The internationalisation of Chinese firms: determinants and the influence of dynamic capabilities and institutions on the post-internationalisation performance

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The Internationalisation of Chinese Firms: Determinants and the Influence of Dynamic Capabilities and Institutions on the Post-Internationalisation Performance

by

Lan Gao

A Doctoral Thesis
Submitted in partial fulfilment of the requirements for the award of Doctor of Philosophy of Loughborough University

2011

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Abstract

This thesis examines the rising phenomenon of the internationalisation of Chinese firms, and aims to shed new light on our understanding of the emergence of firms from emerging economies in the global market. It consists of two parts: the country level study and the firm level. The former identifies the domestic and locational determinants of Chinese outward foreign direct investment (OFDI), while the latter examines the influence of dynamic capabilities and institutions on the post-internationalisation performance of Chinese firms, with a focus on state-owned enterprises (SOEs).

To explore the domestic and locational determinants of Chinese OFDI, the thesis integrates network theory with the traditional explanations of OFDI, the investment development path and the eclectic paradigm. By doing so, a new factor, human mobility, is identified as one of the important domestic and locational determinants of Chinese OFDI. Drawing upon a time series data analysis for the period 1979-2007, this study confirms that Chinese OFDI is driven by its domestic economic development, human mobility and knowledge development and accumulation, and it has a substitute relationship with exports. By examining Chinese OFDI flows to 13 OECD countries over the period 1999-2007, it is shown that human mobility, the strategic assets of the host country, foreign direct investment to China and cultural distance have a positive impact on the locational choice of Chinese OFDI to OECD countries.

To investigate the influence of dynamic capabilities and institutions on the post-internationalisation performance of Chinese firms, this study integrates the dynamic capability framework and the institution-based view, and embeds the analysis in a multi-perspective conceptual framework. It draws on four case studies of Chinese SOEs. The analysis shows the importance of internal dynamic capabilities in achieving overseas success when dealing with changing environments. The managerial mindset has a moderate effect on the impact of dynamic capabilities on post-internationalisation performance. The case analysis also shows how the external institutional environment of both host and home countries influence the performance of Chinese SOEs.
Support from both host and home country governments, unsurprisingly, has a positive influence on performance. However, too much intervention from the home country government imposes constraints on the firms and reduces their willingness to commit to internationalisation.

This thesis makes a number of contributions to the existing literature. First, it provides a better understanding of the overall picture of Chinese OFDI from the macro perspective. The findings also contribute to our understanding of the rise of OFDI from emerging economies in general and from China in particular. Second, a new factor, human mobility, is identified and proved to be significant in determining Chinese OFDI. In this era of globalisation, human mobility has become the driving force of OFDI from emerging economies. Third, a first step is taken towards exploring the influence of both internal and external factors on the post-internationalisation performance of Chinese firms. In order to achieve overseas success, not only do Chinese firms need to improve their internal dynamic capabilities, but also attention needs to be paid to the external institutional environment, which has a significant impact on the performance of Chinese firms pursuing overseas success.

**Keywords:** Chinese OFDI, determinants, human mobility, Chinese SOEs, performance, dynamic capabilities, institutions
Dedication

This work is dedicated to my grandparents, Mr. Ruping Gao and Mrs. Qingrong Liu, and my parents, Mr. Feng Gao and Mrs. Zimin Wang.

“Did I ever tell you that you are my hero
You are everything I wish I could be
I can fly higher than an eagle
Because you are the wind beneath my wings”

—— Wind beneath My Wings
by Bette Midler (1989)

Grandpa, it is my biggest regret that you could not be here to see me graduating, but I know that you will be always watching and blessing me from Heaven.

Grandma, thank you for teaching me to be independent, generous and kind, to never give up, to hold on to my dreams, and to have the courage to pursue.

Dad, thank you for always being there for me, being my best teacher and mentor, being so confident in me and being so supportive.

Mum, thank you for bringing me to the world at the first place, for your unconditional love and sacrifice, for teaching me the real meaning of ‘family’.

I know I have made you proud, but not as proud as I am to call you, Grandpa, Grandma, Dad, Mum. I can never ever thank you enough for all you have done in my life. I love you, whenever and whatever!
Acknowledgement

First of all, I would like to take this opportunity to thank my supervisor, Professor Xiaohui Liu, for the enormous amount of effort and time that she has put into this thesis. Xiaohui is responsible for involving me in this research in the first place, helping me to develop my own research ideas and teaching me to apply econometric analysis (for I had no clue what they are). She taught me what ‘research’ really meant not only by words but also by action. Besides guiding me through my PhD, Xiaohui also helps me to develop my own research capabilities and become an independent researcher. Without her guidance, knowledge, encouragement and patience, it would have been impossible for me to finish this work. A special thank goes to my advisor Dr. Huan Zou for all her suggestions and comments which are highly appreciated. She is always there to listen and offer help. Also, I would like to thank my director of research, Professor Trevor Buck, for his insights and advice.

Second, I cannot say thank you enough to my family, especially my beloved grandparents and my parents, for giving me life and raising me up, for their love, support and encouragement, and for always believing in me. Also I would like to thank my aunt for her care and love, and for treating me as a daughter; my uncle for his wise advice and for his constructive comments on my thesis; my cousins for being brothers and sisters to me, and for listening to my complains and frustrations; my boyfriend, Gongtao Zhang, for his love and understanding, for sharing my happiness and sadness, and for being there for me always.

Last but not least, I thank all my friends for their support, for the laughter and tear we shared. I would like to thank my best friends Xiaojing Gu and Guanghui Zhang for always being there for me, and for always believing in me; my friends in Emmanuel Church, Jenny, Joey, Sarah, Cathey, Sigrun, Simon, Helen, Barry, David, Jon, Tim, Ivan for encouraging me to grow spiritually, for welcoming me to the big family and for helping me to settle in Loughborough;
my mentor, Anissa, for her kindness and wisdom, and for her guidance and prayers; my roommate Meimei, for her listening and encouragement; my MSc classmates Miao and Yuguang, for encouraging me to start a PhD, and for helping me to complete my MSc; my colleagues Xiao zheng, Linna, Yizhe, Zheng, Sabee, Mahani, Joao, David, and Teresa for sharing the PhD experience together.

*For all the people in my life, thank you for making the past few years so special for me. I will always cherish the memories we share. I love you all!*
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Acronym List

2SLS  two-stage least square  
ADF   Augmented Dickey-Fuller  
CEECs central and eastern European countries  
CITIC China's International Trust & Investment Corporation  
CEO   chief executive officer  
ECT   error correction term  
EIBC  Export-Import Bank of China  
EU    European Union  
FDI   foreign direct investment  
FERT  Foreign Economic Relation and Trade  
GDP   gross domestic product  
GMM   generalised method of moments  
IDP   investment development path  
M&As  mergers and acquisitions  
LCD   liquid crystal display  
LR    likelihood ratio  
MNEs  multi-national enterprises  
MOC   Ministry of Commerce  
NDRC  National Development and Reform Commission  
NOI   net outward investment  
OECD  Organisation for Economic Co-operation and Development  
OFDI  outward foreign direct investment  
OLI   ownership location internalisation  
OLS   ordinary least square
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<td>PBC</td>
<td>People's Bank of China</td>
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<tr>
<td>R&amp;D</td>
<td>research and development</td>
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<tr>
<td>ROC</td>
<td>return on capital</td>
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<td>SAFE</td>
<td>State Administration for Foreign Exchange</td>
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<td>SASAC</td>
<td>State Asset Supervision and Administration Commission</td>
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<td>SC</td>
<td>State Council</td>
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<td>SOEs</td>
<td>state-owned enterprises</td>
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<tr>
<td>TNI</td>
<td>transnational index</td>
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<td>UNCTAD</td>
<td>United Nations Conference on Trade and Development</td>
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<td>UNESCO</td>
<td>United Nations Educational, Scientific and Cultural Organisation</td>
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<td>VECM</td>
<td>vector error correction model</td>
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<td>VIF</td>
<td>variance inflation factor</td>
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<td>WIR</td>
<td>World Investment Report</td>
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Chapter 1  Introduction

1.1 Introduction

According to the International Monetary Fund (IMF)’s *Balance of Payments Manual* (1993), foreign direct investment (FDI) is an investment made in order to acquire lasting interest in firms operating in a foreign economy. The investor’s purpose is to gain an effective voice in the management of the firm. In terms of capital flow, only capital that is provided by the direct investor, either directly or through related firms, may be classified as FDI. The forms of investment include equity capital transfers, the reinvestment of earnings, and inter-company loans.

Organisation for Economic Co-operation and Development (OECD) (1996) defines a direct investment firm as a foreign investor which either owns 10% or more of the ordinary shares or voting power of a firm (unless it can be proven that the 10% ownership does not allow the investor an effective voice in the management), or owns less than 10% of the ordinary shares or voting power of a firm, yet still maintains an effective voice in management.

Based on the two definitions above, an effective voice (or control) in management becomes the distinguishing characteristic of FDI. Firms generally use greenfield investments, joint ventures, mergers and acquisitions (M&As) to ensure their controlling power in management. From countries’ perspective, FDI is considered to be an ‘engine of growth’, a source of competitive pressure on domestic industries and a force of integration bringing national economies closer together (Nicolaides, 1992). Central governments can utilise FDI as an economic tool to balance countries’ deficit or surplus position in international payments. For individual firms, FDI is conventionally considered as an approach to exploiting its ownership advantages in foreign markets, in order to raise a firm’s market share and maximise its profit.
In the first decade of the 21st century, FDI, as a conventional approach for firms from developed countries to expand especially in emerging economies and developing countries, has been gradually adopted by firms from emerging economies in order to engage in globalisation. Outward investment from emerging economies remained high in 2007 at $253 billion with a 19.3% annual growth rate (WIR, 2008), which points to the increasing dynamism of this group of countries as sources of FDI. This phenomenon has attracted the attention of researchers and raised new challenges for us to fully understand the internationalisation of firms, especially those from emerging economies. This thesis examines the domestic and locational determinants of Chinese OFDI at the country level. At the firm level, it investigates the influence of dynamic capabilities and the institutional environment on the post-internationalisation performance of Chinese firms. It intends to contribute to the understanding of the OFDI wave from emerging economies, and the theoretical development of the internationalisation of emerging economies in general, by studying the OFDI of one of the largest emerging economies, China.

1.2 Research Context

In 2007, global OFDI amounted to $1,997 billion with a 50.9% annual growth rate (WIR, 2008). The proportion which emerging economies contributed to global OFDI increased from 2.25% in 1985 to 12.67% in 2007 (WIR, 2008). This surge of OFDI from emerging economies was accompanied by the quick emergence of multi-national enterprises (MNEs) from these economies. Although in the 1990s more than 90% of all MNEs were headquartered in developed countries, by 2008 MNEs from emerging economies and developing countries accounted for more than a quarter (28%) of the 82,000 MNEs worldwide (WIR, 2010). Although most of these MNEs are relatively small, a number of large ones with global ambitions have started to emerge on the scene. By the end of 1999, only one among the top 100 MNEs was from an emerging economy. However, in 2007 the number increased to seven which represented a wide range of activities and diverse origins (three from
the Republic of Korea, and one each from China, Hong Kong (China), Malaysia and Mexico) (WIR, 2009).

The surge of global OFDI, especially that of emerging economies has raised some interesting research questions. Why are firms from emerging economies investing abroad? Why are certain locations more attractive to OFDI from emerging economies than others? Is there any difference between the motives of firms from developed countries and those from emerging economies?

There is a great debate on whether the theories developed to explain the activities of traditional MNEs from developed countries, such as the eclectic paradigm (Buckley and Casson, 1991; Dunning, 1977, 1988) and the resource-based view (Peteraf, 1993; Wernerfelt, 1984) can be applied to MNEs from emerging economies. Some researchers find that the motives behind the international expansion of MNEs from emerging economies are often different from those of traditional MNEs from developed countries (Lu et al., 2010a). Market and efficiency related factors are important for both groups, but MNEs from emerging economies are also heavily influenced by increasing competition, both domestic and global, created by traditional MNEs and also by home and host institutional environments (Buckley et al., 2007a; WIR, 2006; Wright et al., 2005).

The conventional theoretical explanations of the OFDI activities can be summarised as: 1) accessing new foreign markets where firms can exploit existing ownership advantages to create competitive advantages; 2) increasing efficiency by entering foreign markets with locational advantages, such as lower labour cost and lower tax; 3) accessing or acquiring natural resources which are scarce or unsustainable in the home country; 4) acquiring specialised technologies, knowledge and new capabilities in foreign markets; and 5) reducing transaction costs by internalising the external markets.
China has been chosen as the research setting for this thesis, not only due to its rapid economic development but also its growing importance in the world FDI. As one of the fastest growing players in international investment, China has attracted the attention of the world because of the increasing number and variety of Chinese firms investing abroad. Nowadays, China is not only acting as the global factory, but is also playing an essential part in global investment. Not only can products made in China be found in every corner of the world, but Chinese firms, including wholly owned subsidiaries, joint ventures, acquired subsidiaries and merged organisations, are also established all over the world, from developed countries, such as the US, Japan and the European Union (EU), to developing countries, such as Cambodia, Mali and Zambia. From 1979 to 2007, Chinese inward FDI was US$251 billion and OFDI was only US$74 billion (United Nations Conference on Trade and Development (UNCTAD), 2008). However, during the period 1991 to 2007, the average annual growth rate of Chinese OFDI flow was 66%\textsuperscript{1}.

\textsuperscript{1} : Calculated by the author based on the data from UNCTAD FDI database (2008).
Previous studies of Chinese OFDI have by and large been consistent with conventional theoretical explanations. Chinese OFDI has been proved to be driven by domestic economic development (Zhang et al., 1996; Liu et al., 2005), and mainly focused on the search for markets, natural resources and strategic assets at both aggregate level (for example, Buckley et al., 2007a) and firm level (for example, Deng, 2007, 2009; Lu et al., 2010). These studies approached the question by exploring the relationships between Chinese OFDI and economic factors (such as economic development, trade and inward FDI), resource factors (such as natural resources and strategic assets) and institutional factors (such as cultural distance and political risk).

One of the important factors which have been largely overlooked in the past is human mobility. In this era of globalisation, finance capital is not the only form of capital floating around the world. The ever more open global environment makes it much easier for human capital to mobilise across countries. China has become the home country with the largest overseas ethnic group and the
highest number of overseas students (United Nations Educational, Scientific and Cultural Organisation (UNESCO), 2008). The old ‘brain drain’ concern, caused by the emigration of high end human resources, may convert into a network advantage and human resources boost generated by two-way human mobility. The relationship between finance capital flow and human mobility, which is yet to be thoroughly examined in the context of Chinese OFDI will be addressed in this study.

Another interesting topic raised by the emergence of MNEs from emerging economies is their performance in the global market. Although Chinese firms are increasing their investments in the global market, including developed countries, their performance has not yet provided satisfactory profits. For example, TCL, the leading electronics business in China, bought the television arm of France’s Thomson in 2003 as well as the handset operations of France’s Alcatel. Both acquisitions caused huge financial loss. As a result, TCL finally decided to shut down most of its European operation\(^2\). Lenovo, the largest manufacturer of PCs in China, acquired IBM’s PC unit in December 2005 for US$1.75 billion. Two years later, in 2007, Lenovo lost its third place in the global PC market to Acer. Meanwhile, Lenovo’s market share in China decreased from 40% to 30%\(^3\). Shanghai Automobile Group acquired a 48.92% share of Ssang Yong Moto (Korean) in 2004 for $500 million. However, Ssang Yong Moto went into administration in 2009\(^4\).

Previous research on the internationalisation of Chinese firms has been mainly focused on motives, while researchers studying internationalisation


\(^3\) [http://money.163.com/09/0311/14/544NAL6U002524U1.html](http://money.163.com/09/0311/14/544NAL6U002524U1.html) accessed on 10/09/2010

\(^4\) [http://money.163.com/09/0311/14/544ND048002524U1.html](http://money.163.com/09/0311/14/544ND048002524U1.html) accessed on 10/09/2010
performance have largely focused on the developed-to-developed country context (e.g. Japanese MNEs operating in the US or Europe) and the developed to emerging economies (e.g. western MNEs investing in China) (Demirbag et al., 2007; Wright et al., 2005). However, factors affecting the post-internationalisation performance of Chinese firms have received scant attention in the academic world.

