examples of institutionally derived market imperfections (Zhang, 2003; Xiao and Sun, 2005).

The institutional reach, however, is neither constrained to the domestic development of firms nor to domestic economic interactions. It also impacts, both positively and negatively, on cross-border business transactions, home country growth models and, it follows, on the outbound investments and international trade of domestic firms. Domestic institutions can therefore shape the internationalisation strategies and motivations of firms (Brewer, 1993; Murtha and Lenway, 1994; Globerman and Shapiro, 2002). Expressed another way, the behaviour and decisions of a country’s domestic institutions may lead to, or reduce, market imperfections which then impact on the decision-taking of its MNEs (Brewer, 1993). Likewise, supranational institutions may affect the behaviour of firms in a similar way. At a supranational level, the concept of ‘institution’ comprises a set of informal and formal factors. In the context of a country’s outward direct investment regime (ODIR), informal factors may include state visits, foreign policy initiatives, and international entrepreneurial networks while the formal elements include concluded bilateral investment treaties, membership of the free trade areas and customs unions, and participation in international led development co-operations such as the South-South

initiative by UNDP, for example. Most countries are today embedded in a nexus of formal multilateral and, increasingly, bilateral agreements which are administered and managed both within supranational agencies and between individual governments (Ramamurti, 2001). Although separate, these formal and informal factors are interlinked. State visits commonly pave the way to more formal arrangements and relationships as the terms and conditions of bilateral agreements and accession to a free trade area are negotiated and implemented. These elements can support and strengthen the behaviour of a country's MNEs abroad (Ramamurti, 2001). We therefore recognize that the institutional setting within which Chinese MNEs operate has both a national and supranational character and that formal and informal elements exist at both levels.

In the following two sections, aspects of this discussion are incorporated into the modelling of China's ODIR. In this, national and supranational elements are recognised, as are formal and informal elements. To help distinguish between elements, the terms 'exogenous' and 'endogenous' are applied. The former refers to elements found beyond the state borders of the home country, while the latter refers to elements present with state borders. This usage extends Eggertsson's (1997) perspective who argues that exogenous factors lie outside the direct sphere of influence of a firm but are controlled by the national political actors, that is, governmental institutions.

4.2 The Chinese outward direct investment regime

Themes and issues discussed previously are incorporated, and linkages with previous sections of this thesis are made explicit. Inevitably, this process leads to some repetition of context, but this is required in order to provide coherency and conclusiveness to the model.

4.2.1 Endogenous institutional factors

The national elements –which are referred to here as 'endogenous institutional elements'– include those formal structures and outcomes of Chinese government that pertain directly to outward FDI and indirectly effect Chinese ODI. The former comprises the policies and regulations of agencies such as the Chinese Ministries of Commerce and Foreign Affairs, the State Administration of Foreign Exchange (SAFE), the National Development and Reform Committee (NDRC), and the People's Bank of China (as described in Section 3.2). Also important are policy implementation and enforcement by the national legislature, judiciary and bureaucracy.

Formal endogenous factors with direct influence

For China, as with many developing countries, the control and, effectively, the restriction of ODI has been a major strand of economic policy.³¹ The maintenance of domestic investment levels and the bolstering of foreign exchange levels are priority objectives (Sauvant, 2005; Vandeveld, 1998). The institutional framework is therefore likely to have determined, to a considerable degree, the ability and will of domestic firms to invest abroad; an overly restrictive foreign exchange policy and outward investment approval procedures may restrict or even prevent ODI from happening (Buckley *et al.*, 2007a).³² On the other hand, the institutional framework may have a positive affect on some firms. The institutional framework of the home country can also contribute to the ownership advantages of a wide range of companies. Companies that originate from a rather restrictive institutional framework gain substantial experience of how to cope with such an environment. Of itself this can constitute a firm-specific advantage, which enables firms to internalise smallest changes and opportunities (i.e. market imperfections) provided by the system. These are the advantages of home country embeddedness, and they can include ability to cope effectively with changing institutional settings and discretionary policies, economising on the use of scarce capital and other input factor, the successful exploitation of domestic and international network capacities to circumvent market imperfections, and the ability to scale products and production systems to suit local needs. This knowledge can be applied in foreign countries that have a similar institutional setting and market environment. In fact, companies might feel more comfortable investing in a country with a similar institutional setting as they can better appreciate it, utilise existing operational leeway and foresee any political developments and administrative decisions that might ensue (Wells, 1983; Lall, 1982; Lecraw, 1977). Because of the ownership advantages gained from their context specific institutional framework, Chinese MNEs (like other developing country MNEs), are likely to have a distinctive foreign investment strategy in terms of location, as exemplified by a perverse reaction to risk and return not predicted by studies on the FDI behaviour of industrialised country firms. These considerations contrast to

³¹ Taiwan's government, for example, sought to achieve domestic economic development and prohibited ODI until the 1960s. Restrictions on ODI were eased in four phases from 1962 onwards and firms were increasingly encouraged and supported to invest abroad (UNCTAD, 1996). The South Korean government encouraged ODI to support exports, fishery and strengthen competitiveness but prohibited it in areas which could negatively affect the economy (Kumar and Kim, 1984). Japan restricted the value of assets held abroad by domestic companies based on balance of payment considerations until the late 1960s (Stone, 1998). ODI restrictions are not constrained to developing countries, however. The United Kingdom restricted ODI between 1914 and 1931 to prevent outflow of hard currency in support of the war economy (Atkin, 1970).

³² We note that Chinese firms can also influence and shape the institutional framework they are embedded in which reflects back on the firm's potential behaviour and performance (Barney and Tolbert, 1997).

the view of Dunning (1996) among others who argues that domestic institutions have either a low neutral effect or an adverse effect on the ownership advantages of OECD country MNEs.

As Section 3.2 makes clear, the Chinese government has defined greatly the legal, regulatory and financial components of the Chinese ODIR, either directly, by administrative fiat (via the ODI approval process and foreign exchange controls), or indirectly, using economic policy implementation and other measures (Buckley *et al.*, 2006). But the government is also the ultimate owner of SOEs (which dominated Chinese ODI prior to 2003) and has in this role effectively been the key operational decision-taker in many investment projects (Buckley *et al.*, 2006). Thus, firms may receive direct governmental support and preferential treatment and may get experienced how to operate under a flawed institutional arrangement or exploit imperfections of the local market. The endogenous elements of the Chinese ODIR are therefore likely to shape outbound investment behaviour.

The most recent measure directly linked to Chinese ODI is the 'Go Global' strategy (see Phases 4 and 5 in Sections 3.3.4 and 3.3.5 for a full account). China has supported the internationalisation of domestic firms since the instigation of the 'Open-Door' policy. International investments by Chinese firms are also made to support the national economic and social development and restructuring (Wang, 2001; Zhao, 2000) (see Section 3.3). In the long-run, the policy of creating favourable conditions for domestic enterprises should see increasing numbers of Chinese firms locate productive activities abroad. The response of relevant government agencies has been to provide greater support and promotion of ODI by offering favourable policies and procedures to investors in many areas, such as in finance, insurance, foreign exchange, taxation, human resources, law and regulation, the provision of information services, training courses on international business and foreign languages, and the establishment of a Overseas Business Service Centre in Beijing and Chinese Chambers of Commerce in foreign countries (see Section 3.3.5). These measures are partially undertaken with the support of international organisations such as UNCTAD and professional organisations such as foreign regional development agencies and consultancies. Key ODI-promoting measures introduced recently include improvements in the availability of commercial loans and funding from the Export-Import Bank of China for earmarked projects (using China's extensive foreign exchange reserves)³³ and preferential arrangements concerning foreign exchange and corporate income tax exemptions to qualifying firms and projects (see Sections 3.2.2 and 3.3.5). Arguably, many of these developments constitute soft budget constraints enjoyed by Chinese MNEs. Soft budget constraints are domestic capital market imperfections. As will be seen, this notion is

³³ China's foreign exchange reserves are valued at more than USD 1,000bn, the largest in the world (FT, 2006d).

fundamental to aspects of the forthcoming analysis. Soft budget constraints normally occur when an organisation's spending is not bound to an annual budget but are extended with high probability by the supervising authority if expenditures exceed the earnings and the survival of the organisation is at risk (Kornai, 1986; Kornai *et al.*, 2003).³⁴ This capital is normally made available at below market rates for a considerable period of time, creating a semi-permanent disequilibrium in the capital market which (potential) outward investors can exploit. Access to soft budget constraints may thus supply companies with sufficient funding to operate abroad. Thus, capital market imperfections can become an ownership advantage for certain companies (Buckley *et al.*, 2007a). Besides soft budget constraints, three further capital market imperfections have been identified for China. Their impact reaches from providing companies with excess capital which they can use (i) to either invest internationally on a trial-and-error basis without putting their domestic business at risk, (ii) to outbid competitors in a fight for resources (especially energy and raw materials, brands and technology) (first three market imperfections listed below), and (iii) to enable firms to invest in the first place (Buckley *et al.*, 2007a). The last factor may be a consequence of domestic government bias in the industry policy and credit allocation. The specific capital market imperfections are as follows in the case of China:

(1) Soft budget constraints enjoyed by state-owned companies

State-owned and state-associated (or state-led) firms may enjoy different co-existing forms of soft budget constraints: they may have capital made available to them at below market rates or receive capital at market rate but are not forced to pay it back (Xiao and Sun, 2005). Both phenomena may be more prevailing in an economy with poor corporate governance on both parts, the lender and the borrower (Lardy, 1998) and where state-owned companies play a significant economic and social role (Broadman, 2001), (such as for Petronas in Malaysia and Chinese SOEs in general);

(2) Inefficient banking system

Inefficient banking systems may make soft loans to potential outward investors either as policy to support the domestic and international growth of the company and through inefficiency, that is negligence of and nescience concerning risk assessment and cronyism. A developing country economy like China often lacks a sound and independent banking system but instead may be dominated by state-owned banks. When capital is made available within such a banking system to other state-owned companies, the transferred capital could be perceived as 'remaining within'

³⁴ Early work on soft budget constraints focused on companies in socialist economies (e.g. Kornai, 1986). More recent work, however, has clarified that soft budget constraints can be observed for local government authorities, non-profit organisations, and financial intermediaries in non-socialist countries as well (e.g. Kornai *et al.*, 2003).

the state system and undermine required scrutiny of the deal. This is argued by Lardy (1998) to be evident for China;

(3) *Intra-firm cross-subsidising*

Business groups may operate an inefficient internal capital market that has the effect of cross-subsidising international business operations.³⁵ The necessary funds for such an internal market are generated in the domestic market and by the exploitation of business opportunities in any business sector;

(4) *Social financial networks*

Family-owned firms may have access to capital from family members, friends, peers and through their wider network. Although this financial source does not necessarily provide access to cheap capital, it might provide access to the required capital for running and expanding the company.

Although these capital market imperfections may constitute a short-term advantage, they also may lead to the opposite in the long-run. Unrestricted access to capital may inhibit the development of international competitiveness because companies have reduced incentive to allocate their resources in the most productive manner. This outcome would contradict the overall objective of the 'Go Global' policy in the case of China.

Furthermore, the intention of the Chinese government is to improve the quality of ODI-related services by further devolving decision-taking on outward investment approvals to local government (see Section 3.3.5). It also intends to minimize 'unfair competition' among Chinese companies abroad by guiding the dispersion of Chinese firms (Wang, 2001) and to introduce measures to coordinate investment in a way that prevents ODI in the same industries in the same countries, because this might lead to 'market cannibalism' among Chinese firms.³⁶

The Chinese government is also active at a supranational level in further supporting and strengthening the outward orientation of Chinese companies. It intends to conclude more bilateral investment agreements and double taxation treaties to protect Chinese investors (Wang, 2001) (see Section 4.2.2) and to further coordinate for mutual benefit China's foreign affairs and official development aid policy (Chen, 2006). In sum, and following full implementation of

³⁵ Business groups are defined as "legally separate firms bound together in persistent formal and/or informal ways" (Granovetter, 2005: 429). Business groups differ from conglomerates which generally have less operational and personal ties with their affiliates.

³⁶ Apparently, though, these measures are confined to competition between Chinese firms but not with domestic and other foreign firms in the host country.

China's WTO commitments, China is likely to further deregulate and liberalise outward FDI-restricting measures with indirect, 'hands-off' economic policies increasingly substituting for direct, 'hands-on' administrative methods of management (Buckley *et al.*, 2006; Sauvant, 2005) (and Sections 3.3.4, 3.3.5 and 3.4.2). The impact on the international investment decision-making of Chinese firms depends on the perceived credibility of these government measures (Murtha and Lenway, 1994). Given the current high government support, Chinese firms have to be certain enough that this support is either long-term enough or provides sufficient (monetary) short-term benefits that market imperfections created are worthy of internalisation.

Formal endogenous factors with indirect influence

Chinese MNEs, *prima facie*, are not only influenced by China's policies directly affecting ODI but also indirectly through other measures. One of these is China's stance toward inward FDI. The Chinese government supports the technological catching-up of domestic firms by implementing, assimilating and successively upgrading foreign technology through accumulated learning in Sino-foreign joint ventures, in-house R&D and demonstration effects (Kim, 1980; Pack and Saggi, 1997). These three measures are argued to lay the foundation for the creation of firm-specific advantages in form of tacit knowledge (Buckley *et al.*, 2002). All these are generally agreed as prerequisites for ODI (Dunning, 1988; Kogut and Zander, 1993). In this respect, the Chinese government has allowed certain international firms' to invest in China only under the condition of the establishment of a knowledge transferring institution, providing local firms with the opportunity to access knowledge (Pack and Saggi, 1997). To further foster the catching-up process of domestic firms, the Chinese government has also initiated several technology- and innovation driven company funding schemes during the 1990s, to build a comprehensive national innovation system (Sigurdson, 2005; Liu and White, 2001). Local firms absorb knowledge through direct and indirect linkages. Direct linkages involve both backward-(supplier) or forward-(customer) linkages, as well as any kind of business collaboration, license arrangements and the purchase of production equipment (Pack and Saggi, 1997) while indirect linkages derive from 'watching' other firms' business operations, functions and products and imitating them (Inkpen, 2000). Both kinds of linkages are present in China, as a consequence of the increased inward internationalisation China's after Deng Xiaoping's journey to South China in 1992 which was interpreted as a commitment to increased liberalisation and market openness. The positive effect of spillovers on Chinese firm's productivity is confirmed by Buckley *et al.*, (2002). Sino-foreign joint ventures, the dominant entry mode during the 1990s (Teng, 2004), have given the Chinese partner multiple possibilities of directly learning from its foreign partner while the growing presence of (wholly owned) foreign firms *per se* provides them with ample examples to follow and copy (Khanna *et al.*, 1998; Inkpen, 2000). A case in point is the lawsuit involving the US-based IT-firm Cisco and

telecommunication equipment producer Huawei, concerning intellectual property infringement based on indirect 'linkages', 'demonstration effects' and 'learning' by Huawei (FT, 2007c). Similarly, Haier has benefited from the transfer of technology in its Sino-foreign joint venture with Liebherr, the German refrigerator company. Haier has also relied on international consultancy firms to help it implement an internationalisation and growth strategy (Liu and Li, 2002).

Actions based on these types of formal institutions may intermingle with the informal sphere, for example, in instances when laws and regulations are interpreted and applied in a discretionary way by certain actors in society. The informal aspect is further exacerbated in the manifold and dense personal linkages that Chinese firms have to government officials, which can lead to local protectionism and favourism. This can also be induced by partial state-ownership (Ding, 2000a; Ralston *et al.*, 2006; Boisot and Child, 1996; Broadman, 2001). However, these informal, interpersonal linkages as well as discretionary policy implementation and enforcement are outside the scope and practicality of this particular research.

4.2.2 Exogenous institutional factors

Of the supranational institutional elements of the Chinese ODIR –the exogenous institutional factors– both formal and informal elements are recognised that might possibly impact on the investment decision taking of Chinese firms. Of interest are four supranational elements of the Chinese ODIR that have the potential to influence Chinese ODI flows and which have each become increasingly prevalent over the last two decades, namely bilateral investment treaties (BITs), double taxation treaties (DTTs); membership of the World Trade Organization/General Agreement on Tariffs and Trade (WTO/GATT) and international entrepreneurial networks.

BITs and DTTs are often seen as policy instruments which countries introduce to improve their locational attractiveness to MNEs (Mallampally and Sauvant, 1999). This should also be the case for Chinese firms, especially as China has entered into a number of bilateral investment treaties and agreements with potential and current host countries (see Section 3.3.5). China is also participating increasingly in supranational agreements and treaties administered by multilateral bodies such as the WTO. Collectively, these agreements and treaties have the potential to shape direct investment and trade flows between China and other countries; the latter often serving as a precursor for FDI. These endogenous elements to China's ODIR are discussed in more detail below.

Bilateral investment treaties and Chinese ODI

BITs are concluded between two countries to protect and promote bilateral investment flows (UNCTAD, 2000, 2005b).³⁷ Prior to 1979, a total of 165 BITs were concluded between countries, a figure which proliferated to 2,392 in 2004 (UNCTAD 2005b). Of these, almost 1,600 were agreed in the 1990s, which highlights their growing importance in the international political economy (UNCTAD, 2000). China signed its first BIT with Sweden in 1982 to protect Chinese firms (Cai, 1999) and is now second only to Germany as a signatory nation in terms of numbers of BITs concluded. China has concluded 116 BITs by February 2006, of which some 63 have been agreed with other developing countries (UNCTAD, 2006, 2005b).³⁸ A BIT provides a legally binding situation in which the foreign investor enjoys greater investment protection for its tangible and intangible assets than domestic laws would otherwise provide and is therefore generally argued to reflect a progressive and positive attitude towards economic liberalism by the contracting parties (Vandeveld, 1998). The conclusion of a BIT should ensure a relatively high level of investment protection which helps the internationalising firm to attenuate risk considerations in the investment decision and focus on commercial considerations (Voss, 1982). In other words, a BIT regulates a distorted market and dilutes market imperfections created by inefficient and (potentially) hostile host governments. Typically, a BIT includes the following elements: national treatment of foreign investors, most favoured nation treatment, fair and equitable treatment of foreign investors, abolition of discriminatory treatment of foreign investors, compensation for expropriated property, free repatriation of profits and capital and the use of extraterritorial dispute settlement mechanisms (Neumayer and Spess, 2005; Ginsburg, 2005). It may also involve the removal of restrictions on FDI and may prevent the host country from imposing requirements on the investing company such as local content or obligatory technology transfers (Sornarajah, 2004; Ginsburg, 2005). A BIT normally applies equally to outbound and inbound investments (UNCTAD, 2000). In addition to these direct measures, the BIT may lead to greater transparency, an improved institutional framework and the removal of FDI restrictions in signatory countries. All this may work as a trigger for FDI since overall investment costs and risks are decreased and business opportunities are widened (Egger and Pfaffermayr, 2004; Ramamurti, 2001). BITs have therefore become an important policy tool for international organizations such as UNCTAD which actively helps developing countries to negotiate, sign and ratify BITs and double taxation treaties (UNCTAD, 2000). Moreover, a concluded BIT may also provide a signalling effect to potential investors

³⁷ BITs and double taxation treaties are both a special kind of International Investment Agreements as are bilateral and regional trade and investment agreements and multilateral investment agreements (UNCTAD, 2005b).

³⁸ It is worth remarking that BITs are concluded between a developed and a developing country or between two developing countries only. To date, there has been no BIT concluded between two developed countries (Ginsburg, 2005).

from third countries (outside of the agreement) because of the commitment to a liberal, transparent and predictable investment environment presented by signatory countries and its departures from perhaps previously hostile attitudes toward foreign investors (Sornarajah, 2004; UNCTAD, 2005b; Naumayer and Spess, 2005).³⁹ However, any such signalling effect may gradually deteriorate over time (Naumayer and Spess, 2005) when the degree of implementation and enforcement of the treaty becomes more important. The effects of a BIT are further diminished by the fact that the dyadic negotiations are normally led by the country with the strongest bargaining position (typically the capital-exporter), and with a weaker counterpart, which may lead to an asymptotic treaty (Sornarajah, 2004; Ginsburg, 2005).

The empirical evidence concerning the effect of BITs on the investment behaviour of industrialised country MNEs is ambiguous. What limited work on the subject is available is now reviewed. This is done here and not in the literature review on traditional FDI determinants present in Section 2.3 because this issue is seldom investigated in econometric work on FDI determinants. This is also the case for DTTs which are considered in the following section. Some research finds empirical support for the positive impact of BITs on FDI (e.g. Neumayer and Spess, 2005; Egger and Pfaffermayr, 2004; Grosse and Trevino, 2005; Salacuse and Sullivan, 2005). One of the more comprehensive studies, that by Neumayer and Spess (2005), find that BITs signed between developing and OECD countries have had a strong positive and robust affect on inward FDI flows to developing countries over the period 1970 to 2001. They also find evidence that BITs signed with third countries have a positive signalling effect on FDI inflows from other countries. Egger and Pfaffermayr (2004) reveal that *implemented* treaties have a stronger positive effect than ones that have merely been signed. However, they find limited evidence that signalling effects are at work in third countries. They also find little pattern of significance depending on the level of development of the countries involved. This is supported by Ginsburg (2005) who reports that advanced developing countries are more likely to sign a BIT. Grosse and Trevino (2005), in a study of the determinants of FDI to Central and Eastern Europe, report a strong positive relationship between the total numbers of BITs concluded by a country and inbound FDI flows. Banga's (2006) study on the impact of BITs on inward FDI to fifteen Asian developing countries finds that the conclusion of such treaties supports the attraction of investments from developed countries.⁴⁰

³⁹ In contrast, Vandavelde (1998) argues that only the potential host country to FDI is forced to liberalise. The home country is acts nationalistic and protective and is seldom challenged by a BIT to change this.

⁴⁰ The fifteen countries are: Bangladesh, China, Hong Kong, India, Indonesia, Malaysia, Nepal, Philippines, Singapore, South Korea, Sri Lanka, Thailand, and Viet Nam (Banga, 2006: 43, Table 1).

Other research yields contrasting results. Banga (2006) reports that his earlier positive finding for FDI originating from a developed country is not confirmed for South-South FDI flows. Banga argues that a BIT between two developing countries does not increase bilateral FDI. Tobin and Rose-Ackerman (2005) argue that the effect of a BIT on FDI is mitigated by country risk levels.⁴¹ They find that, of the developing countries that have concluded a high number of BITs, those with high levels of country risk attract less inward FDI, while the converse is found for low risk countries. One interpretation is that investing firms are more influenced by (commercial) risk conditions than by the nature of supranational investment relations between home and host country. Hallward-Driemeier (2003) also finds that the existence of a BIT has little to no affect upon the flow of FDI from OECD to developing countries. Indeed, the USA has not concluded a BIT with most Southeast Asian countries, most notably China, but American companies are nevertheless important investors in these countries (Sornarajah, 2004). Hallward-Driemeier (2003) argues that a BIT may have an institution-substituting effect instead of providing a better institutional setting, a finding that supports the work of Tobin and Rose-Ackerman (2005). This accords with Ginsburg (2005), who argues that BITs can have a counterproductive effect on the development of sound institutions because the host country can rely on supranational bodies for dispute settlement and enforcement. The lack of institutional development may serve to restrict investor confidence and FDI inflows in the long-run if this were the case.

To our knowledge, the effect of BITs on Chinese MNEs' international investment behaviour has not been researched before. However, the Chinese government is actively pursuing a strategy to increase the protection of outward investors. Especially since 1998, the style of BITs concluded by Chinese is said to have changed to accommodate increasing ODI and the rising number of Chinese investors (Cai, 2006). For example, the Chinese Ministry for Foreign Affairs has established a Department for External Security Affairs to enhance the support and protection of Chinese investors (Cai, 2006). Given the number of BITs that China has concluded and the importance it is assigned to by the Chinese government, the weight of evidence suggests that there is likely to be a positive relationship between Chinese ODI and a BIT concluded between China and a potential or current host country. In addition, Chinese firms may also be attracted by the signalling effect of other BITs if they appreciate the role of dyadic treaties between China and another country.

⁴¹ Different studies have created a country risk index composed of indicators measuring commercial, political and social risks (Oetzel *et al.*, 2001). One commonly used index, for example, is the ICRG composite index (PRS, 2006) which measures country risk on a scale from 0 to 100 with a lower score indicating riskier countries. This notion of country risk contains more information than the creditworthiness used by, for example, Cosset *et al.* (1992) and Eaton *et al.* (1986).

Double taxation treaties and Chinese ODI

As with BITs, the increasing importance of double taxation treaties (DTTs) is reflected in the proliferation of such agreements over the last two decades. The number of DTTs concluded worldwide doubled from 1990 to reach 2,758 in 2005 (UNCTAD, 2006). DTTs are normally concluded between two countries to avoid the double taxation of companies operating in both countries. Country attractiveness is increased because future tax rates on (profitable) foreign affiliates are made more predictable for the investing parent company (Davies, 2004). As with BITs, DTTs are therefore said to have signalling effects to firms from third countries. DTTs, however, also reduce the opportunities for tax avoidance by MNEs, which may be an investment disincentive (Egger *et al.*, 2006; Davies, 2004). Moreover, DTTs may be less important than other locational determinants, especially for investments in developing countries. For example, foreign investors in Africa ranked DTTs in 18th position behind other locational factors such as economic and political stability (UNIDO, 2006). This suggests that DTTs have some merit in the investment package, but may not be as important as other FDI determinants.

Although, theoretically, DTTs are deemed necessary and useful to investing firms, to date, empirical studies of the affect on the investment strategies of industrialised country MNEs have found either zero effect or a negative effect on FDI flows and stocks (Egger *et al.*, 2006; Davies, 2004). For example, Egger *et al.* (2006) find a significant negative association between newly implemented DTTs and outward FDI stock from OECD countries. In other words, DTTs are associated with less FDI to a host country. One explanation is that the enactment of DTT principles results in smaller public budgets in the host country, constraining the resources to build the physical, commercial and social infrastructure necessary to attract and support inward FDI. Blonigen and Davies (2004) also find significant and negative effects of new DTTs on FDI, but positive and significant effects of old treaties. Ambiguities in this work maybe a consequence of noisy data and the inclusion of political and economical risk variables which mask certain interactions (Davies, 2004; Blonigen and Davies, 2004). Or, as stated earlier, DTTs may play a minor role when a sound business environment is in place. The Chinese government seeks to conclude DTTs to support domestic firms (see Section 3.3.5) but, to our knowledge, the effect of DTTs on the investment behaviour of Chinese MNEs –nor from any other developing country– has not been researched before. Following theoretical expectations, a positive relationship is assumed at this stage.

WTO membership and Chinese ODI

Membership of a host country to the WTO (and formerly to GATT) is incorporated into our model as a formal, exogenous element of the Chinese ODIR. The WTO is responsible for administering approximately thirty international treaties and agreements, such as the GATT, the

agreement on Trade-Related Intellectual Property Rights and the agreement on Trade-Related Investment Measures. These agreements govern much of the framework for international trade and international investment (such as most favoured nation and equal treatment of domestic and foreign firms, trade dispute resolution, market access, reductions in preferential trading arrangements and so forth) (Sornarajah, 2004). Membership of the WTO may signal to foreign firms that a country will conform to its strictures and obligations with respect to international trade and investment. The WTO thus constitutes an important supranational component of the institutional framework within which MNEs operate, and, by extension, this is likely also to be the case for Chinese ODI. The expectation is that WTO membership will be viewed favourably by potential Chinese investors, although lack of prior research on this point prevents us from providing further empirical support for this contention.

Regional and bilateral trade agreements and Chinese ODI

Trade is generally a precursor for FDI (Buckley and Casson, 1981). Regional and bilateral trade agreements bear therefore the potential to help domestic firms to establish themselves in a foreign market first through exports and subsequently through FDI, especially as the agreements often include provisions concerning the liberalisation of the host country's inward investment regime and can therefore stimulate intra-regional FDI (Jaumotte, 2004; UNCTAD, 2005b).⁴² Empirical studies on the European market support the notion the intra-regional FDI increase with the conclusion of a regional agreement (e.g. Dunning, 1997). Regional and bilateral trade agreements may in principle impact ODI from any given country in a similar fashion as do BITs and DTTs, because such agreements open host country markets to foreign firms. Trade agreements are, however, not further considered in this study. This is because China has not participated in sufficient numbers of trade agreements over the period under investigation to warrant their inclusion. However, China is now negotiating trade agreements since its accession to the WTO with a number of countries and regional organisations. These are either under negotiation or already have been concluded. They contain steps towards greater trade and investment liberalisation as provided by China's commitments under WTO membership (Wang, 2004). Since 2002, China has been able to conclude or agree upon frameworks with ten countries and regions (Antkiewicz and Whalley, 2004; Chen, 2006).

Informal, exogenous elements and Chinese ODI

In addition to these formal elements, it is argued here that the Chinese ODIR also contains *informal*, exogenous elements. In particular, an informal exogenous element may constitute the access to an international social or business network (drawing upon discussions in Sections

⁴² These agreements are known under various names, including "free trade agreement", "regional trade agreement", "economic partnership agreement", "economic complementation agreement", or "closer economic partnership arrangement" (UNCTAD, 2005b).

2.2.6 and 3.4.5). Such a network may exist between a Chinese company and (i) the Overseas Chinese, (ii) its trading partners, (iii) and international business facilitators (such as investment promotion agencies). Access to such a network has the potential to increase investment flows between countries by lowering transaction costs (see Sections 2.2.6 and 3.4.5). Further elements may include foreign policy such as official development aid and state visits by leading politicians to and from host countries concerned (see Sections 3.3 and 3.4.6). State visits as such are interpreted as informal because they are generally intended to appease and befriend the visited country but bear no codifiable and enforcement mechanisms like home country government action. Such visits may, however, be followed by informal and formal arrangements between the governments that can affect the investment behaviour of Chinese firms. Section 3.3.5 provides examples for China's political activism in Africa which falls into this category. It is argued in Sections 2.2.6, 3.3.5 and 3.4.5 that all these types of informal, exogenous elements may effect the decision-making of Chinese firms positively.

4.3 The Chinese ODIR and international business theory

The Chinese ODIR is presented diagrammatically in Figure 4.1. This synthesises the discussion outlined in this chapter.

Although Chinese companies are embedded in and influenced by the institutional framework presented in this chapter it is apparent from the empirical studies reviewed in Section 2.3 that these elements alone are unlikely to fully explain Chinese ODI. The role of institutional factors has to be disentangled from other influences such as demand conditions and competition levels in the host country. Hence, a combined model that brings the institutional elements and traditional theoretical explanations for FDI together may exert much greater explanatory power than less holistic modelling can accomplish. The Chinese ODIR as presented in Figure 4.1 therefore integrates internalisation theory, the investment strategies of the MNE, and the speed of commitment to the host market (taking a steer from the Uppsala and the New International Ventures theories) presented in Section 2.2. The internalisation theory is depicted at the core of the framework showing internalisation across borders through the investment in a foreign market. The increase of international investment commitment and psychic distance may depend on a firm's access to networks as described in Section 2.2.6. The exploitation of such access may decide whether a firm rather adopts an internationalisation approach as predicted by the Uppsala theory and the New International Venture theory. The inclusion of the international investment strategies (market-, efficiency-, natural resource-, technology- and strategic asset-seeking) reflects the basic strategies that Chinese firms pursue in the host country but may be influenced by the domestic institutional environment.

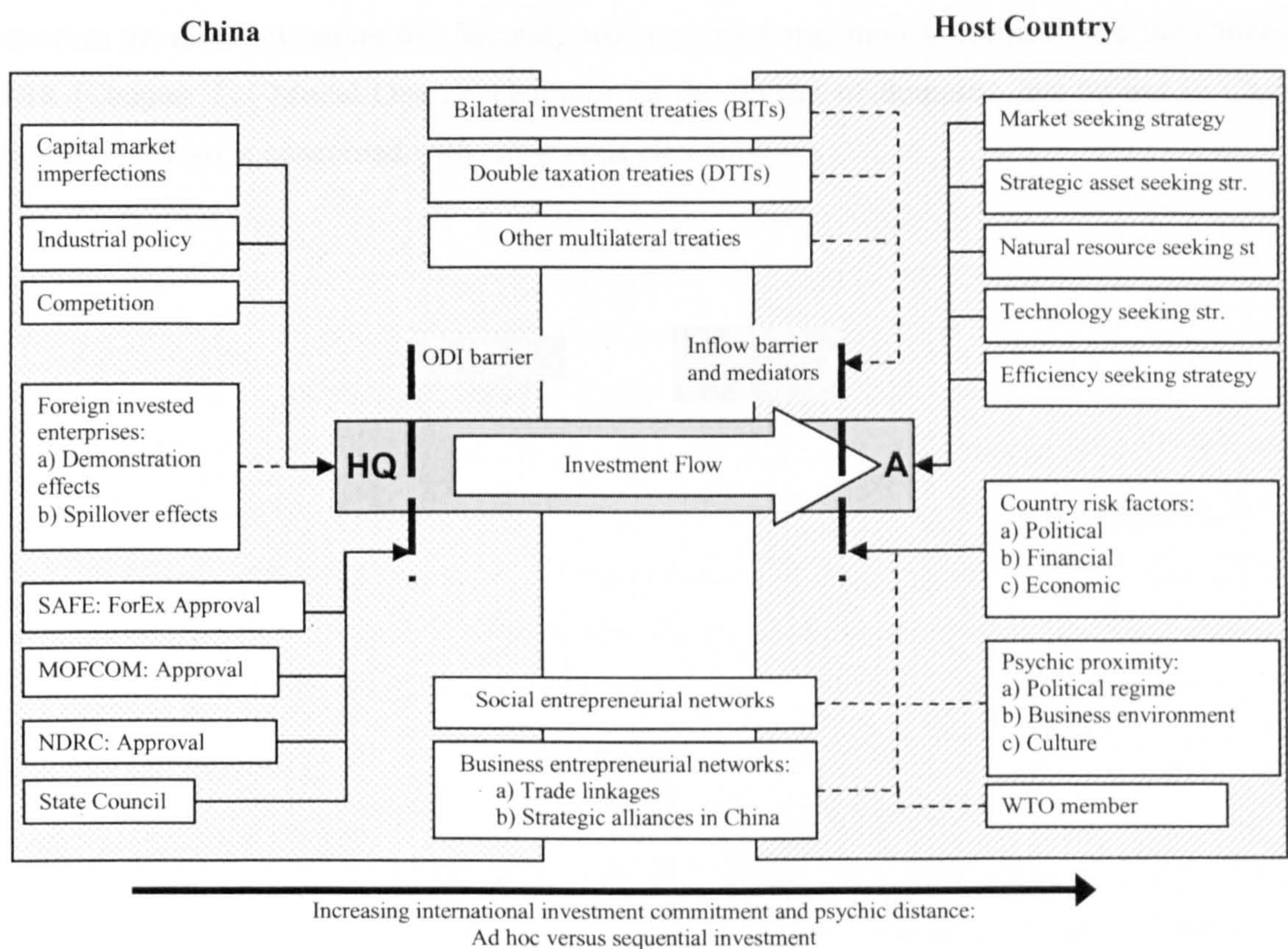


Figure 4.1: The Chinese outward direct investment regime

Notes: (1) Broken arrows (-----) indicate mediating (indirect) effects;

Solid arrows (————) indicate direct effects.