This thesis seeks to redress the balance. First, the thesis proposes to re-examine the domestic and locational determinants of Chinese OFDI by exploring the relationship between Chinese OFDI and human mobility. Second, the appropriate econometric analysis methods will be applied to the most up-to-date data in order to find the dynamic changes in the determinants of Chinese OFDI. Third, this study will take the first step to identify both internal and external factors which influence the post-internationalisation performance of Chinese firms.

1.3 Research Questions and Research Objectives

This thesis aims to examine three research questions at two different levels as specified below.

Country level:

Q1: What are the domestic determinants of Chinese OFDI?

Q2: What are the locational determinants of Chinese OFDI to OECD countries?

Firm level:

Q3: How do dynamic capabilities and institutional environments influence the post-internationalisation performance of Chinese SOEs?
At the country level, the domestic determinants of Chinese OFDI, and the locational determinants of Chinese OFDI to OECD countries are investigated. The former (research question \( Q1 \)) attempts to identify the internal ‘push’ factors influencing Chinese OFDI, while the latter (research question \( Q2 \)) will enrich our understanding of the reasons, the ‘pull’ factors, why MNEs from emerging economies invest in developed countries where they have comparative ownership disadvantages. At the firm level, the influence of Chinese SOEs’ dynamic capabilities (internal factors) and institutional environments (external factors) on their post-internationalisation performance is investigated (research question \( Q3 \)). Each research question has its own research objectives, and is designed to deepen our understanding of the internationalisation of Chinese firms. All the three research questions and objectives will be described and defined in detail in this section.

1.3.1 Country Level

The country level study of this thesis consists of two parts: the domestic determinants of Chinese OFDI and the locational determinants of Chinese OFDI to OECD countries. In order to examine the domestic determinants and locational choices of China’s OFDI at the country level and provide a comprehensive picture, the author divides the country level study into two parts to identify the macro-economic factors ‘pushing’ and ‘pulling’ Chinese OFDI. By doing so, this study reveals not only how domestic development generates Chinese OFDI, but also how advantages and/or disadvantages of host countries comparing to China attract Chinese OFDI. There are both theoretical and methodological reasons to divide the country level study into two parts. Although the domestic determinants and locational choices of Chinese OFDI are related themes, the theoretical foundations for the two parts are different. The former is based on Dunning’s IDP framework; while the later the eclectic paradigm and its extensions (see Chapter 3 for details). In terms of research method, the domestic determinants are examined based on time series analysis and the longitudinal development of China; and the
locational choices involve panel data analysis and the comparison between China and various host countries.

1.3.1.1 Domestic determinants of Chinese OFDI

In traditional internationalisation theories, such as the investment development path (IDP) framework (Dunning, 1981, 1986; Dunning and Narula, 1996), a country’s OFDI position has been linked to its economic development at the aggregate level. The IDP framework established a relationship between a country’s OFDI position and its economic development level. Various studies have proved that as a country’s economy grows and the GDP per capita increases, the economy generates more OFDI.

However, later research also finds that the level of economic development alone cannot sufficiently explain a country’s OFDI activity (Lee and Slater, 2007; Liu et al., 2005). Therefore, this study aims to develop IDP development stages by incorporating network theory and knowledge-based view, explaining how human mobility and knowledge development and accumulation, together with other conventional factors, can motivate or influence a country’s OFDI.

It is important to understand the domestic determinants of Chinese OFDI. The development path of China has been considered as a miracle. Studying the IDP of China provides researchers with a great opportunity to understand the OFDI behaviours of latecomer economies in general, and to test conventional theoretical frameworks in order to contribute to theoretical development and knowledge generation. For policy makers, this research may help them to understand the relationship between OFDI and domestic economic development. Then governments may choose to use the policy leverage to either accelerate or slow down the speed of OFDI. For business managers, the result may lead to a better understanding of the behaviour of their Chinese counterparts. In the evermore competitive business world, an understanding of the counterparts’ strategies helps firms to identify potential rivals and/or partnership opportunities.
To summarise, research question Q1 intends to investigate the domestic determinants of OFDI from China, in particular, by examining the roles which human mobility and knowledge development and accumulation play in promoting Chinese OFDI, in order to extend the traditional IDP framework from the network theory and knowledge-based view perspectives. To the author’s best knowledge, this study is the first one to incorporate both network theory and knowledge-based view into IDP in order to capture the big picture of the relationship between a country’s OFDI activity and its economic and social development.

1.3.1.2 Locational determinants of Chinese OFDI in OECD countries

For any firm wishing to gain access to foreign markets, the choice of location is a critical decision (Ellis, 2000; Reid and Rosson, 1987). Douglas and Graig (1992, p. 302) state that ‘the choice of which country to enter commits a firm to operating on a given terrain and lays the foundation for its future international expansion. It signals the firm’s intent to key competitors and determines the basis for future battles’.

The traditional eclectic paradigm (Dunning, 1977, 1980, 1988) interprets MNEs’ internationalisation behaviour as a process of exploiting their ownership advantages in host markets with location advantages by applying their internalisation advantages. This conclusion is largely drawn from the early pattern of internationalisation of MNEs from developed countries and from some newly industrialised economies, such as Korea, Hong Kong, Singapore and Taiwan. However, the extent to which the traditional theory can successfully explain the OFDI phenomenon of emerging economies, especially that from emerging economies to developed economies, has been challenged by various researchers (for example, Buckley et al., 2007a).

According to the Ministry of Commerce (MOC, 2008b), investment in OECD countries only accounted for 11% of total Chinese OFDI in 2007. Yet the growth rate of this part of Chinese OFDI is astonishing. Over the time period
covered by this study, from 1999 to 2007, Chinese OFDI to OECD countries grew from US$ 181.60 million to US$ 2,916.43 million, with an average annual growth rate of 41.49% (MOC, 2008b). Many famous acquisition and merger cases completed by Chinese firms during this time period took place in OECD countries. For example, Nanjing Automotive Industry Corporation acquired MG Rover for £60 million to establish research and production facilities in the UK; Hair entered the Japanese market by founding a joint venture with Sanyo with Hair holding 60% of the joint venture stake, and established manufacturing plants in South Carolina in the USA.

The rise of Chinese OFDI has raised important theoretical and empirical questions about the factors affecting the locational choices of Chinese enterprises. Blonigen’s (2005, p. 397) review of the empirical literature on FDI determinants reveals that ‘the factors that determine FDI into developed countries is simply much different than into less-developed countries, and that these differences are still not captured adequately in the empirical specifications that we currently estimate’. Chakrabarti (2001) also finds that most determinants of cross-country FDI are fairly fragile statistically. Dunning (1998) points out that the geography of OFDI is quite strongly country specific, though some of the factors explaining the location of FDI may not be unique to its country of origin.

It is widely recognised that patterns of FDI across different geographical regions need to be examined over time, because factors motivating initial MNE investment into a country could change, which leads to investment interests in other locations (Sethi et al., 2003). Buckley et al. (2007a)’s comprehensive empirical research on determinants of Chinese OFDI finds that, prior to 2001, Chinese OFDI had been driven by market-seeking, natural resource-seeking, cultural proximity and institutional support. However, in 2001, the promotion of FDI by the Chinese central government was formalised in the 10th five-year plan, which explicitly outlined the ‘Go Global’ or ‘Zou Chu Qu’. Since then, both the MOC and the National Development and Reform Commission (NDRC) have explicitly encouraged Chinese firms to
invest abroad in order to obtain advanced technologies, management skills and highly skilled personnel. The idiosyncratic state-directed characteristic of Chinese OFDI may well lead to new patterns of investment (Buckley et al., 2007a).

Research question Q2 of this thesis intends to shed light on the determinants of OFDI from emerging economies to developed economies. In particular, a first step is taken toward examining the impact of human mobility on the locational choice of Chinese OFDI, highlighting the impact of two-way human capital flows between China and OECD countries. Moreover, this study uses the most recent dataset to discern the possible changes in the patterns of Chinese OFDI to developed countries by comparing the result to previous studies about locational determinants of Chinese OFDI. Appropriate econometric methods will be applied to analyse the data in order to minimise possible bias.

1.3.2 Firm Level

Many previous studies (e.g. Capar and Kotabe, 2003; Contractor et al., 2003; Lu and Beamish, 2001; Lu and Beamish, 2004; Wan and Hoskisson, 2003) have been devoted to disclosing the nature of the relationship between internationalisation and firm performance, but achieved little consensus. The failure to establish a universal relationship between internationalisation and firm performance triggered a discussion among international business researchers 'as to whether such a relationship really exists or whether there are simply several context-dependent relationships reflecting the conditions when and how internationalisation and firm performance relate' (Bausch and Krist, 2007, p. 319). The present study aims to address how internationalisation performance is affected by various factors, rather than whether or what relationship exists between internationalisation and firm performance.
International operations are highly uncertain (Shenkar, 2001) and subject to risk and failure (Bausch and Krist, 2007). Despite the attraction of internationalisation, the performance of firms investing overseas, whether through M&A transactions, joint ventures or greenfield, has been rather disappointing. In a study of 1,700 M&As in the USA, Europe and Japan, Harding and Rovit (2004) quote a failure rate of 70%. Similar studies of joint venture, which generally outperforms the M&A mode (Li and Guisinger, 1991, Woodcock et al., 1994), suggest that they are highly unstable too: almost a quarter are terminated within the first three years (Kogut, 2002). An estimated 37-70% of international joint ventures are reported to suffer from performance problems leading to costly failures (Cullen, 2002; Fedor and Werther, 1995; Harrigan, 1985; Parkhe, 1991). Although greenfield investments normally outperform the joint venture mode, they are also accompanied by high risks, thanks to the large initial investment required. In light of the growing number of FDI and the relatively high rate of foreign entry failure, academics and managers have become extremely keen to understand the factors that affect the post-internationalisation performance.

In China, there are many different types of ownership of firms. The main ones are state-owned, collective-owned, private, jointly owned, share-holding and cooperative. Thanks to their different development paths, ownership and size, these firms differ in the organisational structures and processes, management systems and resource availability (such as financial, skills, personnel, management and information) needed to expand their operations abroad (Carrier 1994; Shuman and Seeger, 1986). Within emerging economies, SOEs significantly differ from entrepreneurial start-ups and foreign entrants (Peng, 2003) in terms of internationalisation strategies, the impact of institutional factors, and environmental dynamics (Wright et al., 2005). In
order to increase comparability across case studies, a specific type of ownership, SOE\textsuperscript{5}, has been chosen as the subject of this study.

The internationalisation process of Chinese SOEs, as a distinct and easily identifiable phenomenon, provides us with an ideal context to study how Chinese SOEs achieve their overseas success. This study employs a multi-lens and multilevel research strategy to understand the factors influencing Chinese SOEs’ post-internationalisation performance. Based on a theoretical foundation combining dynamic capability and institution-based view, this study will take the first step towards investigating the effect of both internal firm-level factors, dynamic capabilities, and external country-level factors, home and host country institutional environments on post-internationalisation performance of Chinese SOEs. By doing so, this study provides new insights into the factors leading to overseas success.

By examining these research questions, this thesis attempts to make contributions to the development of internationalisation theories in the international business field based on the analysis of the internationalisation of Chinese firms for three main reasons. First, as a growing power in the world economy, China poses many challenges to conventional internationalisation theories, which were largely based on the experience of MNEs from developed countries. China provides researchers with a perfect test-case for

\textsuperscript{5} In the early 1990s, forepart from a few joint ventures and joint-stock companies, firms in China had one of the three types of ownership: state-owned enterprises; collective enterprises (including urban collectives and rural collectives); and private enterprises (including foreign firms). The latter two together are referred to as “non-state-owned firms”, while the first two together are referred to as “publicly-owned firms”. SOEs are all owned by the central government, but they are supervised by the central, provincial, city, and county governments. During the reformation and restructuring of SOEs, some SOEs became joint ventures with collective and/or private enterprises. For these joint ventures, if the government holds more shares than any other shareholders, which means the government is in control of the joint venture, they are named as state-holding enterprises. In this study, the term ‘SOE’ refers to both state-owned and state-holding enterprises.
conventional theories, in order to ascertain whether new theories need to be
developed to explain the rise of emerging economies.

Second, as emerging economies become important contributors to the world
OFDI and economic development, the case of China is not just of interest for
understanding China per se, but more importantly for understanding the
internationalisation of emerging economies in general. The sheer magnitude
and fast growth of OFDI that China has generated in such a short period of
time provide abundant information for researchers to examine the
internationalisation pattern of emerging economies from a multi-dimensional
perspective.

Third, the internationalisation of Chinese firms is of interests not only to
academics, but also to policy makers and managers. A great potential of this
research is to highlight the implications for future policy making and
managerial practice. For policy makers, the country level study of this thesis
will provide more insights on the determinants of Chinese OFDI, which can
help to promote or attract Chinese OFDI. At the firm level, this study will
contribute to managers’ knowledge of factors influencing post-
internationalisation performance with the aim to help Chinese firms further
understand the capabilities and institutional environments needed for
successful internationalisation.

**1.4 Structure of the Thesis**

This thesis consists of eight chapters. Chapter 2 comprehensively describes
the history and institutional environment of Chinese OFDI. The three major
phases of Chinese OFDI, locational and industry distribution and the
development of Chinese MNEs are first described and discussed. Then the
institutional environment of Chinese OFDI is also addressed, focusing on the
role of the government and the financial support provided by the country’s
policy banks.
The main body of the thesis consists of two parts in accordance with the research questions at different levels. The first part is at the country level whilst the second is at the firm level.

The country level study, which consists of Chapter 3, 4 and 5, answers research questions Q1 and Q2. Chapter 3 provides the literature review for the country level research. In this chapter, major internationalisation theories, including the IDP framework and the eclectic paradigm, and relevant applications are reviewed, and the term human mobility is conceptualised. Chapter 4 is the empirical study to identify the domestic determinants of Chinese OFDI, which answers the research question Q1. Chapter 5 is an attempt to identify the locational determinants of Chinese OFDI to OECD countries, which answers the research question Q2.

The second part of this study, which focuses on the firm level and consists of Chapter 6 and 7, will answer research question Q3. Chapter 6 reviews previous internationalisation performance research, and constructs the theoretical framework proposed by the author based on a literature review of previous research. Chapter 7 presents the process of the case studies and the case evidences. The findings of the case studies are discussed in Chapter 7, and propositions are put forward.

Chapter 8 concludes the whole thesis by summarising the main findings and contributions, acknowledging the limitations, presenting practical and political implications and raising questions for possible future research.
Chapter 2    OFDI of China

2.1 Introduction

In the past three decades, the world has witnessed the miraculous renaissance of a country with a long and splendid history, China. In 1978, the Chinese government decided to set the economy as the centrepiece of the country’s development. The famous ‘Reform and Open’ policy signified the beginning of China’s transformation from a planned economy to a market economy.

Accompanying this dramatic internal development has been the increasing influence which China has developed in the global economy. Many Chinese firms speedily developed the knowledge and capabilities which they need to compete in international markets. Nowadays, these Chinese firms are not only defending their ground against traditional MNEs in the Chinese domestic market, but also pushing through their internationalisation reform in order to establish their positions on the global stage. This chapter will explain the history of the internationalisation of Chinese firms, and the economic and institutional environment that gave rise to this process.

2.2 The International Integration of the Chinese Economy

After its establishment in 1949, the People’s Republic of China went through a dramatic reformation of its economy. The economic reform and deregulation started in 1978, signalled by the ‘Reform and Open’ policy. From that time onwards, China gradually started to transform its planned economy into a market economy, to restructure its domestic industries and to integrate its economic and business activities with the global economy. During this period of reformation, thanks to the deregulation and liberation of the market, many SOEs were restructured, or even privatised. These SOEs gradually lost their monopoly position in the domestic market. In addition, private firms emerged
spontaneously all over the country, and MNEs from developed countries have set foot in this vast market with 1.3 billion potential customers. Since then, many Chinese firms have found themselves fighting for survival against not only domestic competitors but also MNEs from developed countries. In order to survive, these Chinese firms quickly grew and solidified their positions in the domestic market. They learnt from their foreign competitors in order to extend their antennas to overseas markets.

2.2.1 The International Integration of the Chinese Economy

In 2007, China became the 19th biggest OFDI home country in the world. In 2008, although the world OFDI declined because of the financial crisis, Chinese OFDI increased from US$ 22.47 billion to US$ 52.25 billion, and took the 14th place in OFDI flow by country (UNCTAD, 2009). From no OFDI to more than US$ 50 billion per year, from the bottom to the 14th place in the league table, China climbed the OFDI ladder at an amazing speed in the space of thirty years.

Figure 2.1 Chinese OFDI Flow and Stock 1979-2007 (2000 constant US$ Million)

Source: UNCTAD (2009)
Table 2.1 Phases of Chinese OFDI

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Phase 3: 2000/2001 onward</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
</tbody>
</table>
Three main phases are proposed in this study, following the change of the government perspective on OFDI over time and the development of Chinese OFDI: Phase 1 Initiating (1979-1991), Phase 2 Accelerating (1992-2000), and Phase 3 Take off (2001-present).

2.2.1.1 Phase 1: Initiating (1979-1991)

The average annual OFDI flow during this time period was US$ 879.26 million (constant value of year 2000). The internationalisation of Chinese firms started immediately after the government established the ‘Reform and Open’ policy in 1978. In August 1979, the State Council issued a circular announcing 15 economic reformation measures. The 13th measure explicitly stated that Chinese firms were allowed to invest abroad for the first time in the history of China. In November 1979, Beijing Youyi Business Service Company founded a joint venture, Jinghe Co. Ltd., with Tokyo Maruichi Ltd. of Tokyo, Japan. This was the first OFDI project after the establishment of the ‘Reform and Open’ policy. The major function of the joint venture was to import technologies and equipments for food production companies in Beijing, and to provide service and training in Japan (Zhang, 2008).

At this stage, developing countries were the main target markets of Chinese OFDI, and only a very small portion was invested in developed countries. Industries and sectors which generated most OFDI included mining, manufacture, construction, transportation, finance and tourism. By the end of 1991, the Chinese government had approved more than 800 overseas trade agents and 911 non-trade OFDI projects (Liu, 1992). Most of the firms were SOEs, and the main entry modes were joint venture and greenfield (Zhang, 2008).

2.2.1.2 Phase 2: Accelerating (1992-2000)

The average annual OFDI flow from 1992 to 2000 increased to US$ 3.12 billion (constant value of year 2000), which was 3.5 times the average annual OFDI flow in Phase 1. At the same time, Chinese firms started to face
increasingly fierce competition in the domestic market, because of the rise of the market-oriented economy and the country’s openness. Many industry leaders and successful firms started to consider OFDI as a self-development opportunity and proactively designed their internationalisation strategies.

Between 1992 and 2000, not only SOEs but also some private firms started going abroad and operating internationally. Industries generating OFDI became more diverse in this phase. Chinese OFDI was not limited to setting up representative offices and trade agents in host countries anymore. More and more Chinese firms set up their own subsidiaries or had a controlling interest in overseas joint ventures. The scale and scope of Chinese OFDI increased significantly during this time period. By the end of 2000, there were 62,981 non-financial Chinese overseas companies (MOC, 2001b). Chinese OFDI, especially the overseas manufacturing investments, had a significant positive impact on exports (Zhang, 2008). It was estimated that, each year, approximately US$ 100 million material and intermediate products were exported caused by OFDI (MOC, 2001b).

2.2.1.3 Phase 3: Take off (2001 onward)

The average annual OFDI flow from 2001 to 2007 reached US$ 9.51 billion (constant value of year 2000), which tripled the value of Phase 2, and was almost 11 times as much as the value of Phase 1. During this period, not only did the amount and the volume of Chinese OFDI increase dramatically, but also the impact of Chinese OFDI on the world economy. Some Chinese firms started to acquire or merge with their competitors in developed countries, which caught the world’s attention, such as the acquisition of IBM PC unit by Lenovo in 2005.

In 2000, the central government issued the ‘Go Global’, or ‘Zou Chu Qu’, strategy. Since then, there have been two parallel strategies concerning Chinese foreign economic relations and trade: ‘Go Global’ (‘Zou Chu Qu’) and ‘Invite in’ (‘Yin Jin Lai’) under the ‘Reform and Open’ economic development framework. In 2001, China became a member of the World Trade
Organisation (WTO). The ‘Go Global’ policy and the membership of WTO significantly boosted Chinese firms’ enthusiasm (Zhang, 2008), and from the second half of 2001, the internationalisation of many Chinese industries took off.

2.2.2 Locational and Industrial Distribution of Chinese OFDI

By the end of 2008, more than 90% of Chinese OFDI was invested in Asia, Latin America and Africa (Figure 2.2). Hong Kong alone attracted 63% of Chinese OFDI stock by the end of 2008 and 69.1% of Chinese OFDI flow in 2008 (MOC, 2009a). In the thirty years of Chinese firms’ OFDI, most investments went to countries geographically and culturally close to China: 66.5% of Chinese OFDI had gone to Hong Kong and Southeast Asian countries. Although the proportion of Chinese OFDI to developed countries in total Chinese OFDI fluctuated around 10% (Table 2.2), the absolute value of Chinese OFDI to developed countries has increased at a steady pace in the past thirty years (MOC, 2009b).

Figure 2.2 2008 Chinese OFDI Stock by Region

Source: MOC (2009a)
Table 2.2 2003-2008 Chinese OFDI Flow by Region (Percentage %)

<table>
<thead>
<tr>
<th>Region</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asia</td>
<td>52.5</td>
<td>54.6</td>
<td>35.6</td>
<td>43.4</td>
<td>62.6</td>
<td>77.9</td>
</tr>
<tr>
<td>Latin America</td>
<td>36.5</td>
<td>32.0</td>
<td>52.6</td>
<td>48.0</td>
<td>18.5</td>
<td>6.6</td>
</tr>
<tr>
<td>Africa</td>
<td>2.6</td>
<td>5.8</td>
<td>3.3</td>
<td>2.9</td>
<td>5.9</td>
<td>9.8</td>
</tr>
<tr>
<td><strong>Sub Total</strong></td>
<td><strong>91.6</strong></td>
<td><strong>92.4</strong></td>
<td><strong>91.5</strong></td>
<td><strong>94.3</strong></td>
<td><strong>87.0</strong></td>
<td><strong>94.3</strong></td>
</tr>
<tr>
<td>Europe</td>
<td>5.3</td>
<td>3.1</td>
<td>4.2</td>
<td>3.4</td>
<td>5.8</td>
<td>1.6</td>
</tr>
<tr>
<td>North America</td>
<td>2.0</td>
<td>2.3</td>
<td>2.6</td>
<td>1.5</td>
<td>4.3</td>
<td>0.6</td>
</tr>
<tr>
<td>Oceania</td>
<td>1.1</td>
<td>2.2</td>
<td>1.7</td>
<td>0.8</td>
<td>2.9</td>
<td>3.5</td>
</tr>
<tr>
<td><strong>Sub Total</strong></td>
<td><strong>8.4</strong></td>
<td><strong>7.6</strong></td>
<td><strong>8.5</strong></td>
<td><strong>5.7</strong></td>
<td><strong>13.0</strong></td>
<td><strong>5.7</strong></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100.0</strong></td>
<td><strong>100.0</strong></td>
<td><strong>100.0</strong></td>
<td><strong>100.0</strong></td>
<td><strong>100.0</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>

Source: MOC (2004a -2009a)

Figure 2.3 presents all the industries with an OFDI stock over one billion US$ by the end of 2008. The business service sector generated the most OFDI stock over the years among all industries and sectors.

Figure 2.3 Chinese OFDI Stock by Industry, 2008 (Current US$ Million)

Source: MOC (2009a)
Different regions have attracted investments of different industries and sectors. In 2009, MOC (2009a) published the distribution of investments of different industries and sectors in major economic regions (Table 2.3). In Hong Kong, the EU and the US, the service sector, finance, wholesale and retailing and manufactory accounted for around 80% of the total Chinese OFDI stock. In Southeast Asia, Chinese OFDI is more diverse. One fifth of Chinese OFDI in this region was concentrated in the power and utilities industry, followed by manufactory accounting for 17.5%. The proportion of investment in tertiary industries is significantly lower than that in more developed regions, such as the EU and the US. Chinese OFDI in Australia is similar to neither developed countries nor developing countries, with nearly three quarter of the investments in mining industry thanks to the rich natural resources in that country. The industrial distribution of Chinese OFDI in different regions reflects the variety of motivations for Chinese OFDI locational choices.
<table>
<thead>
<tr>
<th>Industry</th>
<th>Hong Kong</th>
<th>EU</th>
<th>America</th>
<th>Australia</th>
<th>Southeast Asia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leasing and business service</td>
<td>30.2</td>
<td>10.5</td>
<td>7.4</td>
<td>5.9</td>
<td>13.4</td>
</tr>
<tr>
<td>Finance</td>
<td>26.9</td>
<td>24.4</td>
<td>13.2</td>
<td>2.6</td>
<td>6.9</td>
</tr>
<tr>
<td>Wholesale and retailing</td>
<td>22.5</td>
<td>14.0</td>
<td>36.0</td>
<td>9.8</td>
<td>10.9</td>
</tr>
<tr>
<td>Manufactory</td>
<td>3.1</td>
<td>25.6</td>
<td>23.5</td>
<td>3.6</td>
<td>17.5</td>
</tr>
<tr>
<td>Sub Total</td>
<td>82.7</td>
<td>74.5</td>
<td>80.1</td>
<td>21.9</td>
<td>48.7</td>
</tr>
<tr>
<td>Mining</td>
<td>1.9</td>
<td>7.2</td>
<td>1.3</td>
<td>73.0</td>
<td>6.7</td>
</tr>
<tr>
<td>Transport, warehousing and postal service</td>
<td>9.8</td>
<td>5.4</td>
<td>9.4</td>
<td>1.3</td>
<td>9.3</td>
</tr>
<tr>
<td>Real estate</td>
<td>2.9</td>
<td>2.1</td>
<td>1.0</td>
<td>2.0</td>
<td>0.4</td>
</tr>
<tr>
<td>Construction</td>
<td>0.4</td>
<td>N/A</td>
<td>1.2</td>
<td>0.9</td>
<td>7.6</td>
</tr>
<tr>
<td>Science research, service and geo-survey</td>
<td>N/A</td>
<td>N/A</td>
<td>1.2</td>
<td>N/A</td>
<td>1.9</td>
</tr>
<tr>
<td>Power and other utilities</td>
<td>0.3</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>21.4</td>
</tr>
<tr>
<td>IT</td>
<td>N/A</td>
<td>N/A</td>
<td>4.1</td>
<td>N/A</td>
<td>0.5</td>
</tr>
<tr>
<td>Agriculture, forestry, husbandry, fishery</td>
<td>N/A</td>
<td>4.4</td>
<td>N/A</td>
<td>N/A</td>
<td>3.0</td>
</tr>
<tr>
<td>Water, environment and public facility management</td>
<td>0.9</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Others</td>
<td>1.1</td>
<td>6.4</td>
<td>1.7</td>
<td>0.9</td>
<td>0.5</td>
</tr>
<tr>
<td>Total</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: MOC (2009a)

2.2.3 Chinese MNEs

The history of Chinese MNEs has been determined by the unique development path of the Chinese economy. Before the ‘Reform and Open’ policy initiated in 1978, the Chinese economy was dominated by SOEs. The economy was very self-contained. Firms were under governmental administration, and there was a lack of modern corporate governance.
In Phase 1 of the internationalisation of Chinese firms (1979-1991), the central government started to lose its tight grasp on the economy and open up certain industries to make space for domestic collective firms and foreign capital to grow. However, at this stage, only traditional SOEs had the resources and strategies needed for international expansion. Some construction SOEs started to set up overseas subsidiaries in order to take on the responsibility of the government’s foreign aid projects in developing countries. Other SOEs invested in natural-resources-rich countries in order to supply the scarce resources (including forest, minerals and pelagic fishery) needed for Chinese domestic development (Zhang, 2008). Therefore, Chinese MNEs started to merge in primary and secondary industries. Some trading firms also started to establish agents overseas, but the scale was fairly limited. In contrast to SOEs, private ownership firms focused on their internal development and capital accumulation, which paved the way for their future internationalisation.

In Phase 2 (1992-2000), although state ownership was still at the dominant position, the government started to restructure SOEs by merger and privatisation. Many small SOEs, especially in the tertiary industry, were privatised, while others were merged or restructured to become SOEs holding monopolies in their own industry. These ‘new’ SOEs had a better foundation for internationalisation compared to their predecessors, because the government intended to develop these SOEs into world class enterprises by optimising the allocation of resources. Therefore, during this time, the scale of the internationalisation of some SOEs increased as their capabilities developed. For example, since 1993, Bao Steel Ltd. has established 14 overseas subsidiaries in 11 countries all over the world. It built a vertical value chain including mineral supply, steel production and distribution network (Zhang, 2008). This vertical integration has largely increased the firm’s competitiveness in the global market by securing material supply and reducing transaction costs.

While SOEs were accelerating their internationalisation, an increasing number of private-ownership firms joined the traditional SOEs in internationalisation.
After the first decade of the ‘Reform and Open’ policy, more and more industries opened up to private investors. Some private-ownership firms started to emerge as the industry leaders and strong competitors. They started to proactively search for further development by considering internationalisation. Some privately owned firms which had already succeeded in the domestic market adopted an internationalisation strategy in order to escape from the increasingly fierce domestic market, explore new markets overseas and acquire the resources needed for further development. For example, Haier Group, an electronic manufacturing firm, established 13 overseas subsidiaries and research centres. By the end of the twentieth century, a range of public- and private-ownership firms had become members of the Chinese MNEs club.

Stepping into the new millennium, both the scale and scope of Chinese MNEs increased significantly. In Phase 3, although still in the early stage of their development, Chinese MNEs have emerged in the global market and joined the global competition. In 2006, eight Chinese MNEs from various industries entered the table of the top 100 non-financial transnational corporations from emerging economies and developing countries measured by foreign assets, in which CITIC Group, the Chinese firm with the highest ranking, took the seventh place (WIR, 2008). Six out of the eight have a transnational index (TNI\(^6\)) over 10% (WIR, 2008). All eight MNEs listed in the table are SOEs, which indicates that SOEs are still the leaders in the internationalisation process. By the end of 2008, SOEs contributed 69.6% of Chinese OFDI stock, and of the 40 largest Chinese companies by OFDI stock, 37 are SOEs (MOC, 2009a).

\(^6\) TNI is calculated as the average of the following three ratios: foreign assets to total assets, foreign sales to total sales and foreign employment to total employment.
2.3 Current Institutional Environment of China

While emerging economy governments are still trying to attract more investment from the outside world, many of them (such as, China, India and Brazil) have started to encourage local firms to seek opportunities to invest abroad (WIR, 2008).

As the rule maker, the Chinese government has been directing and monitoring the country’s economic development. The Chinese government initiated the economic development in the late 1970s. Ever since, the government has supported and sustained the fast growth of the economy by deregulating the market and industries, investing in infrastructure and education, improving the legal system and promoting investment. In this section, the role that the government plays in the internationalisation of Chinese firms will be described, including the administration and regulation of Chinese firms going abroad, and the financial support provided by the government for overseas investment.

2.3.1 The Role of the Government

No one can deny the important role of the home government in the development of MNEs. MNEs are regulated by the government, but also work through the government in order to shape the market in their favour. Zhang (2003, p. 44) identified two important conditions for the internationalisation of Chinese firms: ‘first, the central government plays a preeminent role in formulating and implementing China’s home-country policies related to its own multinational corporations. And second, the administrative intervention in and intrusion into corporate decision-making and management with regard to both domestic operations and international business is ubiquitous’.

Although home country institutions have been proved vital for the emergence and development of MNEs from both developed and developing countries alike, they assume added significance in the case of China (Zhang, 2003). In China, there has always been a close relationship between the government
and the market, which results in the important role that the government plays in the internationalisation process of Chinese firms.