(2) HQ: parent firm in China, A: foreign affiliate.

Source: Author.

4.4 Summary

In this chapter, a framework is presented that describes the Chinese ODI regime (ODIR). This is a novel way to represent the institutional factors that have the potential to shape Chinese FDI outflows. As such, it constitutes one of the main contributions made by this study to the understanding of Chinese ODI. Chinese firms are embedded in a nexus of formal and informal constraints at home and internationally that might influence their investment decision-making. The acknowledgement of this and the insight it brings in the evaluation of Chinese MNEs are important. This notion gains even more weight when Chinese ODI is considered because Chinese firms have been highly politicised for most of the period after 1979.

The next chapters assess the explanatory power of the Chinese ODIR as presented in Figure 4.1. First, interview and survey questionnaire data gathered from Chinese MNEs is evaluated with respect to the model (Chapter 6). Second, two cross-sectional models formally test the Chinese ODIR (Chapter 7). Model One concentrates on the impact of domestic institutions in China while Model Two is concerned with exogenous elements.

5 Methodology

This chapter sets out the research methods for this study. Scholars such as Shenkar (1994), Ang (1998) and Eckhardt (2004) argue that Chinese business and China's business environment have special characteristics which are most effectively examined by methodological triangulation and employment of different data sets. It is asserted here that the use of quantitative and qualitative research methods and the investigation of primary and secondary data address the research questions best. This chapter first presents a review on quantitative and qualitative research with explicit reference to international business research on China. The chapter further describes the use and collection of primary and secondary data to address the research questions as presented in Sections 1.2 and 3.4. It describes the way interviewees in China were identified, approached and interviewed. It goes on with a description of how the survey questionnaire in the UK was administered and data analysed. Finally, the set of variables to be used in the econometric models in Chapter 7 are outlined and evaluated.

5.1 Mixed methods approach for Chinese business research

There are a number of challenges associated with doing research in China and about China which have to be considered at the outset of the research design. Some of the challenges are research method-specific while others concern both quantitative and qualitative analysis of primary and secondary data. This section places the discussion of the challenges in the wider context of research methods used in international business research generally and highlights the merits of triangulation in the context of China.

5.1.1 General issues

As will be seen in Section 5.1.2, quantitative and qualitative research methods both have shortcomings which can be addressed using methodological triangulation (Easterby-Smith *et al.*, 2002). Methodological triangulation combines the complementary data collected and analysed with qualitative and quantitative research methods to answer research questions (Tashakkori and Teddlie, 1998). Therefore this approach can achieve a more holistic picture of the research object and helps to answer aspects of research questions that other methods cannot. Given the infancy of the current research object (namely Chinese ODI), the questionable reliability of official data and my position as an outsider with, *prima facie*, limited access to Chinese companies, a triangulation approach is the most appropriate method for this research.

5.1.2 Challenges in cross-sectional research

Quantitative analysis on China using secondary data generally relies on three different sources, namely official sources in China, international organisations and, with respect to international investment or trade flows, the partner country. All of these sources, however, have their shortcomings which need to be considered by the researcher and addressed where possible.

Chinese government agencies publish a wide range of statistical yearbooks covering, among other things, international trade and foreign direct investment. The available data are often constrained by five factors. First, a legal and operational definition of particular items of data is often missing (Shenkar, 1994) or, if set out, tends not to be permanent. Classifications and data collection methods are often changed over time with little, if any, retrospective adjustment of the data concerned (Sinton, 2001). The latter especially compromises longitudinal research of a quantitative type. Second, sub-national institutions in China generally have some freedom in creating statistics which they report to their superiors. This causes incoherence in data coverage and compromises, again, longitudinal and inter-province research (Holz, 2004; Shenkar, 1994; Xu, 2004). The most prominent Chinese statistic constantly under criticism for faulty sub-national reporting is China's gross domestic product (e.g. Rawski, 2002). Having said that, and importantly for this study, the most reliable Chinese statistics concern international trade and (inward) FDI as these have a foreign counterpart to provide 'checks and balances'. Third, inter-province comparison and the generalisation of findings are not always possible (Shenkar, 1994). The provincial statistical bureaus have some flexibility over what statistical figures they report as is represented in the deviating data coverage in the provincial statistical yearbooks (Voss, 2004). Fourth, the national statistical bureau may not disclose statistics it deems classified or otherwise of political sensitivity (Clegg *et al.*, 1996; Shenkar, 1994). Five, the Chinese government has in the past often used statistics for ideological means to support its political agenda. This praxis leads to a distortion of the statistical data and again makes longitudinal analysis challenging (Shenkar, 1994). Although there are some apparently difficulties with Chinese data in particular, the Chinese government has in recent years strengthened its international co-operation with organisations such as the OECD and UNCTAD to increase the accuracy, reliability and international comparability of official Chinese secondary data (Xu, 2004).

To overcome the challenges from the Chinese side, it may seem reasonable to rely on statistical data published by international organisations such as UNCTAD, OECD or the World Bank. The advantage of using such data is that they derive from a single source which strives to refine and tidy up data it receives. International organisations, however, do not collect FDI data themselves but rely on the source countries to provide them with it or they use data collected by

other international organisations. Hence, research has to cope with several challenges concerning the reporting of FDI and inter-country comparability. First, an initial portfolio investment (that is, investment which remains under the 10 per cent threshold for being classified as FDI) may be followed by a subsequent portfolio investment. Combined, these two investments could constitute an FDI because the sum attains the threshold level but is not recorded as such (Stephan and Pfaffmann, 2001). Second, host countries apply different ownership thresholds for the classification of an investment as FDI, varying typically from 10 per cent to 50 per cent. While an investment may be regarded in one country as FDI it may be seen in another as a portfolio investment (Stephan and Pfaffmann, 2001). The ten per cent threshold is internationally most commonly adapted. Third, the definition of FDI comprises retained earnings, inter-company loans and equity capital shares in foreign companies (UNCTAD, 2006). Some countries, however, underreport their inward FDI by not including retained earnings or short-term inter-company loans (Stephan and Pfaffmann, 2001). Fourth, countries may apply varying accounting standards especially with respect to the calculation of retained earnings and the classification of inter-company loans as equity investments. This affects the levels of reportable FDI (Stephan and Pfaffmann, 2001). A case in point is China, which has moved from an accounting system designed to support the centrally planned economic system to a system more similar with the once found in market economies (Tang, 2000; Chen *et al.*, 2002). To date, however, differences between the Chinese and the International Accounting Standards still exist, and this is most apparent in the reported earnings of publicly listed firms in China (Chen *et al.*, 2002). Lastly, research concerning FDI has the advantage that two countries are involved. Thus, official data of the host country could be used for analysis. Nevertheless, depending on the investment amount and investment project number, the host country statistical office may not disclose the inward FDI figure for a particular source country. This, for example, is the case for Chinese investments to the UK, which are neither included in official British documents nor otherwise available to protect the investor.

5.1.3 Challenges in qualitative research

To overcome the problems associated with secondary data, primary data can be collected using either a survey questionnaire or interviews. Both approaches have their merits and challenges in the context of China as illustrated below.

The use of a questionnaire poses a couple of serious concerns in China. First, the applicability of a questionnaire designed by a scholar in a culture different to her home culture can cause construct validity problems due to 'native category' issues (Buckley and Chapman, 1996; Shenkar, 1994). Native categories describe the impact of language barriers, differences in

cultural traditions and backgrounds on the understanding of the questions asked as these build on culture-specific categories. Second, the translation of a questionnaire into Chinese is complicated. Exact meanings cannot always be translated and, hence, lead to misunderstandings on the part of the respondent and, subsequently, to misinterpretation by the researcher (Shenkar, 1994). This problem has an even greater importance when the survey questionnaire is administered in different parts of China as numerous dialects are spoken. For example, Roy *et al.* state (2001: 207) that ““high risk” can be translated as “qiang feng xian” in northern and middle China but as “gao feng xian” in southern China. To Chinese from the south, the word “qiang” has two meanings, one is related to the “magnitude” and the other to “strength.” Construct validity may be impaired as a consequence of ambiguous interpretation. Third, the Chinese respondent might answer with an ideal picture to avoid losing face (*mian zu*) and not with reference to reality or her beliefs and opinions (Adler *et al.*, 1989). Such a pattern questions the construct validity of the questionnaire and external validity. Fourth, Chinese people are often either not familiar with survey questionnaires or are culturally constrained (to avoid uncertainty and favour collectivism), and, hence, tend to place a score in the middle of a five or seven Likert-type scale (Shenkar, 1994; Si *et al.*, 2003). Finally, when a scale in a survey questionnaire includes ‘lucky’ numbers – two, eight, and nine – these answers are more often chosen than others (Ang, 1998). Again, construct validity, as well as reliability and external validity, suffer from such behaviour.

The problems with secondary data and survey questionnaires lead some researchers to suggest that interview-based research is more suitable for research on China (Eckhardt, 2004). However, there are pitfalls to this approach as well. First, most non-Chinese researchers are not sufficiently fluent in Mandarin, the official language in China, or any other local dialect like Cantonese which is essential for Southern China. Often, the non-Chinese researcher therefore has to rely on a local interpreter who may be employed by the Chinese government or the CCP. The interpreter may translate work in loyalty to her ultimate employer with the aim of preventing the interviewer from gathering potentially harming or critically information about the party, the society or the economic situation. In the worst case, she could refuse to do translation at all, being aware that the foreign researcher depends on her goodwill (Shenkar, 1994). The right choice of interpreter is also important from another perspective. Besides the problem of biased translation, the interpreter might not be familiar with international business terminology and find it difficult to translate exact meanings. This again can lead to misunderstandings and misinterpretations (Fischer, 2001). Consequently, construct validity cannot be ensured. Second, Chinese interviewees may tend to answer questions suitable to her position in a hierarchy and not her own opinion (Eckhardt, 2004). Third, the richness of the collected data may be constrained when data collection is conducted by an outsider, i.e. a non-

Chinese who does not belong to a defined group in China. Chinese people are often afraid of giving away too much information which may subsequently undermine their position of power (Roy *et al.*, 2001). For these reasons, it is therefore advisable to conduct interviews in collaboration with a Chinese researcher (Eckhardt, 2004). Fourth, the inclusion of a Chinese researcher in the project may also support access to potential interviewees. Foreigners and outsiders in general often find it difficult to get access to Chinese organisations when they do not speak the local language fluently enough and are not known to the organisation. A local researcher may overcome these problems. Hierarchical structures and groups, give rise to another crucial aspect, which is interdependence. Interdependence describes the situation when someone acts and thinks in a context-related way and in relation to her personal environment rather than based on personal beliefs and attitudes (Eckhardt, 2004). As a consequence, it is important to understand the environment in which the interviews take place to interpret responses correctly (Eckhardt, 2004; Fischer, 2001).

In the following sections the methods used to collect primary and cross-sectional data and their limitations are outlined.

5.2 Primary data collection

For this reason, the primary collection process was split into two parts: interviews in China and a survey questionnaire distributed to Chinese affiliates in the UK. Section 5.2.1 describes the interview process in China. Section 5.2.2 describes the questionnaire survey undertaken in the UK.

5.2.1 Interviews in China

Primary data collection by interview in China took place between May 2006 and August 2006. This section describes the process of identifying potential interviewee candidates and Chinese affiliates and how the interviews were conducted and analysed. The section concludes with limitations and constraints faced using these data collection method.

5.2.1.1 Interviewee identification

Potential interviews candidates were identified among Chinese firms, government decision-makers and stakeholders such as foreign investment promotion agencies with an office in China. The key people interviewed were senior managers from Chinese firms. Interviews with government staff and investment promotion agencies were considered to provide auxiliary,

independent support to the data obtained from the core interviews. To be able to interview a significant number of Chinese MNEs with different ownership forms, the two provinces and municipal area with provincial status of the Yangtze River Delta were selected as the main provinces for the interviews to take place: Jiangsu, Zhejiang and Shanghai. The reasons for this are as follows. The Yangtze River Delta is a regional economic powerhouse in China, which the following stylised facts illustrate. It is a major recipient of inward FDI to China, attracting on average around 30 per cent of total inflows during the years 2001 to 2003 (NBS, various years) and it registered the largest number of foreign enterprises by 2005 (NBS, 2006). The gross domestic product (GDP) accounted on average for 21 per cent of China's GDP between the years 2001 and 2005 (NBS, 2006). The large GDP share is especially driven by private enterprises in Jiangsu, Shanghai and Zhejiang (Wang, 2006b) which are numerous in the Yangtze River Delta region. The large private economy provided sufficient possibilities to talk to Chinese MNEs of different ownership types. The provinces and the municipal area of the Yangtze River Delta accounted for nearly 30 per cent of Chinese ODI stock in 2004 (MOFCOM, 2004b). Finally, the University of Leeds is a member of the Worldwide Universities Network (WUN). In China, only the Universities of Nanjing (Jiangsu) and Hangzhou (Zhejiang) are WUN members. WUN offers fieldwork funding in China only when it is conducted in collaboration with a WUN university. This was a further practical argument to focus the interviews on this region. The School of Management of the University of Nanjing agreed to collaborate on this particular research project which subsequently secured WUN funding for the fieldwork. Co-funding was also secured from the Universities' China Committee, London. The collaboration proved to be useful to get access to some companies as the School of Management, Nanjing enjoys a good reputation in the region and is an important gatekeeper to organisations (Odendahl and Shaw, 2001; Kincaid and Bright, 1957).

Companies

Several sources were used to identify potential firms to be interviewed. No public available directory on outbound investing Chinese companies exists to date. Hence, a total population is not known from which firms could have been sampled (Singleton and Straits, 2001). Instead, firms were added to a newly created database at random when identified. SOEs were relatively easy to locate as most of the 'Top 500' Chinese firms are SOEs and have often invested abroad. Privately-owned companies are difficult to track down, however. Different means were therefore used to identify firms. First, the attendance of a Chinese international trade and investment fair, such as the East-China Fair in Shanghai (<http://www.east-china-fair.com/enindex.htm>), was taken as one indicator for potential outbound investment activities of the participating firm. In particular, privately-owned companies were identified using this approach. Second, international business and trade publication such as the *Financial Times*,

The Economist and *Business Week* were used to identify further potential interview candidates headquartered in the Yangtze River Delta region. Prior to departure to China, the numbers of identified Chinese firms in the focal provinces were as follows: Jiangsu: twenty-nine, Shanghai: twenty-two, and Zhejiang: eighty. Third, a 'snowball strategy' was employed after commencing the research in China. Each interviewed international stakeholder, was asked if he or she could either name one or two outbound investing Chinese firms or recommend the researcher to one or two of relevant companies they were in contact with. Thus, access to a network through a gatekeeper was achieved and the privacy of the Chinese firm ensured (Odendahl and Shaw, 2001). With the help of the 'gatekeepers' three further Chinese firms in Shanghai were identified and interviewed. Table 5.1 presents a summary of the interview schedule.

Government organisations

A number of government organisations with a potential influence on the ODI process of Chinese firms (as identified in Chapter 3.2.2) were identified for interview. The selected organisations on the provincial level were SAFE, MOFCOM and the NDRC. To identify the correct interviewee in each organisation, staff in some investment promotion agencies were asked to recommend an appropriate interview candidate in each of the provincial organisations.

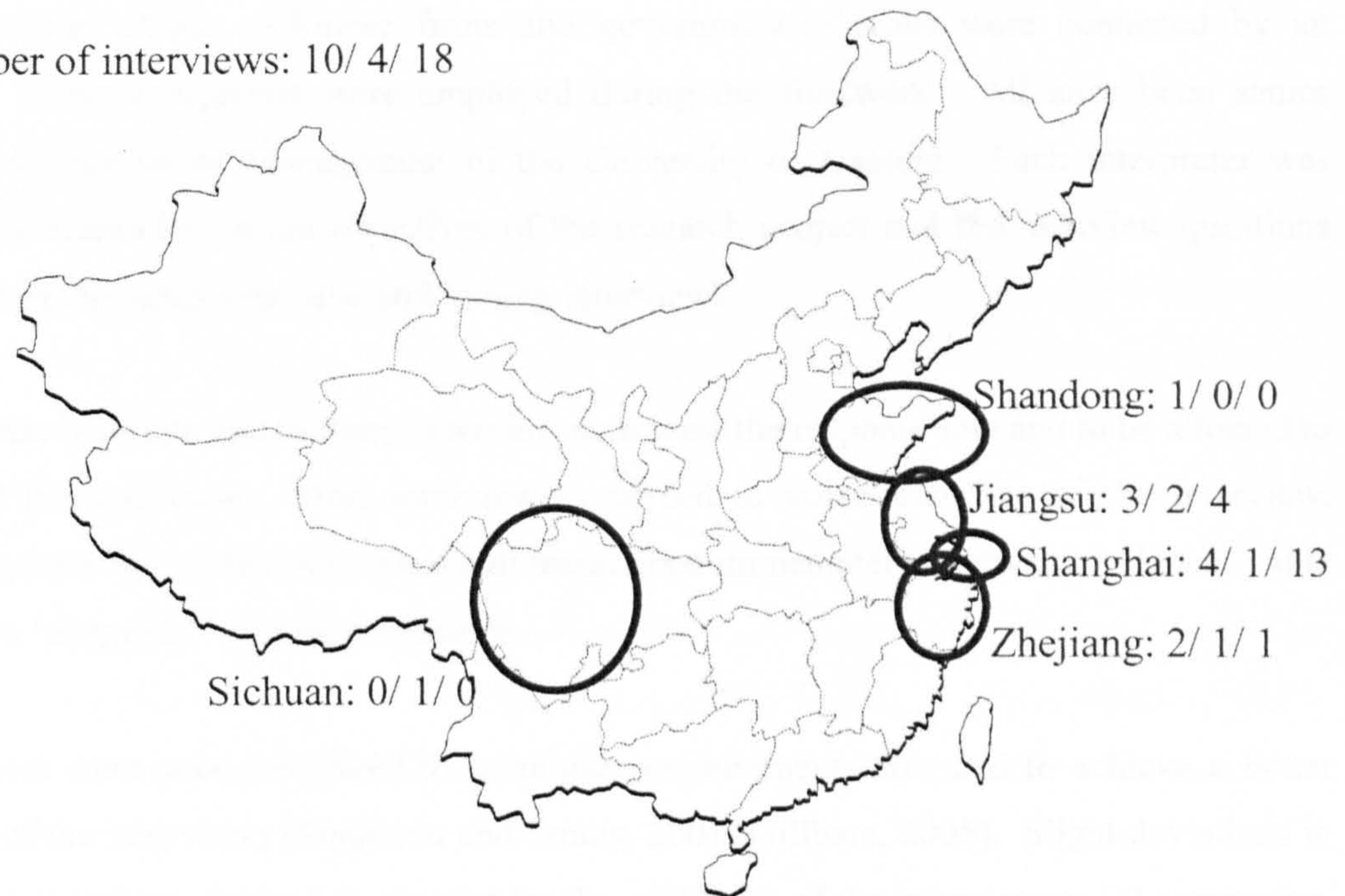
International stakeholders

The limited number of foreign investment promotion agencies (IPAs) in China and the objections of other IPAs to an interview led to a concentration of interviews with European IPAs in China. Both, national and regional IPAs were identified and interviewed. IPAs were identified through an internet search with the keywords 'investment promotion agency' and 'Invest in' and 'China'. Additionally, important international recipients of global FDI were checked to see if they have (i) an IPA and (ii) an office in China. A third source was the 'snowballing' technique. Each interviewed IPA was asked for contact details of other IPAs, and in many cases these were provided.

Figure 5.1 summarises the spatial distribution of the interviews conducted. It shows that the majority of interviews took place in the Yangtze River Delta as planned, and, of these, most interviews took place in Shanghai.

Figure 5.1: Spatial distribution of interviews in China

Total number of interviews: 10/ 4/ 18



Key:

Province: company/ government agency/ foreign IPAs and other stakeholders.

5.2.1.2 Interview organisation and structure

Interview candidates identified using the approach described above were contacted from the UK in March and April 2006 before the researcher left to China in May 2006. An invitation letter was prepared in English and translated by a native Chinese into Chinese. A second native Chinese colleague with considerable research experience in dealing with Chinese firms corrected and improved the language (see Appendix A.2). The translated invitation letter was sent as a facsimile to the most senior manager of the firm. In the letter, the scope of the research was explained and the Chinese research partner (School of Management, Nanjing) introduced. Managers were invited to join the research and an interview requested. This approach secured one interview (with Company 1) before leaving for China. The remaining interviews were organised in China by contacting potential interviewees per telephone without sending them a second written invitation. Non-corporate interviewees were asked if they could suggest one or two other potential interviewees. Some IPAs were very helpful providing either contact details of government officials and other IPAs or by contacting firms directly. Of the ten company interviews, one was organised through the School of Management, one through a foreign MNE, three by IPAs, and one by a government official.

Foreign IPAs, MNEs and other stakeholders were contacted by the researcher in English after having arrived in China. Chinese firms and government officials were contacted by an interpreter. Three interpreters were employed during the fieldwork. All have been senior students at the School of Management of the University of Nanjing. Each interpreter was trained by the researcher in the objectives of the research project and the interview questions before commencing telephone calls and joining interviews.

Anonymity has been ensured to every interviewee to raise the response rate and to be allowed to voice-record the interview. Most interviewees agreed to voice-recording of the interview. Additionally, interview notes were taken and transcribed immediately afterwards. Hence, Table 5.1 presents a ‘disguised’ interview schedule.

The interviews were semi-structured to minimise measurement error and to achieve a better comparison of the interviews (Singleton and Straits, 2001; Gillham, 2005). Slight deviations in the interview questions occurred to account for the affiliation of the interviewee: (a) companies, (b) government officials, and (c) IPAs, foreign MNEs and other stakeholders (see Appendices A.3 to A.5). The structured but open questions provided flexibility for the researcher to react to and engage with the answers of the interviewee (Kincaid and Bright, 1957). All interviews were designed around four broad themes to address the research questions *RQ2*, *RQ3*, *RQ4*, *RQ5*, *RQ9*, *RQ10a*, and *RQ11* in particular. The four themes were: internationalisation stages, investment strategies, international networks, and domestic institutions. With regard to research questions *RQ2* to *RQ5* (which focus on international investment strategies), the interview was designed to identify the possible investment drivers. Concerning *RQ9*, it was intended to gain a good understanding of access and usage of Chinese firms to international networks. The delicate question concerning the impact of domestic institutions on investment decision and an in-depth insight on administrative mechanisms (*RQ10a*) were thought to be obtainable especially through interviews. *RQ11* was tackled by interviewing Chinese firms of different ownership forms and by interviewing government officials, IPAs, and others about their perceptions of Chinese MNEs by ownership type. All this has allowed analysing the interviews systematically following the structure of the model advanced in Chapter 4 and the overall research questions of this research.

5.2.1.3 Limitations concerning interviews

The interviews conducted had number of limitations. First, similar to experience by other researchers (e.g. Thomas, 1993; Yeung, 1995) it was difficult to get access to firms, and this kept the number of company interviews small. Although numerous IPAs provided very useful

insights about the development, strategies and motivations of Chinese MNEs and were helpful in organising interviews, the research object is the Chinese firm. Interviews with some thirty firms would have strengthened the research findings and improved the generalisability of this aspect of the project. Second, although the researcher has a reasonable command of Mandarin, it was deemed necessary to conduct interviews using an interpreter. Questions were asked in English, and these were translated for the interviewee. Similarly, responses were translated to English, despite the fact that the researcher was able to comprehend some of what was said. This process gave rise to a number of limitations. In particular, the interpreters were of varying quality. All three were very engaged and interested in the research but had different levels of understanding of international business and experience in interpreting interviews. Conducting all interviews with one interpreter would have ensured that all were conducted in the same way. The fourth limitation is the usage of an interpreter in general. Having to rely on an interpreter to enforce the researcher's questions dilutes the possibility to press the interviewee to answer a question clearly.

Table 5.1: Anonymised interview schedule

Interviewee(s)	Place and date	Duration
<i><u>Chinese outward investors (Company)</u></i>		
1 Vice General Manager	Nanjing (Jiangsu) 28 May 2006	90 min
2 (a) Dept Director of the HR Development Division (b) Marketing Manager Assistant	Qingdao (Shandong) 19 June 2006	90 min
3 (a) Former Vice President (b) Deputy General Manager	Wuxi (Jiangsu) 12 July 2006	105 min
4 Executive Director	Shanghai 14 July 2006	120 min
5 Vice General Manager	Shanghai 18 July 2006	75 min
6 Managing Director	Shanghai 21 July 2006	60 min
7 Chief Managing Officer	Hangzhou (Zhejiang) 24 July 2006	120 min
8 (a) Special Assistant to Chairman (b) Manager Overseas Marketing Department	Yiwu (Zhejiang) 26 July 2006	90 min
9 Former General Manager of the Australia affiliate	Shanghai 1 August 2006	70 min
10 Vice President	Danyang (Jiangsu) 4 August 2006	75 min
<i><u>Chinese government authorities (Government)</u></i>		
1 Assistant Director	Shanghai 17 July 2006	60 min

2 Business developer	Chengdu (Sichuan) via Skype 20 July 2006	60 min
3 (a) Deputy Director (b) Overseas Investment Division	Nanjing (Jiangsu) 28 July 2006	45 min
4 Section Chief	Ningbo (Zhejiang) 2 August 2006	60 min
5 Vice Division Director	Nanjing (Jiangsu) 3 August 2006	60 min
<i><u>International stakeholders</u></i>		
IPA 1 Chief representative	Shanghai via Telephone 25 May 2006	30 min
IPA 2 Chief representative	Nanjing (Jiangsu) via Telephone 25 May 2006	10 min
Foreign MNE Chief executive officer	Nanjing (Jiangsu) 1 June 2006	60 min
European embassy Trade Officer	Shanghai 2 June 2006	30 min
IPA 3 Business Development Manager	Shanghai 2 June 2006	60 min
Sino-European business facilitator 1 Business Development Manager	Shanghai 2 June 2006	30 min
IPA 4 Chief executive officer	Shanghai 5 June 2006	30 min
IPA 5 Business Development Manager	Shanghai 3 June 2006	75 min
IPA 6 Investment Promotion Officer	Shanghai 5 June 2006	80 min
IPA 7 Chief representative	Hangzhou (Zhejiang) 7 June 2006	60 min
IPA 8 Trade Officer	Shanghai 13 June 2006	75 min
IPA 9 Investment Manager	Nanjing (Jiangsu) 14 June 2006	90 min
IPA 10 Deputy Director	Shanghai 3 July 2006	60 min
IPA 11 Representative	Shanghai 3 July 2006	90 min
IPA 12 General Manager	Shanghai 4 July 2006	80 min
IPA 13 Inward Investment Officer	Shanghai 5 July 2006	90 min
Sino-European business facilitator 2 Chief representative	Nanjing (Jiangsu) 19 July 2006	60 min
Chinese consultant General Manager	Hangzhou (Zhejiang) 24 July 2006	30 min

5.2.2 Survey of Chinese affiliates in the United Kingdom

This section describes the survey undertaken with Chinese affiliates in the UK. It sets out the identification process of Chinese affiliates in the UK, the survey design and how the survey was organized and distributed. It concludes with some limitations of this approach.

5.2.2.1 Identification of Chinese affiliates in the UK

To date, there exists no official database on Chinese firms active in the UK. Several public sources were therefore used to identify UK-based affiliates of Chinese firms. Most firms were identified using the business information providers ICC (ICC, 2005a, 2005b) and Hemscoff (Hemscoff, 2005). Further companies were identified using the homepages of the Chinese Embassy in London and UK Trade and Investment (UKTI), as well as business press such as the *Financial Times*. From these sources 151 affiliates of Chinese firms in the UK were identified that were indicated to be operating in 2005. This number was subsequently reduced to 132 as dissolved, dormant and liquidated companies were excluded from the database. This figure compares well to the UKTI's statement that 220 mainland Chinese companies had invested in the UK by 2006 (UKTI, 2006). The database was then further reduced to 125 firms as those companies for which a valid postal address could not be found were deleted.

5.2.2.2 Survey questionnaire organisation and distribution

In August 2005, 125 Chinese affiliates in the UK received a paper-based questionnaire and cover letter in English explaining the objectives of the research together with a prepaid return envelope (see Appendix A.6 and A.7). Because the Chinese affiliate runs a business in the UK and has to interact with an English-speaking environment, it was decided to not translate the survey questionnaire into Chinese. Anonymity and unidentifiability of individual respondents in the analysis was assured to every Chinese firm in the cover letter. The mailing was directed to the identified senior manager of the UK-based Chinese affiliate or, in cases when no individual could be identified, to the senior manager. The questionnaire was followed-up with a number of telephone calls to explain the project and to encourage participation. If the Chinese company then agreed to participate in the survey, the questionnaire was resent, either by mail, email or fax, depending on the request of the participant. The whole process stretched over eight months until March 2006.

The returned questionnaires and follow-ups led to the exclusion of a further seven firms for various reasons (the firm had since been dissolved or originated from either Hong Kong or Taiwan). During this process, however, an additional four Chinese firms active in the UK were identified. A questionnaire with cover letter and pre-paid return envelope was sent to these firms as well. Thus, a total population of 122 affiliates of Chinese firms active in the UK was

identified. Twenty-one usable responses were received from these firms, giving a response rate of 17.2 per cent.

Before sending the questionnaire to the Chinese affiliates, it was piloted during spring and summer 2005 with two UK firms which were founded by two mainland Chinese individuals. The survey questionnaire was designed around investment strategies and motivation to address in particular research questions *RQ2* to *RQ5* and on strategy changes over time (*RQ6*).

5.2.2.3 Limitations to the survey questionnaire

The survey questionnaire has some limitations. First, the identified population of Chinese affiliates in the UK is relatively small. It is thus difficult to draw a random sample from the population and address only the sample with a questionnaire. Second, the identified population does not necessarily correspond with the true population of Chinese firms in the UK. The view is that it is a fair representation. Other studies inflate the number of Chinese firms in the UK by intermingling firms from mainland China, Hong Kong, Macao, Taiwan and sometimes Singapore into the category 'Chinese firms' (e.g. GLAEconomics, 2004). Third, the small number of usable returned questionnaires limits the analytical methods that can be applied. Fourth, the parent companies of the respondent firms in China were not interviewed during the China fieldwork phase. Thus, this aspect to the research does not deal with 'matched pairs' and this reduces opportunities for triangulation of this element of the data collected.

5.3 Quantitative analysis and secondary data sources

This section describes and discusses the data sources for the dependent and independent variables as employed in the econometric modelling described in Chapter 7.

5.3.1 Data sources and limitations of the dependent variable

Chinese data sources of Chinese ODI used in later cross-sectional models are now reviewed, namely SAFE data (employed in Section 7.1) and MOFCOM data (employed in Section 7.2). The data published in the *Chinese Statistical Yearbook* by the National Bureau of Statistics of China is included for completeness. Aspects of reliability and validity are considered for all three data sources.

SAFE

The State Administration for Foreign Exchange (SAFE) is highly involved in the approval of Chinese ODI (see Section 3.2.2). SAFE has to approve the source and amount of foreign

exchange used by a domestic Chinese enterprise in an overseas investment. Without the approval by SAFE the Chinese company cannot proceed to MOFCOM to apply for the approval of the business project. SAFE therefore records all foreign exchange transactions approved for Chinese ODI as well as capital transfers between the Chinese headquarters and its foreign affiliate (such as reinvested earnings and intra-company loans) and subsequent investments and private sector transactions (Buckley *et al.*, 2006; Wu and Sia, 2002). The data collected by SAFE therefore largely reflects China's balance of payments (BOP) data as published by the International Monetary Fund (IMF). The SAFE dataset available for this research projects is based on SAFE-approved Chinese ODI projects made between the period 1979 and 2001. The data include information on host country, industry sector, foreign market entry mode, and commitment of the Chinese investor. This depth and width makes the SAFE database invaluable for research on Chinese ODI. SAFE staff asserts that his dataset is the most complete and most detailed available on Chinese ODI and includes all projects that fell under its remit over the period under investigation.

There are, however, some limitations associated with the SAFE data (Buckley *et al.*, 2006): SAFE only approves and records Chinese ODI involving transfers of money. When Chinese ODI involves any transaction in kind, i.e. for example when the Chinese investor contributes to an investment project with transfers of equipment, raw materials and intangible assets, these transactions are not approved and recorded by SAFE. Chinese firms were encouraged to invest in kind, especially during the 1980s (Guo, 1984) (see Section 3.3.1) and this may have led to some underreporting of early Chinese ODI. It should also be noted that SAFE data as reported to the IMF is based on collected sample data which may underrepresented real changes to China's BOP (Zhan, 1995; Wu and Sia, 2002). Moreover, some Chinese ODI projects initiated or approved by local governments may not be reported to SAFE (and subsequently to MOFCOM) in order to circumvent the approval process or because the company was exempted from the process (Zhang, 2003; Ding, 2000a). In addition, the SAFE data is only available up to the end of 2001 (when the decision was taken in SAFE to no longer compile data at the level of disaggregation it had done previously) which excludes the period for which MOFCOM reports the fastest and steepest increase of Chinese ODI.

MOFCOM

MOFCOM is the second government authority involved in the approval of initial Chinese ODI projects (see Section 3.2.2). MOFCOM reports in its *Almanac of China's Foreign Economic Relations and Trade* (prior to 2004) and *China Commerce Yearbook* (after 2004) non-financial, approved Chinese ODI by host country. The data is mostly presented as aggregated data and as volume change over two years. The reporting of approved projects causes some of the same

problems as for SAFE data. The exclusion of financial ODI causes further problems. Traditionally, financial institutions from industrialised countries follow their customers abroad (UNCTAD, 2004b). The omission of ODI by China's financial institutions, such as the acquisition of Indonesia-based Bank Halim by the Industrial and Commercial Bank of China and the USD 1.3 billion purchase of the Bank of America businesses in Hong Kong and Macao by the China Construction Bank, both in 2006 (CIBUL, 2007; FT, 2006e), leads to an underreporting of Chinese ODI which will become more severe with increasing Chinese ODI flows. MOFCOM is also not responsible for approving and, hence, registering and reporting ODI by privately-owned firms, nor intra-company loans and reinvested earnings (Wu and Sia, 2002). Moreover, MOFCOM does not record large-scale Chinese ODI which have been initiated by a certain political agenda and foreign policy objectives such as some projects in South Asia and Africa (Buckley *et al.*, 2006). Such investments require the approval of the State Council only. Data published by MOFCOM may therefore significantly underreport the value and scope of Chinese ODI (Wu and Sia, 2002; Cai, 2006). It should be noted, however, that MOFCOM together with the National Bureau of Statistics has undertaken initiatives to strengthen the statistical reporting system and has implemented the 'statistical system of direct overseas investment' (MOFCOM and NBS, 2002). This system places reporting responsibilities on the investing firm and the national and sub-national branches of MOFCOM and widens the scope of the reporting system compared to previous years. MOFCOM (2006c) has also issued in late 2006 a further notice on the importance of a timely, accurate and comprehensive reporting system and the fulfilment of each party's responsibilities. From 2007, MOFCOM and NBS will also collect and report quarterly data on Chinese ODI along with information on ownership type (MOFCOM, 2007). These measures indicate that the Chinese government authorities have acknowledged the current shortcomings in the reporting system on Chinese ODI and could soon make the above criticisms obsolete.

National Bureau of Statistics of China

The National Bureau of Statistics of China (NBS) publishes annually the *Chinese Statistical Yearbook* (CSY). The CSY reports on both the Chinese balance of payments and non-financial Chinese ODI. While the former is reported from 1997 onwards, the coverage of Chinese ODI starts with the CSY 2005 covering 2004 only. Chinese ODI data for 2004 covers net and accumulated end-2004 Chinese ODI by industry sector only. The CSY 2006 also includes information on non-financial Chinese ODI to selected host countries for the year 2005. The limited coverage and current inconsistency in presentation excludes this dataset from use in econometric analysis. The BOP data published in the CSY mirrors SAFE data as published in the *Balance of Payments Statistics Yearbook* (IMF, 2006) and data extractable from UNCTAD's TNC/FDI online database (UNCTAD, 2007a). Both IMF and UNCTAD report, however, data

covering years reaching back until the early 1980s. The crucial limitation of the BOP data is its unidimensionality. Only total ODI is reported, with no breakdown by host country or industry. This dataset is therefore not useable when the determinants of Chinese ODI are investigated and investment strategies are sought to be identified.

Obviously, all three sources do not report illegal, non-approved capital outflows which are often disguised as 'foreign' re-invested in China to benefit from preferential treatment to foreign-invested enterprises (round-tripping). These flows are argued to be of some magnitude (Zhan, 1995; Wu and Sia, 2002; Deng, 2004). The best estimates of illegal capital outflows from China are based on the errors and omissions items in the BOP (Gunter, 2004). Gunter corrects the official errors and omissions data for China's holdings in foreign financial assets, underinvoicing of exports and overinvoicing of imports and lack of disclosure of China's short-term foreign debts before estimating the degree of capital flight from China between 1984 and 2001. Misinvoicing is said to be pervasive among internationally active SOEs as it allows them to keep foreign exchange earnings and to claim more foreign exchange titles at the designated Chinese banks it is required to sell the earnings to (Groombridge, 2001). Employing this thorough approach, Gunter (2004) finds significant fluctuations in capital flight in accordance with government policies. He concludes that over the eighteen year period of his study, capital flight amounted to up to USD 920 billion which represents the upper spread of his estimation. This figure is significantly higher than the accumulated ODI stock reported by either MOFCOM (USD 44.33bn) or UNCTAD (USD 34.66bn) for the end of 2001. Despite these shortcomings, the MOFCOM data, and especially, the SAFE data are the best available on Chinese ODI and its distribution by host country. Both are therefore used in the econometric modelling presented in Chapter 7.

5.3.2 Data sources and limitations of the independent variables

This section describes the data sources for the independent variables used in the econometric models which are collected from different publicly available sources. All variables with monetary figures were either obtained in constant prices (year 2000) or were transformed into constant prices (year 2000). The 'traditional' variables are discussed first, followed by the new 'institution-related' variables that derive from previous discussions (Sections 4.2 and 4.3) and a set of control variables which are included for methodological reasons. Abbreviations in brackets denote the variable's acronym used in the econometric analyses in Chapter 7. All variables used are also presented together with the acronym, source, and selected references to empirical studies in Table 5.2. For purposes of simplification, variables from both econometric

models are discussed together. The discussion of each model in Sections 7.1 and 7.2 presents the variables employed in that specific model.⁴³

Market-seeking investment

The alternate proxies for market-seeking investment decisions by Chinese companies are gross domestic product (GDP), GDP per capita and GDP growth. Data for all three proxies were taken from the *World Development Indicators* database of the World Bank (World Bank, 2006a). The *World Development Indicators* database was accessed through ESDS International.

Drivers for natural resource-seeking investment

Two different proxies are used to measure the natural resources endowment of a host country, namely (i) the percentage of ores and metals exports to total merchandise exports and (ii) the export of crude oil and natural liquefied gas. Data on ores and metals exports was taken from the *World Development Indicators* (World Bank, 2006a) and on crude oil and natural liquefied gas exports from the *Oil Information 2006* published by the International Energy Agency (2006). The *World Development Indicators* and *Oil Information* databases were accessed through ESDS International.

Strategic asset seeking-investment

The propensity of Chinese firms to conduct asset-seeking FDI is proxied by the total number of patent granted per year to residents and non-residents by a host country as published by the *World Intellectual Property Organization* (WIPO) (2006).

Institutional variables

Domestic (endogenous) institutional dummies

Changes to China's domestic policies are integrated in the cross-sectional models in Chapter 7 using two time dummies and one structural break. These proxies have not been employed in earlier studies on Chinese ODI but derive from discussions in Chapters 3 and 4. First, the journey of Deng Xiaoping to Southern China in 1992 and its effects on liberalisation policies is incorporated. The dummy takes the value zero for years before 1992 and one for the year 1992

⁴³ This section presents variables as employed in Model One and Model Two in Chapter 7. Theoretically, more or other variables could have been employed such as home-host country wage differentials, host country infrastructure, and intellectual property rights protection among other things. To achieve a more accurate representation of Chinese ODI, the spatial distribution has been taken into consideration with the selection of the country sample. The inclusion of a significant number developing countries meant the exclusion of some variables due to missing data.

and thereafter. Second, the effects of the change to China's foreign exchange regime in 1994 are captured by a time dummy. The dummy takes the value one for the years following the regime change and zero for earlier years. Third, the instigation of the 'Go Global' policy in 1999 is captured as well. This time, a structural break is used instead of a time dummy. The structural break splits a given period under investigation into two groups and allows for comparison of the results across time frames.

Supranational (exogenous) institutional variables

Information about the conclusion of Bilateral Investment Treaties (BITs) and Double Taxation Treaties (DTTs) between China and a host country and the total number of BITs and DTTs concluded by a host country were obtained from UNCTAD.⁴⁴ The WTO/GATT membership status of a host country was obtained from the WTO (2006) website.

The cultural proximity of a host country to China is measured as the proportion of Overseas Chinese people to the total population of the host country. A host country with an Overseas Chinese population equal to or larger than one per cent of the total population is a dummy variable with the value of one assigned, and zero for all other host countries. The total population of a host country was obtained from the *World Development Indicators* of the World Bank. Data on Overseas Chinese was obtained for the year 1997 (or nearest) from various sources, including Ohio University (2006), Overseas Chinese Affairs Commission (1998), Ma (2003), Kent (2003) and the State Statistics Committee of Ukraine (2006). The country estimate for Croatia was provided directly by the Chinese Embassy in Croatia.

The geographic distance between a host country and China is based on the distance between country capitals and was calculated using the free internet-based tool available at www.geobytes.com. The coverage and accuracy of the tool at [geobytes.com](http://www.geobytes.com) were tested by comparing the results with those retrieved from www.indo.com and www.wcrl.ars.usda.gov/cec/java/capitals.htm. [Geobytes.com](http://www.geobytes.com) was regarded as superior because of its higher accuracy and better data coverage.

Country risk

In both econometric models the country risk composite *International Country Risk Guide* (ICRG) as published by the PRS Group (2006) was used. The ICRG comprises measurements

⁴⁴ I am very grateful to Mr Zhan, Chief of the International Arrangements Sections of the Division on Investment, Technology & Enterprise Development at UNCTAD, and Mr Bekele, Associate Economic Affairs Officer at the International Arrangements Sections (UNCTAD), for providing me with the data.

for political, financial, and economic risk factors. The three subcomponents of the measure comprise twelve, five and five variables, respectively. The subcomponents of 'political', 'financial' and 'economic' risk are aggregated to a value between zero and one hundred. A country risk level of zero denotes an extremely risky country while, at the other extreme, a level of one hundred denotes a very stable and safe country. The annual composite data by the PRS Group have been used. The ICRG has been acknowledged to be the most comprehensive measurement of country risk with regard to country and time period coverage (World Bank, 2007; Nordal, 2001). Having said that, it should be noted that the validity of the ICRG is constrained by reliance on the opinion of a few experts. It also refers mainly to risk factors as perceived by industrialised country rather than developing country firms. This is an important point, and is revisited later in relation to discussion of the findings.

Control variables

The official exchange rate of a country, measured in US dollar, was taken from the *World Development Indicators* while the annual inflation rate of a host country was obtained from the *World Economic Outlook Database* published by the International Monetary Fund (2006). The official exchange rate and annual inflation are used to calculate the purchasing power parity (PPP). PPP is calculated using the difference in the inflation rate between the host country and China plus the percentage appreciation the host country's currency against the Chinese Yuan. The data on Chinese trade: exports from China and imports to China were obtained from the *China Statistical Yearbook* published by the National Bureau of Statistics (various years). Finally, the openness of a host country to inward FDI flows is measured as an annual ratio of inward FDI flows to GDP as published by UNCTAD (2007a). The rationale for inclusion of these variables is provided by the research reviewed in Section 2.3 on FDI determinants in general.

In this study, these variables are assigned acronyms which are presented in Table 5.2. Table 5.2 also presents the source of each variable and selected references of empirical studies which used the variable in similar work on FDI (but not necessarily on Chinese ODI). The time dummy 1994 and the structural break 1999 are indicated as 'new' because no study could be identified using that use two proxies for economic liberalisation in China. This again points to the novelty of this study.

Table 5.2: Variable description and sources

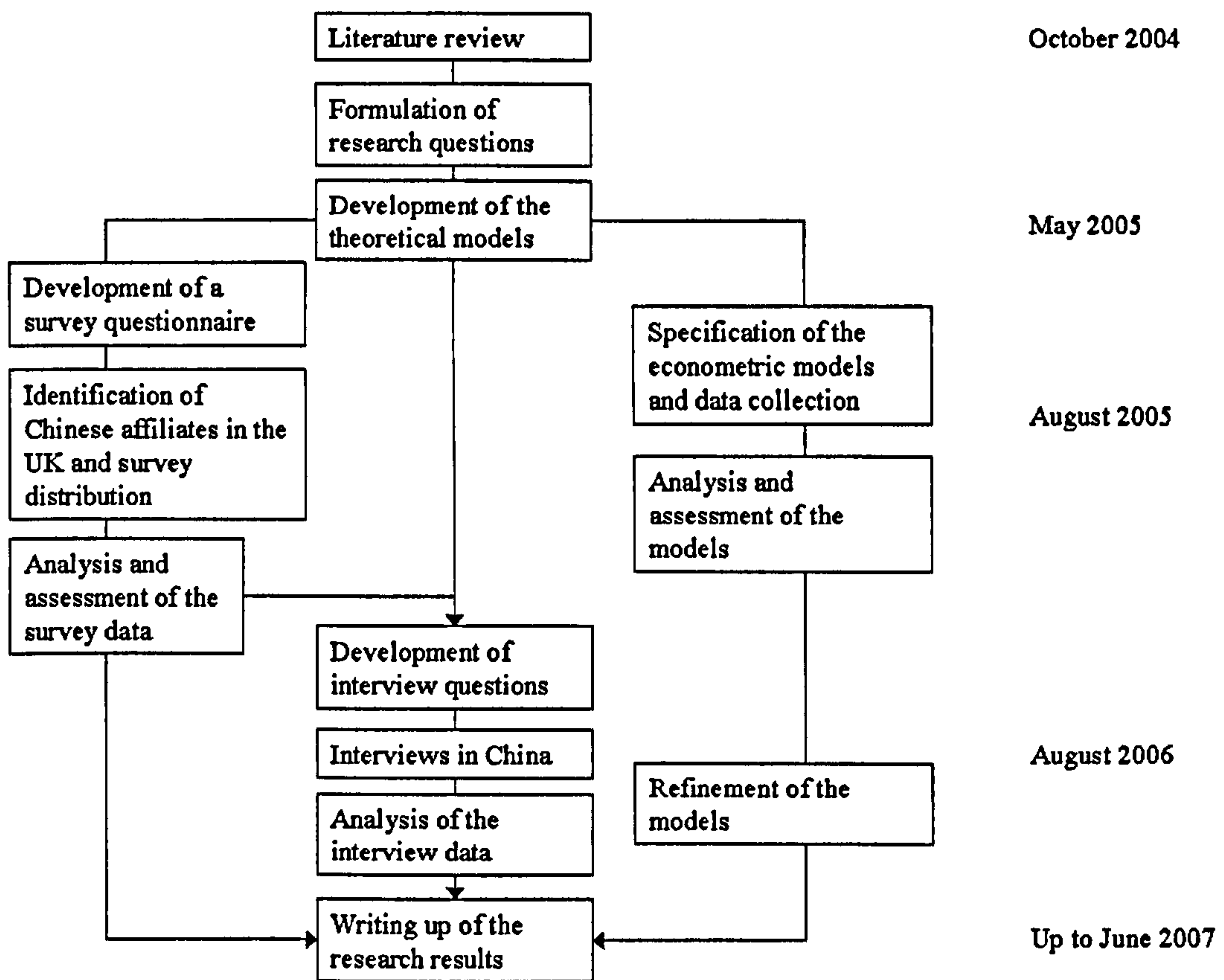
Variable	Acronym	Source	Selected empirical studies
Gross domestic product (GDP) of the host country	<i>LGDP</i>	World Bank (2006a)	Globerman and Shapiro (2003)
GDP per capita of the country	<i>LGDP</i>	World Bank (2006a)	Loree and Guisinger (1995)
GDP growth rate (annual) of the host country	<i>LGDP</i>	World Bank (2006a)	Rammal and Zurbruegg (2006)
Percentage of ores and metals exports to total merchandise exports by a host country	<i>LORE</i>	World Bank (2006a)	Asiedu (2006), Onyeiwu and Shrestha (2004)
Export of crude oil and natural liquefied gas by a host country	<i>LOIL</i>	IEA (2006)	Campos and Kinoshita (2003)
Total number of patents granted per year to residents and non-residents in a host country	<i>LPATENT</i>	World Intellectual Property Organization (2006)	Sun <i>et al.</i> (2002), Filippaios <i>et al.</i> (2003)
Time dummy: Liberalisation policy changes after Deng Xiaoping's journey to south China in 1992	<i>TD92</i>	Naughton (2007)	Sun <i>et al.</i> (2002), Wei <i>et al.</i> (1999)
Time dummy: Liberalisation in China's foreign exchange regime	<i>TD94</i>	Guo and Han (2004), Zhang, 2003	New
Structural break: Instigation of the 'Go Global' policy in China	<i>SB99</i>	Child and Rodrigues (2005)	New
Bilateral investment treaty between China and the host country	<i>BIT</i>	UNCTAD (2006)	Neumayer and Spess (2005)
Number of accumulated BITs involving the host country	<i>LACBIT</i>	UNCTAD (2006)	Grosse and Trevino (2005)
Presence of double taxation treaty between China and the host country	<i>DTT</i>	UNCTAD (2006)	Egger <i>et al.</i> (2006)
Number of accumulated DTTs involving the host country	<i>LACDTT</i>	UNCTAD (2006)	New
Cultural proximity dummy taking the value one if the overseas Chinese population share in the host country is larger than 1 per cent and zero otherwise	<i>CP</i>	Ohio University (2006), Overseas Chinese Affairs Commission (1998), Ma (2003), Kent (2003), UN Population Statistics (2006), and State Statistics Committee of Ukraine (2006)	Gao (2003)
Geographic distance between Beijing and the capital city of the host country	<i>LDIS</i>	www.geobytes.com	Grosse and Trevino (1996)
Country risk - a component measure of political, financial, and economic risk factors	<i>LRISK</i>	International Country Risk Guide (2006)	Biswas (2002)

Official exchange rate between China and the host country	<i>LERATE</i>	World Bank (2006a)	Clegg and Scott-Green (1999)
Annual inflation rate of the host country	<i>LINF</i>	IMF (2006)	Rammal and Zurbruegg (2006)
Purchasing power parity	<i>LPPP</i>	Computed using <i>LERATE</i> and <i>LINF</i>	Sarno and Taylor (2002)
Exports from China to the host country	<i>LEXP</i>	NBS (various years)	Kimura and Lee (1998), Lim and Moon (2001)
Imports to China from the host country	<i>LIMP</i>	NBS (various years)	Seo and Suh (2006); Hejazi and Safarian (2001)
Openness: ratio of inward FDI flow to GDP for the host country	<i>LINFDI</i>	UNCTAD (2007a)	Yeaple (2003)

5.4 Summary and project overview

The structure of the research project is presented in Figure 5.2. Starting with the month in which the research was commenced, the Figure shows how the literature review informed the research questions (see Section 3.4) and led to the conceptualisation of the model advanced in Chapter 4. To address the research questions, primary and secondary data were collected roughly in parallel. The results of the survey questionnaire and the cross-sectional analysis provided different levels of insights and helped to inform the last part of primary data collection, the structured interviews. Although the interviews came last, they are the first to be discussed in Section 6.1 in connection with the model from Chapter 4. The survey questionnaire results are discussed in Section 6.2 before turning towards the econometric modelling in Chapter 7.

Figure 5.2: The research project



Note: The overview of the stages of the research project is not drawn to scale.

6 The determinants of Chinese outward direct investment – interpretations from primary data

In this chapter parts of the Chinese ODIR model presented in Chapter 4 are tested. The particular focus of this chapter with regard to the model rests on the internationalisation strategy and motivation of Chinese firms and their changes over time and the impact of network effects and domestic institutions. This is done by analysing and discussing primary data. The data have been collected through semi-structured interviews in China and a self-administered survey questionnaire in the UK, as explained in Sections 5.2.1 and 5.2.2.

6.1 Interviews of Chinese multinational companies

Based on the Chinese ODIR model advanced in Chapter 4, in this section, an analysis is presented of the internationalisation strategies and motivations of Chinese firms based on primary data collected in interviews with senior managers of the parent company in China. The main concern relates to the impact of international networks and of the domestic institutions on outbound investment behaviour of respondent firms.

6.1.1 Rationale and outline of the fieldwork

Interviews with senior managers of Chinese MNEs were implemented for two reasons. First, current official data historically refers mainly to SOEs and in most recent years Chinese ODI is generally dominated by SOEs with only modest outbound investments by private companies. Conducting interviews therefore provides a possibility to gain in-depth insight of the investment motivation of private firms, and their perceptions about the domestic institutional environment and the effect of international networks on their internationalisation. Second, the interviews provided opportunities to see if there are influences on Chinese ODI other than the ones proposed in Chapter 4. By interviewing both state-owned and non-state owned firms the results by ownership type can be compared.

6.1.2 Interview results and discussion

The companies present in the interview sample are mainly well established and large enterprises in terms of number of employees. The size ranges from twelve employees (Company 6) to more than 40,000 (Companies 1, 2 and 7). The age of the firms ranges from three years (Company 6) to more than fifty years (Companies 1 and 9) with a median of twenty-two years. Inter-industry comparison of the interviewed firms is allowed for as the automobile, fashion,

and high-technology industry are represented by two companies each. Three firms are active in the consumer electronics industry, and one further company is mainly active in the machine tools sector (see also Table 6.1). Likewise, the coverage of three SOE, six private-owned enterprises and one collectively-owned enterprise allows for comparison by ownership types. This addresses *RQ6*. Except for Company 2 (from Shandong Province), all companies are headquartered in the Yangtze River Delta region as follows: Jiangsu province (3), Shanghai (4) and Zhejiang province (2).

Table 6.1: Descriptive analysis of Chinese firms interviewed

Firm	Location	Ownership type	Industry	Size	Year
1	Jiangsu	State-owned	Automobile	Large	1947
2	Shandong	Collectively-owned	Electronic consumer products	Large	1984
3	Jiangsu	State-owned	Electronic consumer products	Large	1979
4	Shanghai	Privately-owned	High-technology	Small	2002
5	Shanghai	Privately-owned	High-technology	Small	2004
6	Shanghai	Privately-owned	Fashion	Medium	1993
7	Zhejiang	Privately-owned	Automobile	Large	1969
8	Zhejiang	Privately-owned	Fashion	Large	1995
9	Shanghai	State-owned	Electronic consumer products	Large	1995
10	Jiangsu	Privately-owned	Machine tools	Large	1992

Notes: (1) Firm size - large: ≥ 250 employees and an annual turnover \geq EUR 50 million; medium: 50 to 250 employees and an annual turnover between EUR 10 and 50 million; small: 10 to 49 employees and an annual turnover between EUR 2 and 10 million (Eurostat, 2007). EUR 1 = Chinese Yuan 10.43 (www.xe.com; 15 May 2007).

(2) 'Year' refers to the year of establishment of the company in China.

Source: Interviews and companies' homepages.

6.1.2.1 International investment strategy and locational choice

The major drivers for ODI of all companies are to gain access to new markets or defend an established market position. International investment tends to have followed the Uppsala theory: the interviewed firms export to the host country or a third market prior to invest in the country (as in the cases of Companies 2, 3, 5, and 8). The interviewee of Company 2 stated that the firm

tended to gain market share and experience in a foreign market through exporting before increasing its commitment to the host country. An investment in an important host country is necessary because success there depends on being able to adapt the product to local needs and to disguise being a Chinese company by producing locally (Company 2). Gu Chujun, chairman of the board of the white goods manufacturer Guangdong Kelon Electrical Holdings, expressed a similar concern in an interview with Business Week (Business Week, 2004). He senses that foreign customers equate Chinese products with low quality and are generally unaware of Chinese brands. The perception of customers is also important for Company 9. Customers trust a locally invested company which can offer its own after-sales service more readily than can an exporting company. Company 9 therefore invests in markets with a high potential and has done so already in eight countries (both developed and developing countries).

Another reason for investing abroad was expressed by Companies 3 and 10: These companies either faced existing trade barriers (Company 3) or anticipated forthcoming trade barriers because of the political atmosphere in the host country (Company 10). An investment behind the trade barrier enables the companies to defend their market position. To minimise the commitment, however, Companies 1 and 3 established completely knocked-down assembly lines only in the host markets. Company 3 actually moved a step further by establishing the assembly line in cooperation with a local partner which further attenuated the business risk connected to an FDI project for it.

Company 1's export business started in the 1960s. On request of the principal shareholder, the government, products were exported to Viet Nam without an export and import license. Such a license was later awarded in 1995. The company invested in different developing countries first before targeting an industrialised country. The first ODI was made in Argentina in the 1990s. The assembly plant did not develop well, however, because of a currency crisis in Latin America. Besides the Argentinean business, Company 1 has today further low-scale completely knocked-down assembly plants in Russia and Sudan which produce for the local market. In 2005, the company pursued its most important foreign investment by acquiring a known manufacturing company in the United Kingdom (see also below). A further plant may be opened in Malaysia.

Another market-seeking investment was conducted by Company 3. Company 3 invested in Indonesia and Malaysia to open assembly plants for completely knocked down parts in the mid-1990s. The investment decision was driven by high demand in the country and increasingly higher tariffs. The company had exported to these countries previously but faced a changing customs system which increased export prices. It therefore adopted a defensive market-seeking

strategy to maintain market share. The company invested in Argentina in 2000 for similar reasons. In both occasions, an economic crisis in 1997 and 2001 ended the foreign venture. As a consequence, the firm had to divest its South Asian and South American businesses. The Southeast Asian business was further affected by a change to the import tariff system in the host country. While earlier high import tariffs favoured local assembly of products, the change to lower tariffs on finished products diminished this. Company 3 argued that 'political crises like the Asian Crisis in 1997 and that in Argentina cannot be anticipated. This raises an interesting issue. Do Chinese firms thoroughly evaluate the country risk of a target country before investing there?

There is a sense that Chinese firms operate domestically and internationally with a very short-term strategic orientation (IPA 12). Focusing on short-term profits, these firms try to grasp business opportunities as they appear. Second, it is commonly argued that developing country firms tend to invest in peer countries because of 'home country embeddedness' they would be more familiar with the institutional system and, hence, be more successful (see Sections 2.2.7 and 2.2.8). The comments of the interviewee from Company 3 point to the opposite. The firm invested in both Southeast Asia and South America shortly before the relevant crises became apparent. Indeed, the negative experience of Company 3 is today highly ingrained in the interviewees' attitude towards ODI. The interviewees argue that, though investments in developing countries are relatively cheap and the company has been approached to invest in other developing countries, unforeseeable political risks make investments in developing countries unpalatable. Chinese companies should therefore, the interviewees go on, invest in a safe and stable country –in this case, in a Triad economy. These countries have, however, high market entry and operational cost and require a well established Chinese brand prior to investment. An investment in the Triad economy is therefore not feasible for a Chinese firm at the current point in time. The interviewees suggest that Chinese firms should rather cooperate with foreign firms in China, and manufacture for and learn from them. This concern is shared by Company 9. High business operation costs forced Company 9 to divest its European business. Company 9 established an affiliate in a European capital to run the European business from there. Soon after establishment, however, the firm moved several times to find cheaper office space. Ultimately, the firm gave up because of high office and labour costs. The high labour cost and regulation was of concern for Company 9 because it was not sure whom they were hiring. The interviewee, who was responsible for the European operations before he was delegated to other foreign affiliates, considers that it takes at least six months for a Chinese firm to properly assess and train a new employee abroad. If the company is not satisfied with the employee, European law makes it difficult to fire the person easily. International Chinese business failure has also occurred with firms outside this sample: The grey and white goods

producer TCL acquired the cathode-ray-tube TV business from France's Thomson in 2003 to become the world largest TV unit producer. In 2006, however, TCL divested most of the European business operations. TCL had been unable to turn around the European operation and suffered from continuous loss. One factor driving this development was the company's underestimation of the market shift from tube to flat screen TV sets (FT, 2006f).⁴⁵

A somewhat different market penetration strategy has been pursued by Company 5. The company was founded in 2002 and established its first foreign affiliate in Hong Kong at the end of 2005. The quick internationalisation has been forced by internationally active competitors and limited infrastructure in China which impeded domestic corporate growth. Several reasons favoured Hong Kong over other locations: First, an agent of the company had established links to Hong Kong firms and this secured some customers for the firm. Second, Hong Kong was perceived as a good location for pursuing business outside of China. The affiliate in Hong Kong has been labelled the Asian headquarters. Third, Hong Kong has a well educated, English-speaking workforce but is culturally close to mainland China, which makes it easier to conduct business. The investment in a psychically close country follows, again, patterns predicted by the Stages theory. The fourth reason is outside the theory, though. Company 5 was looking for a venture capitalist to partner with it. The investor happened to be in Hong Kong and thus it was a logical decision for the company to establish an affiliate nearby. With additional funding and with the support of an international network (see below), Company 5 invested in the UK in 2006 and intends to invest in San Francisco and Los Angeles sometime during 2007.

Two companies in the sample arguably followed an asset-seeking investment strategy by acquiring a European firm. Company 1 purchased in 2005 an insolvent British manufacturing firm. The objective was to gain access to an established but ailing brand and to revive it, and to access high quality physical assets and opportunities to enhance the products manufactured in China based on the acquired technology. At the same time, the Chinese firm would get access to advanced technology and blueprints which could help to upgrade the business in China and make the products more appealing to the customer. It was also thought that this would strengthen its bargaining position in a related Sino-foreign joint venture. The foreign partner in this strategic alliance is currently the technology supplier. This dependency may attenuate with newly gained know-how, however. After finalising the acquisition, the Chinese firm has

⁴⁵ TCL actually failed to establish a sustainable business despite receiving a combined Chinese Yuan 14billion credit (about USD 2billion) and USD 1.5billion overseas business insurance to support its international expansion from the Import and Export Bank of China, China Export Credit Insurance Company and China Development Bank (SinoCast China Business Daily News, 2005).

transferred part of the production line to Nanjing to produce for the Chinese market. A second and third production line will eventually commence production in England and the USA. The acquisition of know-how and technology and subsequent transfer is not uncommon after a purchase by a Chinese firm: Qingdao Iron & Steel General Corporation bought the bankrupt steel mill Geneva Steel (USA) for USD 40mn to dismantle the production facilities in the USA and reassemble them in China. The same happened after Jiangsu Shagang Corporation acquired the German smeltery Westfalenhuette in 2001 and the German state-of-the-art coking plant Kaiserstuhl in 2002 (CIBUL, 2007).

A different objective has been followed by Company 4 which bought an Italian fashion manufacturer in 2006. Rather than focusing on the technology and design capabilities of the Italian firm, the Chinese company is seeking to use it as a gate to the European market. Additional purchases of European companies might follow if this serves the aim to establish the company better in Europe.

Compared to the other companies in the sample, the development of Company 8 is quite different. The company started to export to countries with a mature fashion market soon after establishment and opened affiliates in Hong Kong, the United Arab Emirates and Russia. A consequence of being “established in China, developed in the world” (Company 8), international business accounts now for more than 60 per cent of the firm’s turnover. Although the company intends to invest in Europe, it has identified the Chinese market as mature enough to expand and invest domestically as well. The international business share to total revenues is therefore likely to decrease over time.

6.1.2.2 Networks facilitating internationalisation

*“When staying at home you rely on your parents,
when going away you rely on your friends.”*

Company 8

The companies interviewed use business and social networks to get information about the target country to invest in. In some occasions, they are actually pulled into the target country by the network. Though both business and social networks facilitate internationalisation, they are employed to varying degrees by respondent firms.

Business links are foremost established (a) via customers or (b) through export agents. A sparse network of agents in particular can play a vital role in providing information about the foreign market and potential investment opportunities which could help setting up the business. Further information can be sought from other Chinese firms which have invested in the target region. Approaching Chinese firms in the target market for business intelligence is seen to be more fruitful when the company is not a direct competitor. Consequently, the company can only gain general information about the business and legal conditions in the target market but no product, customer habit and competitor specific information (Company 8). Such business links can also be used for acquisitions. Company 1 had established business contact with a European company in 1998 and subsequently acquired it in 2005. The first hand knowledge about the target company provided Company 1 with crucial information on which to pursue the purchase.

Social linkages are of lesser importance. The large SOE interviewed argued that their business is too big to rely on such personal networks. Though other firms acknowledged that linkages to the Overseas Chinese and the Chinese Chamber of Commerce sometimes exist to collect information about the target market prior investing, they assert these facilities are not perceived as very important. The Overseas Chinese Diaspora may be too assimilated to the local environment and lack a reflective and objective opinion about the business environment and opportunities in the respective target country (Company 8). Nevertheless, Overseas Chinese people are welcomed as employees in the foreign affiliate because they may help to bridge the communication gap between the parent, the foreign affiliate and the host market by speaking both Chinese and English fluently (e.g. Company 5). A deviation from expectation as expressed in the model on Chinese ODI advanced in Chapter 4, Chinese firms seem not to employ Overseas Chinese people as brokers to attenuate transactions costs and facilitate the establishment of a new business. They are rather employed *after* the business has been established to achieve lower transaction costs for the running operation. Although this function of the Overseas Chinese differs from the model, it still holds true that mainland Chinese firms may invest in locations with a significant portion of ethnic social ties which can be exploited. No difference could be detected by firm size or ownership form. One reason for this could be that foreign Chinese affiliates generally tend to be relatively small regardless of the ownership form of the parent company. Chinese affiliates in the UK and in Germany, for example, often have not more than five employees (see also Section 6.2; Young *et al.*, 1998; GFW, 2004).

Besides linkages to customers, suppliers and ethnic groups, other access to business facilitators is important in the internationalisation of Chinese firms. Most IPAs interviewed screen Chinese companies to identify potential investors. Selected enterprises are approached to consider an investment in the home country of the IPA – the IPA functions here as a bridge for the Chinese

company. In so doing, IPAs either focus on the largest Chinese firms, under the assumption that size is a good predictor of investment capability and willingness, or they seek to identify Chinese firms which could complement the economic structure of the home country. The latter approach is not confined to any particular firm size or ownership type but rather aims to get the 'best' investor. For example, this investor selection process was of crucial importance for the internationalisation of the two international new ventures in the sample (Companies 5 and 6). Both companies had been approached by a foreign IPA 'out of the blue' and invited to consider an investment in the home region of the IPA. Because of the call from one IPA and the business connections provided by it, the companies did not consider other locations either in the European host country, in Europe in general or outside of Europe for the investment. The companies therefore do not know if monies are invested in the most profitable way and if any long-term strategy and corporate development might be impeded by the investment. Indeed, Company 5 would like to identify an IPA in California to take the role of a middleman for the USA and help it to establish an affiliate.

Conflict is detected between the experience and viewpoint of small Chinese international new ventures and the interviewees of larger firms. One large SOE (Company 9) confirmed that IPAs try to persuade the company to invest in a particular region. He asserts, however, that the services offered are too expensive. The IPA tries to indulge the company by offering the best lawyers, accountants, business sites and so forth which are, at the same time, also the most expensive ones. In-house research, reports Company 9, can do the same job as an IPA to lower cost. And such research has to be done anyway as no company would invest abroad without evaluating the proposed target region itself and against other regions. The provided contact in the target region may be, though, revived later when the foreign business has left the infant stage and becomes more prosperous. It can therefore be suggested that small and relatively resource-scarce Chinese firms may rely more on IPAs as a bridge or broker to connect them to a target market than larger ones do.

Company 6 reported satisfaction with the service provided by the IPA and its support in establishing potential business contacts in the target region, but the firm is reluctant to follow the call. Without having established a strong market position in China and lacking abundant financial resources, a foreign commercial commitment may put the whole organisation at risk it was stated. This is a gamble the owner is not willing to take. Instead, its investment decision has been postponed while working on and extending the business links to the target country.