2.3.1.1 Political and administrative departments of OFDI

There are a number of key political and administrative bodies that regulate and supervise the OFDI of China, by setting the laws and regulations concerning OFDI, controlling the investment approval process, and even evaluating the OFDI performance of firms, especially SOEs. The main government organisations include the NDRC, the MOC, People’s Bank of China (PBC), State Administration for Foreign Exchange (SAFE), State Asset Supervision and Administration Commission (SASAC), and State Council (SC). The main areas that each government body focuses on are described in Table 2.4.
<table>
<thead>
<tr>
<th>Regulator</th>
<th>Main responsibilities with regard to China’s OFDI</th>
</tr>
</thead>
</table>
| NDRC      | • formulate and implement strategies of national economy  
            • direct, promote and coordinate the restructuring of the economic system  
            • organize the formulation of comprehensive industrial policies  
            • draft relevant laws and regulations concerning national economic and social development, economic system restructuring and opening up to the outside world  
            • formulate regulations |
| MOC       | • Draft and implement policies and regulations of foreign trade and investment  
            • Approve non-financial OFDI projects proposed by SOEs  
            • Implement bilateral and multilateral treaties  
            • Coordinate China’s foreign aid policy |
| PBC       | • Draft and implement monetary policy  
            • Draft and implement foreign exchange policy  
            • Manage and supervise foreign exchange reserves |
| SAFE      | • Supervise and manage the foreign exchange market of the state  
            • Make foreign exchange policy suggestions to the PBC  
            • Manage China’s foreign exchange reserves |
| SASAC     | • Manage, supervise and control non-financial SOEs  
            • Provide institutional support for OFDI of SOEs  
            • Directly influence SOE decision-making |
| SC        | • Regulate the national economic development  
            • Manage foreign affairs, including negotiating bilateral treaties  
            • Provide financial support through policy banks |

2.3.1.2 Approval process

*The Measures for the Administration of Outbound Investment*, which was issued by the MOC on 16 March 2009, and came into effect on 1 May 2009, largely simplified the approval process of OFDI proposals.

All projects proposed by SOEs under control of SASAC, and projects with a potential investment of over US$100 million, are subject to MOC’s review. MOC is also in charge of reviewing investments in countries which do not have diplomatic relations with China, in countries specified by the MOC, in more than one country, and investments with a specific purpose of overseas listing.

Investments with a value of US$ 10 million or more but less than US$ 100 million, and investment in the energy and mineral industries are subject to the review of provincial-level Foreign Economic Relation and Trade (FERT) departments.
For the above investments, both MOC and provincial-level FERT need to contact the Chinese embassies or consulates in host countries for suggestions and information. Embassies and consulates need to provide information about the social security and economic development of the host countries, the bilateral trade between China and the host country, and other information considered necessary. After consulting the local embassies or consulates, MOC and provincial-level FERT must complete the review and approval process within 15 working days, provided that the application documents submitted are complete and comply with legal requirements.

For investments that do not fall into the categories discussed above, firms only need to submit an online application form, SOEs to MOC and all others to provincial-level FERT. The review and approval process is expected to be completed within three working days.

According to MOC’s statistic of the OFDI projects reviewed and approved in 2008, 85% of these cases could have been reviewed by the provincial-level FERT rather than MOC, which signifies a significant decentralisation of the OFDI approval process. Comparing to its predecessor, the 2009 measure also loosens the requirement of document firms needed to provide. The biggest difference is that the 2009 measure no longer explicitly requires firms to provide the OFDI finance resource availability certificate from SAFE or its provincial-level counterparts.

### 2.3.2 Financial Support

In 1994, the Chinese central government founded one of the three state policy banks, the Export-Import Bank of China (EIBC) in order to promote the international activities of Chinese firms and help them to set foot in the global market. This bank is under the direct supervision of the State Council and solely owned by the Chinese government. Its international credit ratings are compatible to the national sovereign ratings. Headquartered in Beijing, EIBC now has eleven domestic business branches, four domestic representative offices, and three overseas representative offices. For the latter are located in
Southern & Eastern Africa, Paris and St. Petersburg. To date, it has established correspondence relationships with more than 500 overseas banks.

The EIBC was initially set up to provide finance to promote exports and imports. It was also designed to assist with offshore contract projects, and to consolidate Sino-foreign relationships and international economic and trade cooperations. In addition the bank took on the responsibility of providing finance assistance to Chinese firms’ OFDI, as more Chinese firms started investing overseas. There are two main ways in which EIBC provides support for such internationalisation: preferential loans and buyer credit.

2.3.2.1 Preferential loans

There is no set maximum maturity term for preferential loan. Normally, the term of the loan set by the EIBC is no longer than 15 years, compared to the five years time limit offered by commercial banks.

Besides the extended maturity term, the EIBC preferential loan offered for OFDI purposes also comes with a favourable lending rate. Currently, regardless the length of the loan term, EIBC offers a lending rate which is 180 basis points below the benchmark one-year loan rate set by the People’s Bank of China (PBC). For example, on 25 December 2010, PBC set the benchmark one year loan rate at 5.81% (5.85% for a one-to-three year loan, 6.22% for a three-to-five year loan, and 6.40% for over five years). However, if the loan is for overseas investment purposes, the EIBC offers Chinese firms a preferential loan rate of 3.51% for a maximum 15 year term.

For example, in September 2008, the EIBC provided US$ 200 million financing guarantee to Changsha Zoomlion Heavy Industry Overseas Investment Management (Hong Kong) Co. Ltd, a company founded and controlled by Changsha Zoomlion Heavy Industry Science & Technology Development Co. Ltd. The loan was to be used to back up financing from Standard Chartered Bank (Hong Kong) and Singapore Development Bank for the purpose of its acquisition of CIFA Italy. This is significant for two reasons:
it is the largest financing guarantee that the EIBC has ever provided, and also it is a guarantee offered to a domestic client for financing its international borrowing. The acquisition is the largest overseas investment transaction in the Chinese engineering and machinery industry. After the acquisition, Changsha Zoomlion would complete its transition from a domestic industry leader into a leading global player in the global concrete machinery market. Changsha Zoomlion and CIFA combined would occupy the first place in the world concrete machinery market.

2.3.2.2 Buyer’s credit

Besides preferential loans, EIBC also provides buyer’s credit in order to help Chinese firms’ overseas business partners to increase their purchase capability. By doing so, EIBC indirectly guarantees the sales volume and profitability of Chinese firms’ overseas investment projects.

On 16 November 2005, the EIBC signed a financing agreement with the Nigerian clients of Huawei Technologies in Lagos. Huawei Technologies has received financing support from the Bank ever since it expanded into overseas markets. In line with its long-term commitment to the expansion of the Nigerian telecommunications market, Huawei Technologies has become one of the largest telecommunications equipment suppliers in Nigeria and established a good brand image. The project that was financed under the Agreement was the first project that the Bank supported in the Nigerian telecommunications market. The successful implementation of the project not only boosted the rapid and healthy development of the Nigerian telecommunications and information industry, but also strengthened bilateral cooperation in this field, thus promoting the in-depth development of the economic and trade cooperation between the two countries.

Another example of such financial support approach is a cooperation agreement signed in September 2004 with Haier Electrical Appliances Co. Ltd. to provide export buyer’s credit of US$ 1.5 billion. The said credit was mainly to be utilized for a five-year programme including the export of mechanical
and electronic products, complete sets of equipment and high- and new-technology products. It also included the overseas investment projects, offshore engineering contracts and other ‘Go Global’ projects.

Over the past few years, through its implementation of the business strategy of becoming an MNE, Haier Group has achieved a stable increase in its market share. So far, it is the only Chinese brand that has been included in the Top 100 World’s Most Famous Brands.

As a state export credit agency, the EIBC has responded to the practical needs of Chinese firms’ internationalisation, and supported firms to explore overseas markets by providing them with buyer’s credit. The signing of such cooperation agreements is another good example showing the use of EIBC as a policy financial instrument.

**2.4 Summary**

Since 1979, China has integrated itself into the world economy with tremendous efforts and has achieved a result which it can be proud of. Not only has it attracted a huge amount of inward FDI to help domestic economic development, but also China has become a major contributor to the global wave of OFDI. The Chinese OFDI has been through three major phases, during which Chinese MNEs started to emerge and join the global competition.

The fast development of Chinese OFDI in the past thirty years has been accompanied by the reform and growth of the Chinese domestic economy and social development. According to the traditional IDP framework, which will be reviewed in detail in Chapter 3, a country starts to generate OFDI when its economic development reaches a certain level (Dunning, 1988, 2001). Therefore, Chinese OFDI may also be determined and motivated by its domestic economic and social development. This will be examined in Chapter 4.
As mentioned in section 2.2.2, the locational and industrial distribution of Chinese OFDI has presented some uneven patterns across world regions. This uneven distribution raises interesting questions about the motivation of Chinese OFDI. The locational choice of Chinese OFDI in OECD countries will be investigated in Chapter 5.

There is no doubt that SOEs are at the forefront of Chinese firms’ internationalisation. Unlike the traditional western MNEs governed by founders or professional managers, Chinese SOEs were born from government departments and heavily influenced by their ‘in-line managers’, central and provincial governments. SOEs did not need to face any form of competition before the ‘Reform and Open’ policy was published in the late 1970s. During the economic reform and the internationalisation process, Chinese SOEs had to become more market-oriented, rather than simply following the government’s instructions, in order to survive the fierce competition in both domestic and international markets. However, whether Chinese SOEs have the capability to adapt to complex international markets has become a concern of the government, managers and academics. Because of the large amount of OFDI generated by SOEs, it is important to understand how SOEs’ internal capabilities might influence their post-internationalisation performance.

Although the Chinese government is gradually loosing its grip on SOEs, it is still playing an important role in the internationalisation of Chinese firms by setting regulations, providing financial support, and informing or guiding investment direction. A number of government departments are involved in administration and the approval process of OFDI. During the last decade, the government has been actively promoting Chinese OFDI through providing policy and financial support and simplifying the approval process. Chapter 7 will address factors that have influenced the post-internationalisation of Chinese SOEs: both their own internal dynamic capabilities and the institutional environments.
Chapter 3    Literature Review and Conceptualisation

3.1 Introduction

This chapter provides a comprehensive review of the FDI literature with a specific focus on those especially fit into the purpose of the country level research of this study. It includes a review of relevant theories about the internationalisation process of firms, including Dunning’s IDP framework and the eclectic paradigm, and conceptualises the role of human mobility in internationalisation. This review brings the relevant literature together which provides the theoretical foundation for the country level research of this study.

This chapter is organised as follow so: Section 3.2, the review of Dunning’s IDP framework and empirical studies will serve to answer the first research question \( Q1 \) regarding the domestic determinants of Chinese OFDI. Section 3.3 reviews the eclectic paradigm and related studies in order to lay the theoretical foundation for research question \( Q2 \) concerning the locational determinants of Chinese OFDI in OECD countries. Then, the discussion moves on to the conceptualisation of human mobility in Section 3.4.

3.2 Literature Review on Domestic Determinants of OFDI

The IDP framework (Dunning, 1981, 1986; Dunning and Narula, 1996) is one of the most insightful applications and extensions of the eclectic paradigm (also known as the ownership-location-internalisation (OLI) advantage framework) (Dunning, 2001), and it has been widely used to explain a country’s FDI position. The major contribution of the IDP is that it establishes a relationship between a country’s FDI position and the level of its economic development. In this section, the IDP framework will be reviewed first, followed by a review of the relevant empirical studies.
3.2.1 IDP Framework

The IDP framework is based on two premises: first, there are consistent patterns of structural change with development; and, second, these changes have systematic relations with patterns of FDI (Lall, 1996). Chenery et al. (1986) proposes that development is systematically associated with important structural shifts that are independent determinants of the growth process. The structural shifts identified by Chenery et al. (1986) include the following four factors: the growing share in gross domestic product (GDP) of manufacturing and modern services; greater capital- and skill-intensity of production; a shift in consumption patterns from simple to sophisticated and differentiated products; and the appearance of new sources of comparative advantages in trade (Lall, 1996). Patterns of structural change are not uniform. They differ by size of country, resource endowments, initial structure of the economy and choice of development policies (Chenery et al., 1986).

The IDP framework proposes that patterns of O- and L- advantages, which are closely related to the structural factors traced by Chenery et al. (1986), tend to develop a predictable pattern of FDI flows with income growth (Lall, 1996). The IDP framework is comprehensive and ambitious, since it considers how structural changes in ownership and locational factors affect patterns of international capital flows, corporate behaviour and government policies (Lall, 1996).
Dunning’s IDP framework of FDI and economic development suggests that countries tend to go through five main stages of development (Figure 3.1). Dunning, Kim and Lin (2001) present a modern refinement of the IDP hypothesis mainly measured by GDP per capita in terms of 1994 US$ values.

**Stage 1 (GDP per capita below $1,000)**

During the first stage of the IDP, counties attract very little FDI because of weak L-advantages, such as limited domestic markets (purchasing power is limited due to the low per capita income), inadequate infrastructure and a poorly educated labour force. At this stage of the IDP, there is likely to be very little OFDI because of lack of O- and I-advantages. Foreign firms will prefer to export to and import from this kind of market. Therefore, the country’s net FDI position will be near zero.
Stage 2 (GDP per capita $1,000-$3,000)

At stage 2, FDI starts to rise, while OFDI remains low or negligible. A country at this stage is normally characterised by rapid economic growth and an enlarged domestic market (increased L-advantages), which attract a large amount of inward FDI. Meanwhile, although elements of OFDI begin to emerge as firms have increased the O-advantages compared to the previous stage, the value of OFDI is still small. Therefore, the country is still a net recipient of FDI at this stage.

Stage 3 (GDP per capita $3,000-$10,000)

Countries in Stage 3 are marked by a gradual decrease in the rate of growth of inward FDI, and an increase in the rate of growth of OFDI. Domestic firms further develop their O-advantages, and compete with foreign firms in the same sectors. However, such countries are still net recipients of FDI.

Stage 4 (GDP per capita exceeding $10,000)

Stage 4 is reached when a country is a net outward investor, with OFDI equalling or exceeding inward FDI, and OFDI growing faster than inward FDI. At this stage, domestic firms can not only effectively compete with foreign-owned firms in domestic sectors, but penetrate foreign markets as well.

Stage 5

Beyond stage four, both inward and outward FDI are to continue to increase. The net outward investment (NOI) position of a country fluctuates near the zero level again, as in stage one. But ‘beyond a certain point in the IDP, the absolute size of GNP is no longer a reliable guide of a country’s competitiveness; neither, indeed, is its NOI position’ (Dunning and Narula, 1996, p. 11). Table 3.1 summarizes the five stages of the IDP framework.
Table 3.1 The IDP Framework Summary

<table>
<thead>
<tr>
<th>Stage</th>
<th>Inward FDI</th>
<th>Outward FDI</th>
<th>NOI</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Insufficient L-advantages</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>→ No inward FDI except natural resource-seeking FDI</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Absence of domestic firms’ O-advantages</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>→ No outward FDI</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Around zero</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Development of ‘generic’ L-advantages</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>→ Faster growth of inward FDI than of GDP</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Emergence of domestic firms’ country-specific O-advantages</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>→ Little outward FDI</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Negative and declining</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Erosion of L-advantages in labour-intensive activities and development of created-asset L-advantages</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>→ Decrease in the rate of growth of inward FDI</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Growth of country-specific O-advantages</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>→ Increase in the rate of growth of outward FDI</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Negative but increasing</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>L-advantages entirely based on created assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>→ Superiority of outward FDI over inward FDI</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Firm-specific O-advantages more important than country-specific O-advantages</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Positive</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Theoretically, fall and then fluctuation around zero of the NOI, but in fact, no more reliable relationship between a country’s international investment position and its relative stage of development</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


Researchers have proved that there is a relatively strong causal relationship between FDI activities and economic development (Dunning and Narula, 1996; Barry et al., 2003; Boudier-Bensebaa, 2004; Kalotay, 2004). However, GDP per capita, which is used as the default variable to measure the level of economic development in the IDP framework and later empirical studies, is an insufficient sole indicator of FDI (Boudier-Bensebaa, 2004): complementary variables are needed when explaining countries’ FDI activities (Dunning and Narula, 1996; Kalotay, 2004; Liu et al., 2005; Ozawa, 1996; Zhang et al., 1996). GDP per capita does give a broad and quantitative evaluation of a country’s economic development, but it does not take into account the structural changes in economies, which only indirectly impact on created wealth (Boudier-Bensebaa, 2004).
Because of criticism of its simplicity, the IDP framework has been revised and extended (e.g. Dunning and Narula, 1996; Zhang et al., 1996; Dunning et al., 2001; Durán and Ubeda, 2001, Liu, et al., 2005). The complementary factors identified in previous research, which include government policy, trade and asset endowment, will now be addressed.