Despite the usefulness of drawing on the knowledge and experience of networks, Company 9 stated that even the best linkages cannot substitute an own affiliate as a source of information and knowledge flows as the middleman usually filters what he disseminates.

6.1.2.3 Ambiguous impact of the institutional environment

The Chinese government is generally argued to perceive ODI positively and encourages it (Government 1, 2, 3 and 5). Chinese ODI in manufacturing in Africa and Southeast Asia is seen as a good means to circumvent trade barriers and import quota of major target markets. Investments in developed countries are viewed as a good channel to access technology and better production facilities not readily available in China. The current trend is therefore to establish R&D facilities instead of trade offices in these countries (Government 1). The Chinese government therefore provides preferential long-term loans for large Chinese ODI projects. Additionally, local agencies organise seminars to inform potential Chinese investors about foreign business opportunities, market conditions and legal environment in conjunction with IPAs from a potential target country. To adjust these measures to 'customers' needs, Government 2 regularly visits potential Chinese investors to gain a better understanding of their international business plans. Although they do advise the firm on locational choice, the final investment decision is taken by the firm interviewees reported. The latter point is reinforced by the interview with Government 3. This agency screens the investment applications and points out to Chinese firms if there is the danger of entering into competition with other Chinese firms in the host market which would cannibalise their market share. The government will not, however, reject the application. Government 4 actually argued that the whole application process is a registration process to gather information on where and how many Chinese firms invest. Based on this information, the local authorities can provide more focused host country and industry information to Chinese firms.

The perception of the impact of these measures differs greatly by ownership type. SOEs generally see no problem in the approval process and perceive no other bureaucratic measures as hurdles to invest abroad. The Jiangsu-based SOEs (Companies 1 and 3) regard the institutional setting as at least neutral towards the firm's international ambitions. This gives the firms enough leeway to make strategic decisions without interference and unnecessary hurdles. The acquisition of a UK company by Company 1 was supported by the local government and the Ministry of Foreign Affairs. The former provided essential advice about legal and taxation issues while the latter corresponded with the national and local government of the host country. The initiative to purchase the insolvent firm came, however, from Company 1 and it also did not receive any subsidies to carry out the acquisition. The acquisition had to be approved by the

shareholders of the company. Any approval system for this particular investment and other investment abroad by the company was not recognised by the interviewee. The increasing bargaining power through government involvement is also reported by Company 2. Company 3 acknowledged that they benefit from the composition of its shareholders. One shareholder is headed by a former high-ranked national politician. This connection provides the company with invaluable access to resources and bargaining power. The larger enterprises generally acknowledge that they enjoy good relationships with the local government, which is interested in prosperous local companies. They argue that the typical government support received is help in understanding the legal and regulative environment in the host country and advice on how to go smoothly through the outward investment approval process. But the interviewees stated the government neither interferes in business decisions directly nor instructs the company to conduct a certain investment in a particular country. The government is also supportive in other aspects. The interview with a government agency in Chengdu (Government 2) sheds some light on this. The local branch of the national agency has identified the key industries in Sichuan which could be internationalised. The agency is therefore developing a long-term strategy for member companies to be able to internationalise in cooperation with the relevant business associations. This includes considerations about level of research intensity, supply chain improvements, a general 'upgrade' of the industry, and identification of target markets. The primary target markets are currently Russia and Southeast Asia which provide the relevant resources and technologically lag behind China and which provides companies from Sichuan a firm-specific advantage. The secondary target is Europe, and Germany specifically. The interviewee mentioned two reasons for the country choice: Germany is the largest European market for typical Sichuan products and is not mainly focusing on attracting high-value added and high-technology FDI from China as other European countries arguably do. To achieve these objectives, the agency has to persuade other government authorities to provide better supportive measures to local companies. The Sichuan example reveals two important issues: First, the local government is not only supportive to ODI but rather actively tries to provide a domestic institutional environment which nurtures the growth of domestic firms and enables them to venture abroad. Second, core local industries are identified and strengthened. This strategy may increase the likelihood that these firms are internationally competitive and also reinforces domestic economic growth. It fails, however, to support capable companies outside of the core industries.

The smaller, private firms generally perceive the institutional environment in a less positive light than do SOEs. The institutional environment has generally disfavoured ODI by private firms for a very long time (reported by Company 4). One way of constraining ODI is a very cumbersome approval process for which privately-owned firms do not receive advice like their

state-owned peers. Such firms therefore tend to invest in a foreign tax haven like the British Virgin Islands which provides them with easier access to external funding and avoids future ODI approval by the Chinese government (Companies 4 and 5). The latter objective is denied by Government 2, however. The objective is to reinvest the money back in China (round-tripping) rather than circumventing the Chinese ODIR this interviewee contends. She acknowledges, however, that numerous privately-owned firms channel funds outside of China using personal contacts for ODI. Her agency is trying to encourage these firms to retrospectively register these investments to give them a more official status.

An exception to this negative perception was given by the interviewee of Company 8. He saw no problem with the local government authorities in supporting the company's international activities. The interviewee, who is the Special Assistant to the company's Chairman, is a former employee of the local MOFCOM office where he was in charge of supervising local ODI. It therefore remains questionable to what extent he answered from a company or government perspective. It is also unclear how his established contacts within MOFCOM and possibly other authorities facilitated the company's internationalisation.

The perception on the impact of the Chinese ODIR differs more by ownership type than by home province of companies from the Yangtze-River Delta provinces. Nevertheless, provincial differences could be detected. The Vice President of Company 10 revealed that the company was recently bought by a Chinese affiliate of a state-owned firm. He was formerly managing this Hubei province based subsidiary. The Vice President therefore has been in the unique position to experience the impact of very different provincial institutional environments on ODI. The attitude of bureaucrats in Hubei towards ODI was very negative he reports. An ODI approval easily took six months to be approved which hampered the international development of the company. In contrast, this process is normally finalised within four weeks in Jiangsu he says. This negative experience somewhat mirrors the perception that government authorities have to be encouraged to support firms to invest abroad (indicated by Government 2).

6.1.3 Summary

The analysis of Chinese MNEs based in the Yangtze River Delta partially supported the Chinese ODIR as advanced in Chapter 4 and answered the research questions underpinning the framework. Depending on the firm size, the institutional environment has been a barrier to outbound investment (*RQ10a* and *RQ11*). Recent reforms of the approval system and an increasingly positive attitude of the government authorities in this coastal region towards ODI have eased that tension. The international network has only a supportive role (*RQ9*). Business networks and contacts to business facilitators like IPAs are generally favoured over ethnic

connections when it comes to gaining host market information. Overseas Chinese are appreciated though as communicative bridges to the foreign market, and as customers and employees. Moreover, the majority of the interviewed Chinese firms went through a sequential internationalisation process starting with direct or indirect exporting before investing abroad. This finding supports the Uppsala model for Chinese MNEs (*RQ7*). Hence, it is no surprise that outbound investment is mostly driven by defensive market-seeking motives. Only the two Chinese international new ventures Companies 4 and 5 seem to follow an offensive strategy to access new markets (*RQ8*). Moreover, the ability of Chinese firms to assess business risks connected to the political and economical situation and to the business environment in the host market seems somewhat underdeveloped as the examples of Company 3 and 9 showed. As these firms enjoy well established connects to and support from their local governments, some support is found for the notion of capital market imperfections as a determinant of Chinese ODI as advanced in Chapter 4. Finally, Chinese firms interviewed are motivated predominantly by market seeking strategies (*RQ2*). Only a minority of firms interviewed conducted a foreign direct investment either to access technology (*RQ4*) or in order to acquirer an established brand (*RQ5*). Natural resource seeking motives could not be detected (*RQ3*) as the firm sample contained manufacturing firms only.

Having analysed data gathered at the Chinese headquarters, it is important to see how these findings are reflected in foreign affiliates. The next section therefore investigates the internationalisation strategy and competitive advantage of the Chinese firm as perceived by affiliates in the UK.⁴⁶

6.2 A survey of Chinese affiliates in the UK

6.2.1 Rationale and outline of the fieldwork

This section is concerned with the investment motivations of Chinese firms (*RQ2* to *RQ5*) and changes to the determinants of Chinese ODI over time (*RQ6*).⁴⁷ This is done by looking at Chinese investments in the UK. Within Europe, the UK accounts for the majority of global FDI inflows. Chinese ODI destined to the European market in general and to the United Kingdom in particular is only a small fraction of total Chinese outflows (see Table 6.2). Official data published by MOFCOM indicates that the European Union (EU-27) received an annual average of about 2.5 per cent of total Chinese ODI flows between 1990 and 2003. The modest amount

⁴⁶ Note, however, that the firms surveyed in the UK are not affiliated with the parent companies interviewed in China.

⁴⁷ This section is based on Cross and Voss (2007).

of Chinese ODI destined to Europe is low relative to global Chinese ODI figures, and in comparison to the amount of global FDI Europe receives from elsewhere. Europe received consistently around forty per cent of annual global flows between 1990 and 2005 (UNCTAD, 2007a). Although overall Chinese ODI to Europe is small, Liu (2004) states that China has become a top ten foreign investors in the UK. The UK was chosen as a focus country for this part of the study for reasons of convenience. Subsequent research on other host countries for Chinese ODI would provide interesting comparisons.

The low proportion of total Chinese ODI accounted for by Europe is reflected in the number of recent Chinese FDI projects observed by Europe-based institutions. GLAEconomics (2004) reports that seventy investment projects were undertaken by Chinese companies in Europe between 1997 and 2004, with the UK being the main recipient with forty investment projects. The IPA Invest in France Agency (2006) reports similarly modest figures for the period 2002 to 2004, during which they observed twelve investment projects made by Chinese firms in Europe. However, current numbers of Chinese owned projects in Europe have risen since 2004. Between 2004 and mid-2006, ninety-two such projects took place, according to Invest in France Agency (2006). The increase of Chinese investments into Europe is also reflected in the rising number of acquisitions of European firms by Chinese MNEs (see Table 6.3). In many cases, this has involved the purchase of underperforming assets, and, in several cases, of insolvent firms. Of twenty acquisitions made by Chinese MNEs of European companies between 1997 and 2005, nineteen were completed after 2000 and sixteen after 2003. British companies were the acquisition targets on five occasions; all after 2000. These acquisitions seem to be strategic-asset related investments whereby the Chinese companies are motivated to obtain access to existing technology, patents, R&D facilities, brand name, and distribution channels. This accords with the strategic asset motivation identified for Chinese MNEs more generally in recent years by Buckley *et al.* (2006), von Keller and Zhou (2003), among others (see Section 3.4.2). Although these sources indicate that the numbers of Chinese investment projects have increased, two remarks are necessary. First, figures for Europe are still relatively small when compared to the total number of outbound investment projects made by Chinese firms. To illustrate, Invest in France reports ninety-two projects in Europe between 2004 and mid-2006 while the Chinese government approved 1,067 investment projects in total in 2005 alone (China Law & Practise, 2006). Second, project-level data should be viewed with caution. The official Chinese publications on ODI, the *Almanac of China's Foreign Economic Relations and Trade* and the successor *China Yearbook of Commerce*, state that 282 investment projects in the Europe Union (EU-15) were approved between 1997 and 2003 (MOFCOM, various years). Although these are approved figures and do not necessarily correspond with realised investments, the difference of 253 investment projects is considerable.

Table 6.2: Cumulative stock of Chinese ODI to Europe, 1990-2003 (three year average, USD million and %)

	1990-1992	1993-1995	1996-1998	1999-2001	2002-2003
Total (three year average in USD million)	1,338.48	1,760.11	2,354.67	3,777.62	10,382.09
Developed countries (%)	69.44	64.12	49.95	36.11	22.60
European Union 27 (%)	2.36	2.55	2.50	2.43	2.60
Austria	0.10	0.12	0.09	0.06	0.03
Belgium & Luxembourg	0.05	0.06	0.07	0.06	0.10
Bulgaria	0.00	0.01	0.01	0.05	0.03
Czech Republic	0.04	0.03	0.02	0.07	0.05
Denmark	0.02	0.02	0.01	0.01	2.22
Estonia	0.00	0.00	0.00	0.00	0.01
Finland	0.01	0.01	0.01	0.01	0.04
France	0.58	0.52	0.41	0.26	0.32
Germany	0.52	0.48	0.42	0.36	0.61
Greece	n/d	n/d	n/d	n/d	0.00
Hungary	0.02	0.09	0.18	0.21	0.13
Ireland	n/d	n/d	n/d	n/d	0.00
Italy	0.22	0.17	0.13	0.22	0.25
Latvia	0.00	0.00	0.16	0.15	0.07
Lithuania	0.00	0.00	0.03	0.02	0.02
Netherlands	0.18	0.25	0.23	0.17	0.11
Poland	0.01	0.04	0.03	0.02	0.03
Portugal	0.06	0.13	0.10	0.06	0.03
Romania	0.00	0.00	0.07	0.34	0.20
Slovakia	n/d	n/d	n/d	n/d	0.00
Slovenia	n/d	n/d	n/d	n/d	0.00
Spain	0.15	0.18	0.17	0.11	0.07
Sweden	0.08	0.10	0.08	0.05	0.04
United Kingdom	0.33	0.33	0.29	0.22	0.24
Other Western Europe (%)	0.33	0.25	0.20	0.14	0.07
Central and Eastern Europe (%)	4.11	5.58	4.36	3.60	4.08

Notes: (1) n/d (no data) denotes years for which no Chinese ODI to the host country was recorded by MOFCOM.

(2) Chinese ODI data for three European countries is not available.

Source: MOFCOM (various years) *Almanac of China's Foreign Economic Relations and Trade* and MOFCOM (2004) *China Commerce Yearbook*.

Table 6.3: Selected acquisitions of British companies by Chinese firms

Acquiring company	Target company	Industry	Year	USD mn
Nanjing Automobile Corp.	MG Rover	Automobile	2005	106.0
Shanghai Automobile Industry Corporation	MG Rover (blueprints only)	Automobile	2004	67.5
Huaxiang Group	Lawrence Automotive Interiors	Automobile	2006	6.7
China Zhenhua Oil Ltd.	Amlon Trading Ltd.	Oil and Gas	2005	n/a
Greencool Technology Holding Ltd.	Leyland Product Developments	Automobile	2004	n/a

Note: n/a: not available.

Source: CIBUL (2007) *China M&A Database*.

To date, academic analysis of Chinese investments in Europe is limited. To our knowledge, only two such academic studies have been conducted: Young *et al.* (1998) examine Chinese investments in the UK and Van den Bulcke and Zhang (2006) have identified the reason for declining numbers of Chinese affiliates in Belgium.

Young *et al.* (1998) identified twenty-four Chinese companies in the UK. The majority of them were long established, small scale, state-owned trading enterprises. Such companies are motivated to invest directly in the UK for different reasons than are industrialised country firms. This observation derives mainly from two factors: First, the internationalisation strategy of Chinese companies is founded largely on directives issued by the State Council. Second, general theory asserts that companies need to hold ownership advantages over domestic firms in the host country to compensate liabilities of foreignness for unfamiliarity of the host country's business and political environment (see Section 2.2.2). In the Young *et al.* (1998) study, the researchers observe no obvious ownership advantages among the Chinese firms interviewed. The authors regard this as a major constraint for future corporate development. This is reinforced by a lack of focus by the Chinese firms investigated on core competences. The companies rather tend to diversify in an often unrelated range of businesses. Nevertheless, Young *et al.* (1998) acknowledge that state-ownership helps the firms to mitigate business risk. The Chinese government often carries the ultimate financial burden of any international business for Chinese firms, especially when soft-budget constraints are enjoyed by the parent company in China which has been often the case during the 1980s and 1990s (Naughton, 2007) (see Sections 3.1 and 4.2.1).

Van den Bulcke and Zhang (2006) identified thirty Chinese affiliates operating in Belgium during the 1990s. However, by the end of the 1990s, most of these companies had either moved their European operations to Germany or the Netherlands or had closed down without providing further information about their European business activities. Two of the main drivers for disinvestment identified by Van den Bulcke and Zhang (2006) were the difficulties associated with getting employee visa and work permits, which severely interrupted business operations. Other research argues that the relatively low Chinese investment figures into Europe can be explained by factors identified for FDI from other Asian countries in the 1980s and 1990s (von Keller and Zhou, 2003; Stone, 1998; UNCTAD, 1996). Specifically, it is argued that Chinese companies preferentially invest in the USA because it is a larger, more homogeneous market, and has had stronger economic and political ties with China for a longer period than has Europe.

Both Young *et al.* (1998) and Van den Bulcke and Zhang (2006) do not take into consideration if and how the investment strategies of Chinese companies have changed over time. The UK was one of the first countries to host Chinese firms in the early 1980s (Zhang, 2003). China's industry and corporate structure has changed significantly since then. It is therefore sensible, as Buckley *et al.* (2006) propose, to look at historic and emergent Chinese ODI pattern with respect to the investment strategies (see also Table 3.7). This framework proposes that Chinese firm' behaviour has changed since 2000 in response to evolving domestic and international conditions. This section applies this theoretical framework to a real case, namely Chinese investments in the UK, to assess the explanatory power of the framework. More specifically it is proposed that the investment motives and determinants of Chinese firms which have entered the UK market prior 2000 differ from later entrants firms. This approach informs especially *RQ6* of this study.

6.2.2 Methodology

The survey questionnaire was distributed to Chinese affiliates in the UK (see Section 5.2). The survey was designed in such a way that it allows 'historic' and 'emergent' investment behaviour to be identified under each investment strategy type ('market-' and 'asset'-seeking) and the perceived competitive advantage of the respondent firm. A five-point Likert-type scale was employed in the questionnaire, with the categories ranging from (1) 'of utmost importance' to (5) 'of no importance' or (1) 'strongly agree' to (5) 'strongly disagree' for the items under investigation. The questions were labelled in the order of appearance in the survey questionnaire and are presented together with the mean score for early and late entrants in Tables 6.9 to 6.12. Throughout the discussion the mean is reported together with a superscript denoting early entrants (E) and late entrants (L) and with a subscript denoting the relevant

question. The subscript denotes, first, the question type with regards to the historic-emergent (H E) investment strategy framework and, second, the investment strategy itself, i.e. offensive market-seeking (O), defensive market-seeking (D) and asset-seeking (A) investment.

6.2.3 Research findings and discussion

Stylised facts about the responding Chinese investors are presented first. This is followed by a discussion of investment strategies identified for Chinese companies in the UK from the survey instrument. To test the historic-emergent investment strategy framework, the data is split by the time of entry into the UK as follows: Firms which have invested prior 2000 are labelled 'early entrants' (labelled 'early' or 'E') and are proposed to have followed a historic investment behaviour (N=12). 'Late entrants' invested in the UK in 2000 or later (labelled 'late' or 'L') and are argued to follow an emergent investment behaviour (N=9). Finally, the perceived sources of competitive advantage of both groups of Chinese investors are evaluated as reported in response to survey questions.

6.2.3.1 Stylised facts of Chinese investors in the UK

Similarly to Young *et al.* (1998), Chinese investors in the UK are generally found to be mature and large companies. This is reflected in the age of respondent firms and in the numbers of worldwide employees. About half of the respondent companies were either first established in the 1940s and 1950s or following China's economic liberalisation during the 1980s and 1990s. In contrast to the interview sample, there is no Chinese 'born global' among respondent firms (see also Table 6.4).

Table 6.4: Years of establishment of parent company and FDI projects in the UK

Decade	Establishment of the parent company in China ^(a)	First outward FDI by the parent company ^(b)	Establishment of UK operation ^(c)
2000s	0	3	9
1990s	5	6	5
1980s	6	5	6
1970s	1	0	1
1960s	1	1	0
1950s	5	0	0
1940s	3	0	0

Notes: (a) N=21; (b) N=15 (6 missing); (c) N=21.

The majority of the respondent firms are state-owned Chinese enterprises (62.9%; see Table 6.5). Only two companies (9.5%) regard themselves as being privately-owned. Four companies

are listed on a Chinese stock exchange (in Shanghai or Shenzhen). However, lack of information on shareholder structure makes it difficult to further classify these as either state- or privately-owned. Nevertheless, the majority of Chinese listed companies are typically either directly or indirectly state-owned (Wong *et al.*, 2004). This leads us to infer that the public listed companies in our sample can be regarded as state-owned. Interestingly, the ownership pattern of Chinese investors differs across the two time frames in question. Early investment projects were normally conducted by SOEs. Among the late investors, five are state-owned but already two are privately-owned. This distinction may reflect recent changes in the Chinese economy which is steadily becoming more driven by the private sector (OECD, 2005b) (see Section 3.1).

Table 6.5: Ownership structure of the Chinese parent company

		Year of first entry to UK	
		Pre-2000 ^(a)	2000 and after ^(b)
SOE	under SASAC ^(c)	9	1
	under a Chinese Ministry	1	1
	under a Chinese Province government	1	0
	under a Chinese Municipality	0	0
	Chinese listed company	1	3
	Privately-owned enterprise	0	2
	Township and Village Enterprise	0	0

Notes: (a) N=11 (1 missing) and (b) N=7 (2 missing); (c) SASAC: State-owned Assets Supervision and Administration Commission.

In line with the Chinese policy direction towards ODI (see Section 3.3), most Chinese investment in the UK occurred after 1979. Eleven Chinese affiliates were established between 1979 and 2000 and nine thereafter (Table 6.5). The trend of increasing numbers of investment projects by Chinese firms reflects the general pattern of Chinese ODI into Europe as described in Section 6.2.1. The one Chinese affiliate established in the 1960s is most probably a state-owned trading company, since such firms were allowed to invest abroad before 1979 (Zhang, 2003).

The majority of the respondent Chinese firms have significant international business experience. This is inferred from the number of other countries in which these companies operate. Fourteen companies have operations in at least eleven countries and another four have operations in between six to ten countries (at the time of the survey). Although data on the spatial distribution of these countries is not available, the numbers of foreign affiliates suggests that the companies are generally well accustomed to operating at an international scale (see Table 6.6).

Table 6.6: Scope of internationalisation of respondent firms

No. of countries with Chinese affiliate	Year of first entry to UK	
	Pre-2000 ^a	2000 and after ^b
20 and more	5	4
11 to 20	3	2
6 to 10	2	1
2 to 5	1	1

Note: (a) N=12, (b) N=9.

The Chinese parent companies are generally large in size in terms of numbers of employees (see Figure 6.1). This is not reflected in their investments in the UK, though. Fifteen Chinese companies have more than five thousand employees worldwide. The majority of Chinese investments operations in the UK, however, employ workforces of less than twenty-four employees (N=20) (see Figure 6.2). One explanation is that the majority of the Chinese respondents are engaged in trade-related activity (see Table 6.7).

Figure 6.1: Number of employees worldwide of Chinese respondent firms

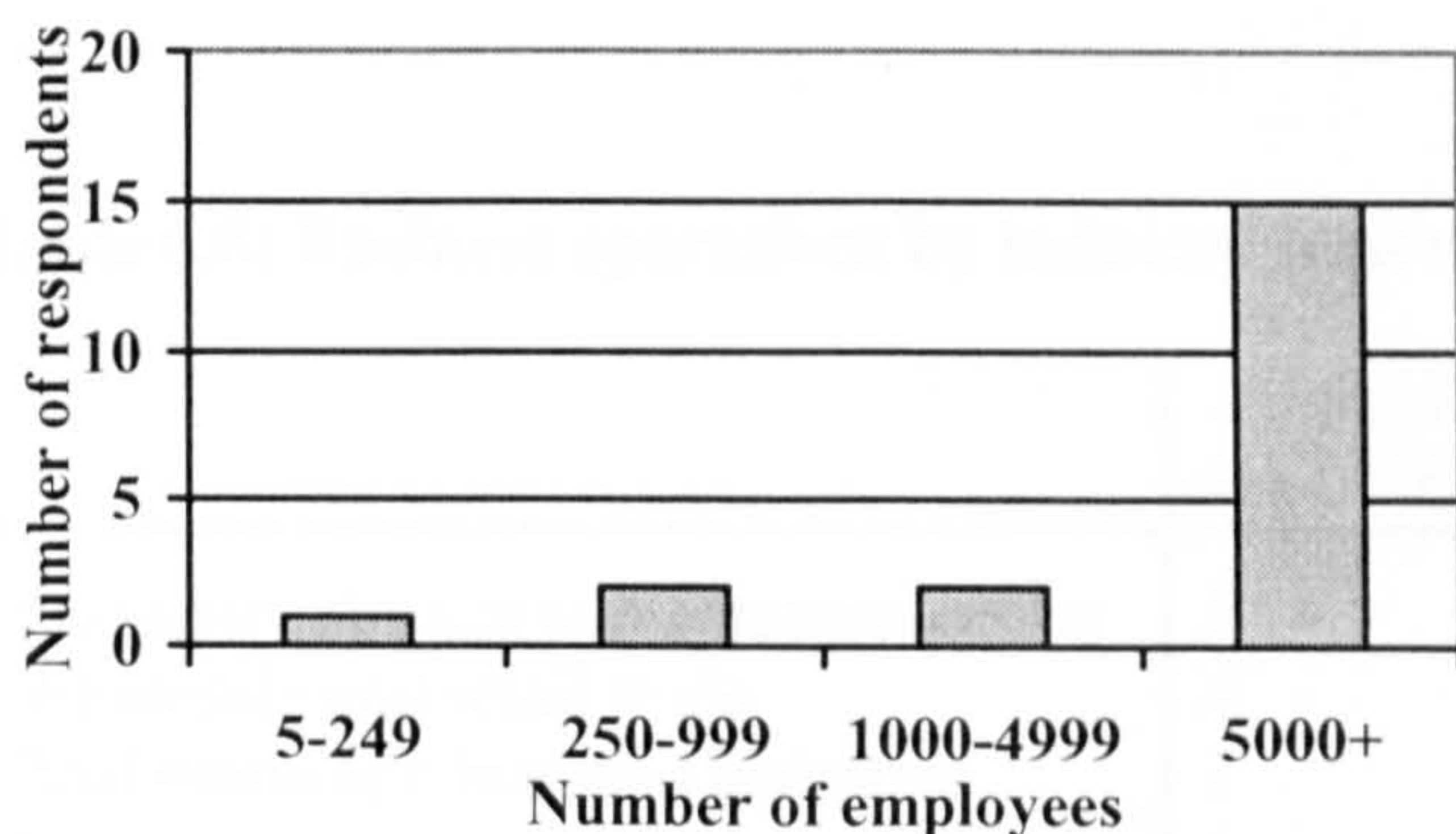
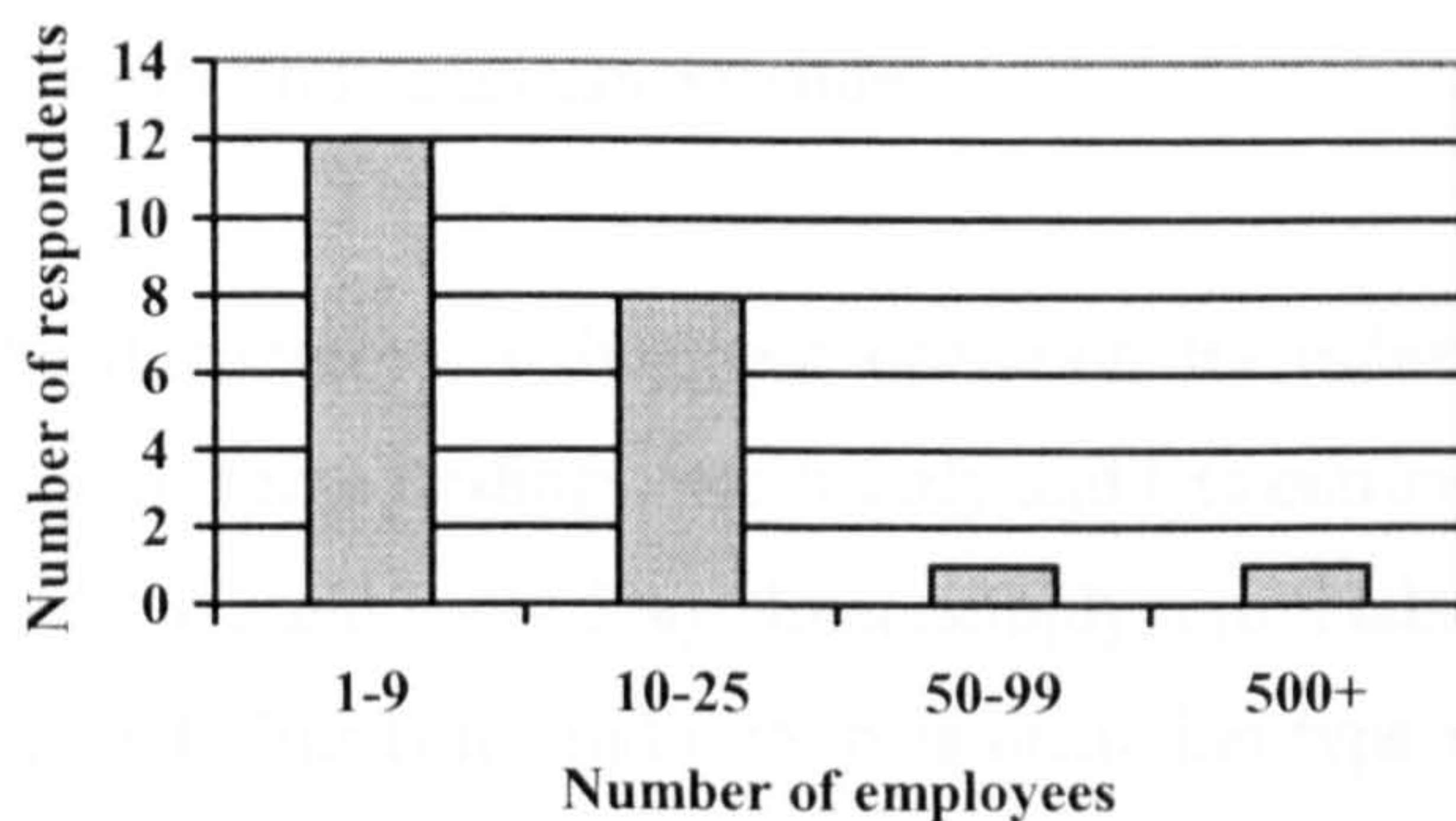


Figure 6.2: Number of employees in Chinese affiliates in the UK



The Chinese respondents firms have commonly more than one business activity in the UK. The focus is on trade-related activities, however. In general, late entrants are proportionally more active in trade-related activities (64.3%) than are early investors (60.0%). On the other hand, late entrants are also more involved in manufacturing related activities (21.4% compared to 5.0%). The explanation for this is straightforward: early entrants tended to establish and operate a representative office more frequently (35.0%) than do late entrants (14.3%) (see Table 6.7).

Table 6.7: Type of UK operation of Chinese respondent firm

	Year of first entry to UK	
	Pre-2000	2000 and after
Representative office	6	2
Export	5	1
Import and Sales	4	5
Import and Warehousing	2	1
Import and Local servicing	1	2
Manufacturing (Acquisition)	1	0
Manufacturing (Greenfield)	0	2
Manufacturing (JV)	0	1

Note: Multiple answers possible.

Table 6.8: Business operations by industry sector of respondent firms

	Year of first entry to UK	
	Pre-2000	2000 and after
Transport, storage and communication	5	1
Wholesale and retail trade	4	3
Real estate and business activities	2	1
Manufacturing	1	1
Hotel and Restaurant	1	0
Financial services	1	1
Fishing	0	1
Construction	0	1

Note: Multiple answers possible

The distribution of business operation by industry sector of the Chinese respondent firms supports these findings. Both early and late entrants generally operate in trade-related industries (E=64.3% and L=44.5%). Interestingly, cross tabulation between Table 6.7 and 6.8 reveal that, although four firms indicate their operation type is manufacture-related, only two respondents actually place their business operation in the manufacturing sector.

6.2.3.2 Investment strategies of Chinese respondent firms

Offensive Market-seeking behaviour

The responses to the questionnaire provide some evidence that the main investment strategy for market-oriented Chinese companies in the UK differs between early and late entrants (see Table 6.9). The main purpose for late entrants is to raise their company profile in a large market for which they have identified growth potential for their company ($\bar{x}_{EO5}^L = 1.89$). Instead of serving the UK through exports from China or elsewhere, these companies see greater merit in operating with a local office in the UK which can enhance their local recognition and corporate development ($\bar{x}_{EO1}^L = 2.00$, $\bar{x}_{EO4}^L = 1.89$). Moreover, these companies generally focus their current attention on the UK market specifically, since they do not seek to obtain Europe-wide reach from their UK base ($\bar{x}_{EO3}^L = 3.13$). This might change in future, though, as late entrants indicate that they are seeking to collect European market information ($\bar{x}_{HO1}^L = 3.00$). These findings indicate that late entrants have indeed adapted an emergent investment strategy in the UK market (see Table 6.2). This finding is further supported by the fact that early entrants do not score as important the market size and potential of the UK ($\bar{x}_{EO5}^E = 3.45$). Nor do they place importance on the need to raise the company's profile in the British market or to increase the overall profit of the company ($\bar{x}_{EO4}^E = 3.45$, $\bar{x}_{EO3}^E = 3.00$). Early entrants are, however, concerned with developing new markets outside of China ($\bar{x}_{EO1}^E = 2.25$).

Table 6.9: Offensive market-seeking investment drivers of Chinese respondent firms

Investment motive		Year of first entry to UK	
		< 2000 \bar{x}_E	2000 ≤ \bar{x}_L
EO4	To raise the profile of your company in Europe	3.45 ^(a)	1.89
EO5	Size and potential of the British market	3.45 ^(a)	1.89
EO1	To develop new markets outside of China through direct investment	2.25	2.00
EO3	To increase corporate profits	3.00	2.25 ^(d)
HO1	To collect information and gain knowledge about European markets	2.83	3.00
EO3	To establish a headquarters for your firms' European operations	3.27 ^(a)	3.13 ^(d)
HO2	Proximity of the UK to large, third markets for exports	3.40 ^(b)	3.50 ^(d)
EO6	Strength of your company's brand in the UK	3.91 ^(a)	3.63 ^(d)
HO3	Ease of exporting to the industrialised countries from the British location	4.22 ^(c)	4.43 ^(e)

Notes: H= 'historic', E= 'emergent'; 1= 'utmost importance', 5= 'of no importance'; $N_E = 12$, except (a) 11, (b) 10, (c) 9; $N_L = 9$, except (d) 8, (e) 7.

Other offensive market-seeking drivers are not scored highly by either early or late entrants. For example, both early and late entrants indicate that they are not investing to use the UK as an export platform to serve third markets in continental Europe ($\bar{x}_{HO2}^E = 3.40$, $\bar{x}_{HO3}^E = 4.22$; $\bar{x}_{HO2}^L = 3.50$, $\bar{x}_{HO3}^L = 4.43$).

Defensive Market-seeking behaviour

The defensive driven investment strategies for early and new entrants are similar (see Table 6.10). This suggests that the propositions derived from the historic-emergent investment strategy framework of Buckley *et al.* (2006) are not supported for this type of Chinese investment to the UK. Chinese investments seem to be a reaction mainly to the increased integration of China into the global economy and the growing international competition that Chinese companies face as a consequence ($\bar{x}_{ED3}^E = 2.25$; $\bar{x}_{ED3}^L = 2.67$). They are not a response to competitive pressures and saturated demand in the home market, which Buckley *et al.* (2006) regard as an emergent trend ($\bar{x}_{ED1}^E = 3.45$, $\bar{x}_{ED2}^E = 4.20$; $\bar{x}_{ED1}^L = 3.88$, $\bar{x}_{ED2}^L = 4.44$). Thus, Chinese companies invest in the UK to defend and further expand their close relationship with British customers ($\bar{x}_{ED4}^E = 3.00$; $\bar{x}_{ED4}^L = 2.89$). Such behaviour is considered as both a historic and emergent feature of the investment strategies by Buckley *et al.* (2006). Other defensive

Table 6.10: Defensive market-seeking investment drivers of Chinese respondent firms

Investment motive	Year of first entry to UK	
	< 2000 \bar{x}_E	2000 ≤ \bar{x}_L
ED3 In response to growing international competition	2.25	2.67
ED4 To be closer to your important customers	3.00	2.89
HD3 To improve the competitiveness of your company's export activities	3.27 ^(a)	3.13 ^(c)
HD2 To support export activities in the European Union	3.30 ^(b)	3.22
HD1 To support your company's export activities in the UK	2.91 ^(a)	3.33
ED7 To overcome tariff and non-tariff barriers to your company's trade with the UK and the European Union	4.36 ^(a)	3.56
ED1 In response to growing competitive pressure in Chinese markets	3.45 ^(a)	3.88 ^(c)
ED6 To defend existing market share in the British market by investing locally	3.82 ^(a)	4.67
HD4 To help obtain business license or other approvals for your products in Europe	4.10 ^(b)	4.38 ^(c)
ED2 Because your parent company's markets are becoming saturated in China	4.20 ^(b)	4.44
ED5 To spread the risks associated with producing internationally	4.18 ^(a)	4.67

Notes: H= 'historic', E= 'emergent'; 1= 'utmost importance', 5= 'of no importance'; $N_E = 12$, except (a) 11, (b) 10; $N_L = 9$, except (c) 8.

investment motives, such as circumventing trade barriers set up by the European Union, seem to be an issue for late and not early entrants ($\bar{x}_{ED7}^E = 4.36$; $\bar{x}_{ED7}^L = 3.56$). A risk diversification strategy is not identifiable for either category of investors ($\bar{x}_{ED5}^E = 4.18$; $\bar{x}_{ED5}^L = 4.67$). Overall, these findings can be attributed to the high level of state-ownership of early entrant firms sampled, a status which may have given them ready access to cheap finance at home and led the investment decisions to be influenced by national political and economic agendas of China (Buckley *et al.*, 2007a; Young *et al.*, 1998).

Asset-seeking investment strategy

The asset-seeking investment strategies pursued by Chinese companies support a qualitative shift in behaviour as proposed in the Buckley *et al.* (2006) framework (see Table 6.11). Late entrants highlight as important the need to acquire new and advanced management skills and to tap into existing pools of knowledge to improve their overall business profile and profitability ($\bar{x}_{EA3}^L = 2.78$, $\bar{x}_{EA4}^L = 3.25$). This could mean that late entrants are more likely to be searching for technologies and soft skills to enhance their competitive position in the markets in which they operate. These two strategies are less pronounced for early entrants ($\bar{x}_{EA3}^E = 3.08$, $\bar{x}_{EA4}^E = 4.10$). Early entrants are more driven by historic investment strategies, i.e. to be closer to suppliers and to gain better access to intermediate products ($\bar{x}_{EA2}^E = 3.42$, $\bar{x}_{HA2}^E = 3.40$). Interestingly, and in contrast to current understanding, the respondent Chinese companies are not interested in purchasing a British brand ($\bar{x}_{EA6}^E = 4.55$; $\bar{x}_{EA6}^L = 4.25$).

Table 6.11: Asset-seeking investment drivers of Chinese respondent firms

Investment motive		Year of first entry to UK	
		< 2000 \bar{x}_E	2000 ≤ \bar{x}_L
EA3	To gain better access to new management know-how and ideas	3.08	2.78
EA4	To gain access to new technology	4.10 ^(b)	3.25 ^(c)
HA2	To gain access to intermediate products not readily available in China	3.40 ^(b)	4.33
EA2	To be closer to your British suppliers	3.42 ^(b)	4.22
EA6	To purchase a known British brand	4.55 ^(a)	4.25 ^(c)
EA1	To carry out research and/or product development in the UK	4.09 ^(a)	4.44
HA1	To obtain access to raw materials not available readily in China	4.18 ^(b)	4.56
EA5	To improve access to sources of cheaper external finance	4.09 ^(a)	4.56

Notes: H= 'historic', E= 'emergent'; 1= 'utmost importance', 5= 'of no importance'; N_E= 12, except (a) 11, (b) 10; N_L= 9, except (c) 8.

There are two explanations. First, late entrants may be sufficiently confident of their current Chinese brand and may see no reason to buy an existing one. Second, the reluctance of early entrants to acquire a British brand may be due to the lack of importance placed by them on profile and public awareness building in the UK.

Competitive advantage

We now assess the sources of competitive advantage as reported by the respondent firms (see Table 6.12). The most striking finding is that Chinese companies in the UK seem to base their competitive advantage on soft-skills, for example the business skills held by the management team that was gained through international education ($\bar{x}_{CA4}^E = 2.09$, $\bar{x}_{CA12}^E = 2.82$; $\bar{x}_{CA4}^L = 1.75$, $\bar{x}_{CA12}^L = 2.88$). Though business skills are important, it is questionable just how sustainable a firm-specific advantage this is for Chinese MNEs. A more authentic firm-specific factor highlighted by respondents may be represented by the extensive international corporate network and the strong support from the Chinese parent company reported. Both aspects are present for early and late entrants but are more pronounced for latter ones ($\bar{x}_{CA10}^E = 2.91$, $\bar{x}_{CA11}^E = 2.55$; $\bar{x}_{CA10}^L = 2.50$, $\bar{x}_{CA11}^L = 1.88$). The strong support from the Chinese parent company may provide the UK affiliate with cheap investment capital arising from imperfect Chinese capital markets (Buckley *et al.*, 2007a; Antkiewicz and Whalley, 2006).

Table 6.12: Perceived firm-specific advantages of respondent Chinese firms

Firm-specific advantage		Year of first entry to UK	
		< 2000 \bar{x}_E	2000 ≤ \bar{x}_L
CA4	High levels of relevant business skills in your UK management team	2.09 ^(a)	1.75
CA11	Strong support from your Chinese parent company	2.55 ^(a)	1.88
CA7	Demand for your company's products and/ or services is strong	2.67 ^(b)	2.38
CA10	Your firm has good access to a widespread distribution network outside of the UK	2.91 ^(a)	2.50
CA9	High level of marketing know-how in your British company	3.09 ^(a)	2.63
CA6	You have British nationals on your management team in the UK	3.63 ^(a)	2.63
CA12	Internationally-educated management team in your UK company	2.82 ^(a)	2.88
CA8	Internationally experienced management team in your UK company	2.64 ^(a)	3.00
CA5	Technological dominance of your company's products	3.82 ^(a)	3.00 ^(b)
CA1	Lack of international experience of your parent firm in China	3.27 ^(a)	3.00
CA3	Low level of technological capability in your parent company	3.45 ^(a)	3.33
CA13	Your management team in the UK is made up of ethnic Chinese people	3.18 ^(a)	3.38
CA2	Insufficient understanding of the UK business environment in your Chinese parent company	3.25	3.44

Notes: 1= 'utmost importance', 5= 'of no importance'; $N_E = 12$, except (a) 11, (b) 9; $N_L = 8$, except (b) 7.

However, the influence of the parent company may impede the development of the UK affiliate as the parent companies are often reported to lack international business experience ($\bar{x}_{CA1}^E = 3.27$; $\bar{x}_{CA1}^L = 3.00$). This may lead to misinterpretations of market information and thus sub-optimal business strategies. This finding is somewhat surprising given that most Chinese companies sampled started to internationalise some years ago. Given the managerial shortcomings identified by the respondents of their parent company, whether or not access to international distribution channels constitutes genuine source of advantage to Chinese firms is an open question. The high level of control exerted by the parent may serve to constrain the activities of overseas affiliates and reduce their activity to act entrepreneurially and react appropriately to changing market and industry conditions. Early and late entrants in the UK do not perceive their products or technological capacity being competitive or advanced ($\bar{x}_{CA5}^E = 3.82$, $\bar{x}_{CA3}^E = 3.45$; $\bar{x}_{CA5}^L = 3.00$, $\bar{x}_{CA3}^L = 3.33$). This could either be a reflection of a limited product range being offered by Chinese firms in the UK, compared with other countries, or that the respondents are confident that they will be capable to offer technologically advanced products in the future.

6.2.4 Summary

This section has for the first time used the theoretical propositions contained in the historic-emergent investment strategy framework for Chinese MNEs presented by Buckley *et al.* (2006) to analyse Chinese investment in a host country, in this case the UK. The findings provide partial support for the framework and, hence, some confirmation of *RQ6*. Concerning *RQ6*, the analysis has revealed some evidence that ODI behaviour by Chinese MNEs has changed after 2000, i.e. for Chinese companies which entered the UK market in or after that year. The strategies have become increasingly more driven by the objectives of (i) developing foreign markets for offensive reasons and (ii) to gain better access to foreign technology and know-how to enable the company to strengthen their firm-specific advantages (see also Table 6.13). Such investment patterns are not evident for Chinese companies that invested in the UK before 2000. Further, defensive market-seeking investment behaviour of early and late Chinese entrants into the UK market is found to differ markedly. Similarly, and contrary to common opinion, both groups of companies have not invested in the UK for strategic asset-seeking purposes like acquiring an established brand. These shifts in the investment behaviour of Chinese MNEs have not been identified for the UK or other countries before in extant research. The firm-specific advantages of Chinese firms compared to those commonly held by Western MNEs are found to deviate somewhat. Chinese firms operating in the UK do not seem have conventional firm-specific advantages prior to their investment in the UK. They are better characterised as

“multinationals without advantage” (Fosfuri and Motta, 1999). Early and late entrants indicate that they possess good managerial skills and somewhat low levels of technological capabilities. These are atypical firm-specific advantages and seem, *a priori*, to decrease the abilities of Chinese MNEs to compete successfully in the UK.

Table 6.13: Evolving investment strategies and competitive advantage of Chinese firms in the UK as identified in the survey

		<u>Historic</u> prior to 2000 entrant firms	<u>Emergent</u> 2000 and after entrant firms
Market seeking	Offensive	--	Raise profile and access highly potential host market
	Defensive	Response to international competition and to support exports of the parent	Response to competition
Asset seeking		Underdeveloped but some indications that firms invest to access managerial capacity and intermediate products	Still underdeveloped but firms increasingly focus on accessing technology, managerial capacities and ideas
Source of competitive advantage		Business skills, international management experience, and strong support from parent company	Business skill, strong support from parent company and demand for company's products

Source: Adapted from Cross and Voss (2007).

This generally supports early findings by Nolan and Zhang (2002) and Shenkar (2005) concerning the capabilities of Chinese firms and by Buckley *et al.* (2007a) that the investment decision of Chinese MNEs may not be similar to Western MNEs. It also mirrors early research on South Korean MNEs by Kumar and Kim (1984), for example. Kumar and Kim argue that the firm-specific advantages of Korean firms deviate from Western firms in that they rely on low-cost production and highly motivated staff. It is, however, likely that the pattern of Chinese firm-specific advantage might change in future. Late Chinese entrants to the UK are already more likely to seek to obtain location-specific technologies which might enable them to strengthen firm-specific advantages. This effect would be magnified should the firms be able to raise their technological capabilities elsewhere as well (either in China or in other locations) and if the intra-firm technology transfer is effective and well guided. Sigurdson (2005), among others, has noted that Chinese companies are also increasingly strengthening their R&D efforts in China, for example. In short, this survey helps inform the following research questions posed in this study. In particular, it reveals that the investment motives of Chinese firms change over time (*RQ6*) and that for Chinese investments in the UK market seeking motives (*RQ2*) generally dominate over other motives (*RQ3* to *RQ5*). However, Chinese firms which entered the UK

after 2000 are more likely to invest for offensive market seeking and technology seeking (*RQ4*) motives than firms which established an affiliate prior to 2000.

6.3 Comparison and discussion of the qualitative research

The investment strategies of Chinese companies have changed over time. The findings reveal fruitful insights in differences by ownership form concerning the perceived influence of the institutional environment on decision-making.

The senior management team in the headquarters of Chinese firms perceives outbound investments mainly as a means to gain a foothold in foreign markets and service these better. It is possible that this understanding has not been disseminated to foreign affiliates. Chinese affiliates in the UK are not very clear about the investment motive of their respective parent (although these parents did not participate in this research). In the UK, investment is somewhat driven by the market but both offensive and defensive strategies are underdeveloped. Only firms which have more recently invested in the UK have more pronounced offensive strategy and also acknowledge that some was undertaken to obtain advanced technology.

Chinese private firms perceive the Chinese institutional environment as more hostile than do SOEs. Although they acknowledge that the constraints have eased somewhat over the last five years, they tend to organise their international activities through an offshore company which does not suffer interventions, either directly or indirectly, of the Chinese government. Chinese government officials implicitly recognise that private firms have not been well treated under the past and current regime when they refer to the vast amount of ODI conducted by these firms that is not recorded by any official statistics. SOEs see the government as a neutral actor who rather encourages ODI as it may help to create strong companies which in return strengthens the local economy. This perception is in line with the viewpoint of government officials who despite the behaviour of private firms perceive the system as balanced and welcoming of ODI. The communality between the SOE and government officials is not surprising as both ultimately form part of the state-sector and can be regarded as mutually supportive of each other.

The results of Section 6.1 and 6.2 somewhat differ. One explanation for the deviation in the research findings lies in the research method applied. First, the data analysed in Section 6.1 was collected in the Chinese headquarters of the company while that of Section 6.2 draws upon information provided by UK affiliated. Second, interview data has been used in Section 6.1 which generally allows to reformulate a question if the respondent understands it wrongly and to probe if the interviewee does not reply to the question. Third, and as mentioned already, two

different samples of Chinese MNEs are analysed in this Chapter. It was not possible to have dyadic pairs of firms, that is to approach the Chinese headquarters and the respective affiliate in the UK. The survey questionnaire was employed first. Because it was distributed anonymously the identity of the responding company cannot be revealed and, hence, the parent company is not identified.

This chapter has analysed Chinese ODI using primary data collected directly from Chinese MNEs. In particular insights around a number of research questions have been obtained. It is revealed that Chinese firms predominantly conduct outbound investments for market servicing purposes (*RQ2*) and only a small number of firms seek to obtain advanced technology (*RQ4*) or strategic assets (*RQ5*). The importance of improved access to technology may increase in future because the data analysed indicates that firms which invested in the UK after 2000 are more inclined to invest for such a motive. This also supports the notion that the investment strategies of Chinese firms have changed over time (*RQ6*). The endogenous and exogenous elements of the Chinese ODIR, as summarised in Figure 4.1, are partially supported. The influence of the formal endogenous elements is perceived differently by state-owned and small, privately-owned Chinese firms (*RQ11*). While the former perceives it as neutral or supportive, private firms rather perceive the institutional environment as an impediment to internationalisation (*RQ10a*). The influence of the informal, exogenous element (that is, the access to international networks) as similarly diverse perceived among these groups of enterprises (*RQ9*).

To identify specific determinants of Chinese FDI, it is important to take a more abstract, aggregated perspective and employ macroeconomic data and official ODI data to inform the research. This is done in the following chapter. Chapter 7 builds upon material presented in Section 6.1 where the impact international networks and the domestic institutional environment have been outlined. As with this chapter, the analysis in Chapter 7 assesses whether or not changes to the determinants of Chinese ODI, in accordance to *RQ6*.

7 Cross-sectional data analysis of the determinants of Chinese outward direct investment

This chapter presents two econometric analyses of Chinese ODI using, first, foreign investment project data as collected by SAFE and, second, aggregated data as published by MOFCOM. The analyses focus on different aspects of the institutional framework as advanced in Chapter 4. Section 7.1 is based on our publication in the *Journal of International Business Studies* (Buckley *et al.*, 2007a) which concentrates on domestic institutional factors and international network effects. Section 7.2 concentrates on international institutional factors and international network effects. Both sections build upon our earlier work by Cross *et al.* (2007) published in *Multinational Enterprises and Emerging Challenge of the 21st Century*, a book edited by John H. Dunning and Tsai-Mei Lin. In order to avoid ambiguity in the presentation of the cross-sectional models and the discussion, Hypotheses 1 to 6 relate to Model One while the Hypotheses 7 to 15 refer to Model Two. The key findings, as summarised and compared in Section 7.3, are that Chinese MNEs are strongly influenced in their international investment decision-taking by cultural links to the host country, by market-seeking motives and increasingly by resource-seeking motives. The investment risk perception of Chinese firms also deviates significantly from that expected of profit maximising industrialised country firms.

7.1 Model One: Domestic institutional factors and international network effects – An analysis of SAFE data

The first econometric analysis focuses predominantly on the effects of domestic institutional factors, namely the effect of the trip by Deng Xiaoping to southern China in 1992 and the instigation of the ‘Go Global’ policy in 1999, and of international networks involving host countries as presented in Chapter 4. The analysis also incorporates the international investment strategy model of Dunning (1993). The latter factors, and hypotheses deriving from them, are presented first as they constitute the ‘traditional’ drivers of international production. The ‘new’, institutional drivers of Chinese ODI and hypotheses are presented section 7.1.1.

7.1.1 Operationalisation of Model One

Hypotheses

Motive for market-seeking FDI

Market-seeking FDI by industrialised country MNEs is generally found to be destined to countries with large absolute markets (generally measured in GDP or GNP), countries with a

large relative market size (generally measured in GDP/capita) or countries with a potentially large market in the future (generally measured in annual growth of GDP) (see Section 2.3). Though these three proxies capture different aspects of market-seeking FDI, they are often used as alternates in the analysis of market-seeking FDI and will be treated accordingly in this study (e.g. Clegg and Scott-Green, 1998; Rammal and Zurbruegg, 2006). Proposing that Chinese MNEs generally behave like their industrialised country counterparts, the following alternate hypotheses can be derived:

Hypothesis 1a: Chinese ODI is associated positively with absolute host market size;

Hypothesis 1b: Chinese ODI is associated positively with host market size per capita;

Hypothesis 1c: Chinese ODI is associated positively with host market growth.

Motive for resource-seeking FDI

Resource-seeking FDI occurs in countries which are relatively well resource endowed. China is relatively scarce in natural resources. The lack of resources impedes the stable supply of energy and other input factors for productive processes (see Section 3.3). Ores and minerals, for example, are important resources in steel industry and subsequently in the construction industries. Both of these are industries that have expanded dramatically over the last five years along with the increase in gross capital formation in China. Consequently, China is a major importer of ores and minerals and has a market share of world imports of metalliferous ores and metal scrap of 21.7% in 2004, while the share of world imports was even higher for selected metals such as chromium (54%) and iron ore (44%) in 2004 (Deutsche Bank Research, 2006). It can be predicted that Chinese companies backward integrate along the supply chain in natural resources to ensure the stable supply of these inputs. It hence follows that:

Hypothesis 2: Chinese ODI is associated positively with host country endowments of natural resources.

Motive for asset-seeking FDI

Asset-seeking FDI is generally destined to countries with a large accessible knowledge base. This can be proxied by the number of patents granted in the host country (e.g. Makino *et al.*, 2002). The number of patents granted in a host country generally reflects the endowment of domestic companies with firm-specific advantages produced from in-house R&D effort (Hall *et al.*, 1986; Griliches, 1990). Foreign firms may seek proximity to companies or clusters of companies which are engaged in R&D and have patents filed. This proximity may enable the investing firm to access and internalise existing knowledge easier through collaboration, spillover and demonstration effects and, hence, strengthen its firm-specific advantages (see

Section 2.3). It has been argued that Chinese companies invest increasingly in foreign locations to conduct research and access foreign stocks of knowledge (von Zedtwitz, 2005; Sigurdson, 2005; Chen and Jiang, 2003). Thus:

Hypothesis 3: Chinese ODI is associated positively with host country endowments of ownership advantages.

FDI and country risk

Industrialised country companies tend to be relatively risk-averse when conduct FDI and invest in countries with low levels of country risk (comprising political, commercial and economic risk) or substitute arm's length service modes for FDI in countries with higher levels of risk (Buckley and Casson, 1981, 1999; Nordal, 2001). The propensity of Chinese companies' investment behaviour is expected, *a priori*, not to differ from industrialised country firms. It is therefore proposed that Chinese firms direct their foreign investments to countries with relatively low levels of country risk. However, perverse investment behaviour would be observable if Chinese companies enjoy domestic capital market imperfections as advanced in Section 4.2. Such market imperfections could enable Chinese firms to invest in countries with relatively high risk levels:

Hypothesis 4: Chinese ODI is associated negatively with rising levels of host country risk.

Cultural proximity

As explained in Sections 2.2 and 4.2, cultural proximity (*CP*) between two countries may help to reduce transaction costs. The investor may feel more familiar with the way business is conducted in the host country and establish business links easier. Cultural divergence, however, is internationally more common than convergence (Hofstede, 1983). More often than not experience companies liabilities to foreignness (Zaheer, 1995). Internationalising firms may therefore be inclined to invest in a location which offers greater cultural proximity. Firms may therefore invest in countries where a significant proportion of the population is constituted by emigrants from the firm's home country, as advanced in the Chinese ODIR in Section 4.3. This pattern may be more pronounced in culturally more distant countries. It follows from this discussion and the earlier explanations in Chapter 4.3 that:

Hypothesis 5: Chinese ODI is associated positively with the proportion of ethnic Chinese in the host country population.

Domestic policy liberalisation

The discussion in Section 4.3 highlights that domestic policies influence the propensity of firms to invest overseas as the policies create or dilute market imperfections. Deng Xiaoping, late Chairman of the Central Military Commission of the CCP and *de facto* leader of China from the late 1970s to early 1990s (Yahuda, 1993; Naughton, 1993), travelled twice to Southern China, 1984 and 1992, to stress the importance of FDI and economic liberalisation (Naughton, 1993, 2007). Both journeys strengthened the position of Chinese reformers and provided a positive signal to foreign investors – clearly reflected in the upsurge of inward FDI – and, arguably, to domestic investors willing to invest abroad (Cai, 2006). The possible effects of the first trip by Deng on Chinese ODI are not included in this analysis as the available data series only starts in 1984 (see Figure 1.1). The second trip in 1992, however, marks the beginning of the third phase of Chinese ODI and is accordingly included and the effects on Chinese ODI estimated (*TD92*). This variable captures the endogenous informal institutional element of the Chinese ODI presented in Figure 4.1:

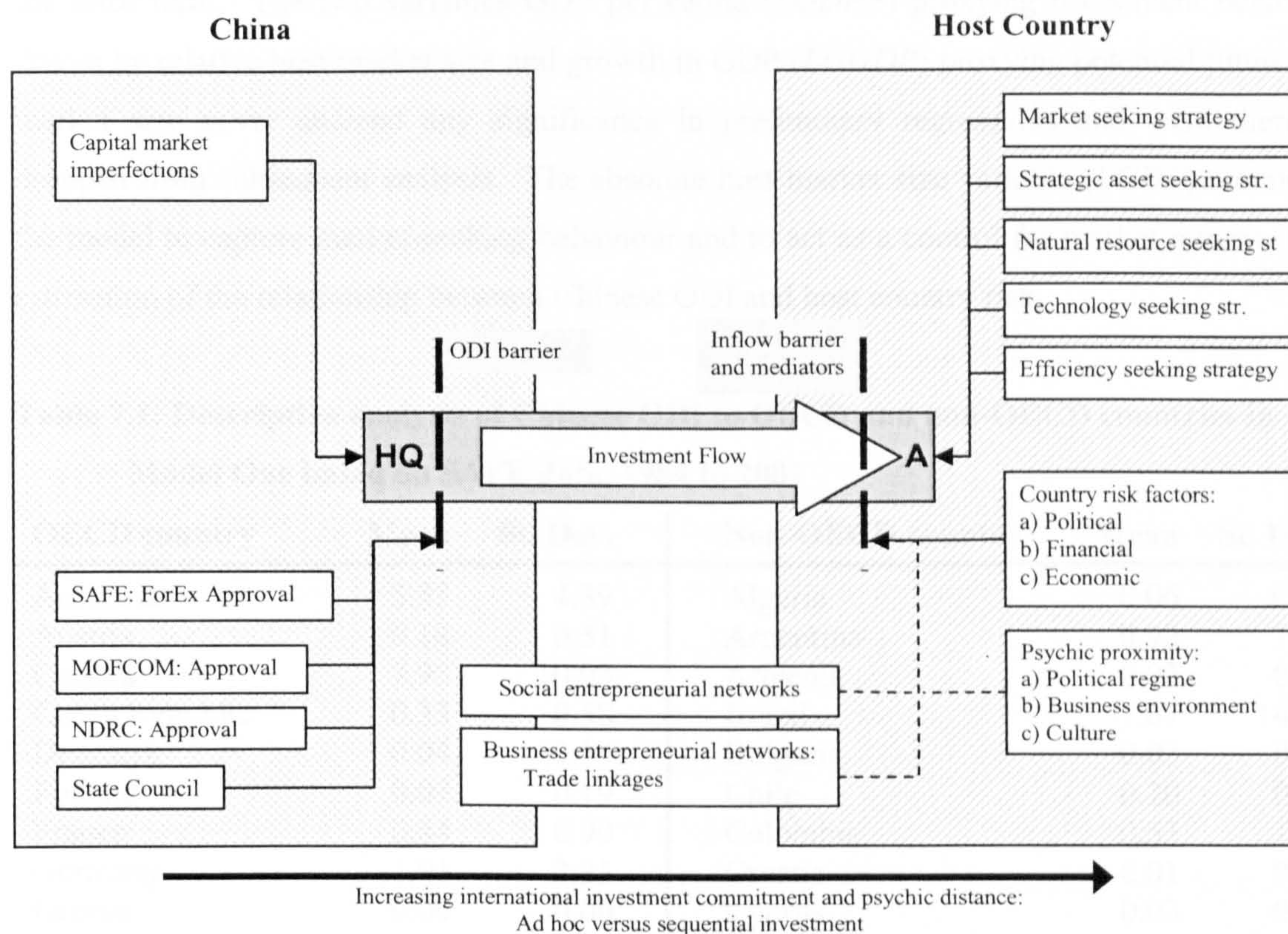
Hypothesis 6: Liberalisation of Chinese FDI policy in 1992 increased Chinese ODI.

Control variables

Beside these main variables the econometric model incorporates a number of control variables as employed in other empirical studies on FDI (e.g. Clegg and Scott-Green, 1998; Love and Lage-Hidalgo, 2000; Barrell and Pain, 1996). The control variables for this model are the official exchange rate of the host country (*LERATE*), the annual inflation in the host country (*LINF*), China's exports to the host country (*LEXP*), imports from the host country to China (*LIMP*), the geographical distance between Beijing and the capital of the host country (*LDIS*) and the openness of the host country to inward FDI (*LINF**D*). The data sources for each main and control variable are presented in Section 5.3.

The interactions of the variables and how they are linked into the model of national and international institutional elements as presented in Chapter 4 is depicted in Figure 7.1:

Figure 7.1: The Chinese ODIR – Domestic institutions (Model One)



Notes: (1) Broken arrows (-----) indicate mediating (indirect) effect;
Solid arrows (————) indicate direct effects.

(2) ‘ForEx’ stands for Foreign Exchange;

(3) ‘A’ denotes the affiliate of the investing firm in the host country; and

(4) ‘HQ’ the headquarters of the investing firm in the home country, in this case China.

Source: Adapted from Figure 4.1.

Model and method

The above discussion suggests the following well-specified log-linear model to explain Chinese ODI with respect to domestic institutions, international networks and investment strategy (Equation 1):

$$\begin{aligned}
 \text{LFDI} = & \alpha + \beta_1 \text{LGDP} + \beta_2 \text{LGDPP} + \beta_3 \text{LGGDP} + \beta_4 \text{LORE} + \beta_5 \text{LPATENT} + \beta_6 \text{LRISK} \quad (\text{EQ1}) \\
 & + \beta_7 \text{CP} + \beta_8 \text{TD92} + \beta_9 \text{LERATE} + \beta_{10} \text{LINF} + \beta_{11} \text{LEXP} + \beta_{12} \text{LIMP} + \\
 & \beta_{13} \text{LDIS} + \beta_{14} \text{LINFDI} + \varepsilon_{it}
 \end{aligned}$$

In equation EQ1, α denotes the intercept, β stands for unknown parameter of interest and ε for the error term. The two variables GDP per capita (*LGDP*) proxying investment behaviour driven by relative host market size and growth in GDP (*LGGDP*) proxying potential future host market size never attained any significance in preliminary regressions and were therefore dropped from subsequent analysis. The absolute host market size variable (*LGDP*) remains in the model to capture market-seeking behaviour and to act as a control for market returns in the estimation of the relationship between Chinese ODI and host country risk.

Table 7.1: Descriptive analysis of Chinese ODI to OECD and non-OECD countries in Model One based on SAFE data, 1984 to 2001

OECD country	Mean	St. Dev.	Non-OECD country	Mean	St. Dev.
Australia	5.55	4.39	Algeria	0.06	0.15
Austria	0.18	0.51	Argentina	0.92	1.48
Canada	7.98	10.03	Armenia	0.02	0.10
Czech Republic	0.33	0.58	Brazil	7.07	14.85
Denmark	0.04	0.14	Bulgaria	0.03	0.08
Finland	0.07	0.19	Chile	0.20	0.35
France	0.84	0.90	Colombia	0.53	1.90
Germany	1.91	2.35	Croatia	0.01	0.06
Greece	0.00	0.00	Cyprus	0.03	0.08
Hungary	0.73	1.09	Ecuador	0.23	0.40
Italy	0.62	1.58	Egypt	5.40	18.36
Japan	211.81	889.04	Ghana	0.97	1.96
Mexico	16.61	48.29	Hong Kong SAR	192.18	490.34
Netherlands	0.43	0.75	India	0.71	2.71
New Zealand	0.30	0.48	Indonesia	4.67	11.80
Poland	0.75	1.62	Israel	0.01	0.03
Portugal	0.25	0.64	Malaysia	14.01	45.74
South Korea	5.51	15.22	Morocco	14.01	0.51
Spain	0.99	2.93	Nigeria	1.89	4.43
Sweden	0.18	0.41	Philippines	4.89	13.60
United Kingdom	1.57	4.09	Russia	6.90	13.50
United States	33.13	28.11	Singapore	11.13	28.40
			South Africa	7.07	15.59
			Sudan	116.82	466.60
			Thailand	14.23	25.21
			Ukraine	0.46	0.93
			Venezuela	27.76	83.56
OECD countries	13.17	190.02	Non-OECD countries	15.50	134.79

Source: Calculated from SAFE (2005).

Note: Means and standard deviations of Chinese ODI are calculated from project value as reported by SAFE, converted into constant (year 2000) USD million.

The dependent variable (*LFDI*) is the total annual amount of foreign exchange approved by SAFE during the investment project approval process. This analysis is based on Chinese ODI in forty nine host countries, twenty-two of which are members of the OECD and twenty-seven non-members (see also Table 7.1). Table 7.1 presents a descriptive overview of Chinese ODI in OECD and non-OECD countries. The data shows a large variance in the data, as illustrated by high standard deviations compared to the annual mean of Chinese ODI to a host country.

Two statistical models were used to estimate equation (EQ1), namely pooled ordinary least squares (POLS) and the random effects (RE). A fixed effects model cannot be used since the equation includes a time dummy variable. A Lagrangian multiplier (LM) test was conducted to identify whether POLS or REs furnished the better model. The LM value is significantly different from zero and indicates that the REs estimation is preferable to that of POLS. The discussion below is therefore based on the REs results.

The effect of Deng Xiaoping's trip to Southern China in 1992 and the subsequent policy changes on Chinese ODI are tested with a structural break dividing the sample into a pre-1992 period (1984 to 1991) and post-1992 period (1992 to 2001). The impact on the level of economic development of the host country is tested by splitting the sample into an OECD and a non-OECD sub-sample. Both sub-samples are analysed for the whole period 1984 to 2001. The correlation matrix (Table 7.2) shows that no serious collinearity between the variables.

Table 7.2: Correlation matrix for Model One

	LFDI	LGDP	LORE	LPATENT	LRISK	LERATE	LINF	LEXP	LIMP	LDIS	LINFDI
LFDI	1.000										
LGDP	0.219	1.000									
LORE	0.004	0.027	1.000								
LPATENT	0.069	0.668	0.192	1.000							
LRISK	-0.043	0.485	0.179	0.462	1.000						
LERATE	0.075	-0.261	-0.128	-0.224	-0.276	1.000					
LINF	-0.002	-0.288	0.174	-0.142	-0.453	-0.098	1.000				
LEXP	0.443	0.657	-0.129	0.375	0.352	0.041	-0.395	1.000			
LIMP	0.358	0.728	0.088	0.459	0.402	-0.130	-0.321	0.855	1.000		
LDIS	-0.177	-0.037	0.234	-0.084	-0.010	-0.332	0.198	-0.495	-0.422	1.000	
LINFDI	0.183	-0.256	-0.124	-0.263	0.131	-0.007	-0.186	0.125	-0.007	0.087	1.000

Note: The time dummy TD92 is excluded from the correlation matrix.

7.1.2 Results and discussion of Model One

First, the determinants of Chinese ODI in Model One are discussed for the whole time period and OECD and non-OECD countries combined as presented in Table 7.3. This is followed by the introduction of the structural break for 1992 and the assessment of its impact on the determinants of Chinese ODI. Then, differences in findings are investigated for OECD and non-OECD countries in order to see if the decision-taking of Chinese firms differs between developed and developing host countries.