Government policies play an important role in a country’s FDI activities (Zhang et al., 1996; Durán and Ubeda, 2001). Dunning and Narula (1996) propose that the liberalisation and privatisation of the market have proved not only to increase indigenous efficiency but also promote FDI activities. The attempts by many governments, such as China, to attract inbound investment have led to an increased flow and restructuring of inward investment. These country-specific factors have substantial influence on the development path of an economy (Dunning and Narula, 1996). It is especially true that in emerging economies, FDI activities are more related to government strategy than the level of development (Durán and Ubeda, 2001).

Dunning et al. (2001) find that there is increasing interaction between trade and the FDI position of a country as development proceeds. There is a debate about whether FDI has a substitution or complementary relationship with trade. Camarero and Tamarit (2003) summarise early attempts which reconcile the theory of MNEs with trade theory:

- Vertical integration, in which the production process is decomposed by stages in different countries, is based on different factor endowments and, therefore is an efficiency-seeking FDI that may have a mainly complementary relationship with trade.

- Horizontal integration, in which a firm sets up abroad to produce the same products or provide the same services as it does in the home country, is mainly based on the improvement of market access or market growth prospects, thus generating a market-seeking FDI that will have a substitution relationship with trade.
The third factor is asset endowment. Based on the world economic data of 1992, Dunning and Narula (1996) find that the patterns of asset endowment (natural or created) also influence the shape of the IDP. Countries that have a relatively strong natural asset position have a higher growth rate of inward FDI, but a much lower growth rate of outward FDI, than countries without such a position or with a strong created asset position.

Dunning and Narula (1996) also point out that the IDP is best analysed on a country-by-country basis because of its idiosyncratic nature. This is supported by Chenery et al. (1986)’s finding that patterns of structural shift, which are closely related to a country’s O- and L-advantages, vary between countries. This idiosyncratic nature of the IDP framework has been supported by several empirical studies (Bellak, 2001; Boudier-Bensebaa, 2004; Buckley and Castro, 1998; Dunning and Narula, 1996; Durán and Ubeda, 2001; Kalotay, 2004; Twomey, 2000).

3.2.2 Applications

One group of studies uses cross-sectional data of mixed developed and developing countries in order to measure the functional relationship between a country’s level of inward and outward FDI and the degree of economic development (Dunning and Narula, 1996; Durán and Ubeda, 2001). They both find evidence to support the relationship between FDI activity and economic development proposed by the IDP framework. The major methodological problem of cross-sectional analyses is that a static tool describing an existing relationship between variables at a specific point in time, is applied to the IDP, which is a dynamic concept describing the relationship between a country’s FDI position and the degree of economic development across time (Durán and Ubeda, 2001). The structural changes in the world economy, such as FDI to the tertiary service sectors and between industrialised countries, make it increasingly difficult to evaluate Stages 4 and 5 using an aggregate cross-sectional test (Dunning and Narula, 1996).
Another group of studies analyses the peculiarities of IDP for individual countries and is of a longitudinal nature (e.g. Buckley and Castro, 1998; Clegg, 1996; Graham, 1996; Liu et al., 2005; Zhang et al., 1996). These studies hinge on the idea that the evolution of a particular country in a given period is always unique and it can be well compared with the previous and subsequent periods of the same country (Kalotay, 2004). This type of study, which is based on time-series data, has become the mainstream in terms of testing the IDP framework. Most previous studies are based on time-series data of a particular country or a group of countries with similar characteristics. These empirical studies will be reviewed here and categorised into two categories: developed countries and emerging economies.

### 3.2.2.1 The IDP and Developed Countries

The main debate about the investment development paths of developed countries focuses on Stages 4 and 5 since many developed economies spontaneously enter Stage 4 because of their NOI (Clegg, 1996; Graham, 1996).

In the original IDP framework, Dunning and Narula (1996) propose a quadratic equation (Equation 3.1) and a fluctuating equilibrium around zero for the NOI of counties in Stage 5.

\[ \text{NOI} = C + \beta_1 \text{GDP} + \beta_2 \text{GDP}^2 + u \]  

**Equation 3.1**

However, in empirical tests, little evidence is found to prove the existence of the fluctuating equilibrium (Graham, 1996; Durán and Ubeda, 2001). Although Bellak (2001) finds a fluctuation in Stage 5, it is not around a constant mean as Dunning and Narula (1996) postulate.

Buckley and Castro’s (1998) study based on data from Portugal agrees that the IDP is a major contribution to the theory of international investment. However they also find that Portugal's IDP does not follow the previously
assumed quadratic function, and they propose that a higher degree, quintuple, equation (Equation 3.2) may fit better.

\[ NOI = C + \beta_1 GDP^2 + \beta_2 GDP^3 + \beta_3 GDP^4 + u \]  \hspace{1cm} \text{Equation 3.2}

Bellak (2001) also finds that an equation of the fourth degree (Equation 3.3) fits Austria’s development path better.

\[ NOI = C + \beta_1 GDP + \beta_2 GDP^2 + \beta_3 GDP^3 + \beta_4 GDP^4 + u \]  \hspace{1cm} \text{Equation 3.3}

There is a process of economic convergence among the developed countries (Durán and Ubeda, 2001). Therefore, it has been suggested that the IDP framework is useful, albeit with some shortcomings for a mature investing nation (Clegg, 1996).

3.2.2.2 The IDP of Emerging Economies

Although the IDP framework was initially established based on the FDI activities of developed countries, it has been tested in the circumstances of some emerging economies, and evidence has been found to support the IDP framework in these empirical studies (Barry et al., 2003; Boudier-Bensebaa, 2004; Buckley and Castro, 1998; Kalotay, 2004; Liu et al., 2005). For emerging economies, which are mainly in Stages 1, 2 and 3 of the IDP, inward FDI has a clearer correlation with the level of development than outward FDI. The latter is more dependent on government development strategies, which confirms that the national government plays a fundamental role at the initial stages of the IDP (Durán and Ubeda, 2001).

Central and Eastern European Countries (CEECs)

In the case of CEECs, Boudier-Bensebaa (2004) and Kalotay (2004) both find evidence to support the J-shaped curve of the first two stages of the IDP. The case of CEECs also seems to confirm the idiosyncratic character of the IDP (Kalotay, 2004). There are signs of the applicability of the IDP to 'small'
CEECS. However, the Russian Federation does not seem to fit at all into the IDP framework. In that instance, a combination of ‘system-escape’ factors (capital flight) and global corporate strategic aspirations results in major capital export, without the necessary GDP per capita usually assumed to be a prerequisite for that (Kalotay, 2004).

**China**

Zhang et al. (1996) have tried to apply the IDP framework to the evolution and patterns of the inward and outward FDI of China in the period of 1979-1992. Due to lack of sufficient data, a descriptive analysis is used to emphasise the changing patterns of inward and outward FDI, and their interaction with the development of the Chinese economy. Their findings reveal that the Chinese government played a fundamental role in determining Chinese FDI in this period: the trends of Chinese FDI correspond closely to the main characteristics of the first two stages of the IDP, especially in the coastal provinces of Eastern China.

In a more recent study, China has been proved to associate with patterns of outward FDI largely consistent with the IDP hypothesis, though supplementary variables are needed to compensate for the relationship between outward FDI and the country’s level of economic development (Liu et al., 2005). However, even combining GDP per capita with investments in human capital, exports and inward FDI, only less than half of Chinese OFDI can be explained. This implies that there still are key explanatory factors missing in the existing explanatory equation.

### 3.2.2.3 Methodology issues

There are a few methodological issues that need to be addressed. First, the ordinary least square (OLS) regression model has been the most commonly applied econometric estimation method used by previous empirical studies. However, without any prior tests concerning the characteristics of the dataset, this choice of estimation model is questionable, since the results of the
standard regression technique will be spurious if any of the variables regressed contains a unit root (Johansen and Juselius, 1990, Johansen, 1992; Phillips and Perron, 1988). Researchers have identified a lag structure in the relationship between OLI advantages and FDI position, which leads to the non-stationary nature of the time-series data (Clegg, 1996). This in turn means that the results generated by the OLS regression method can be misleading and unreliable. Some other econometric properties of the dataset, such as cointegration and endogeneity, also need to be addressed because the existence of these properties is crucial to the methodology of time series modelling used in economics and business (Burke and Hunter, 2005). In the case of endogeneity, the generalised method of moments (GMM) regression model is more appropriate than OLS.

Second, in terms of measurement of data, two types of independent variables have been used to model the IDP framework: GDP per capita as an indicator of the general level of development, and a range of O- and L- advantages and government-policy variables. In principle, the latter has some advantages over the former because of the significant increase in the model's explanatory power (Bellak, 2001). As for the dependent variable, FDI flow data is considered as a biased picture of the NOI due to the lack of consistent series on re-invested earning, which makes earlier work on flows largely misleading (Bellak, 2001). In comparison, FDI stock data generally yield better results.

By taking these issues into consideration, this study will apply a series of more advanced econometric methods to explore the relationship between a group of factors and Chinese OFDI stock, in order to increase the validity and reliability of the results.
<table>
<thead>
<tr>
<th>Study period</th>
<th>Study</th>
<th>Data period</th>
<th>Location</th>
<th>Data</th>
<th>Method</th>
<th>Dependent variables</th>
<th>Independent variables</th>
<th>Finding</th>
<th>Comments</th>
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<tbody>
<tr>
<td></td>
<td>Dunning and Narula (1996)</td>
<td>1992</td>
<td>88 developed and developing countries</td>
<td>Cross-section</td>
<td>Linear regression</td>
<td>NOI</td>
<td>GDP</td>
<td>A relatively strong causal relationship between FDI activity and economic development</td>
<td>A static analysis of a dynamic phenomenon</td>
</tr>
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<td></td>
<td>Graham (1996)</td>
<td>1950-1992</td>
<td>United States</td>
<td>Time-series</td>
<td>Descriptive analysis</td>
<td></td>
<td></td>
<td>Some evidence to support stage 5, but the hypothesis needs some rethinking</td>
<td>GDP is not mentioned.</td>
</tr>
<tr>
<td></td>
<td>Ozawa (1996)</td>
<td>Japan</td>
<td>Descriptive analysis</td>
<td></td>
<td></td>
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<td></td>
<td>Support for the IDP when supplemented by the technology development path</td>
<td></td>
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<td></td>
<td>Zhang and Bulcke (1996)</td>
<td>1979-1992</td>
<td>China</td>
<td>Time-series</td>
<td>Descriptive analysis</td>
<td></td>
<td></td>
<td>Fundamental role of national government; FDI trends correspond to the first two stages of the IDP</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Buckley and Castro (1998)</td>
<td>1943-1996</td>
<td>Portugal</td>
<td>Time-series</td>
<td>OLS regression</td>
<td>NOI per capita</td>
<td>GDP per capita</td>
<td>Confirm the idiosyncratic character of the IDP. A quintic equation fits Portugal much better than</td>
<td>Uses FDI flow data rather than stock bearing in mind that the sum-of-flows</td>
</tr>
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</table>
the original quadratic
equation. IDP cannot be
used as a prediction
mechanism. Non-
economic factors matter.

<table>
<thead>
<tr>
<th>2000s</th>
<th>Method</th>
<th>Time-period</th>
<th>Country</th>
<th>Method</th>
<th>Variables</th>
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<tr>
<td>Twomey (2000)</td>
<td>1900-1996</td>
<td>Canada</td>
<td>Time-series</td>
<td>Descriptive analysis</td>
<td>Confirmation of the IDP’s idiosyncratic nature</td>
</tr>
<tr>
<td>Bellak (2001)</td>
<td>1980-2000</td>
<td>Austria</td>
<td>Time-series</td>
<td>OLS regression</td>
<td>NOI per capita, GDP per capita, A fluctuation in stage 5 but not around a constant mean; empirical support for the idiosyncratic nature of the IDP; path varies according to industry-type and partner country.</td>
</tr>
<tr>
<td>Durán and Ubeda (2001)</td>
<td>1997</td>
<td>85 countries</td>
<td>Cross-section</td>
<td>Multivariate analysis: factorial analysis, cluster analysis, non-parametric test</td>
<td>Structural variables: degree of economic development, peculiarities of countries and nature of international trade, Redefine stage 4; support the IDP. No evidence for fluctuant equilibrium. For developing countries, outward FDI is more related to government strategies than the level of development.</td>
</tr>
<tr>
<td>Barry et al. (2003)</td>
<td>1980-1999</td>
<td>Ireland-US</td>
<td>Time-series</td>
<td>OLS regression</td>
<td>NOI, GDP, Consistent with the IDP concept; interrelationship between inward FDI and economic growth</td>
</tr>
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<td>Boudier-Benseba</td>
<td>1992-2002</td>
<td>CEECs</td>
<td>Panel</td>
<td>OLS regression</td>
<td>NOI, GDP, Results support the IDP, but GDP alone is not a method underestimates stocks.</td>
</tr>
<tr>
<td>Source</td>
<td>Period</td>
<td>Sample Size</td>
<td>Methodology</td>
<td>Analysis</td>
<td>Findings</td>
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<tr>
<td>a (2004)</td>
<td></td>
<td></td>
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<td>good proxy for development; NOI divergence between CEECs and the EU, but convergence within CEECs</td>
</tr>
<tr>
<td>Kalotay (2004)</td>
<td>1992-2001</td>
<td>7 CEECs</td>
<td>Time-series</td>
<td>Descriptive analysis</td>
<td>Confirms the idiosyncratic character of the IDP. Supports the IDP except the Russian Federation, where a combination of capital flight and global corporate strategic aspirations carried out by capitalists result in a major capital exporting world because of the uneven wealth distribution.</td>
</tr>
<tr>
<td>Liu et al. (2005)</td>
<td>1979-2002</td>
<td>China</td>
<td>Time-series</td>
<td>GMM</td>
<td>Outward FDI stock; GDP per capita; Export; Human capital; stock Inward FDI</td>
</tr>
<tr>
<td>Lee and Slater (2007)</td>
<td></td>
<td>Korea (Samsung)</td>
<td>Case study</td>
<td></td>
<td>IDP can be strengthened by adopting economic variables measuring technological and innovation capacity</td>
</tr>
</tbody>
</table>
3.2.3 Summary

As a theoretical framework introduced more than thirty years ago, the IDP framework has been extensively applied and augmented in previous research. Researchers find that developed countries automatically enter stage four of the IDP framework and reach stage five shortly after. However, the FDI performance of developed countries is not consistent with the fluctuation phenomenon proposed by the IDP framework. The IDP framework, however, is strongly supported by empirical studies based on the cases of emerging economies, which are mostly in Stages 1, 2 and 3.

It seems that the simple and descriptive nature of the IDP framework may prevent it from reflecting the reality of MNE behaviour, especially those from emerging economies. The business environment and patterns of economic development have changed rapidly in this era of globalisation. The situation of emerging economies is much more complicated than that of developed countries. In order to catch up with developed countries, emerging economies may not follow the five stages proposed by the IDP framework, but skip some early stages by promoting OFDI alongside their domestic economic development. The OFDI activities of emerging economies are more influenced by country-specific factors, which indicates that the IDP framework need to be augmented to incorporate factors other than economic development.

In summary, although the IDP framework is a useful tool to explain a country’s FDI position, it alone cannot satisfactorily explain a country’s OFDI activity. Previous empirical studies prove that, although economic development level is an important indicator of OFDI, country-specific factors should be included in order to provide a more comprehensive picture. Therefore, Dunning and Narula (1996) call for detailed individual country studies in order to provide a better understanding of the domestic determinants of a country’s OFDI. Although some common variables are used in regression equations, the coefficients of the variables are highly dependent on the dataset. Thus, in Chapter 4 of this thesis, the author will augment the IDP framework through the theoretical lens of network theory and knowledge-based view. This will facilitate further exploration of the domestic determinants of Chinese OFDI.
3.3 Literature Review of the Locational Determinants of OFDI

3.3.1 The Eclectic Paradigm

The concept of the eclectic paradigm, first introduced by Dunning (1977), is widely used to explain and analyse the economic rationale of international production in relation to MNE activity. The eclectic paradigm (Dunning, 1977, 1988) contends that MNEs have competitive or ‘ownership’ advantages compared to their major rivals, which they utilise in establishing production in sites that are attractive due to their ‘location’ advantages. In addition, MNEs retain control over their networks of assets (both tangible and intangible) because of the ‘internalisation’ advantages.