Findings for the full time period and all countries

Absolute host market size (*LGDP*), cultural proximity (*CP*) and policy liberalisation in China (*TD92*) are all found to be significant for the full time period and signed as predicted. These findings support Hypotheses H1a, H5 and H6. The level of country risk (*LRISK*), however, is found to be significant but with a sign contrary to expectation and this does not support H4. The proxies for natural resource-seeking FDI (*LORE*) and asset-seeking FDI (*LPATENT*) are both found to be insignificant. Therefore, Hypotheses H2 and H3 are not supported. The main findings are now discussed in more detail.

The absolute market size of a host country (*LGDP*) has a strong positive influence on Chinese ODI for the full time period under investigation as hypothesised (H1a). This finding indicates that Chinese companies tend to invest in developed countries with large absolute markets and thus behave more like industrialised countries MNEs rather than destining their investment to developing countries as predicted by the literature on developing country MNEs (e.g. Lecraw, 1993) (see Section 2.2.8). Indeed, a 1 per cent rise in *LGDP* increases Chinese ODI by 0.35 per cent. The second variable following prediction is cultural proximity (*CP*). This finding suggests that Chinese companies tend to invest in locations with a significant number of Overseas Chinese where they can exploit relational assets (Dunning, 2002; Costin and Herken, 2006). This confirms the view that networks are important to the internationalisation of Chinese MNEs as proposed in Sections 3.4 and 4.3. The liberalisation policies instigated by Deng Xiaoping's journey in 1992 (*TD92*) are found to have had a positive effect, as hypothesised, on Chinese ODI (H6). One interpretation is that policy changes encouraged local government authorities to support 'their' enterprises to invest abroad.

Table 7.3: Results for determinants of Chinese ODI in Model One (SAFE data)

		All countries 1984-2001 (1)	All countries 1984-91 (2)	All countries 1992-01 (3)	OECD 1984-2001 (4)	Non-OECD 1984-2001 (5)
H1a	Log GDP (<i>LGDP</i>)	0.3448 (0.1640)**	0.5085 (0.2787)*	0.2448 (0.2009)	0.6674 (0.3650)*	0.3472 (0.2238)
H2	Log Ore/Min (<i>LORE</i>)	0.1447 (0.1057)	0.1039 (0.1654)	0.2253 (0.1206)*	-0.0138 (0.3906)	0.1820 (0.1144)
H3	Log Patents (<i>LPATENT</i>)	-0.0363 (0.0359)	0.0794 (0.0605)	-0.0516 (0.0439)	-0.0752 (0.0773)	-0.0262 (0.0447)
H4	Country risk (<i>LRISK</i>)	-1.7997 (0.6974)**	-0.7347 (1.0846)	-2.6308 (0.9750)***	-1.8973 (1.8807)	-1.4560 (0.8903)
H5	Cultural proxy (<i>CP</i>)	1.4929 (0.4276)***	1.4520 (0.6059)**	1.5338 (0.4634)***	2.0464 (0.8415)**	0.8414 (0.6563)
H6	Policy dummy (<i>TD92</i>)	0.6961 (0.2534)***	---	0.8033 (0.3002)***	0.9489 (0.3178)***	0.4104 (0.4021)
	Exchange rate (<i>LERATE</i>)	0.0688 (0.0463)	0.1032 (0.0638)	0.0246 (0.0618)	0.2319 (0.1866)	0.0142 (0.0540)
	Log Inflation (<i>LINF</i>)	0.1891 (0.0734)**	0.4664 (0.1167)***	0.1323 (0.0896)	0.3487 (0.1579)**	0.1320 (0.0914)
	Log CHNs exp (<i>LEXP</i>)	0.6153 (0.1291)***	0.2731 (0.2094)	0.8275 (0.1803)***	0.4062 (0.2053)**	0.8375 (0.1964)***
	Log CHNs imp (<i>LIMP</i>)	-0.2544 (0.1027)**	-0.3087 (0.2061)	-0.3098 (0.1204)**	-0.1914 (0.1898)	-0.3677 (0.1374)***
	Log Distance (<i>LDIS</i>)	0.1554 (0.2972)	-0.9266 (0.4794)*	0.2885 (0.3400)	0.7452 (0.7360)	0.0171 (0.4259)
	Log Inward FDI (<i>LINFDI</i>)	0.0510 (0.1244)	0.3294 (0.1562)**	-0.0589 (0.0439)	-0.1181 (0.2480)	0.1218 (0.1546)
	<i>N</i>	402	116	286	198	204
	LM Test	$\chi^2(1) = 15.43$ ***				
	Adjusted R ²	0.6019	0.6142	0.6024	0.5763	0.6737

Notes: (1) Standard errors are in parentheses.

(2) ***, ** and * indicate that the coefficient is significant at the 1%, 5% and 10% levels, respectively.

Contrary to expectations, the country risk variable (*LRISK*) is negatively associated with Chinese ODI. The variable *LRISK* is constructed in such a way that higher values indicate lower country risk. Our finding therefore suggests that Chinese ODI tend to be associated with risky countries. In other words, a 1 per cent decrease in host country risk is associated with a decrease in Chinese ODI of 1.8 per cent. This finding does not support H4. As the model specification controls for market returns by including *LGDP*, the finding suggests that the international investment behaviour of Chinese firms differs from industrialised country investors. Although the perverse investment behaviour of Chinese firms is not supported by earlier research on country risk and ODI from industrialised countries (e.g. Biswas, 2002), it reflects the theoretical framework put forward in Chapter 4. The institutional framework in China creates market imperfections, not at least regarding the domestic capital market, which

may induce such kind of behaviour as the perception of risk or on the risk-adjusted return deviates from Western perceptions (Ruefli *et al.*, 1999). There are a number of reasons why Chinese firms may not behave in the conventional manner. First, Chinese state-owned firms may not act to maximise profits, but rather to satisfy a somewhat more political agenda which could be influenced by domestic institutional elements (Boisot and Child, 1988) (see Sections 3.3.1, 3.4.6, and 4.2.1). Second, Chinese ODI is increasingly destined to developing countries which generally rank high in respect to country risk (Cosset *et al.*, 1992) (see Tables 3.3 and 3.5). Much of this investment may have been promoted by political affiliations and connections between China and the developing host country government concerned (see Sections 3.3.5 and 3.4.6). Third, the home country embeddedness of Chinese firms may provide them with firm-specific advantages and enable them to invest in a riskier environment (Costin and Herken, 2006) that enable them to attenuate the risk associated with operating in a similar host country environment (see Section 2.2.8). Fourth, Chinese firms may be prepared to invest in countries generally avoided by industrialised country firms because of ethical or political reasons and a civil society which watches over them (see Sections 3.4.6 and 4.2.1). Fifth, it should be noted that the relative inexperience of some Chinese firms concerning the establishment and management of large-scale operations abroad may have led to FDI projects being undertaken with insufficient due diligence and attention to associated risks (Wong and Chan, 2003; Ma and Andrews-Speed, 2006). Accordingly Mr Bo Xilai, China's Minister of Commerce, has stated that Chinese firms should evaluate investment risks more carefully before undertaking ODI (MOFCOM, 2006d). This view is supported by the interview findings reported in Section 6.1. Finally, Cai (2006) makes the point that Chinese firms invest in riskier developing countries because (i) the Chinese government explicitly supports investments in such countries and (ii) Chinese companies try to avoid competition with industrialised country MNEs.

It is important to point out that the finding for *LRISK* could indicate that common country risk measurements may not appropriately reflect risk perceptions of developing country companies. The ICRG index used here as well as other indices such as the Business Environment Risk Intelligence (BERI) and Freedom House, are typically designed and calculated to advise industrialised country firms in their international investment decisions. Developing country firms, however, are embedded in a particular institutional framework. This means that they may not perceive risk in the same way as do industrialised country firms. This suggests that familiar country risk indices may have to be recalculated and adjusted to capture the behaviour of developing country firms.

The coefficients for the main variables for asset-seeking (*LPATENT*) and natural resource-seeking FDI (*LORE*) show no significance. Thus, the Hypothesis 2 and 3 are not supported.

This lack of significance suggests that Chinese firms have neither been motivated to acquire strategic intellectual capital assets nor natural resources over the time period under investigation.

Findings for the structural break in 1992 and all countries

In order to investigate whether or not the determinants of Chinese ODI have changed over time (*RQ6*), the data is divided into two time periods around 1992. The results are shown in Table 7.3. The results indicate that different locational determinants and motivations apply over time as proposed by Buckley *et al.* (2006). Absolute market size (*LGDP*) and cultural proximity (*CP*) were important determinants of Chinese ODI for the period prior to 1992 but in the post-1992 period natural resource endowment (*LORE*), cultural proximity (*CP*), and policy liberalisation (*TD92*) are positively associated instead. As in the equation for the full sample, country risk (*LRISK*) is found to be significant but with the wrong sign and for the latter period only.

These findings are mainly in agreement with the earlier discussion (see Section 6.2) that there has been a significant change in the foreign investment behaviour of Chinese enterprises over time and that this is at least partly due to the variable policy regime, as suggested by our finding for the policy liberalisation variable (*TD92*) which indicates a surge in ODI for the year 1992. Arguably, this provides further substantiation for the notion that institutional factors have influenced patterns of Chinese ODI. It is found that, over the period under study, Chinese firms have moved away from undertaking mainly market seeking strategies in nearby foreign markets towards the securing of raw materials in riskier markets. These findings reinforce the view that the securing of natural resources has become an imperative in more recent years, in line with Chinese domestic growth and increasing demand, and that this investment has been directed to countries with higher levels of country risk.

The highly significant and positive coefficient for cultural proximity (*CP*) in both time periods supports hypothesis H5 that familiarity between populations is important in the flow of Chinese FDI. The facilitating role of the Overseas Chinese persists throughout the period under study, as expected, and suggests that relational assets indeed constitute an ownership advantage for Chinese firms when they invest in countries with a significant Chinese population. This confirms a major element of the Chinese ODIR advanced in Figure 4.1.

Findings for the full time period split by OECD and non-OECD countries

Theory suggests that home country market imperfections can exert a significant impact on the decisions of foreign investors (see Section 4.2). It follows that Chinese government policy may have led to a distinctive pattern of ODI by host country type. Here, this is tested for developed and developing countries by comparing results for the sub-samples of OECD and non-OECD member countries in Table 7.3. Market size (*LGDP*) is found to be a significant determinant of Chinese ODI within the group of OECD countries, suggesting that Chinese investment is preferentially destined to larger markets. This is a conventional result, and captures the part of Chinese ODI that is market seeking. Also significant is the cultural proximity variable (*CP*). This variable appears to be capturing the tendency for Chinese firms to invest in OECD countries where a sizeable population of ethnic Chinese can be found. The significant and correctly signed policy liberalisation variable for OECD countries only (*TD92*) yields insight into the relatively undeveloped state of the FDI decision process by Chinese investors. The policy change in 1992 is associated with a large increase in FDI to the developed world. This implies that the decision to invest was previously tightly circumscribed by government, and this may be the reason why a full and conventional pattern of significance is not observed. However, the pattern of investment flows to the developed economies fits with Chinese government priorities during liberalisation (see Section 3.3.5).

One of the most compelling earlier findings, that the main variable country risk (*LRISK*) is significant and signed contrary to expectation, is lost in both equations. From this, it is inferred that, while Chinese ODI is associated with higher levels of host country risk, the difference in risk in the data is primarily that between developed and developing countries, rather than within these two country groupings. The apparent preference for less-developed and risky host countries as against developed hosts is consistent with the argument concerning lower cost of capital enjoyed by state-owned enterprises, as well as with the relatively unsophisticated country risk evaluation processes of Chinese investors (see Sections 4.2.1 and 6.2.3). This result supports the theoretical contention that domestic capital market imperfections in China have been crucial to ODI over the time period in question as advanced in the Chinese ODIR.

7.2 Model Two: International institutional factors and international network effects – An analysis of MOFCOM data

The second cross-sectional analysis of Chinese ODI in Model Two focuses predominantly on the effects of international institutional factors, namely the effects of bilateral agreements and membership to the WTO, and international networks to host countries as advanced in the Chinese ODIR framework shown in Chapter 4.⁴⁸ The instigation of the ‘Go Global’ policy in 1999 is again incorporated and a domestic policy variable is introduced to capture changes in the Chinese foreign exchange regime in 1994. Model Two also incorporates the international investment strategy framework of Dunning (1993) (see Section 2.3.3). Hypotheses related to ‘traditional’ drivers of international production are presented first, followed by the hypotheses related to ‘new’, institutional drivers. Model Two is necessary because, first, the SAFE data ends in 2001 and therefore do not capture the recent increase in Chinese ODI (see Figure 1.1). Second, it has been shown in Section 5.3 that MOFCOM and SAFE collect and report somewhat different data on Chinese ODI. Employing MOFCOM data helps to identify determinants of Chinese ODI over a long time period to be evaluated. This triangulation improves the reliability of the findings for the research as a whole.

7.2.1 Operationalisation of Model Two

Hypotheses

Market-seeking FDI

Contrary to Model One of Section 7.1, Model Two takes a developing country MNE stance on market-seeking activities. Developing country firms generally tend to invest in other developing countries or in less developed countries (Lecraw, 1993; Wells, 1983). In both situations, the investing firm is argued to have firm-specific advantages which would not exist or are less pronounced if the firm is to invest in a more advanced country than the home country. Contrary to what is proposed under Hypothesis 1 of Model One, developing country firms here are predicted to invest in countries with a small relative and absolute market size in terms of GDP/capita and GDP. China is a developing country and the investment behaviour pattern of Chinese companies may be similar to that of other developing countries. It hence follows that:

⁴⁸ Section 6.2 is based on Buckley *et al.* (2007b).

Hypothesis 7: The relative market size of a host country is negatively associated with Chinese ODI flows.

Resource-seeking FDI

FDI is often driven to access locally-bound resources such as oil and gas (see Section 2.3). China lacks sufficient oil and gas resources and has become a major importer of these commodities since the mid-1990s (Ma and Andrew-Speed, 2006; Naughton, 2007). These resources are not only important energy sources but also crucial input in other industries such as chemical and plastic industries. Chinese firms can either satisfy their demand through purchases on the international market or internalise the market through FDI in order to minimise price and supply volatility. The latter is favoured by the Chinese government and involved government authorities (as shown in Sections 3.3.4 and 3.3.5). It therefore follows that:

Hypothesis 8: The level of natural resources endowments of a host country is associated positively with Chinese ODI flows.

Asset-seeking FDI

The rationale for the inclusion and application for the number of patents granted in the host country as a proxy for host country technology related capabilities follows the justification in Model One for Hypothesis 3. Thus:

Hypothesis 9: The number of granted patents in a host country is positively associated with Chinese ODI flows.

Domestic policy liberalisation

The Chinese ODIR framework advanced in Figure 4.1 identifies domestic policies as an important driver of ODI by Chinese companies. The assessment of the source of hard currency has usually been the first step in the Chinese outward investment approval process. The liberalisation of the foreign exchange regime in 1994 made it easier for Chinese firms to generate hard currency income. This could have led to more Chinese firms considering to use their fund to invest internationally, hence:

Hypothesis 10: China's outward FDI flow is positively associated with liberalization of foreign exchange controls in 1994.

Bilateral investment treaties

BITs are generally designed to protect the investor in a host country and to promote FDI to the host country. Following the discussion in Section 4.2.2, such an agreement between two countries may therefore be associated with increasing bilateral direct investment flows. China is currently the second largest signatory of BITs after Germany (UNCTAD 2006, 2005b). This may indicate that the Chinese government has recognised the role that BITs can play in supporting Chinese investors and increasing Chinese ODI. Anecdotal evidence suggests that a BIT concluded by China with a host country is followed by an increase in Chinese ODI in that country. In particular Chinese ODI in Thailand is said to have increased steeply after the conclusion of a BIT (Frost, 2005). As discussed in Section 4.2.2, an indirect effect of BITs may derive from a positive signalling effect to third country investors. The BIT concluding countries acknowledge that they consider a stable and predictable business environment and enforceable rights for foreign investors as being important. Such a statement may be regarded by third country investors as equally important as a bilateral agreement between the firm's home country and another country. Therefore, two hypotheses follow:

Hypothesis 11a: A host country's propensity to attract Chinese ODI flows is positively associated with the conclusion of a BIT with China.

Hypothesis 11b: A host country's propensity to attract Chinese ODI flows is positively associated with the total number of BITs it has concluded.

Double taxation treaties

As was shown in Section 4.2.2, DTTs are generally designed to regulate the taxation of foreign investors in the home and host country. A DTT normally attenuates the double-taxation and possibilities of tax avoidance of foreign investors. China has signed a number of DTTs during the 1990s and has become an important signatory of DTTs (UNCTAD, 2005b). DTTs may have a similar signalling effect to third country investors as do BITs. The DTT concluding countries acknowledge that they consider a predictable taxation policy as important for businesses. Such an avowal may be regarded by third country investors as important as a bilateral agreement between the firm's home country and another country. Therefore, two hypotheses follow:

Hypothesis 12a: A host country's propensity to attract Chinese ODI flows is positively associated with the conclusion of a DTT with China.

Hypothesis 12b: A host country's propensity to attract Chinese ODI flows is positively associated with the total number of DTTs it has concluded.

WTO membership

A further formal exogenous element of the Chinese ODIR (see Figure 4.1) is the WTO membership status (*WTO*) of a host country. The membership of the WTO (and formerly to GATT) may (in a similar way to BITs and DTTs), signal to foreign investors that the host country will conform to its strictures and obligations with respect to international trade and investment. This avowal is stressed by the fact the WTO governs much of the framework for international trade through, for example, the agreement on Trade-Related Intellectual Property Rights and on Trade-Related Investment Measures. These agreements, and hence the WTO, govern issues related to equal treatment of domestic and foreign firms, trade dispute resolution, market access, reductions in preferential trading arrangements and so forth. The WTO thus constitutes an important formal exogenous element of the institutional framework within which (Chinese) MNEs operate. Hence:

Hypothesis 13: Countries that are members of the WTO attract higher Chinese ODI flows.

Cultural proximity

The cultural proximity (*CP*) proxy in this econometric model is taken from the former analysis of Chinese ODI. A larger share of Overseas Chinese in the host country's total population may attenuate transaction costs for mainland Chinese firms and thus make it easier for them to connect and cooperate with local businesses in the host market. This is in line with discussions presented in Sections 4.2.3. Thus:

Hypothesis 14: China's ODI is positively associated with a greater the proportion of ethnic Chinese people in a host country's population.

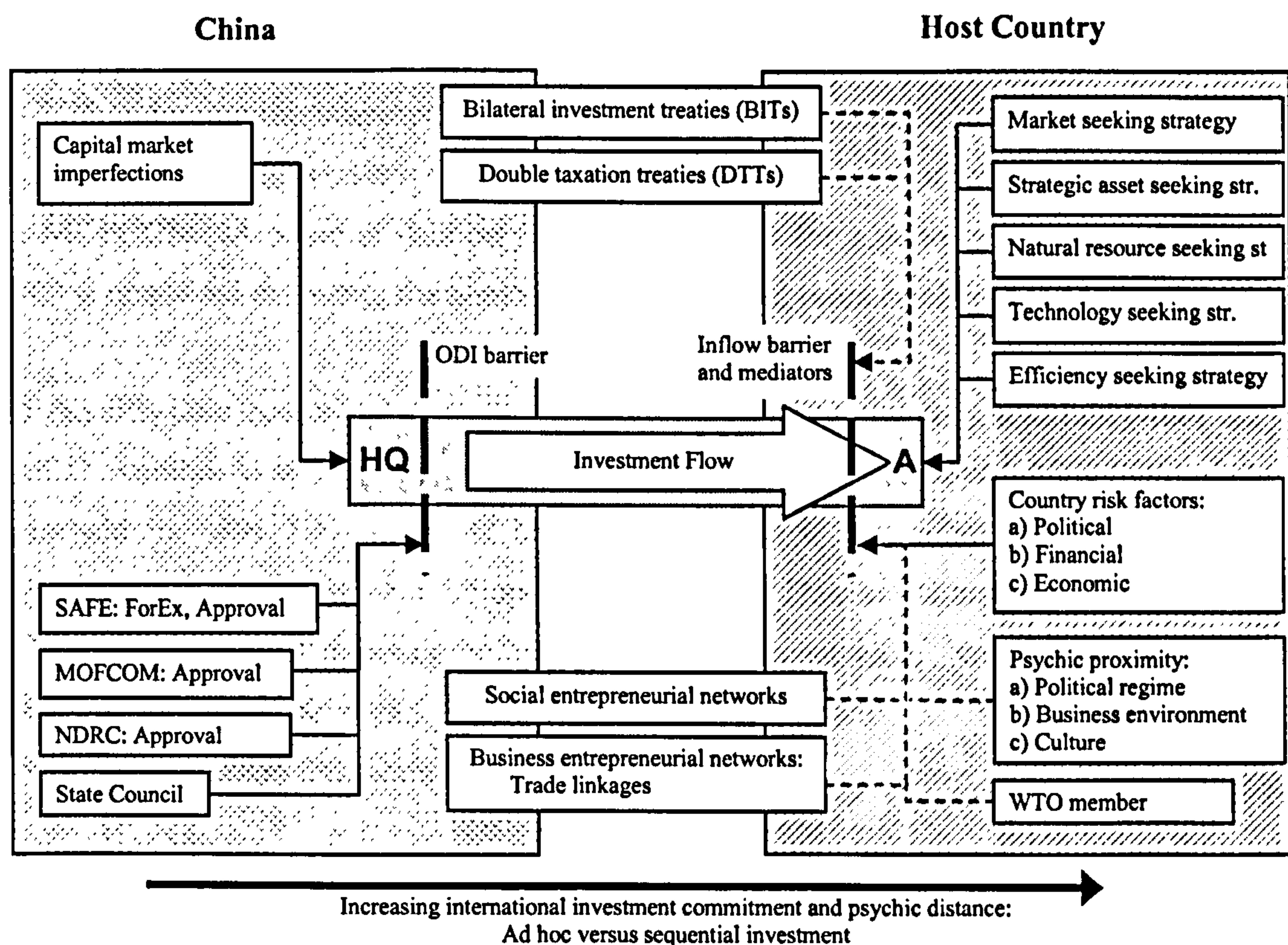
Geographical distance

Geographic distance (*LDIS*) is included as an exogenous element in the Chinese ODIR and, hence, in Model Two. Increasing geographical distance between host and home market raises the transaction costs when the business is conducted at arm's length. FDI becomes therefore more cost-efficient with greater geographical distance (see Section 2.3 for a discussion).

Hypothesis 15: Geographic distance of the host country's capital from Beijing is positively associated with Chinese ODI flow.

Model Two also incorporates a number of control variables similar to the ones employed in Model One. The control variables for this model are the level of host country risk as measured by the PRC Group in its ICRG index (*LRISK*), power purchasing parity (*LPPP*), the official exchange rate of a country (*LERATE*), the annual inflation rate in the host country (*LINF*), China's exports to the host country (*LEXP*) and imports from the host country (*LIMP*) and the openness of the host country to inward FDI (*LINF**FD*). The data sources for both main and control variable are presented in Section 5.3. Figure 7.2 depicts Model Two.

Figure 7.2: The Chinese ODIR – Supranational institutions (Model Two)



- Notes: (1) Broken arrows (---) indicate mediating (indirect) effects;
 Solid arrows (—) indicate direct effects.
- (2) 'ForEx' stands for Foreign Exchange;
- (3) 'A' denotes the affiliate of the investing firms in the host country; and
- (4) 'HQ' the headquarters of the investing firm in the home country, in this case China.

Source: Adapted from Figure 4.1.

Model and method

The above discussion suggest that a well-specified model for the explanation of Chinese ODI with respect to the effect of international institutions and the variables derived from theory can be constructed as follows (EQ2):

$$\begin{aligned} LFDI = & \alpha + \beta_1 LGDPPC + \beta_2 LOIL + \beta_3 LPATENT + \beta_4 TD94 + \beta_5 BIT + \beta_6 LACBIT \quad (EQ2) \\ & + \beta_7 DTT + \beta_8 LACDTT + \beta_9 WTO + \beta_{10} CP + \beta_{11} LDIS + \beta_{12} LRISK + \\ & \beta_{13} LPPP + \beta_{14} LERATE + \beta_{15} LINF + \beta_{16} LEXP + \beta_{17} LIMP + \beta_{18} LINFDI + \\ & \epsilon_{it} \end{aligned}$$

In EQ2 α denotes the intercept, β stands for unknown parameter of interest and ϵ for the error term. The dependent variable (*LFDI*) is the total annual amount of ODI approved and reported by MOFCOM. A panel of data on fifty-five countries for a period of 13 years from 1991 to 2003 is employed extending the number of countries and years compared to Model One.

Of the fifty-five countries twenty-two are OECD member countries and thirty-four are non-OECD member countries. A descriptive analysis of the employed MOFCOM dataset is presented in Table 7.4. It should be noted here that it is possible that the high mean for Denmark with respect to other European countries and Denmark's history as a host for inward FDI is based on false reporting by MOFCOM for a recent year. No other sources, including business and financial press, could support the reporting of a USD 350 million Chinese investment project in Denmark.

The equation (EQ2) was analysed using POLS and one way RE estimators. A fixed effects estimator cannot be used since this equation includes dummy variables which are invariant with respect to time for the country concerned. A LM test was conducted for each sample under investigation to identify whether POLS or RE furnished the better model. The LM test values were significantly different from zero in five of nine cases indicating that RE estimators is preferred in these cases. Table 7.6 presents the results and shows if either POLS or RE results are chosen and are hence discussed in the next section. The hypothesized effect of the instigation of the 'Go Global' policy at the beginning of Phase 4 of Chinese ODI in 1999 is addressed by allowing for a structural break. Possible changes in the determinants of Chinese ODI by level of economic development of the host country are also explored by splitting the sample by OECD and non-OECD membership status. The correlation matrix (Table 7.5) indicates no major problem of collinearity in the dataset.

Table 7.4: Descriptive analysis of Chinese ODI to OECD and non-OECD countries in Model Two based on MOFCOM data, 1991 to 2003

OECD country	Mean	St. Dev.	Non-OECD country	Mean	St. Dev.
Australia	11.44	22.04	Algeria	0.34	0.63
Austria	0.19	0.37	Argentina	1.04	1.21
Canada	27.51	75.48	Armenia	0.02	0.07
Czech Republic	0.37	0.74	Brazil	9.83	13.49
Denmark	27.31	98.38	Bulgaria	0.27	0.57
Finland	0.27	0.91	Chile	0.31	1.35
France	1.96	5.16	Colombia	0.67	2.02
Germany	4.65	6.48	Croatia	0.03	0.12
Greece	0.02	0.06	Cyprus	0.00	0.00
Hungary	0.87	1.14	Ecuador	0.11	0.18
Italy	1.82	3.21	Egypt	4.81	6.48
Japan	7.41	20.76	Ghana	1.17	2.12
Mexico	14.01	29.86	Hong Kong SAR	344.99	1044.83
Netherlands	0.72	1.09	India	1.57	2.88
New Zealand	3.50	10.54	Indonesia	11.56	21.49
Poland	0.21	0.49	Israel	0.12	0.39
Portugal	0.00	0.00	Kenya	1.78	2.00
South Korea	22.99	56.03	Madagascar	1.25	2.50
Spain	0.36	0.71	Malaysia	2.13	1.98
Sweden	0.25	0.50	Mongolia	5.60	11.51
United Kingdom	1.84	3.16	Morocco	0.56	1.29
United States	50.17	71.52	Nigeria	3.98	4.43
			Pakistan	2.23	3.62
			Peru	0.95	1.02
			Philippines	14.29	33.61
			Romania	1.67	2.69
			Russia	29.62	66.00
			Singapore	7.08	12.33
			South Africa	9.31	8.76
			Sudan	1.76	3.26
			Tanzania	3.30	4.87
			Thailand	17.91	36.65
			Ukraine	0.61	1.13
			Venezuela	1.59	4.36
OECD countries	8.08	29.32	Non-OECD countries	14.19	178.38

Source: Calculated from MOFCOM (1990-2003).

Note: Means and standard deviations of Chinese ODI flow are calculated on the annual data published by MOFCOM, after transformation into constant (year 2000) USD million.

Table 7.5: Correlation matrix of Model Two

	LFDI	LGDP	LOIL	LPATENT	BIT	LACBIT	DTT	LACDTT	WTO	CP	LDIS	LRISK	PPP	LERATE	LINF	LEXP	LIMP	LINFDI
LFDI	1.0000																	
LGDP	.0129	1.0000																
LOIL	.2051	.1357	1.0000															
LPATENT	.0531	.5580	.0908	1.0000														
BIT	-.0950	.1426	-.1025	.0914	1.0000													
LACBIT	.0420	.2614	.0950	.2305	.5727	1.0000												
DTT	.0793	.4648	-.0085	.4540	.3325	.4506	1.0000											
LACDTT	.1296	.4331	.2265	.4421	.3749	.6622	.6639	1.0000										
WTO	-.0792	-.3255	.0557	-.0790	.0502	-.1057	-.0746	-.1619	1.0000									
CP	.3521	.2073	.1931	.0627	-.0583	-.0759	.1728	.1396	-.1626	1.0000								
LDIS	-.1443	-.0545	.2630	-.1794	-.2172	-.1057	-.2849	-.2542	.0041	-.2579	1.0000							
LRISK	-.0044	.7103	-.0459	.4574	.2527	.3757	.4470	.4736	-.4551	.1730	-.0475	1.0000						
PPP	-.0607	-.0812	-.0464	-.0345	.0586	-.0584	-.1131	-.1398	.2234	-.0467	-.0277	-.0620	1.0000					
LERATE	.1016	-.4710	-.0716	-.2618	-.0594	-.0608	-.2534	-.2744	.0005	-.0478	-.1936	-.3546	-.0628	1.0000				
LINF	-.0963	-.1284	-.0947	-.0387	.0005	-.1281	-.1123	-.1829	.2595	-.0713	.0142	-.1184	.8652	-.0901	1.000			
LEXP	.4438	.5221	.1854	.4087	.0986	.3765	.3775	.4803	-.3026	.4096	-.3872	.3959	-.1313	-.1095	-.1838	1.0000		
LIMP	.3809	.5369	.2197	.4603	.1694	.3297	.4213	.4477	-.2019	.4125	-.3076	.3995	-.0183	-.2047	-.0417	.8064	1.0000	
LINFDI	.1805	.2299	.1619	-.1321	.0418	.2737	.0860	.1180	-.3490	.3698	.1627	.3090	-.2360	-.0481	-.2890	.2517	.0950	1.0000

Note: The policy time dummy 'TD94' is excluded from the correlation matrix.

7.2.2 Results and discussion of Model Two

The discussion is structured as follows: First, the results for the full time period under investigation and all countries (1991-2003) are discussed (Table 7.6). Second, the findings for several sub-samples are compared and discussed: (i) The above discussions and results in Section 7.1 suggest that Chinese ODI might be influenced by a changing national institutional framework over time. This is considered by comparing the results for the full country sample for the two periods 1991 to 1998 and 1999 to 2003. To identify (ii) the influence of the level of economic development of the host country on Chinese ODI, results depending on OECD membership status of the host country (member versus non-member), are discussed separately. (iii) The above mentioned time break in 1999 is re-applied to both country sub-samples and the findings compared.

Findings for the full time period and all countries

For the full time period the variables relative market size (*LGDP*), WTO membership status of the host country (*WTO*), and cultural proximity (*CP*) have significance with the expected sign. Thus, Hypotheses H7, H13 and H14 are supported. The policy dummy (*TD94*) is significant though signed contrary to expectation and thus H10 is not supported. The variables testing the other hypotheses do not obtain significance for the full time period.

Concerning the traditional determinants of FDI, the results indicate that Chinese MNEs preferentially direct their investment to developing countries as a body of literature on developing country MNE proposes (e.g. Lall, 1983; Lecraw, 1977; Monkiewicz, 1986; Lecraw, 1993). One interpretation is that market-seeking Chinese firms seek investment opportunities in countries that are at a similar stage of development and institutional environment to China and where they enjoy a competitive advantage over local and foreign firms. The competitive advantage may derive from the firms' ability to combine and adopt technologies to local conditions and a reflection of home country embeddedness (see Section 2.2.8).

Formal and informal exogenous elements of the Chinese ODIR are partially found to influence the decision-making of Chinese firms. Of the formal element, host country membership of the WTO is found to be positively associated with greater inflows of Chinese ODI (confirming H13). This is attributed in part to the locational advantages derived from compliance of the host country to international trade and investment rules and frameworks that are attractive to Chinese MNEs. Market-seeking Chinese firms that engage in export-platform FDI to serve third

markets may also benefit from tariff reductions and GATT-imposed trade regimes by investing in a WTO member state. Some support is also established for the role played by the informal exogenous element of the Chinese ODIR: the existence of international business and social networks (cf. 'guanxi relationships') which is proxied by cultural proximity (*CP*). The presence of an appreciable Chinese population in a host country is positively associated to inbound Chinese ODI flows perhaps because such networks provide Chinese firms with wider networking possibilities. This finding suggests strongly that relational assets are important to the internationalization of Chinese firms. This finding is robust and supports the earlier findings on *CP* in Section 7.1 where a different dataset for the dependent variable was employed. Given that Chinese MNEs in the period under study were almost entirely state-owned, this finding might be regarded as surprising. However, it is clear from this and other studies (e.g. Erdener and Shapiro 2005; Dunning 2002; Costin and Herker, 2006) that relational assets are an enduring source of competitive advantage for Chinese firms irrespective of ownership type.

The time dummy for the measure of the formal endogenous element of the Chinese ODIR, namely the relaxation of foreign currency controls in 1994 (*TD94*), is statistically significant but with a sign contrary to expectation. Thus, H10 is not supported. Chinese ODI is found to be negatively associated with the liberalization of foreign exchange controls in 1994. This result is surprising but may provide some evidence of an idiosyncratic approach to decision-taking on international business matters by Chinese MNEs. As discussed in Section 7.1, Chinese MNEs seem to have a perverse attitude towards risk (by comparison to industrialised country firms) in that they reveal a propensity to invest in higher risk countries (as measured using a country risk index developed in industrialised countries) (Buckley *et al.*, 2007a). This phenomenon is argued to be related to domestic capital market imperfections enjoyed by Chinese MNEs (see Section 4.2.1). In line with this argument, one interpretation for the negative association of Chinese ODI and the 1994 foreign exchange liberalization is that the policy change created market imperfections which gave Chinese firms greater access to hard currencies from domestic sources and reduced their need to invest abroad to retain earnings in hard currency (Tan, 1999). Nevertheless, it is revealed in Model Two that endogenous institutional factors do seem to have had a determinant effect on FDI outflow from China.

Table 7.6: Results of determinants of Chinese ODI in Model Two (MOFCOM data)

Estimation technique	All Host Countries				OECD Host Countries only				Non-OECD Host Countries only				
	RE	RE	RE	RE	OLS	OLS	OLS	OLS	OLS	OLS	OLS	OLS	RE
	1991-2003 (1)	1991-1998 (2)	1999-2003 (3)	1991-2003 (4)	1991-2003 (5)	1991-1998 (6)	1991-2003 (7)	1991-2003 (8)	1991-2003 (9)				
H7 Log GDP per capita (<i>LGDP</i>)	-1.409 (0.425)***	-1.426 (0.479)***	-1.794 (0.631)***	-0.773 (0.675)	-0.942 (0.904)	0.234 (1.146)	-1.696 (0.338)***	-1.527 (0.429)***	-2.079 (0.922)**				
H8 Log Crude Oil/NLG Export (<i>LOIL</i>)	0.044 (0.090)	0.038 (0.112)	0.238 (0.142)*	0.166 (0.120)	-0.136 (0.159)	0.360 (0.208)*	0.243 (0.080)	-0.173 (0.103)	0.193 (0.211)				
H9 Log Patent (<i>LPATENT</i>)	-0.065 (0.093)	-0.017 (0.124)	0.013 (0.140)	0.248 (0.189)	0.468 (0.247)*	0.145 (0.325)	-0.171 (0.103)*	-0.135 (0.141)	-0.768 (0.153)				
H10 Policy time dummy 1994 (<i>TD94</i>)	-2.852 (0.671)***	-2.999 (0.689)***	..	-3.835 (1.002)***	-4.959 (1.057)***	..	-0.650 (0.908)	-0.900 (0.969)	..				
H11a Bilateral investment treaty with China (<i>BIT</i>)	-1.064 (0.814)	-1.025 (0.964)	-1.046 (1.437)	-2.254 (1.533)	-2.326 (1.732)	-1.464 (3.790)	-0.526 (0.892)	-1.009 (1.163)	0.380 (1.846)				
H11b Log Accumulated BITs (<i>LACBIT</i>)	0.021 (0.460)	-0.335 (0.511)	-0.968 (1.027)	-0.341 (0.655)	-1.307 (0.738)*	2.769 (1.821)	-0.465 (0.530)	-0.263 (0.648)	-2.525 (1.560)				
H12a Double taxation treaty with China (<i>DTT</i>)	0.894 (0.836)	1.420 (1.039)	-0.300 (1.504)	0.924 (1.762)	-0.242 (2.054)	1.598 (4.258)	0.958 (0.788)	0.758 (1.007)	-0.771 (1.764)				
H12b Log Accumulated DTTs (<i>LACDTT</i>)	0.416 (0.474)	0.313 (0.572)	0.471 (0.805)	-1.966 (1.431)	-0.724 (1.628)	-4.874 (3.714)	0.470 (0.400)	0.430 (0.517)	1.366 (1.013)				
H13 WTO/GATT membership (<i>WTO</i>)	2.042 (1.234)*	2.109 (1.448)	0.626 (2.067)	-1.313 (4.166)	1.049 (4.307)	..	0.893 (0.950)	0.451 (1.236)	0.782 (2.314)				
H14 Cultural Proximity (<i>CP</i>)	2.258 (1.268)*	4.219 (1.510)***	0.522 (1.812)	1.430 (1.318)	0.711 (1.631)	3.651 (2.863)	1.084 (1.465)	5.000 (1.942)**	-3.369 (3.591)				
H15 Log Geographic Distance (<i>LDIS</i>)	1.473 (0.899)	1.748 (1.038)*	-0.037 (1.281)	1.047 (1.578)	0.619 (2.099)	1.968 (2.966)	1.254 (0.920)	2.423 (1.117)*	-0.791 (2.422)				
Log Country risk (<i>LRISK</i>)	-0.163 (2.034)	2.283 (2.443)	0.078 (4.063)	-1.035 (5.939)	12.143 (8.295)	-8.685 (11.338)	0.735 (1.922)	0.450 (2.257)	4.868 (5.041)				
Log PPP (<i>LPPP</i>)	0.003 (0.002)	0.002 (0.002)	0.002 (0.013)	0.094 (0.027)***	0.039 (0.035)	0.175 (0.053)***	0.228 (0.002)	0.003 (0.002)	-0.009 (0.012)				
Log Exchange Rate (<i>LERATE</i>)	0.453 (0.163)***	0.421 (0.190)**	0.147 (0.244)	0.604 (0.326)*	0.528 (0.443)	0.487 (0.612)	0.057 (0.125)	-0.056 (0.172)	0.214 (0.322)				
Log Inflation	-0.002	-0.002	-0.005	0.071	0.166	0.287	-0.181	-0.002	-0.023				

(LINF)	(0.001)*	(0.001)*	(0.046)	(0.062)	(0.080)**	(0.292)	(0.001)	(0.001)	(0.042)
Log China's Exports (LEXP)	1.551 (0.295)***	1.380 (0.345)***	2.030 (0.540)***	1.758 (0.497)***	1.855 (0.611)***	0.671 (0.979)	1.652 (0.285)***	1.484 (0.338)***	1.965 (0.632)***
Log China's Imports (LIMP)	0.506 (0.184)***	0.341 (0.227)	0.192 (0.344)	0.941 (0.442)**	0.924 (0.611)	1.481 (0.759)**	0.426 (0.183)**	0.333 (0.232)	0.421 (0.394)
Log Inward FDI (LINFDI)	0.984 (0.355)***	0.441 (0.466)	0.342 (0.752)	1.903 (0.598)***	2.791 (0.825)***	-0.564 (1.503)	0.755 (0.383)**	0.136 (0.499)	0.935 (1.222)
Number of cases	715	440	275	286	176	110	429	264	165
Lagrange Multiplier Test	40.97***	16.59***	6.59**	n.s.	n.s.	5.76 **	n.s.	n.s.	3.16 *

Notes: (1) Standard errors are in parentheses; n.s. = not significant; .. indicates that the variable was not included in that specific model.

(2) ***, ** and * indicate that the coefficient is significant at the 1%, 5% and 10% levels, respectively.

Of the remaining main variables, no significant relationship with Chinese ODI is found. Traditional variables proxying FDI motivation, such as host country's exports of oil and NLG (*LOIL*) and patents granted (*LPATENT*), and variables proxying exogenous institutions, such as the conclusion of a BIT or a DTT with China (*BIT* and *DTT*, respectively) or the signalling effect of total BITs and DTTs concluded by a country (*LACBIT* and *LACDTT*, respectively) and geographic distance from Beijing, all fail to gain statistical significance. Thus, Hypotheses H8, H9, H11a, H11b, H12a, H12b and H15 are not supported.

With respect to the FDI motivations of Chinese firms, no evidence is found to support either natural-resources seeking or asset-seeking behaviour by Chinese MNEs. The finding that the proxy for natural-resources FDI is not significant offers support to the contention held by Ma and Andrew-Speed (2006) that the internationalization of Chinese national oil companies (NOCs) was at an infancy stage in the mid-1990s and were only recently pushed to 'Go Global' (Meidan, 2006). Although there is anecdotal support for the empirical finding, it contrasts to that of Buckley *et al.* (2006, 2007a) and the earlier findings presented in Section 7.1. There, a positive association for resource endowments with Chinese ODI is found the period 1992 to 2001. This finding is supported by Cross *et al.* (2007) for Chinese ODI to developed countries. The different findings are most probably caused by new natural resource endowment proxy employed in the current study, i.e. *LOIL* instead of *LORE*, and different data source for the dependent variable, that is MOFCOM data instead of SAFE data.

The lack of significance for strategic-asset seeking FDI concurs with the finding of Buckley *et al.* (2007a). It supports the view that Chinese MNEs have only recently begun their international quest for improved access to foreign-held knowledge, technology and skills and that the internationalisation of R&D by Chinese firms is small in number and scale (see also Buckley *et al.*, 2006; von Zedtwitz, 2005).

In respect to the Chinese ODIR-related variables, no evidence is found to support the view that formal supranational agreements have influenced the volume and direction of Chinese ODI. Of itself, this does not necessarily discount the fact that the institutional regime has an effect, but rather that Chinese firms may have responded to the ODI facilitation characteristics associated with employed exogenous variables in an idiosyncratic way. In other words, Chinese firms may not place much importance on the investment and financial risk-reducing features of international treaties such as BITs and DTTs. There are a number of explanations. The first explanation derives from earlier discussion in Chapter 4 and Section 7.1.2. Domestic capital market imperfections in China may give rise to perverse attitudes towards risk and profit maximization (Buckley *et al.*, 2007a). Hence, Chinese companies enjoying access to cheap

capital in China may disregard the benefits associated with international trade and investment agreements or consider them to be irrelevant. Second, bilateral treaties might be concluded by the Chinese government as a sign of friendship and political support for host countries in question, but do little to attract Chinese MNEs (Buckley *et al.*, 2007b). Third, the proxies employed for bilateral treaties measure only the existence of a treaty but lack a qualitative assessment. The proxies may therefore fail to account for the direction of impact of each treaty as countries with higher bargaining power may impose a treaty which secures unilateral investment protection rights and enforcement. It could therefore be the case that some of the bilateral treaties concluded by China provide greater access and protection of foreign investments in China than of Chinese ODI elsewhere.

Finally, the finding for geographic distance is also not significant for the full country sample and the full time period. Again, this is in contrast to the work of Buckley *et al.* (2007a, 2007b) who report a significant and negative association between distance and Chinese ODI volumes.

Findings for the time period 1991 to 1998 and all countries

This section is concerned with the effect of an introduced structural break on these key findings. For the period 1991 to 1998, prior to the instigation of the 'Go Global' policy, no change in the results is found for market-seeking FDI behaviour (H7), the policy time dummy for 1994 (H10) and cultural proximity (H14) after the introduction of the structural break. Thus Hypotheses H1, H4 and H8 are supported for this time period as well. However, the result for WTO membership (H13) is no longer significant. By contrast, geographic distance now attains significance and has a positive coefficient, supporting H15. This finding suggest that some aspects of the internationalization of Chinese firms is predictable by general theory, which asserts that firms substitute FDI for exports when serving more distant markets (Buckley and Casson, 1981) (see Section 2.2.1).

Findings for the time period 1999 to 2003 and all countries

For the second time period (1999 to 2003), a number of differences compared to the findings of the full sample are detectable. In particular, the coefficient for crude oil and natural liquefied gas exports (*LOIL*) of the host country is now significant and with the expected positive sign. This supports H8 in the latter time period. This finding is not surprising as China's national oil companies (NOC) are explicitly encouraged by the Chinese government to expand

internationally to secure access of energy sources (Meidan, 2006) as was described in Section 3.3.5. The significance of this variable for the latter period only lends further weight to the contention of Ma and Andrews-Speed (2006) that the internationalization of China's NOCs accelerated in the late 1990s. In contrast, the measures of cultural proximity (*CP*) and geographic distance (*LDIS*) lose their significance. Viewed together, the findings for cultural proximity across the two sub-periods may reflect growing confidence in the ability of state-owned Chinese MNEs to conduct international business independently of local ethnic and social business networks. However, the advantages of cultural proximity may become significant again in the future, as greater amounts of Chinese FDI are accounted for by private, and non state-owned, Chinese MNEs (MOFCOM, 2004b; CAITEC and WDA, 2005). The finding for geographic distance may reflect a wider spatial distribution of Chinese ODI in more recent years (see also Table 3.5). This might be in response to government policy (Buckley *et al.*, 2006) or to greater influence of market forces and discretionary decision-taking by Chinese MNEs.

Findings for the full time period and split by OCED and non-OECD countries

In order to assess whether or not the level of economic development of the host country influences the investment behaviour of Chinese MNEs, the model was run separately for OECD and non-OECD member countries. Continued support for H7 (relative market size, *LGDP*) is found, but for the non-OECD country sub-sample only. Hypotheses 13 (*WTO*) and H14 (*CP*) are no longer supported when individual country sub-samples are considered. This suggests that there is greater variance for these two variables between rather than within country groupings. The measure used to test H10 (*TD94*) continues to be significant and is negatively signed, but only for the OECD country sub-sample: no support is found for H10 when the non-OECD country sub-sample is examined separately. The variable *LPATENT*, however, attains significance for the non-OECD countries alone, but with a negatively signed coefficient, contrary to expectation for the full sample. *LPATENT* is the proxy that captures strategic-asset seeking behaviour of Chinese MNEs under H9. This finding reveals a propensity for Chinese MNEs to invest in countries with relatively lower technology asset stocks, but only when non-OECD countries are concerned. This may reflect improved competitiveness of Chinese MNEs in such contexts as well as complementarities between their offering and local demand conditions similarly to the ones identified for other developing country MNEs (e.g. Lall, 1983; Lecraw, 1993).

Findings for OECD countries for the two sub-time periods

When re-invoking the structural break for 1999 for the OECD countries alone, the measurement for the resources endowments of the host country (*LOIL*) attains significance for the later but not the earlier sub period, and has the expected positive sign. Thus, evidence is found to support H8 for OECD countries, but only for more recent years. This finding seems to capture the growth in natural resources-seeking behaviour by Chinese MNEs observed in the full sample (Ma and Andrews-Speed, 2006; Meidan, 2006), which is increasingly being directed to the industrialized countries. Similarly, the finding for *LPATENT* in the earlier period (1991 to 1998), which is significant and positively signed (as expected), provides the only support for H9 in Model Two. This finding indicates that Chinese MNEs have been attracted to countries with higher levels of technology stocks, but only when that country is an industrialized country and only in the earlier period of international expansion of Chinese ODI under study. This finding is at odds with some aspects of the received wisdom concerning the internationalization of Chinese firms in the 1990s, which indicates that information-gathering and support of the export process were key drivers for Chinese ODI and that technology-seeking motivations have only become significant in more recent years. Examination of the sub periods for OECD countries only reveals statistical significance of *LACBIT*, one of the measures of the formal exogenous component to the Chinese ODIR, for the period 1991 to 1998. However, the negative sign on the coefficient is contrary to expectation. This finding reveals that Chinese MNEs preferentially invest in OECD countries that have concluded fewer numbers of BIT agreements. One interpretation is that Chinese MNEs are discouraged by the positive signalling effects that a country's conclusion of BITs agreements might have on their decision-taking.

Findings for non-OECD countries for the two sub-time periods

Re-invoking the structural break for 1999 for the non-OECD countries sub-sample, the measures of relative market size (*LGDP*), cultural proximity (*CP*) and geographic distance (*LDIS*) are significant and with the expected sign, as they have been for the full sample. While *LGDP* is significant for both sub-periods, the latter variables gain significance for the period 1991 to 1998 only. This provides partial support for H14 and H15, and therefore for the informal exogenous institutional elements of the Chinese ODIR.

The proxies for natural resources-seeking (H8) and strategic asset-seeking (H9) FDI are not significant and the hypotheses thus not supported. Likewise, the remaining endogenous and exogenous elements of the Chinese ODIR do not achieve significance for the non-OECD

country sub-sample in both sub-periods. The hypotheses H10, H11a, H11b, H12a, H12b, and H13 are therefore not supported for this sub-set.

7.3 Comparison and discussion of econometric Models One and Two

The empirical analyses of Chinese ODI with respect to the institutional framework put forward in Chapter 4 have revealed some interesting findings. As Models One and Two are based on different datasets it is important to compare the findings, relate them to the Chinese ODI framework advanced in Figure 4.1 and to findings with those of other studies. The latter aspect is constrained to studies on other countries as there exists no such empirical study on Chinese ODI.

Concerning the traditional determinants of FDI, both Models One and Two indicate that the market seeking motive is a major driver of Chinese ODI (*RQ2*). Interpretations differ, however. Model One focuses on the absolute market size as a proxy for market seeking FDI and therefore generally on investments in developed countries. The finding is in line with a number of studies on industrialised country ODI (e.g. Clegg and Scott-Green, 1998; Loree and Guisinger, 1995). It rejects the proposition that developing country firms cannot invest in developed countries because of limited firm-specific capabilities (e.g. Hymer, 1960). Model Two employs a relative market size variable to investigate the attraction of Chinese investment to developing countries, to test the proposition of studies by Lecraw (1993) and others. The positive result for both models is probably a consequence of the different time periods under investigation. Model One goes seven years further back in time than does Model Two. Model One therefore catches more Chinese ODI into developed countries around the Pacific Rim as described in Chapter 3. This reveals that both models reflect Chinese ODI well.

China's surge for natural resources is growing and driving ODI (*RQ3*). Anecdotal evidence for this phenomenon is ample (e.g. Ma and Andrew-Speed, 2006). For the first time it is also confirmed by an econometric study. Models One and Two show a significant association between the natural resource proxy (as a measure of natural resource-endowments of a host country) and Chinese ODI, but for the latter periods only – 1992 to 2001 and 1999 to 2003, respectively.

The modelling also reveals that country risk perception and classification may be different among Chinese firms compared to industrialised country firms. Model One indicates that Chinese firms preferentially direct investments to riskier countries. This finding runs contrary

to empirical work on FDI from industrialised countries (Delios and Henisz, 2003a; Biswas, 2002). However, it can be explained by the domestic capital market imperfections argument, as discussed before (*RQ10a*).

The novel dimensions of the Chinese ODIR advanced in Figure 4.1 are only partially supported. Great consistency is found for the proxy of psychic distance. The influence of the Overseas Chinese on the decision-making of Chinese firms is positive in Model One and also for all countries and developing countries in Model Two (*RQ9*). This finding supports the notion that networks are important in Chinese international business and especially that Chinese businesses may be influenced to invest in countries because of 'guanxi' networks (e.g. Ferrantino, 1992). Mixed support is provided for the input of policy liberalisation on Chinese MNE decision-taking. While the 1992 liberalisation had a positive affect on Chinese ODI (Model One) and the 1999 liberalisation caused an increase as well (Model Two), the 1994 reform is found to have had a negative effect on Chinese ODI (Model Two). Less support is identified for the exogenous elements of the ODIR (*RQ10b*). Bilateral investment treaties and double taxation treaties found not to effect levels of Chinese ODI to particular countries. The same is true for WTO membership status of a host country. The explanation for these findings is that Chinese firms are more concerned about market opportunities than safeguarding their investment (in the long-term). This supports the earlier reported finding concerning the investment risk perception of Chinese firms and that this might be a consequence of capital market imperfections they enjoy in China.

8 Conclusions

The objectives of this research were to identify the determinants of Chinese ODI; to identify the international investment strategies pursued by Chinese MNEs, and evaluate the effect of the domestic and international institutional environment on the determinants, investment strategies and behaviour of Chinese MNEs. The role of international business and social networks has been given particular emphasis. These objectives were addressed in eleven separate research questions. In this chapter, each of these research questions are re-stated and answered with reference to analyses presented in Chapters 6 and 7. This is done by testing the model advanced in Chapter 4 of the Chinese outward direct investment regime or Chinese ODIR (see Figure 4.1). In this concluding chapter, the contributions made by this research are highlighted. This is followed by a brief statement of the limitations of the research and suggestions for further work to address them.

8.1 Main findings

In this section, the key research findings are presented under each individual research question.

RQ1 – What are the determinants of Chinese ODI?

Econometric testing of the Chinese ODIR in Chapter 7 reveals a number of determinants of Chinese ODI which are also found in similar work on developed country ODI. However, it is also found here that the significance of these determinants is itself dependent upon the level of development of the host country. In particular, absolute market size is a determinant of Chinese investments in OECD countries while it is lower relative market size (GDP per capita) for non-OECD countries. This finding suggests that some Chinese firms see increasing market potential with increasing market size. This might be a niche market strategy, as exemplified by Haier's investment in the micro-refrigerator market in the USA, or to support the export function when servicing developed country markets from a distance. This latter point is confirmed by the positive and significant finding for exports to the host country from China, which is another important driver of Chinese ODI revealed in the econometric modelling. The fact that Chinese ODI is associated with countries with relatively low GDP per capita levels suggests that some Chinese firms demonstrate a propensity to serve less economically advanced markets, perhaps because they are able to exploit their home country-embeddedness and where their firm-specific advantages are best utilised, because of their ability to adapt to market conditions

similar to their home market, or for other reasons. In this sense, Chinese MNEs also behave like other developing country firms (e.g. Lecraw, 1993). Thus, there is some evidence to suggest that a dualism is emerging in the character of Chinese MNEs, with some possessing features of developed country firms and others resembling more developing country firms in respect to international decision-taking. However, since some FDI to the developed countries may have been motivated by non-market related considerations (natural resources seeking or as listening posts), this type of assertion cannot be made without reflecting on the investment strategies of Chinese MNEs.

Very interesting is the finding which relates to host country risk as a determinant of Chinese ODI. In studies on the investment behaviour of developed country firms, this variable is normally found to be negatively associated with FDI inflows to a country (Buckley and Casson, 1976; Oetzel *et al.*, 2001). Chinese firms, however, are revealed to demonstrate a propensity to invest in more risky host countries. Arguably, such idiosyncratic investment behaviour is encouraged by aspects of the Chinese ODIR, in particular, the endogenous element which derives from special features of China's institutional environment. This, it is asserted here, has created capital market imperfections which mean that Chinese firms do not receive commercial risk in the way that is expected of profit-maximising firms that answer to shareholders. These capital market imperfections derive from soft budget constraints, the low cost of capital, internal funding deriving from the corporate structure of Chinese conglomerate firms (which now often incorporate a Chinese financial institution), participation of the State in corporate governance, and the inefficient Chinese banking system, amongst other things. Consequently, many Chinese MNEs may be investing with less concern for lost sunk investment. Such companies may know that their core operation is not under threat from a risky foreign venture. This is a key finding for this research, and, as has been argued in Buckley *et al.* (2007a), suggests strongly that capital market imperfections constitute a special application of the internalisation theory.

As was discussed in Section 7.1, however, the finding for country risk also highlights a possible shortcoming of country risk measures commonly used in econometric work of this type (i.e. the problem of native categories). Existing measures have been devised from the perspective of profit-maximising industrialised country firms. Such measures may be poor at capturing the investment decision-taking process and risk perceptions of developing country firms. This suggests that country risk measures may need to be revisited to explain the growing phenomenon of ODI from developing source countries.

Of the Chinese ODIR advanced in Chapter 4, little evidence is found to support the determinant role of the formal exogenous elements, namely bilateral investment treaties (BITs) and double

taxation agreements (DTTs). However, this finding does not necessarily mean that these factors should not be included in our model. Three explanations are envisaged for the lack of significance of these variables in the econometric model: one, the finding supports the work of Hallward-Driemeier (2003), Banga (2006) and Tobin and Rose-Ackerman (2005) who all argue, somewhat contentiously, that BITs have no effect on the internalisation behaviour of firms in general; two, that Chinese firms do not respond to the signalling effect of these agreements (because of capital market imperfections in China or for other reasons), and (iii) that the measures used in the econometric models do not capture the full effect (perhaps because of qualitative differences contained in individual agreements). Only limited support is found for WTO membership status of the host country, which is another formal, exogenous element of the Chinese ODIR. Other elements of the Chinese ODIR are discussed below in the context of more specific research questions.

RQ2 – To what extent is Chinese ODI driven by market-seeking motivations?

It is clear from both the primary data collected during interview and a survey of UK affiliates of Chinese firms (and analysed in Chapter 6), and the secondary SAFE and MOFCOM FDI data analysed econometrically in Chapter 7, that market-seeking motives underpin a significant amount of Chinese ODI. This finding provides the first robust, empirical confirmation of the assertions made by a number of scholars writing on Chinese ODI, such as Deng (2003, 2004), Wang (2002) and others.

RQ3 – To what extent is Chinese ODI driven by natural resource-seeking motivations?

The motivation to internalise natural resources across borders is observed to be an important driver of Chinese ODI, especially in recent years. The analysis in Chapter 7 reveals that access to oil, natural liquefied gas, ore and minerals is one driver of Chinese investments across both developed and developing host countries. This finding concurs with Ma and Andrew-Speed's (2006) description of the investment behaviour of natural resources-oriented Chinese MNEs. These authors report that these types of Chinese MNE only began actively pursue foreign investments of significant magnitude in the late 1990s. Again, this is, to the best of our knowledge, the first robust, empirical evidence of this change in behaviour.

RQ4 – To what extent is Chinese ODI driven by the objective of accessing advanced technology?

Econometric modelling reveals that Chinese firms tend to invest in OECD countries to access more advanced and state-of-the-art technology (as measured by the proxy of patenting intensity).

Older extant work on the international expansion of Chinese MNEs places little importance on this aspect of their investment strategies (e.g. Zhan, 1995) but confirms anecdotal evidence presented in more recent work, for example by Child and Rodrigues (2005) and Zhang (2003). Viewed collectively, this body of evidence suggest that investment motives of Chinese firms have shifted away from supporting the export function of domestic state-owned enterprise and gathering information on industrialised country markets towards the acquisition of foreign-owned capabilities and intangible assets. This hints to the fact that, in some aspects, some Chinese firms are adopting features of industrialised country firms in this respect. However, this finding may also be capturing that part of Chinese ODI that is asset augmenting: that is, investment that is made to acquire ownership advantages that previously were absent or only poorly developed.

A further duality in the character of Chinese ODI is detected in the primary data collected for this project. The questionnaire survey of Chinese affiliates in the UK (presented in Section 6.2) reveal that especially the early entrant places little importance on accessing technology and know-how. These firms have mainly been established to develop markets in the UK and, in some cases, Europe. Likewise, the majority of the firms interviewed in China report that their prime objective for FDI is to gain market access. Technology-seeking FDI was important for only two of the ten companies interviewed and, in both cases, this was sought through acquisition and the purchase an established brand name. Other forms of asset acquisition were not detected in the primary data collection phases.

RQ5 – To what extent is Chinese ODI driven by the objective of accessing strategic assets?

This research question is addressed mainly through interview with Chinese parent MNEs. Despite detailed probing, no evidence was found to indicate that the firms interviewed had internationalised for asset-seeking reasons. This finding is supported in the questionnaire survey of Chinese affiliates in the UK. The affiliates placed very low importance on the objective of acquiring a British brand when entering the UK. Thus, no confirmation is found for the work of Deng (2004) and Buckley *et al.* (2006), for example, who asserts that this type of investment behaviour is on the increase among Chinese firms. Caution must be extended to the generalizability of this finding, however, given the small sample size of firms that participated in both phases of the primary data collection.

RQ6 – Have the determinants of Chinese ODI changed over time?

There is some indication that the determinants of Chinese ODI have indeed changed over time and that this is in response to policy changes in China; that is, to changes to the formal, endogenous element of the Chinese ODIR. This is evident in the results of the econometric testing of the Chinese ODIR framework. Model One in Section 7.1 employs a time-break in 1992 to capture liberalisation effects. Findings reveal that, for the later period, the natural resources (ores and minerals) seeking motive is a significant investment driver, while the propensity of Chinese firms to invest in large (OECD) countries decreased. Model Two of Section 7.2 also employs a structural break, this time to detect the effect of ODI encouragement as articulated by China's 'Go Global' policy and the respective Five Year Plans. Again, the importance of natural resources (oil and natural liquefied gas) as an FDI determinant is revealed to have grown after 1999. Viewed together, these findings may reflect government policy changes, which, since the mid 1990s have sought to promote security in the supply of natural resources and to encourage FDI flows to the developing countries as part of China's South-South foreign policy (discussed in Section 3.3.5). They also confirm the inclusion of home country policy as a formal, endogenous element of the Chinese ODIR as advanced in Figure 4.1.

Analysis of the survey data on Chinese affiliates in the UK also reveal changes to the investment strategies of Chinese firms over time. It is found that Chinese firms which invested in the UK before 2000 (that is, before the instigation of the latest liberalisation measures) sought to gain market information best accessible through a local affiliate and to support the export function of the parent company. This behaviour changed for firms that entered the UK after this date. These firms are shown to be more actively exploiting the local market and, but to a lesser extent, to access technology. In context of this aspect to the work, partial confirmation is provided for Buckley *et al.*'s (2006) historic-emergent investment strategy framework.

RQ7 – Do Chinese firms follow a gradualistic approach to internationalisation?

The research sought to discover whether or not Chinese ODI behaviour could be explained by the Stages theory (Uppsala approach) of internationalisation. cursory examination of official aggregate approved Chinese ODI statistics published by MOFCOM shows that Chinese firms did invest in psychically distant countries in the early 1980s (in project value terms). This confirmed in Model Two of the econometric modelling in Chapter 7 (which takes MOFCOM FDI data as the dependent variable). This suggests a departure from the Stages theory (Johanson and Vahlne, 1977; Johanson and Wiedersheim-Paul, 1975). However, the nature of the data means that it is not possible to identify if the companies gradually increased their

commitment in host countries – the second part of the Uppsala model. In this research, it is found in both the interviews in China as well as the survey of Chinese affiliates in the UK that respondent firms tended to export to a host country or agree on business cooperation before committing themselves fully to a particular host market. There is also some evidence to suggest that sequence of countries targeted by respondent firms is predicted by the Stages model. Most respondent firms were found to direct their first foreign investment to a developing country that, more often than not, was geographically close to China. Perhaps surprisingly, the Stages Model has not been applied to explain Chinese ODI in extent research, so far as we know. This research provides tentative findings that the Stages theory may have at least some explanatory power.

RQ8 – Do Chinese firms conduct FDI shortly after establishment?

Despite some support of the stages theory, other aspects of Chinese firm behaviour detected in this research are not explained by it, and the International New Ventures theory seems to have greater explanatory power (Oviatt and McDougall, 1994, 2005). In particular, it is found in interviews with Chinese MNEs that smaller Chinese firms directed their first investment to a psychic distant market shortly after being established. These firms have only modest levels of national and international business experience and a poor domestic economic base. These firms are found to have business models that are not constrained to the domestic market but are rather shaped for specific customers. The firms interviewed exploited business opportunities as and when they were detected. This is the first time such behaviour is reported in international business literature for Chinese firms, so far as it is known.

RQ9 – To what extent do the Overseas Chinese people influence the international investment behaviour of Chinese firms?

The importance of international networks in the investment decision-making of Chinese firms is evident in Models One and Two, which find strong support for the notion that Overseas Chinese are a driving force behind Chinese ODI. One interpretation is that access to such networks reduces transaction costs associated with gaining local market knowledge and understanding of business opportunities. Given that both models mainly capture FDI conducted by state-owned firms, this finding is arguably counter-intuitive. One might expect such types of firms to place little importance on relational capital as a source of ownership advantage. However, the strength of the finding for the proxy used to capture the relationship between ODI and the percentage of the host country population that is ethnically Chinese suggests that relational capital is indeed an important influence on the decision-taking of these types of firms. This

finding confirms that of Bräutigam (2002), who reports that Chinese ODI to east Africa is also supported by access to Chinese business and social networks. However, this study is the first to provide statistical evidence of this phenomenon.

The analysis of primary data, however, does not fully support this notion. The Chinese firms interviewed acknowledged that they are interested in recruiting Overseas Chinese as employees because they help to mitigate the effects of psychic distance. But these firms see no benefit in including Overseas Chinese in the investment decision-making process. Instead, these firms generally use some sort of broker, especially foreign investment promotion agencies in China. Such agencies are either used to enter a foreign market because they provide immediate access to local expertise and business contacts or contacts with the agency are maintained by the Chinese firm to identify useful business professionals (such as lawyers and accountants) as the foreign affiliate expands. The firms identified as candidate Chinese international new ventures in particular benefited from this type of resource.

RQ10a – To what extent does the domestic institutional framework in China support the international investment strategies of Chinese firms?

It is found that the endogenous institutional environment in the Chinese ODIR has a mixed effect on international investments by domestic firms. Model One concentrates on testing the role of domestic capital market imperfections, and policy changes and liberalisations evident in the years 1992, 1994 and 1999, on the internationalisation of Chinese MNEs. Results indicate that the influence of domestic capital market imperfections and the confidence gained following the reforms and liberalisation policies in 1992 were positive (Buckley *et al.*, 2007a). As mentioned above, support is therefore found for inclusion of institutional factors in the analysis of Chinese ODI (as encapsulated in the Chinese ODIR framework advanced in Chapter 4). The foreign exchange liberalisation step in 1994, however, had a detrimental effect on aggregate Chinese ODI levels. One interpretation is that Chinese firms had fewer incentives to invest abroad to secure hard currency as a consequence. Further support for the influence of institutional factors on Chinese MNE behaviour have already been discussed above in the context of research questions *RQ1* and *RQ6*, in particular.

Interview data obtained from MNEs in China allows more fine-grained analysis. It is found that small Chinese MNEs and private Chinese firms experienced a constraining effect exerted by the domestic institutional framework. This was evidenced by the transfer of investment funds and aspects of co-ordination of international activities to the British Virgin Islands to circumvent restrictive investment approval procedures at home. These firms therefore responded to other

market imperfections not related to capital markets. The institutional environment has constrained the international development of these types of firms until quite recently. It is likely that recent changes to the regulatory framework (and, in particular, to the simplification and streamlining of the approval process and the shift from formal approval to simple registration) may encourage these types of firms to expand abroad more frequently.

RQ10b – To what extent does the international institutional framework support the international investment strategies of Chinese firms?

The research finds little support for the proposition that the international institutional environment impacts appreciably on the investment decision-making of Chinese firms. This is revealed in Model Two (Section 7.2) using proxies for the number of BITs and DTTs concluded by China and host country membership status of the WTO. The proxies fail to show any significant association between these international institution-related factors and Chinese ODI. Possible explanations are provided above in relation to research question *RQ1*. The only time that a proxy for an exogenous institutional factor attains statistical significance is in Model Two for OECD countries in the period 1991 to 1998, and then the co-efficient is negatively signed. This indicates that Chinese firms show a propensity not to invest in developed countries when these demonstrate high levels of investment security. This finding is interpreted to be a reflection of capital market imperfections again in that Chinese firms avoid investing in markets that offer a predictable and transparent investment regime, perhaps because of lower risk-adjusted returns on investment. A second interpretation is that the ownership advantages Chinese MNEs derive from their home-country embeddedness are reduced in such situations.