Over the past three decades, the eclectic paradigm has been the main explanation for the increase in MNE activities. It has been applied in management, economic geography, evolutionary economics, development economics and many other social science fields (Cantwell and Narula, 2003). It has also been the target of considerable criticism and extended by various scholars. In this section, a review of the eclectic paradigm is followed by a review of empirical studies on the locational choice of FDI.

3.3.1.1 Ownership Advantages

O-advantages (primarily from possession of intangible assets) are those specific to the nature and/or nationality of the firms’ ownership. These are MNE characteristics that lead to competitive advantages in supplying foreign markets (Dunning, 1988, 1998; Eden, 2003). Initially, the O-advantages are broken into three types (Dunning, 1977):
• Type 1: advantages that arise from creating and/or acquiring particular unique tangible or intangible assets that are independent of the multinational character of the firm.

• Type 2: advantages that derive from being part of a MNE. These advantages are mainly due to the size and established position of the firm, exclusive or favoured access to inputs, access to the resources of the parent company and economy of scale. The MNE, as a whole, may benefit from the lower cost of accessing internal resources.

• Type 3: advantages that come solely from multi-nationality. Larger number of foreign markets in which the MNE has operation, more opportunities and advantages the MNE has in accessing international markets for information, finance and labour.

However, this statement is strongly challenged by the proponents of internalisation theory (for example, Buckley and Casson, 1985). They argue that the failure of international intermediate product markets is both a necessary and sufficient condition to explain the existence of MNEs.

As a response, Dunning (1988) reorganised the O-advantages into two groups: asset, the original type 1 advantages, and transaction, the original types 2 and 3, advantages of MNEs. The former refers to the ownership of specific assets created and/or acquired by MNEs, compared to those possessed by rivals. The latter ‘mirror the capacity of MNE hierarchies vis-à-vis external markets to capture the transactional benefits (or lessen the transactional costs) arising from the common governance of a network of these assets, located in different countries’ (Dunning, 1988, p. 2).

These advantages must be sufficient to compensate for the costs of setting up and operating a value-adding operation in a foreign market, in addition to
those faced by indigenous producers or potential producers (Dunning, 1988), in order that FDI will replace export as an MNE tool to enter foreign markets. Nowadays, since MNEs generally compete with one another in the global market, Cantwell and Narula (2003) suggest that O-advantages must be measured vis-à-vis competition from foreign MNEs rather than indigenous firms.

While the O-advantage of one MNE is compared with that of MNEs of foreign countries, not only will firm-specific ownership endowments decide the advantages but also country-specific factors. Dunning (1977) uses country-specific O-advantages to explain why the O-advantages of Japanese iron and steel firms over South Korean ones will be very different from those of UK tobacco firms over Brazilian tobacco firms or US computer firms over French computer firms. However, this industry-country-specific ownership advantage is not rigorously developed or theoretically consistent (Meitland and Nicholas, 2003). The under-theorised country-specific O-advantage has been recognised and has been treated as a neglected factor (Dunning, 1998). Some more recent research utilises this country-specific O-advantage to explain the rise of MNEs from emerging economies (e.g. Antkiewicz and Whalley, 2006; Buckley, et al., 2007a; Child and Rodrigues, 2005; Erdener and Shapiro, 2005; Warner et al., 2004). The country-specific O-advantages include access to cheap financial capital because of market imperfections (Antkiewicz and Whalley, 2006; Child and Rodrigues, 2005; Warner et al., 2004). They also include economising on the use of capital (Buckley, et al., 2007a), experience of operating within complex emerging market contexts (Holburn and Zelner, 2010; Morck et al., 2008), and the ability to engage in beneficial relations (Dunning, 2002; Erdener and Shapiro, 2005).

3.3.1.2 Location Advantages

The second element of the eclectic paradigm is concerned with the location of production. The L-advantages are used to answer the question where MNEs invest. Firms will engage in foreign production whenever they perceive it is more profitable to combine their O-advantages with some immobile asset
endowments or other intermediate products in another country (Dunning, 1979, 1988, 1995).

Traditionally perceived L-advantages include the spatial distribution of inputs and markets, transport and communication costs, government intervention and psychic distance (Dunning, 1979). More recently, the L-advantages have been more concerned with the following factors (Dunning, 1995):

- the endowments of interdependent immobile assets;
- the spatial integration of complex and rapidly changing economic activities;
- the role of national and regional authorities.

The relative advantages of particular locations are often internalised within the market. Therefore, the choice of location may well be influenced by market failure or imperfection (Dunning, 1988). Structural market distortions, and those arising from government policies (such as the tax holiday zones setup by the Chinese government, and tariff protection for domestic firms in certain industries or sectors) may either encourage or discourage inward and outward FDI.

MNE activities appear wherever transaction benefits are likely to result from combining their O-advantages with L-advantages of host countries. Increasing interaction between the three pillars of the eclectic paradigm, especially the first two, has been emphasised by many scholars (Dunning, 2001; Cantwell and Narula, 2003; Devinney et al., 2003). FDI based upon the O-advantages of the investing firms in time $t$ may well affect the L-advantages of the host country in time $t+1$; while the response of firms to market failure, and/or their choice of location for their innovating activities, will critically affect the shape of their future O-advantages (Dunning, 2001).
3.3.1.3 Internalisation Advantages

Besides O- and L-advantages, a third set of choices, concerning the way a firm organises the generation and utilisation of accessible resources and capabilities in different locations, is referred to as I-advantages (Dunning, 2001). I-advantages arise when a firm is able to benefit from a full return on its ownership of distinctive assets such as its own technologies, as well as from coordinating the use of complementary assets, subject to the costs of managing a more complex network (Cantwell & Narula, 2003). It answers the question as to why firms prefer to exploit their O-advantages abroad internally rather than sell them to foreign companies through market transactions.

Buckley and Casson (1991, p. 33-34) identify four main groups of factors relevant to the internalisation decision:

- **Nation-specific factors**: the political and fiscal relations between the nations concerned;
- **Region-specific factors**: the geographical and social characteristics of the regions linked by the market;
- **Industry-specific factors**: the nature of the product and the structure of the external market;
- **Firm-specific factors**: the ability of the management to organise an internal market.

If the benefits of internalisation offset the costs, firms may coordinate interdependent activities internally by management rather than externally by market forces (Buckley and Casson, 1991).

Dunning (1977) sees the motivation of firms to internalise markets as twofold: to capitalise on the advantages of distortions or unbalance in external mechanisms (market or public authorities) for allocating resources and to avoid the disadvantages of market imperfections. All things being equal, the
more internal transactions the MNE engages in, the greater its opportunities for benefiting from the economic policies of national governments (Dunning, 1977) and avoiding the pitfalls of the single market. Although I-advantages are one critical part of the eclectic paradigm, Dunning (1988, 1998) argue that the O-advantages answer the question that whether the MNE should internalise the product markets within its home country or in a foreign country.

3.3.2 Extensions: Locational Determinants of FDI

For more than three decades, the eclectic paradigm has remained the dominant analytical framework for explaining the determinants of FDI and MNE foreign investment. The paradigm has been applied to different levels of analysis and extended in many ways. One major application explains the locational determinants of FDI.

The identification and value of the ownership, location and internalisation parameters that influence an individual MNE in an international production decision vary according to the motives underlying such production (Dunning, 1988). Different kinds of investment incentives may influence locational choice, entry mode, and the competitive advantage.

Depending on the nature of the advantages that firms are exploiting and/or exploring, FDI may be classified into market-seeking, resource-seeking, efficiency-seeking and strategic asset-seeking (Dunning, 1998, 2000). In recent years, researchers have identified a new type of FDI, institution-seeking, which complements the traditional four. Different kinds of FDI are naturally attracted by different kinds of L-advantages and the market conditions of host countries.

### 3.3.2.1 Market-seeking FDI

The market-seeking FDI is attracted by a range of factors, including: large and growing domestic markets; competitiveness within the industry of the host country; the quality of national and local infrastructure; macroeconomic
policies; proximity to customers; agglomerative spatial economies and local service support facilities; and promotional activities by regional or local development agencies (Dunning, 1998).

In the context of a country with a population of 1.3 billion people and a domestic market growing at tremendous speed, Chinese firms appear to have little reason to seek markets elsewhere. However, the growth of China’s export-driven economy has caused increasing concern to developed countries about its international trade surplus. OFDI has therefore gradually become a good defensive market-seeking option for Chinese firms in order to facilitate exports, by-pass quotas and find new markets to avoid fierce domestic competition (Buckley et al., 2007a; Lu et al., 2010a; Luo and Tung, 2007). Previous empirical research has found that Chinese OFDI to developed countries is indeed driven by market-seeking (Buckley et al., 2007a; Cheung and Qian, 2009).

3.3.2.2 Resource-seeking FDI

Resource-seeking FDI is designed to gain access to natural resources. MNEs are particularly attracted to opportunities in host countries for upgrading the quality of resources and the processing and transportation of their output (Dunning, 1998). This kind of FDI is also known as supply oriented FDI (Dunning, 2000).

China’s economic development is famous for its high consumption of resources. The demand for natural resources, such as oil, coal and natural gas, has increased at a tremendous speed. FDI in the energy and mineral industries is encouraged by the government to meet the constantly growing needs at home (Lawrence, 2002). Many Chinese firms, especially SOEs, started to invest in resource-rich countries in order to secure the stability of the supply of domestically scarce natural resources (Ye, 1992; Zhan, 1995; Liu and Li, 2002). Examples include Chinalco’s US$19.5 billion investment for an 18% stake in Rio Tinto, a multi-national mining company strongly represented in Australia; China Minmetals’ US$2.3 billion purchase of OZ
Minerals, a diversified Australia mining company producing copper, zinc, lead, silver and gold; and Chinese Hunan Valin Iron and Steel Group’s US$225 million investment for a 16% stake in the third largest Australian iron ore producer, Fortescue (Bierenbaum, 2009). However, although there are many famous cases of Chinese firms investing in natural resources overseas, previous research has found no empirical evidence to support the resource-seeking motive of Chinese OFDI (Buckley et al., 2007a).

3.3.2.3 Efficiency-seeking FDI

Efficiency-seeking FDI is influenced by labour costs and availability, the competitiveness of the market, infrastructure quality, local services and proximity to users (Dunning, 1998). However, there are some factors distinguishing the efficiency-seeking FDI from market-seeking FDI. While market-seeking FDI mainly focuses on profitability generated by increasing market share and sales promotion, efficiency-seeking FDI focuses on the benefits of reducing production and transaction costs.

Efficiency-seeking firms optimise their production processes by moving production to countries with L-advantages in terms of low labour costs. This has been the motivation for various MNEs from developed countries investing in emerging economies. For example, China has attracted overseas MNE FDI in its labour-intense manufacturing and garment industries. However, in view of the relatively low labour costs in China, this efficiency-seeking type of FDI is unlikely to be one of the major locational determinants of Chinese OFDI in the near future.

3.3.2.4 Strategic asset-seeking FDI

Recent technological advances, more intensive inter-firm competition, the opening up of new markets and the increasing mobility of some kinds of firm-specific assets have led to new motives for foreign production (Dunning, 2001). Not only does FDI constitute as a means of exploiting the existing O-
specific advantages of the investing firms, it is also as a vehicle for augmenting these advantages (Dunning, 2001). As a new scenario of FDI, strategic asset-seeking does not fit the traditional explanation of FDI motivations of the eclectic paradigm, which initially proposes that FDI will happen if and when three conditions are satisfied (Dunning, 1977):

- O-advantages: the firm possesses certain unique O-advantages;
- L-advantages: some immobile factor inputs in another country will benefit the firm in conjunction with the O-advantages;
- I-advantages: the firm will benefit more if it chooses to use the O-advantages itself rather than to sell or lease them to foreign firms.

However, FDI which intends to acquire new O-advantages, rather than exploits the existing ones, has become an increasingly important form of cross-border economic activity, especially for MNEs from emerging economies (Dunning, 2001; Makino et al., 2002).

Researchers have studied the strategic asset-seeking motives of Chinese OFDI through various case studies (e.g. Deng, 2007, 2009; Rui and Yip, 2009), and confirmed that many famous cases, especially M&As of Chinese firms in OECD countries, were indeed driven by strategic asset-seeking (Deng, 2009; Rui and Yip, 2009). However, researchers have not yet found evidence to support this proposition at aggregate level empirical studies. Buckley et al. (2007a) find no evidence to suggest that Chinese OFDI in the 1980s and 1990s was seeking strategic assets, even those invested into OECD countries.

### 3.3.2.5 New development: Institution-seeking

The institutional environment has become an important factor which has attracted a huge amount of attention in international business research. Previous research has found that institutions influence all aspects of MNE
activity, including investment strategy, location choice, performance, organisation of local subsidiaries and resource allocation (Henisz and Swaminathan, 2008; Meyer and Nguyen, 2005; Slangen and Beugelsdijk, 2010; Wright et al., 2005).

OFDI can be used by MNEs from both developed countries and emerging economies to escape from the institutional voids and political hazards of their home countries (Luo and Tung, 2007; Witt and Lewin, 2007). Underdeveloped institutions are fast changing and sometimes unpredictable, especially in emerging economies, and this creates a less favourable investment environment for firms pursuing greater efficiency and competitiveness (Luo and Tung, 2007; Peng, 2003). A host country with a more efficient, transparent and non-discriminate institutional environment will certainly attract MNEs from emerging economies who are eager to avoid the institutional constraints and hazards of their home countries (Luo and Tung, 2007; Yamakawa et al., 2008).

Ingrained into Chinese institutional culture are unpredictable regulatory changes, bureaucratic red tape, corruption, discrimination between state-owned and private firms and poor law enforcement. Despite the best efforts of the Chinese government to liberate the domestic market and fiscal system, these can still pose a major challenge for Chinese firms to improve their efficiency and competitiveness. While the domestic institutional environment continues to be challenging, OFDI provides Chinese firms with an approach to directly explore the more open and well-developed institutional environments elsewhere. Therefore, it will not be surprising to see that more investment-friendly institutions in developed countries (e.g. less corruption, better political stability, less discrimination, more transparent and better functioning capital markets, more entrepreneur-friendly markets) will become a major attraction to Chinese firms investing overseas (Lee et al., 2007; Peng, 2003).

Although immature home country institutions may pose serious constraints on firms’ expansion, these complex and underdeveloped institutions can potentially help firms to develop country-specific O-advantages and facilitate
their OFDI activities in two major ways. First, some emerging economy governments have established policies and regulations to promote domestic firms’ OFDI, such as the ‘Go Global’ policy of China and the preferential government loans for firms investing overseas (Luo et al., 2010). Previous research has confirmed that supportive government policies facilitate both the market- and strategic asset-seeking OFDI of Chinese private firms (Lu et al., 2010a). Chinese firms can use OFDI to secure such financial and non-financial privileges offered by their government, including those towards inward FDI through reverse investment (Luo and Tung, 2007). For example, they may use the preferential loan provided by the government to set up overseas subsidiary, and then reinvest some portion of the loan from the overseas subsidiary back to China (Luo and Tung, 2007).

Second, the experience of dealing with complex home country institutions gives MNEs from emerging economies an advantage in other emerging economies with similar institutions, compared to MNEs from developed countries. Western and Japanese MNEs generally have difficulty in operating in host countries with dysfunctional institutions (Desai et al., 2004). In contrast, firms from emerging economies have survived the institutional disadvantages in their home countries and accumulated abundant experience dealing with complex institutional environments, which can then be exploited in other emerging economies and developing countries with similar institutions (Khanna and Palepu, 2006; Morck et al., 2008; Perkins, 2005).

3.3.3 Summary

From a theory to a paradigm, the eclectic paradigm has been well developed in the past three decades. Initially, the eclectic paradigm was developed to explain the existence of MNEs. Later, it has been widely applied to explain various aspects of MNEs’ foreign activities, including the motivation for foreign value-added activities, locational choice and entry mode selection. It has been well acknowledged that the eclectic paradigm is dynamic rather than static. The O-, L- and I-advantages have not been remained unchanged (Dunning, 2001; Buckley and Hashai, 2009; Cantwell and Narula, 2003; Devinney et al.,
Buckley and Hashai (2009) state that the perceptions of O-, L- and I-advantages are continuous and the three counteract or support each other in development.

By extending the eclectic paradigm to explain locational determinants, four distinguishing motives of FDI, namely market-, resource-, efficiency- and strategic asset-seeking, have been formerly identified in previous research, with institution-seeking emerging in more recent research. However, the results of the empirical studies based on these theoretical propositions are far from consensual or consistent. Buckley et al. (2007a)’s comprehensive empirical study of the locational determinants of Chinese OFDI between 1984 and 2001 finds some dynamic changes of the determinants over time, and significant differences between Chinese OFDI to OECD and non-OECD countries. These dynamics indicate the need to study the locational distribution pattern of Chinese OFDI over time in order to capture the possible shifts of determinants in an ever changing global economic environment. Furthermore, new factors need to be observed, since the traditional theoretical perspective alone may not be adequate to explain the special feature of Chinese OFDI, especially in OECD countries (Buckley et al., 2007a; Mathews, 2006; Wright et al., 2005). Therefore, Chapter 5 of this thesis will address the locational determinants of Chinese OFDI in OECD countries by examining a new factor, human mobility, with other complementary factors based on the most up-to-date dataset in order to disclose the dynamic changes of the locational distribution pattern of Chinese OFDI.

### 3.4 Conceptualisation of Human Mobility

Recent research has shown that the internationalisation process of firms is partly driven by their networks (Chen and Chen, 1998; Madhavan and Iriyama, 2009; Majkgard & Sharma, 1998; Sharma and Blomstermo, 2003; Zhou et al., 2007). Networks have been identified as a crucial factor in the internationalisation process, especially at the initial stage (Batjargal, 2007; Coviello, 2006; Sharma and Blomstermo, 2003). Firms that operate in an
international network may enjoy a learning advantage and find it easier to go abroad than firms whose exchange partners are domestic firms (Sharma and Blomstermo, 2003). Networks enable firms to gather superior information about each other and about potential markets (Gulati, 1995; Sharma and Blomstermo, 2003; Elango and Pattnaik, 2007). This in turn will reduce informational asymmetries, promote trust, and lower transaction costs (Gulati et al., 2000).

Since the network has a positive impact on firms’ internationalisation decision, it is not surprising that the network also influences choice of location (Chen and Chen, 1998; Chen et al., 2004; Filatotchev et al., 2007). Firms are more likely to invest in places where their network partners locate or where they may develop network relationships which carry low risk to the existing network (Chen et al., 2004). Highly-skilled immigrants in the US have facilitated venture capital outflow to their respective home countries (Madhavan and Iriyama, 2009). Chen and Chen (1998) find that strategic networks motivate Taiwanese FDI towards the United States, while relational networks facilitate Taiwanese FDI in Southeast Asia and China. Compared to large MNEs, the smaller the firms are, the more sensitive they are to relational networks in their choice of FDI location (Chen and Chen, 1998; Chen et al., 2004).

Networks have become a kind of advantage which can be exploited in foreign markets (Singh and Kundu, 2002), especially in the case of China. The benefits accruing from relations in host countries and networking skills, which some researchers term a relational asset (Dunning, 2002; Erdener and Shapiro, 2005), are often linked to the Chinese diaspora in the case of the internationalisation of Chinese firms. The relational assets which are embedded in ethnic or familial networks within a specific minority population in the host countries can be exploited, and reduce investment and commercial risk as a consequence (Lecraw, 1977; Zhan, 1995; Lau, 2003). Many Chinese investors rely quite heavily on ethnic and familial links in order to reduce risk and psychic distance, which is an attempt to compensate for the information asymmetry when entering unfamiliar business conditions and the shortage of
qualified staff with appropriate language skills and international business management experience (Child, 2001).

Previous research found that Chinese diaspora contributed a large proportion of Chinese inward FDI from South and Southeast Asia and facilitated bilateral trade between these countries and China, especially in the early stage of China’s economic revolution (Chen and Chen, 1998; Ng and Tuan, 2002; Smart and Hsu, 2004; Tung and Chung, 2010), and started to facilitate Chinese OFDI (Buckley et al., 2007a). However, research concerning the Chinese diaspora is rather static and ignores the two-way human mobility between home country and host country. In this era of globalisation, the international movement of human capital across country boundaries has become much more common, with more students going abroad for education and MNEs transferring employees among subsidiaries. New networks can be constantly formed during such mobilisation (Adler and Kwon, 2002; Kugler and Rapoport, 2005). This increasing scale of human mobility in recent decades can significantly extend the business network which Chinese firms can access and exploit.

Research (Faini, 2004; Docquier and Marfouk, 2004) has also found that most receiving countries of migrants have introduced restrictive immigration policies in order to increase the quality of immigration. This increasing quality of migrants is more likely to facilitate knowledge, technology and information transfer, and network development which are much needed for the internationalisation of Chinese firms. These migrants also provide highly employable human resources with appropriate language skills and international business experience. Due to the shared ethnic and cultural background and cognitive frames, the communication between migrants and Chinese firms is subject to fewer cultural barriers, and leaves less room for misunderstanding (Holbum and Zelner, 2010; Kaplan, 2008).

Therefore, in this study, human mobility is defined as highly-skilled migrants, who live in a country which is not their country of origin, and those who lived in a country other than their country of origin but have returned to their home
country. This concept captures the two-way human capital flow between the home country and host countries, which includes international mobile students, academics, and personnel working, or who have worked, overseas. The extensive network developed by human mobility and the intensive knowledge embedded within this network will, to a certain extent, facilitate Chinese OFDI and help Chinese firms reduce the risks and uncertainty that accompany internationalisation. In this study, the author intends to investigate the influence of this factor on Chinese OFDI.

3.5 Summary

Previous studies have proved that a single theory lens can no longer sufficiently explain the ever more complicated and dynamic development of world OFDI activities, especially when more and more emerging economies, such as China, become the sources, rather than just the recipients, of the OFDI. Findings based on data collected from developed countries cannot explain the special features of the OFDI from emerging economies. The complex nature of the determinants of OFDI requires an integrated theoretical framework to be developed in order to explain the phenomenon of the OFDI of emerging economies.

Besides the need for an integrated theoretical framework, the idiosyncratic nature of the determinants of OFDI, thanks to country-specific factors, also requires detailed individual country studies to provide a better understanding (Dunning and Narula, 1996). Therefore, in Chapters 4 and 5, the author will investigate the domestic and locational determinants of Chinese OFDI by applying an integrated conceptual framework, especially by incorporating human mobility, to the most recent dataset, in order to deepen our understanding of the determinants of the OFDI from emerging economies.
Chapter 4 Domestic Determinants of Chinese OFDI

4.1 Introduction

The aim of this chapter is to analyse the relationship between Chinese OFDI and a range of domestic factors in order to identify the domestic determinants of China’s OFDI, and to consider whether Chinese OFDI follows the conventional standard pattern proposed by Dunning’s IDP framework (Dunning, 1981, 1986; Dunning and Narula, 1996), or whether new theories are needed for emerging economies such as China. Since appropriate econometric procedures have been developed to disentangle causality relations, this study will apply more advanced econometric methods in order to capture the interdependent and time-dependent nature of the relationship between the factors proposed.

The chapter is organised as follows: first, a brief review of Dunning’s IDP framework, network theory and knowledge-based view will provide the theoretical foundation for this study. This is followed by Section 4.3, which develop the hypotheses of this study. Then, in Section 4.4, research methods and data will be discussed and described. The empirical results are presented in Section 4.5, followed by a discussion in Section 4.6. A brief summary will be presented in Section 4.7.

4.2 Theoretical Background

As reviewed in Chapter 3, the IDP framework (Dunning, 1981, 1986; Dunning and Narula, 1996) is one of most widely applied theoretical frameworks for explaining a country’s FDI position. The IDP framework established a relationship between a country’s FDI, both inward and outward, position and its economic development (measured by GDP per capita). This framework has been tested using data from various developed and developing countries in previous empirical research (e.g. Dunning and Narula, 1996; Buckley and
Castro, 1998; Bellak, 2001; Barry et al., 2003; Liu et al., 2005). Although evidence has been found to support the IDP framework, it is widely accepted that a country’s economic development level alone is not sufficient to explain its FDI position (e.g. Boudier-Bensebaa, 2004; Kalotay, 2004; Liu et al., 2005). Therefore, besides a country’s economic development level, other complementary factors which reflect country-specific characteristics need to be considered in order to augment the framework and provide a more comprehensive explanation of the country’s FDI position. In this thesis, the author intends to augment the IDP framework by incorporating both network theory and the knowledge-based view to explain the domestic driving forces of Chinese OFDI.

Developed in the 1980s, the IDP framework did not pay attention to the impact of globalisation or the inter-connected world economy, which includes the role of networks. The IDP framework emphasises the relationship between a country’s economic development and its FDI position. However, the influence of networks was completely ignored in the original model.

The network theory has been widely applied in business and management research (Chen and Chen, 1998; Sharma and Blomstermo, 2003; Chen et al., 2004; Filatotchev et al., 2007). In most existing studies, networks have been used as a means of explaining the internationalisation process. For example, the ‘Guanxi’ network plays an important role in Chinese firms’ internationalisation process and post-internationalisation performance (Wu and Choi, 2004; Zhou et al., 2007). However, if we view networks as an asset rather than a means, they may well become the kind of advantage that can be exploited in foreign markets (Singh and Kundu, 2002). In this era of globalisation, the emerging phenomenon of human mobility across country boundaries has brought new structural shifts in a country’s social and economic development. The networks formed during the mobilisation will become a country-specific asset which can contribute to a country’s O-advantage development and in turn become a driving force in the generation of the country’s OFDI.
Besides networks, knowledge development and accumulation is another factor which was neglected by the original IDP framework. Although Dunning and Narula (1996, p. 4) state that ‘the extent to which outward direct investment is undertaken will be influenced by … technology development’, this relationship was not sufficiently developed or empirically tested in their study. In a knowledge-based society, knowledge assets, which can no doubt contribute to a country’s O-advantage development, are of great importance in improving national competitiveness. The need to exploit, augment and sustain a country’s O-advantages through knowledge development and accumulation is crucial. However, the GDP per capita indicator used in the IDP framework can merely reflect the level of knowledge, especially the tacit knowledge, possessed by the country. In international business research, the knowledge-based view has become an important approach to explaining the existence of MNEs (Kogut and Zander, 1992, 2003). The decision to enter a foreign market is often made by managers based on the current knowledge stock of the firm (Kogut and Zander, 2003).

Both networks and knowledge development and accumulation can contribute to firms’ O-advantage accumulation. Firms can then exploit these invaluable assets in overseas markets in order to successfully bring their internationalisation strategies to fruition. It should be noted that in this study, both network theory and the knowledge-based view, which are technically firm-level theories, will be applied at country level. Although both theories were initially developed to explain individual behaviour and MNE activity, it is not unusual to apply them in country level studies (e.g. Liu et al., 2005). When considering the relationship between a country’s OFDI position and its determinants, the application of network theory and the knowledge-based view may be justified for the following reasons, especially in the context of China.

Chinese society is highly collective, and the widely known concept ‘Guanxi’ is one of the most important concepts in Chinese culture. Networks have always been considered one of the most crucial assets in the Chinese business world. When OFDI activity is investigated at country level, overseas networks may
well be considered as a national asset. In this study, the overseas network is reflected by the human mobility factor.

The knowledge-based view mainly considers knowledge as one of the most strategically important resources. When we meditate on the attitude towards knowledge in China, we can find strong evidence that knowledge has been playing an important role in the government’s development strategy. The promotion of the ‘Ke Jiao Xing Guo’ (fortify the country by science and education) strategy by the central government explicitly and strongly signifies the government’s support for research and development. After thirty years fast economic development, China is going through a painful transition from a labour-intense economy to a knowledge-intense one. The government’s emphasis on knowledge development implies the willingness of the country to develop its O-advantages by creating and accumulating knowledge, which may provide the foundation for the emergence of its OFDI activities.

4.3 Hypotheses

4.3.1 Economic Development

A country’s level of economic development is the sole explanatory factor of the country’s FDI position in the traditional IDP framework (Dunning, 1981, 1986; Dunning and Narula, 1996). Dunning (1981, 1986) argues that the O-advantages accumulated during a country’s economic development contribute to the country’s FDI activities. As the economy grows, a country’s L-advantages gradually develop into O-advantages, and domestic firms develop their own capabilities and accumulate operational experience which can be applied to their internationalisation process. The accumulated O-advantages can be developed into competitive advantages which can be exploited overseas. Therefore, the higher the level of its economic development, the more OFDI activities the country can generate.

Many empirical studies have found evidence to support Dunning’s IDP framework based on data of various countries, such as China (Liu et al., 2005)
and Ireland (Barry et al., 2003). However, although previous research has proved a country’s economic development level to be a key factor leading to a country’s OFDI, economic development is insufficient to explain a country’s FDI position on its own (Dunning and Narula, 1996; Liu et al., 2005). Here, the conventional IDP framework is formalised as:

*H1: Chinese OFDI is positively associated with the country’s economic development level.*

### 4.3.2 Inward FDI

Inward FDI, like OFDI, has been considered as the dependent variable explained by a country’s economic development in the IDP framework. However, it can be anticipated that a complex relationship exists between the inward and outward FDI as a country progresses along the IDP time scale (see Figure 3.1).

Inward FDI is often attracted by the host country’s L-advantages, such as market size, resources, favourable investment policies, low labour costs etc. Meanwhile, inward FDI also contributes to the host country’s development through capital investments and productivity spillovers. In the case of China, on the one hand, MNEs can explore the enormous Chinese market and enjoy the favourable investment environment created by the Chinese government through inward FDI. On the other hand, indigenous firms can accumulate their own O-advantages by learning from their foreign rivals in terms of new technologies, organisational strategies and functional competence (Scott-Kennel and Enderwick, 2005). These newly achieved O-advantages can then be exploited overseas (Dunning et al., 2001). In previous studies, positive intra- and inter-industry productivity spillovers have been proved to exist from inward FDI to Chinese firms (Buckley et al., 2007b; Chang, 2005; Driffield and Love, 2007; Hegazi and Safarian, 1999; Liu et al., 2009; Wei et al., 2001, 2008; Wei and Liu, 2006). FDI is also proved to lead to better innovation performance of indigenous firms through technological spillovers (Hegazi and Safarian, 1999, Liu and Buck, 2007). All these positive effects of inward FDI
will encourage the offensive OFDI activities of Chinese firms as they exploit the O-advantages accumulated through learning from their western rivals.

However, every coin has two sides. Although inward FDI contributes to the host country’s economic development in various respects, it may also increase the host country’s domestic competition and squeeze out inexperienced indigenous firms. Previous researchers have attempted to measure whether inward FDI enhances industrial competitiveness in a host country, but with inconclusive results (Hegazi and Safarian, 1999). Backer and Sleuwaegen (2003) find that, in the short-run, inward FDI and import competition discourage entry and stimulate exit of domestic entrepreneurs, but this effect can be moderated or even reversed due to positive spillovers of inward FDI.

In China, the government used to have control and protection over most industries and sectors before deregulation. When, in the 1980s, the country started the dramatic transition from a planned to a market economy and to pursue privatisation in previously state-owned industries and sectors, the central government did not only remove the barriers of inward FDI, but set up special tax holiday zones to attract inward FDI, which put indigenous firms at a competitive disadvantage. Therefore, indigenous firms were forced to compete with mature MNEs, despite insufficient financial capital, technology, management skills and experience. As indigenous firms grew fast and foreign MNEs were given more freedom by the deregulation, market competition became more and more intense. Chinese firms may start to explore overseas markets by defensive OFDI to further develop and explore their O-advantages in relatively less developed countries and escape from domestic institutional and market constraints. Therefore, the author proposes that:

H2: Chinese OFDI is positively influenced by the level of inward FDI attracted to the country.
4.3.3 Trade

Dunning et al. (2001) propose that a country’s OFDI position and its trade level interact as the country’s development proceeds. The Uppsala internationalisation process model (Johanson and Vahlne, 1977, 2009) considers export and OFDI as two distinct stages in a firm’s internationalisation establishment chain. The model, based on observation of the internationalisation of Swedish firms, proposes that firms start their internationalisation process with export. As they consolidate their position in foreign markets, they replace local agents with their own sales office. Eventually, if the performance is satisfactory, firms will establish production branches in host countries in order to overcome trade barriers. The Uppsala internationalisation process model (Johanson and Vahlne, 1977, 2009) indicates that there is a substitution relationship between OFDI and trade.