Extant work on the role of institutional factors such as BITs and DTTs mainly examine FDI flows from developed to developing countries and the results are inconclusive (Banga, 2006; Hallward-Driemeier, 2003). This study is the first to explore the impact of these types of institutional factors on Chinese ODI. It is likely that the increase in the volume of developing country ODI, particularly when directed to other developing countries, will see the effect of BITs and DTTs become clearer in research. Currently, extant work suggests that such agreements have little or no effect on the internationalisation of developing country firms. This study finds a similar result for Chinese MNEs. Given the amount of effort by UNCTAD and other agencies to see these types of agreements concluded, this is a contentious finding.

RQ11 – Do the determinants of Chinese ODI vary by ownership type?

Issues concerning the moderating effect of ownership type on the internationalisation of Chinese firms were investigated primarily through interview. As Section 6.1 demonstrates, no major difference is detected in the investment behaviour across ownership types (that is, between state-owned and privately-owned firms). Differences are only detectable for the *perceived* impact of endogenous institutional factors as discussed above under research question *RQ10a*. The issue of perception was found to be important in interviews with government officials, several of whom pointed out that they felt that the approval process did not prejudice against any particular ownership type. This is despite the fact that privately-owned firms were prevented from investing abroad legally prior to 2004. For medium and smaller-sized Chinese firms, the managers interviewed *did* feel constrained by the institutional environment, in contrast to what the interviewed government officials said. Lack of transparency in the relevant regulations and procedures is likely to be one explanation for this difference in opinion.

8.2 Contributions of the research

This research makes a number of important contributions.

First, this thesis advances a framework that seeks to explain the institutional environment within which Chinese ODI takes place. While this model is likely to benefit from subsequent refinement and improvement, it represents an important contribution to the understanding of Chinese ODI by bringing to the fore the importance of the institutional framework within which Chinese firm decision-taking happens. It also has the potential to advance understanding of ODI from other developing countries, where institutions also affect greatly the growth of domestic firms. Implicit to the design of the Chinese ODIR is the notion that explanations of ODI from other developing countries should also take into account the institutional framework and other features of the home country in a way that extant work on the subject often fails to do. This is likely to necessitate further special application of the core theory of international business to developing country ODI.

Second, and it follow from the previous point, in this thesis internalisation theory is advanced with a special application. It is argued in Chapter 4 and shown in Chapter 7 that Chinese firms have ventured abroad by exploiting imperfect domestic capital markets. This is revealed by the propensity of Chinese firms to invest in risky countries. This conclusion makes a major contribution to the understanding of historical trends in Chinese ODI, and this is reflected in the

fact that key findings are presented in a forthcoming article in the *Journal of International Business Studies* (Buckley *et al.*, 2007a).

Third, this research is the first to attempt to gain insight on the Chinese ODI phenomenon using econometric techniques, certainly insofar as it is known of English-language sources. In so doing, proxies are developed that have not been used before to identify determinants. This includes the use of structural breaks and time dummies to capture the effects of policy changes and changes to firm behaviour. The determinant role of the Chinese diaspora on patterns of Chinese ODI is also modelled formally for the first time. This necessitated the design of a new proxy not used previously in work of this type. This proxy attains statistical significance across several specifications of the econometric models used here, and this provides strong indication of the importance of the Overseas Chinese to the internationalisation of Chinese MNEs, even state-owned ones. This is a novel finding.

Fourth, a variety of international business theories, in addition to the core theory, are applied to inform the analysis, namely New Institutional Theory, the Stages Theory and the New International Venture theory. Some evidence is found that these theories have the power to explain at least a part of Chinese ODI and that this depends very much upon firm size. The application of such theories to the understanding of Chinese ODI has not been made previously.

8.3 Limitations and suggestions for further work

Despite its contributions, there remains scope for improving the research methods and approaches adopted in this research. First, the incorporation of institutional theory has proved to be a major step forward in understanding Chinese ODI. The proxies employed here could be refined, however. The effects of political events on firm behaviour are only poorly captured using binary dummy variables. Instead, they may merely indicate a trend. Thus, the development of more robust, sophisticated and sensitive proxies is necessary. This is true for any investigation on the role of institutions in international business. Ideally, new proxies should have greater universal application and cross-country comparability so that they can be employed in studies on ODI from other developing countries as well. Second, future analysis of the influence of business and social networks on the internationalisation of Chinese firms is needed, and this should attempt to achieve the following. Dyadic interviews should be conducted with the headquarters and (i) its affiliates and (ii) the brokers that have been found to facilitate the decision-making of those Chinese firms that took part in this research. This is likely to deliver more in-depth knowledge about the mechanisms and utilisation of such

networks from multiple perspectives than was possible here. Information gained could be used in other econometric models to investigate nuances and subtleties that were not possible to detect with the research methods used in this study. Third, although the identification of domestic capital market imperfections as a determinant of Chinese ODI is a contribution, measurement could be better refined. Though ambitious, proxies for the four types of imperfections as identified in Chapter 4 should be developed to measure their effect on Chinese ODI more accurately. This would be facilitated by better quality Chinese ODI data for use as dependent variables in econometric work. Besides time-series data, ideally data would ideally include a break-down by home province and industry to capture more detailed home country effects. Fourth, research findings suggest that fresh approaches to the application of international business theory to the understanding of Chinese ODI have the potential to be fruitful. Extant work generally applies Dunning's OLI framework only, with little consideration of other contributions to international business theorizing, in particular, the New Institutional Theory, the Stages Theory and the International New Ventures Theory. Although tentative, this study suggests that these theories can also help to explain Chinese ODI. Future analysis should also take account of emergent strategies in ODI behaviour, especially of efficiency seeking FDI which is not investigated in this study. As Chinese firms continue to expand their geographic reach and range of international operations it is likely that efficiency seeking FDI will become more commonplace as they rationalise and re-organise their international supply chains in response to greater regional integration and other influences. Finally, the Chinese ODIR framework which constitutes a central part of this research and one of its major contributions would benefit from refinement and improvement. Although the importance of elements of it has been confirmed in empirical testing, other parts have not. This raises the question as to whether or not this is because of weaknesses in the proxies employed or shortcoming in underpinning theory. Application of this framework to other developing countries would shed light on this issue.

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Appendices

Appendix A.1 Country classification

Developed economies

North America	Bermuda, Canada, United States of America
Asia	Israel, Japan
Europe	Austria, Belgium, Belgium-Luxembourg, Cyprus, Czechoslovakia (former), Czech Republic, Denmark, Estonia, Finland, France, Germany, Gibraltar, Greece, Hungary, Iceland, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Norway, Poland, Portugal, Slovakia, Slovenia, Spain, Sweden, Switzerland, United Kingdom
Oceania	Australia, New Zealand

Developing economies

Africa

Eastern Africa	Burundi, Comoros, Djibouti, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Mayotte, Mozambique, Rwanda, Seychelles, Somalia, Uganda, United Republic of Tanzania, Zambia, Zimbabwe,
Middle Africa	Angola, Cameroon, Central African Republic, Chad, Congo, Democratic Republic of the Congo, Equatorial Guinea, Gabon, Sao Tome and Principe
Northern Africa	Algeria, Egypt, Libyan Arab Jamahiriya, Morocco, Sudan, Tunisia
Southern Africa	Botswana, Lesotho, Namibia, South Africa, Swaziland
Western Africa	Benin, Burkina Faso, Cape Verde, Côte d'Ivoire, Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Mauritania, Niger, Nigeria, Saint Helena, Senegal, Sierra Leone, Togo

Latin America

Caribbean	Anguilla, Antigua and Barbuda, Aruba, Bahamas, Barbados, British Virgin Islands, Cayman Islands, Cuba, Dominica, Dominican Republic, Grenada, Haiti, Jamaica, Montserrat, Netherlands Antilles, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Trinidad and Tobago, Turks and Caicos Islands
Central America	Belize, Costa Rica, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama
South America	Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Falkland Islands (Malvinas), Guyana, Paraguay, Peru, Suriname, Uruguay, Venezuela

Asia

Eastern Asia	China, Hong Kong SAR, Macao SAR, Taiwan, Democratic People's Republic of Korea (North Korea), Republic of Korea (South Korea), Mongolia
Southern Asia	Afghanistan, Bangladesh, Bhutan, India, Islamic Republic of Iran, Maldives, Nepal, Pakistan, Sri Lanka
South-Eastern Asia	Brunei Darussalam, Cambodia, Indonesia, Lao People's Dem. Republic, Malaysia, Myanmar, Philippines, Singapore, Thailand, Timor-Leste, Viet Nam
Western Asia	Bahrain, Iraq, Jordan, Kuwait, Lebanon, Palestinian territory, Oman, Qatar, Saudi Arabia, Syrian Arab Republic, Turkey, United Arab Emirates, Yemen

Oceania

Fiji, New Caledonia, Papua New Guinea, Solomon Islands, Vanuatu, Kiribati, Marshall Islands, Federated States of Micronesia, Nauru, Northern Mariana Islands, Palau (former Pacific Islands, also known as Belau), Cook Islands, French Polynesia, Niue, Samoa, Tokelau, Tonga, Tuvalu, Wallis and Futuna Islands

Transition economies

Asia	Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Republic of Moldova, Russian Federation, Tajikistan, Turkmenistan, Ukraine, Uzbekistan
Europe	Albania, Bosnia and Herzegovina, Bulgaria, Croatia, TFYR Macedonia, Romania, Serbia and Montenegro, Yugoslavia, SFR (former)

Source: UNCTAD (2007a).

Appendix A.2 Invitation facsimile to Chinese headquarters

xxxxx 您好:

我写这封信的目的是关于我的采访申请, 研究领域是中国的跨国公司。

我在英国利兹大学攻读博士课程。我写这封信是希望您参加我的博士课题研究——中国的跨国公司。此项研究是为了更好的理解中国跨国公司的运营方式, 管理特点和面临的问题。

此项研究是在利兹大学国际经济研究中心彼得·巴克利教授和柯若师教授, 以及南京大学经济学院院长赵署明教授共同指导下进行的。利兹大学国际经济研究中心是英国研究国际经济和现代中国经济最好的研究部门之一 (<http://lubswww.leeds.ac.uk/cibul>) 本研究是该研究中心研究中国跨国公司的一部分。

我殷切地期望您接受我的采访。这项研究会给参与各方带来很多益处: 这是一个前古未有的关于中国跨国公司的大规模的采访调查和专项研究, 您的参与将帮助我更好的理解中国公司进入国际市场以后所面临的机遇与挑战。我的研究能为有关在发展中国家的跨国公司理论做出有价值的学术贡献。在研究结束后, 我将会给您免费寄一份研究报告, 从中您将了解和您相似的或不同的中国跨国公司所面临的挑战和机遇。这项研究也将有助于利兹大学商学院设立适合亚洲市场的MBA课程。

这次采访不会占用您太多的时间, 大概 60 分钟左右。这是一个独立的学术报告, 它不是由任何个人, 公司或者团体资助的。我将不会询问任何敏感性问题。您提供的所有信息都会得到严格的保密, 将不会提供给任何第三方。研究报告不会提到任何企业或者个人。

如果您能接受我的采访, 请通过邮件: bushv@leeds.ac.uk 或者通过传真 0044-11 33 43 68 08 和我联系。如果方便的话, 我会在 5 月 15 日以前同您联系确认。

我将在 x 月 xx 号到 x 月 xx 号之间到贵公司进行采访。如果您知道对我这次研究还有更合适的部门, 请您把我的信也转寄给他们并转告我, 以便我同他们联系。

希望尽快得到您的答复, 再次感谢您的关心和合作。

博士研究
员: Hinrich Voss

英国利兹大学
2006 年 4 月

Appendix A.3 Interview question guideline: Chinese firms

Background information

Please describe briefly your role and duties in your firm.

Could you please describe the business activities of your company in mainland China.

Could you please describe the current legal ownership arrangement of your company.

Based on your description, would you say your company is a state-owned enterprise, a collective-owned enterprise, a private-owned enterprise or a foreign-invested company?

Does your company have an export and import license?

In which year did your company receive an export and import licence?

In which year did your company *first* export?

Does your company have any assets in countries outside of mainland China?

Why does your company make equity investments outside of mainland China?

Are there any domestic reasons which pushed your company to invest in a foreign country?

Please describe briefly *how* decisions to invest abroad are taken in your company.

When did your company invest in a foreign country for the *first* time?

How many foreign countries has your company currently invested in?
Could you please list the countries.

Does your company pursue the same business activities in all countries?

Approximately, in the last completed financial year what percentage of your company's total turnover can be attributed to foreign activities outside of mainland China?

Approximately, in the last completed financial year what percentage of your company's total assets is located outside of mainland China?

Approximately, in the last completed financial year what percentage of your company's total workforce is employed outside of mainland China?

Which foreign investment is the *most important* for your company?

Why is the investment in ... the most important for your company?

When did you invest in?

What was the *single most important* motivation for your company to carry out this investment?

All further questions will focus on the most important foreign venture of your company

Before investing in country X, did your company have any trade relations with this country?

Before investing in country X, did your company have a joint venture with a company from X in China?

Before investing in country X, was your company a customer or supplier of a company from X in China?

How important were these links and contacts in the decision to set up the subsidiary?

Did any of the just mentioned business relationships assist your company in the foreign investment?

During the actual process?

Have these business links and contacts proved important to the overall success of the subsidiary?

Did you ask them for advice or did they offer advice to your company?

Could your company have carried out the investment without the advice of these linkages and contacts?

How important are international ethnic relationships, i.e. with other Chinese, for your company's international business activities?

What personal contacts to Overseas Chinese or to Chinese networks did your company have in ... prior your investment in ...?

Did this personal network assist your company to decide where to invest?

What kind of assistance did your company receive?

Did you ask these personal contacts for advice or did they offer advice to your company?

Have these personal contacts and networks proved important to the overall success of the subsidiary?

Did your company receive any assistance from any Chinese institutions while investing in a foreign country?

If your company received assistance from different actors, which one was the most important for your company?

Competitive advantage (existence, strengthening)

What do you think makes your company successful in mainland China?

It is argued among researchers that a company has to have a competitive advantage over its competitors when it is investing in a foreign country. What do you think makes your company successful in country X? Is it the same competitive advantage as in mainland China?

Do you think your company in mainland China benefits from the existence of foreign firms in mainland China?

Do you think your company's domestic business operation benefits from your company's foreign venture?

What was the *single most* serious challenge faced by your company when *setting up* the foreign business operation?

What was the second most serious challenge faced by your company when setting up the foreign business operation?

What is the *single most* important challenge for your company's foreign operation *today*?

What is the second most important challenge for your company's foreign operation *today*?

The domestic institutional framework

How would you describe the Chinese government's attitude towards international investments by Chinese firms?

Is it any different on provincial or municipal level?

Is any Chinese state authority responsible for advising, monitoring and regulating your firm's foreign investments?

Did any state authority have any influence on your company's foreign investment decision?

Did any state authority have any influence on your company's investment scale?

Did any state authority have any influence on your company's foreign location selection or all of them?

Do you think the activities and behaviour of any state authority influences the speed of your company's foreign business development?

Has the influence of government authorities on your investment decisions changed over the last years? E.g., shifted from one authority to another or in magnitude?

Is your company required to obtain an investment approval from the Chinese government before making an investment in a foreign country?

Could you please describe the investment approval process that your firm is required to follow. If you are not involved in the approval process, could you please introduce me to the person in charge?

Do you think the approval process influences the speed of your company's foreign business development?

Has any foreign investment application by your company ever been rejected by Chinese state authorities?

What consequences did the rejection cause for your company?

Do you plan to expand your foreign business operations within the next five years?
Do you plan to invest (or to expand your) within the European Union?

Could you think of any issue I have not asked you that is important and should be discussed as well?

Appendix A.4 Interview question guideline: Chinese government officials

Background information

We start with some questions concerning your and your organisation's background

Could you please describe briefly your role and duties in your organisation.

Could you please describe the activities and responsibilities of your organisation.

Where is your organisation located in the Chinese administrative system?

Has your organisation a mandate to deal with Chinese investments abroad?

For how long has your organisation this mandate?

How does this mandate look like?

Has the mandate of your organisation changed since your organisation received it?

How many people in your organisation are working in the area of Chinese outbound investment?

Are there any further governmental bodies in China which also have a mandate to deal with Chinese investments abroad?

To what extent differs there mandate from yours?

Are there any overlapping responsibilities and duties between your and any other government organisation towards Chinese investments abroad?

How is your organisation dealing with overlapping responsibilities and duties?

How would you describe the relationship between your organisation and each of these organisations?

Is there a final decision taker inside or outside your organisation how can rule over all governmental organisations in case your objectives and operations differ?

Do you know anybody in any of the other organisations we should talk to?

The following questions deal with Chinese firms which would like to invest in a foreign country

Are all Chinese enterprises allowed to invest overseas?

Has this always been the case?

Are there any industry sectors in which Chinese firms are *encouraged* to invest abroad?

Are there any industry sectors in which Chinese firms are *not allowed* to invest abroad?

Has this industry sector policy always been in place like this?

Are there any countries in which a Chinese firm is *encouraged* to invest in?

Are there any *countries* in which a Chinese firm is *not allowed* to invest in?

Are Chinese firms required to obtain an investment approval from your organisation before making an investment in a foreign country?

Could you please describe in detail the formal ODI approval process from your organisation's perspective.

What kind of documents has an applying company to provide?

How long does the approval process takes normally?

Is any documentation available that sets out the formal approval process?

Have there been any changes in the approval system during the past five years?

Does a Chinese firm have to apply for *every* foreign investment project?

Does a Chinese firm have to apply for an investment approval when it is using *money earned in the host country*?

Does a Chinese firm have to apply for an investment approval when it has *secured external funding* from a source *outside* of China?

Once a Chinese firms has invested in a foreign country, are there any duties the firm has to fulfil?

Is there any government organisation which supports Chinese firms during their investment location screening process?

Is there any government organisation which supports Chinese firms during their investment scale decision process?

Is there any government organisation which supports Chinese firms during their entry mode decision process?

Is there any government organisation which supports Chinese firms during their approval process?
Are these supportive activities available to state-owned as well as privately-owned firms?

Which Chinese government institution do you think have the greatest effect on ODI by Chinese firms?

Are you aware of any sub-national policy or activity which contradicts policies and regulations on national level?

Are you aware of any Chinese firms which invested without any official approval outside of mainland China?

In your opinion, what is the *single most important* motivation for Chinese firms investing outside of China?

In your opinion, what is the *second most important* motivation for Chinese firms investing outside of China?

In your opinion, what is the *single most important* challenge for Chinese firms investing outside of China?

In your opinion, what is the *second most important* challenge for Chinese firms investing outside of China?

Have these motivations changed over the last five year?

Does your organisation have any data on Chinese outbound investment?

How do you explain the recent surge in Chinese outbound investment?

Does your organisation have any data on the success rate of Chinese foreign ventures?

Is there anything we should have talked about but I did not ask you?

Appendix A.5 Interview question guideline: Other stakeholders

Background information

We start with some questions concerning your and your organisations' background

Could you please describe briefly your role and duties in your organisation.

Could you please describe the activities of your organisation.

Does your organisation deal with Chinese investments abroad?

Since when is your organisation dealing with outbound investment from China?

Has the scope of your organisation toward outbound investment from China changed since your organisation deals with it?

How many people in your organisation are working in the area of Chinese outbound investment?

The following questions deal with Chinese firms which would like to invest in a foreign country

Are all Chinese enterprises allowed to invest overseas?

Has this always been the case?

Are there any industry sectors in which Chinese firms are *encouraged* to invest abroad?

Are there any industry sectors in which Chinese firms are *not allowed* to invest abroad?

Has this industry sector policy always been in place like this?

Are there any countries in which a Chinese firm is *encouraged* to invest in?

Are there any *countries* in which a Chinese firm is *not allowed* to invest in?

Are Chinese firms required to obtain an investment approval from your organisation before making an investment in a foreign country?

Could you please describe in detail the formal outward investment approval process.

What kind of documents has an applying company to provide?

How long does the approval process takes normally?

Have there been any changes in the approval system during the past five years?

Does a Chinese firm have to apply for *every* foreign investment project?

Does a Chinese firm have to apply for an investment approval when it is using *money earned* in the *host country*?

Does a Chinese firm have to apply for an investment approval when it has *secured external funding* from a source *outside* of China?

Once a Chinese firm has invested in a foreign country, are there any duties the firm has to fulfil?

Does the Chinese national government supports outward investment by Chinese firms?

Does the Chinese provincial/municipal government (local level) supports outward investment by Chinese firms?

Is there any government organisation which supports Chinese firms during their investment location screening process?

Is there any government organisation which supports Chinese firms during their investment scale decision process?

Is there any government organisation which supports Chinese firms during their entry mode decision process?

Is there any government organisation which supports Chinese firms during their approval process?
Are these supportive activities available to state-owned as well as privately-owned firms?

To what extent is the outward investment by Chinese firms influenced by the Chinese government's policy?

Does the Chinese government impede outward investment by private Chinese enterprises?

Which Chinese government institution do you think have the greatest effect on outward investments by Chinese firms?

Are you aware of any sub-national policy or activity which contradicts policies and regulations on national level?

Are you aware of any Chinese firms which invested without any official approval outside of mainland China?

In your opinion, what is the *single most important* motivation for Chinese firms investing outside of China?

In your opinion, what is the *second most important* motivation for Chinese firms investing outside of China?

Have these motivations changed over the last five year?

Are there any *domestic* factors which might *push* Chinese firms to invest overseas?

How do you explain the recent surge in Chinese outbound investment?

In your opinion, what is the *single most important* challenge for Chinese firms investing outside of China?

In your opinion, what is the *second most important* challenge for Chinese firms investing outside of China?

Where do Chinese firms tend to invest?

Do Chinese firms have *established business contacts* to the host country *prior* their investment?

Do Chinese firms receive any support through established business contacts when they invest overseas?

Do Chinese firms have *established personal contacts to ethnic Chinese* in the host country *prior* their investment?

Do Chinese firms receive any support from the personal contacts to ethnic Chinese when they invest overseas?

Does your organisation have any data on Chinese outbound investment?

Does your organisation have any data on the success rate of Chinese foreign ventures?

Does your organisation has any direct contact to outward investing Chinese firms?

Could your organisation support me in getting access to these Chinese firms for a research interview?

Is there anything we should have talked about but I did not ask you?

Do you know anybody in any of the other organisations we should talk to?

Appendix A.6 Cover letter to Chinese affiliates in the UK

Leeds, xxxx, 200x

Dear Sir or Madam,

Re: 'Chinese firms in United Kingdom' Survey

We write to invite your participation in a major research project on Chinese firms in the UK which we are conducting here at the University of Leeds. Chinese firms like yours have been active in the UK for many years. However, very little is known about the reasons why the UK was chosen as an investment location by Chinese firms and what the perceptions are of the UK as a place to do business. This survey is an important step in improving our knowledge about Chinese firms in the UK.

The study is being carried out by researchers from the Centre for Chinese Business and Development (CCBD) and the Centre for International Business at the University of Leeds (CIBUL). Together, these Centres represent one of the leading British research institutions on international business and contemporary Chinese business studies. (You can find more information about us at the following websites: <http://www.leeds.ac.uk/ccbd> and <http://lubswww.leeds.ac.uk/cibul>). The study is being led by myself and is part of a much larger project on Chinese multinational firms that we are doing here at Leeds.

We would be very grateful if you could take a few minutes of your time to complete the enclosed questionnaire and return it to us in the prepaid envelope provided. The questionnaire does not ask you to give any commercially sensitive information. We can assure you that all the information provided will be treated in the strictest confidence and will not be passed on to any third party. It will be impossible to identify individual companies or people in our analysis or report. This is an independent piece of academic research and we are not being sponsored by or in any way supported by another company or organisation.

Your participation in our survey will have a number of benefits.

Benefits to us: This is the first large scale survey of Chinese firms ever conducted in Europe. Your participation will help us to better appreciate the challenges and opportunities which the UK presents to Chinese firms.

Benefit to you: Through our close relationship with the Department of Trade and Industry and other government bodies, our research will help inform policy that will ultimately enhance the investment environment for you and other Chinese firms in the UK.

If you have any questions about this survey, please direct them to me at bushv@leeds.ac.uk. If you would like more information about any aspect of our work on China, please direct your enquiries to Adam Cross, Director of CCBD, at arc@lubs.leeds.ac.uk or by mail at the address above.

We look forward to receiving your response and thank you in advance for your participation in our research.

Yours sincerely,

Hinrich Voss
Doctoral Researcher
Centre for International Business
University of Leeds

A survey of Chinese firms in the UK

Section One: Background Information

About you

- 1) What position do you have in your company?
- 2) In what year did you first join your current employer in China?
Please select one answer
- 2003-2005 1999-2002 1995-1998
1980-1994 Before 1980
- 3) How many years have you worked for your company in the UK?
Please select one answer
- 1-3 7-10 20+
4-6 11-20

About your parent company in China

- 4) In what year was your parent company first established in China?
- 5) How many employees does your parent company employ worldwide (including China)?
Please select one answer
- Less than 49 1000-4999
50-249 5000+
250-999 Don't know
- 6) Which of the following best describes the legal organisation of your parent company in China?
Please select one answer
- A state-owned enterprise under the administration of the State-owned Assets Supervision and Administration Commission (SASAC)
- A state-owned enterprise under the control of a ministry
- A state-owned enterprise under the control of a provincial government
- A state-owned enterprise under the control of a municipal government
- A township/collective enterprise
- A firm that is privately owned
- A corporation that is listed on a Chinese stock exchange
- Other, please specify: _____
- Don't know

7) In what year did your parent company in China first invest in an international market outside of mainland China?

8) How many countries does your parent company in China operate in, including the UK.
Please select one answer

- The UK only
- 2-5 countries outside of mainland China (including the UK)
- 6-10 countries outside of mainland China (including the UK)
- 11-20 countries outside of mainland China (including the UK)
- 20+ countries outside of mainland China (including the UK)
- Don't know

About your company in the UK

9) In which year was your company first established in the UK?

10) Which of the following best describes your company's present organisational form and activities in the UK? *Please select all boxes which apply*

- Representative office
- Importing with local sales operation
- Importing with local warehousing operation
- Importing with local servicing operation
- Exporting operation
- Assembly (importing plus local processing or assembly operation)
- Local company-owned manufacturing or production:
 - ◊ a wholly-owned greenfield entry
 - ◊ a wholly-owned entry made via an acquisition
 - ◊ an equity joint venture entry (both minority and majority)
- Other, please specify:

11) Please indicate the industry your UK company is mainly active in.
Please select one answer

- | | | | |
|---|--------------------------|--------------------------------------|--------------------------|
| Agriculture, Hunting and Forestry | <input type="checkbox"/> | Construction | <input type="checkbox"/> |
| Fishing | <input type="checkbox"/> | Wholesale and Retail Trade | <input type="checkbox"/> |
| Oil, Mining And Quarrying | <input type="checkbox"/> | Hotels and Restaurants | <input type="checkbox"/> |
| Manufacturing | <input type="checkbox"/> | Transport, Storage and Communication | <input type="checkbox"/> |
| Electricity, Gas and Water Supply | <input type="checkbox"/> | Financial Services | <input type="checkbox"/> |
| Education | <input type="checkbox"/> | Health and Social Work | <input type="checkbox"/> |
| Real Estate, Renting and Business Activities | <input type="checkbox"/> | Public Administration and Defence | <input type="checkbox"/> |
| Other Community, Social and Personal Service Activities | <input type="checkbox"/> | | |

Other, please specify

12) How many employees does your company have in the UK?

Please select one answer

- | | | | | | |
|-------|--------------------------|---------|--------------------------|---------|--------------------------|
| 1 | <input type="checkbox"/> | 26-49 | <input type="checkbox"/> | 200-499 | <input type="checkbox"/> |
| 2-9 | <input type="checkbox"/> | 50-99 | <input type="checkbox"/> | 500+ | <input type="checkbox"/> |
| 10-25 | <input type="checkbox"/> | 100-199 | <input type="checkbox"/> | | |

13) Who has overall control of your company in the UK (control means making major decisions concerning the company's present and future direction and strategy)?

Please select one answer

- The managing director or general manager in the UK
- The board of directors of your parent company in mainland China
- The principle Chinese bank with which your parent company deals
- A Chinese government ministry or agency (municipal, provincial, or national?)
- A family in China
- Individual owners of your parent company in China
- A company group in the UK (in a conglomerate situation)
- A regional headquarters outside of the UK
- Other, please specify:
- Don't know

Section Two: Investment Motivation

14) Thinking about your company's **first** investment in the UK, how important were the following factors in your company's decision to invest in the UK.

Please select for each factor one box that matches your view most closely, as follows:

	Of utmost importance	Very important	Of moderate importance	Of little importance	Of no importance	Don't know
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
In response to growing competitive pressure in Chinese markets	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
To develop new markets outside of China through direct investment	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
To obtain access to raw materials not available readily in China	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
To benefit from Chinese government incentives (e.g. in taxation, foreign exchange) to invest overseas	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
To increase corporate profits	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Because your parent company's markets are becoming saturated in China	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
To comply with Chinese government's policy statements	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
In response to growing international competition	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
To gain access to intermediate products not readily available in China	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
To carry out research and/or product development in the UK	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
To be closer to your British suppliers	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
To support your company's export activities in the UK	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Because you were invited to invest by a British customer or supplier	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
To collect information and gain knowledge about European markets	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
To be closer to your important customers	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
To gain better access to new management know-how and ideas	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
To benefit from lower production costs in the UK compared to China	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
To spread the risks associated with producing internationally	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
To defend existing market share in the British market by investing locally	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
To support export activities in the European Union	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
To gain access to new technology	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Of utmost importance	Very important	Of moderate importance	Of little importance	Of no importance	Don't know
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
To improve access to sources of cheaper external finance					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
To overcome tariff and non-tariff barriers to your company's trade with the UK and the European Union					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
To improve the competitiveness of your company's export activities					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
To purchase a known British brand					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
To take advantage of investment incentives in the UK					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
To establish a headquarters for your firms' European operations					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
To raise the profile of your company in Europe					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

15) If there were important factors that influenced your company's decision to invest in the UK that are not listed under question 14), please state these here.

Section Three: The UK as a business location

16) Thinking about your company's **current business**, how important are the following factors in influencing your company's decision to locate in the UK?

Please select for each factor one box that matches your view most closely, as follows:

Of utmost importance	Very important	Of moderate importance	Of little importance	Of no importance	Don't know
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Availability of low cost land, compared to other industrialised countries					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Tax concessions and incentives in the UK					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Size and potential of the British market					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Political stability in the UK					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Because of the support provided by a regional investment promotion agency in the UK					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ease at which profits are repatriated to China					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Efficient <u>local</u> government in the UK					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Chinese business and family connections in Britain					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Good transportation infrastructure					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Availability of technical and skilled workforce					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Of utmost importance	Very important	Of moderate importance	Of little importance	Of no importance	Don't know

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Availability of low cost labour, compared to other industrialised countries					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Proximity of the UK to large, third markets for exports					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Because the UK is a signatory country to international trade and investment treaties with China					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Reliable communication networks					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ready availability of finance capital in the UK and European Union					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Absence of foreign exchange controls					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cultural similarity of the UK with China					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ease of exporting to the industrialised countries from the British location					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Because the UK is a member of the European Union					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
The UK provides a good base for further investment in Europe					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
The location was recommended by a business associate					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Enforceable intellectual property right laws in Europe					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Because of the presence of ethnic Chinese-owned suppliers and customers in the UK and Europe					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Because the UK is <u>not</u> a Eurozone state member					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
In response to promotion in China by a regional investment promotion agency in the UK					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Because family members live in Great Britain					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Because your firm is allowed to reinvest earnings in the European Union					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Clear and flexible labour laws in the UK					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparent and straightforward accounting laws in the UK to international norms (i.e. ISA)					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Because the UK is an English-speaking country					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Strength of your company's brand in the UK					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
The ease at which a business can be established in the UK					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Because the UK is highly open to international business					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
To help obtain business license or other approvals for your products in Europe					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Other, please specify: _____					

Section Four: Difficulties

17) To what extent do you agree or disagree that the following factors have **negatively** affected the ability of your company to develop its business in the UK?

Please select for each factor one box that matches your view most closely, as follows:

Strongly agree	Mildly agree	Neither agree nor disagree	Mildly disagree	Strongly disagree	Don't know
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Delays in obtaining international investment approval from the Chinese authorities					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Visa restrictions in China that hinder the movement of staff					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Weak support from the Chinese government (e.g. concerning market research, country information, international trade fairs)					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Difficulty in raising investment finance in China					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Inadequate tax exemptions for the export of equipment, raw materials and/or intermediate products from China to the UK					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Lack of international experience within your parent firm in China					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Problems arising from cultural differences between the UK and China					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Insufficient understanding of the UK business environment in your Chinese parent company					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Low level of technological capability in your parent company					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Difficulties in obtaining work visas from the British authorities					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Your company is not well known in the UK					
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Other, please specify: _____

Section Five: Determinants of Success

18) In your opinion how important have the following factors been in contributing to your company's **success** in the UK?

Please select for each factor one box that matches your view most closely, as follows:

Of utmost importance	Very important	Of moderate importance	Of little importance	Of no importance	Don't know
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

High levels of relevant business skills in your UK management team

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
--------------------------	--------------------------	--------------------------	--------------------------	--------------------------	--------------------------

Technological dominance of your company's products

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
--------------------------	--------------------------	--------------------------	--------------------------	--------------------------	--------------------------

You have British nationals on your management team in the UK

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
--------------------------	--------------------------	--------------------------	--------------------------	--------------------------	--------------------------

Demand for your company's products and/ or services is strong

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
--------------------------	--------------------------	--------------------------	--------------------------	--------------------------	--------------------------

Internationally experienced management team in your UK company

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
--------------------------	--------------------------	--------------------------	--------------------------	--------------------------	--------------------------

High level of marketing know-how in your British company

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
--------------------------	--------------------------	--------------------------	--------------------------	--------------------------	--------------------------

Your firm has good access to a widespread distribution network outside of the UK

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
--------------------------	--------------------------	--------------------------	--------------------------	--------------------------	--------------------------

Strong support from your Chinese parent company

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
--------------------------	--------------------------	--------------------------	--------------------------	--------------------------	--------------------------

Internationally-educated management team in your UK company

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
--------------------------	--------------------------	--------------------------	--------------------------	--------------------------	--------------------------

Your management team in the UK is made up of ethnic Chinese people

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
--------------------------	--------------------------	--------------------------	--------------------------	--------------------------	--------------------------

Other, please specify: _____

THANK YOU FOR YOUR COOPERATION !

Would you like to receive a **FREE** copy of the research findings?

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YES. Please give your Email address _____,
 fax number _____
 or postal address _____