However, the debate in the international business field about whether there is a substitution relationship or a complementary one between OFDI and trade does not stop here. The relationship between OFDI and export has been proved to be complicated and ambiguous. On the one hand, previous empirical work examining the relationship has generally found strong evidence for complementarity (e.g. Head and Ries, 2001, Rob and Vettas, 2003, Swenson, 2004). This can be explained by the different advantages attached to the strategies of OFDI versus export. For example, the lower marginal costs of OFDI contrast with the lower fixed costs and lower risks associated with export. This leads to the complementary solution, where MNEs serve a foreign market by both OFDI and export (Rob and Vettas, 2003). On the other hand, since OFDI allows lower marginal costs of transportation, it may be a substitute for export when there is enough product demand in the foreign market, which can generate high profit that can cover the higher fixed costs generated by OFDI compared to export (Blonigen, 2005). Moreover, OFDI also provides a solution to overcome trade barriers and trade quotas in order to minimise the possible international anti-dumping lawsuits.

In the case of China, the fast economic growth has been largely reliant on export demand. The government has been explicitly encouraging OFDI projects which facilitate exports in order to maintain export growth. Between 2002 and 2008, 16.2% of Chinese OFDI stock was contributed by wholesale and retail sectors (trade related) compared to 5.3% generated by manufacturing industry (MOC, 2009). The former is more likely to produce a complementary relationship between Chinese OFDI and exports, while the later a substitute one. Therefore, OFDI may well become a complementary approach to internationalisation alongside exports, so that Chinese firms may benefit from the advantages of both internationalisation approaches. Chinese firms can still enjoy relative low labour cost and vast production capability at home by exporting intermediate or finished products. Meanwhile, OFDI will enable Chinese firms to internalise the external markets to reduce transaction costs and overcome trade barriers. Liu et al. (2005) find evidence of complementary relationship between Chinese OFDI and exports; however, the coefficient is statistically insignificant. Thus, the author proposes that:

\[ H3: \text{Chinese OFDI is complementary to the country’s international trade.} \]

4.3.4 Human Mobility

Human capital has been considered a potent supplementary variable to the IDP hypothesis. Previous studies (Dunning et al., 2001; Liu et al., 2005) have found that a rise in human capital stock leads to an increase in OFDI, suggesting that domestic human capital development is an important factor affecting China’s OFDI growth. However, little attention has been given to the
relationship between OFDI and human mobility. The reasons why human mobility has been chosen as one of the explanatory variables in this study are threefold.

First, previous studies have found evidence to link a country’s overseas networks to its domestic development and FDI (e.g. Buckley et al., 2007a; Chen and Chen, 1998; Loane and Bell, 2006; Ng and Tuan, 2002; Smart and Hsu, 2004; Zhou et al., 2007). The internationalisation process of firms is found to be driven by their network ties (Chen and Chen, 1998; Majkgard & Sharma, 1998; Sharma and Blomstermo, 2003; Zhou et al., 2007). The importance of networks in internationalisation has been widely recognised and examined (Chen et al., 2004; Coviello and Munro, 1995; Coviello and Munro, 1997; Loane and Bell, 2006; Luo, 1997; Welch and Welch, 1996; Zhou et al., 2007). The two-way human capital flows may help Chinese firms to form international business networks, overcome cross-country cultural barriers, gather information about foreign markets and access cutting-edge technologies, which can lead to fewer OFDI risks and more O-advantages. Therefore, in order to capture the influence of the Chinese overseas networks on Chinese OFDI, the human mobility factor is examined in this study to explore the possibility of augmenting the IDP framework with network theory.

Second, the development of networks is dynamic rather than static. Considering the internationalisation of Chinese firms, the network built by human mobility may have a stronger influence on Chinese firms’ OFDI activities than the Chinese diaspora, which has often been used in previous research to capture the important ‘Guanxi’ concept (e.g. Buckley et al., 2007a). There are mainly two concerns relating to the use of the Chinese diaspora. First, until 2000, among the 33 million overseas ethnic Chinese, 82.85% are inhabited in Asia, especially South and Southeast Asia (Guo et al., 2009). This can hardly capture the dynamic characteristics and the global scale of Chinese overseas networks. Not even mention the explanatory power for the emergence of OFDI from China to developed countries. Second, it has been found that the later generations of migrants become less committed to the original ethnic economy than their parents (Bonacich and Modell, 1980). On
the contrary, the two-way human mobility factor reflects the more recent trend of Chinese global networks, as more Chinese migrants flow to developed countries, such as the US, Canada, Australia and the EU, than traditional host countries in South and Southeast Asia (Guo et al., 2009). Meanwhile, this more recent human mobility trend, especially to developed countries, can significantly enlarge the global network (Kugler and Rapoport, 2005) which can be accessed by Chinese firms and contribute to the information and knowledge flow between China and the host countries, which could facilitate Chinese OFDI in the long run.

Third, the existing literature (Beine et al., 2001; Mountford, 1997; Stark et al., 1997; Vidal, 1998) has demonstrated that migration prospects can increase net human capital formation in the home country and boost domestic enrolment in higher education. In China, the number of domestic graduates increased from 165 thousand in 1978 to 4.48 million in 2007 (China Statistical Yearbook, 2008). In fact, China has become the original country which sends out the greatest number of internationally mobile students who study in foreign countries where they are not permanent residents (UNESCO, 2006). According to UNESCO (2006), Chinese students alone count for 14% of global mobile students. The Ministry of Education of China estimates that there have been more than 1,067,000 Chinese studying abroad. Many of these overseas students later on become permanent migrants, and only about 275,000 have returned to China from 1978 to 2006. The average return rate of overseas Chinese students is about 25.8%. The state-sponsored group has a much higher return rate than the self-sponsored: the ratios are 76.4% and 21.2% \(^7\), respectively. This group of human capital adds a distinctive knowledge intensive characteristic to recent human mobility of China.

\(^7\) Calculated by the author based on the data from the Ministry of Education of China website.
http://www.moe.edu.cn/ accessed on 10/7/2009
This two-way human capital flow in the past three decades has built up a transnational Chinese community, which provides a source of world-class skills and global connections to leading-edge technologies and overseas markets for the country’s development (Saxenian, 2002). Thus, the author proposes that:

\[ \text{H4: Chinese OFDI is positively associated with the country’s human mobility.} \]

4.3.5 Knowledge Development and Accumulation

The knowledge-based view considers knowledge to be one of the most important resources possessed by firms. Knowledge may either be generated internally through innovation or acquired externally through learning. All the generation and learning take place inside individual human heads. An organisation or country learns in only two ways: first, through the learning of its members; and second, through ingesting new members who have knowledge that the organisation or country did not previously have (Simon, 1991). In this study, this generating and learning process is integrated at the country level in order to satisfy the research objective.

As mentioned in the theoretical background Section 4.2, the promotion of the ‘Ke Jiao Xing Guo’ policy signified that the country had put knowledge development at the centre of domestic development. Knowledge development and accumulation can certainly increase firms’ intangible O-advantages, which cannot be easily copied by rivals. These will in turn lead to sustainable competitive advantages and overseas success. Moreover, the country’s thirst for knowledge indicates that China is undergoing the transition from a labour-intense economy to a knowledge-intense one. In order to catch up with developed countries in terms of strategic asset creation, OFDI may be used as an important approach for acquiring cutting-edge knowledge, especially for China, which is still lagging far behind in the innovation stakes.

A country’s knowledge development largely depends on its investment in research and development (R&D). In this technology era where knowledge is
ever more important, a country’s economic growth is directly linked to growth in productivity, which depends on technology innovations through knowledge created by investment in R&D (Jones, 1995). Prior research has found that R&D investment alone can explain 89.2% of national innovative capacity which has a significant impact on achieving a high market share of high-technology markets (Furman et al., 2002). In terms of OFDI, an increasingly positive effect of R&D investment on the country’s OFDI has been found in the case of Japan (Drake and Caves, 1992). Thus:

\[ H5: \text{Chinese OFDI is positively associated with the country’s knowledge development and accumulation.} \]

Therefore, combining the basic IDP hypothesis \((H1)\) with the four supplementary hypotheses, OFDI is considered to be a function of the following variables:

\[ \text{OFDI} = f(\text{GDPP, FDI, TRADE, HM, KNOW}) \quad \text{Equation 4.1} \]

where GDPP is GDP per capita, FDI denotes inward FDI, TRADE means exports of goods and services, HM stands for human mobility (measured by the net outward flow number of overseas students and academics) and KNOW represents knowledge development and accumulation, which is measured by the country’s investment in R&D.

### 4.4 Research Design

#### 4.4.1 Time-series Data Analysis

Following conventional IDP studies (e.g. Barry et al., 2003; Kalotay, 2004; Liu et al., 2005), this study also adopts an aggregative approach by using macro-level time-series data. The author follows the standard procedure for the time-series analysis including the unit root test, the cointegration test, and the system exogeneity test in order to detect the possible existence of certain characteristics of economic data which may influence the validity and
reliability of the final regression. These pre-tests helped the author to choose the appropriate estimation method.

### 4.4.1.1 Unit root test

For time series data, the first step is to test the stationarity property of the variables. The existence of a unit root is often a theoretical implication which questions the rational use of information available to researchers (Phillips and Perron, 1988). In particular, the presence of a unit root indicates that the trend is stochastic (variation is systematic but hardly predictable), rather than deterministic (variation is completely predictable) through the presence of a polynomial time trend (Maddala and Kim, 1998; Phillips and Perron, 1988). Unfortunately, it is well known that macro economic data is often non-stationary at level and standard regression techniques, such as OLS, will produce spurious results if the variables under consideration contain unit-roots and are non-stationary (Johansen and Juselius, 1990, Johansen, 1992; Phillips and Perron, 1988). In fact, in spurious regressions, the statistically significant relations among the variables that appear in the results merely reflect a contemporaneous correlation rather than a causal relationship.

The augmented Dickey-Fuller (ADF) test (Dickey and Fuller, 1981) is applied to detect the possible existence of unit roots of the variables. The null hypothesis of this test is that the variable contains a unit root, and the alternative is that the variable is generated by a stationary process.

### 4.4.1.2 Cointegration

Cointegration is an econometric property of time-series variables, which means that if two or more series are themselves non-stationary, but a linear combination of them is stationary, then the series are said to be cointegrated (Maddala and Kim, 1998). Cointegration may happen when two variables cannot drift too far apart because of the market, or when two series are the input and the output of a black box of limited capacity, or of finite memory (Granger, 1981). The existence of cointegration indicates that the two series
'move in a similar way, ignoring lags, over the long swings of the economy and in trend...although the two series may be unequal in the short term, they are tied together in the long run' (Granger, 1981).

A regression equation only makes sense when the dependent variable and the independent variable(s) do not drift too far apart from each other over time, which means there is a long-run equilibrium relation between them (Maddala and Kim, 1998). If the dependent variable and its explanatory variables drifted apart from each other over time, the relation obtained by regression would be spurious (Enders, 2004; Maddala and Kim, 1998). Therefore, it is important to test whether the variables are cointegrated and have a long-run relation.

In the case of multi-cointegration, the vector error correction model (VECM) should be applied, as the deviation of the equilibrium from its long-run relation will be fed into its short-run dynamics in the VECM (Burke and Hunter, 2005; Enders, 2004). The error correction term (ECT) represents the long-run relation between the variables. The VECM($p$) can be written in the following form:

\[
\Delta X_t = c + \Pi X_{t-1} - \sum_{i=1}^{p-1} \Gamma_i \Delta X_{t-i} + \varepsilon_t
\]

where \(X_t\) is an \(n \times 1\) vector of non-stationary \(I(1)\) variables, \(c\) is an \(n \times 1\) vector of constants, \(\varepsilon_t\) is an \(n \times 1\) vector of white noise, \(\Pi\) is \(\sum_{i=1}^{\hat{r}} \Gamma_i - I_n\) (\(I_n\) being the \(n \times n\) identity matrix) and \(\Gamma_i\) is an \(n \times n\) coefficient matrix (Burke and Hunter, 2005). \(\Pi X_{t-1}\) in Equations 4.2 is sometimes called the long-term part and represents the long-term relation between the variables in the equation (Lutkepohl and Kratzig, 2004). If the coefficient matrix \(\Pi\) has reduced rank \(r < n\), \(\Pi\) can be written as \(\Pi = \alpha \beta^\prime\) where \(\alpha\) (loading matrix) and \(\beta\) (cointegration matrix) are \(n \times r\) matrices with rank \(r\). \(r\) is the number of cointegration relations and each column of \(\beta\) is the cointegration vector (Lutkepohl and Kratzig, 2004).
Cointegration can be tested by applying the Johansen and Juselius (1990) procedure in which two tests are conducted: the trace test and maximal eigenvalue test. The method is to estimate the $\Pi$ matrix from an unrestricted vector autoregressive model and to test whether the restrictions implied by the reduced rank of $\Pi$ can be rejected. The null hypothesis for the trace test is the number of co-integration vector $r \leq n$, for eigenvalue test is $r = n$. The non-rejection of the null hypothesis indicates that there are $n$ co-integration relations in the dataset. The rejection of the null hypothesis indicates the acceptance of the alternative hypothesis $r \geq n$ and the need to continue to the next stage to test null $r \leq n+1$.

4.4.1.3 System exogeneity

Including endogenous variables into the regression model may be problematic for inference and analysis purposes. The existence of endogeneity implies the existence of two-way causal relations between dependent variables and its explanatory variables (Liu et al., 2005), which means the traditional OLS regression method cannot be utilised because the regression coefficients of the OLS regression will be biased. Therefore, the system exogeneity characteristic of the data needs to be tested in order to choose the appropriate regression model.

The variable is said to be weakly exogenous for the estimated parameter vector if estimating the parameter vector within a conditional model (conditional on the variable) does not entail a loss of information compared to estimating the vector in a full model without conditioning on the variable (Lutkepohl and Kratzig, 2004). Weak exogeneity can be tested against data by defining the stochastic properties of the conditioning variables in the VECM, which has the advantage that one can formulate a partial system as a conditional model and discuss its properties (Johansen, 1992). Restrictions can be imposed to the loading matrix, $\alpha$, in order to detect the existence of weak exogeneity. If the $i$-th row of the $\alpha$ matrix is all zero, then the $i$-th variable is said to be weakly exogenous with respect to the cointegration matrix $\beta$. 
The null hypothesis of the weakly exogenous test is that the variable is weakly exogenous to the system. Therefore, the rejection of the null hypothesis indicates that the variable is endogenous and needs to be addressed in regression method selection.

4.4.1.4 Generalized method of moments (GMM)

Equation 4.1 estimated in this study can be re-written in a simplified version of Equation 4.2, as in Equation 4.3:

$$\Delta OFDI_t = c + \eta \xi_{t-1} + \sum_{i=1}^{n} \gamma_i \Delta X_{t-i} + \varepsilon_t$$  \hspace{1cm} \text{Equation 4.3}

where $\Delta$ means the differences, $OFDI_t$ is the dependent variable, $X_i$ is a vector of the explanatory variables and $\xi_i$ is the disequilibrium of the last period, $\xi_t = OFDI_t - \gamma' X_t$ (Patterson, 2000). $\xi_{t-1}$ in Equations 4.3 is the ECT and represents the long-term relationship between the variables in the equation.

Where cointegration and endogeneity exist, Equation 4.3 should be estimated by using the GMM (Greene, 2000). In the twenty years since it was first introduced, GMM has become a very popular tool among empirical researchers. Many standard estimators, including OLS, can be seen as special cases of GMM estimators (Baum et al., 2003; David Roodman, 2006). GMM differs from OLS regression by taking into account reverse causation between variables. Liu et al. (2005) conducted a GMM estimation technique that takes into account time trends and co-movements between variables for the first time to increase the reliability of the conclusion, which will also be applied in this study.

4.4.2 Data

As mentioned in Section 4.3, the relationships between OFDI and economic development, inward FDI, trade, human mobility and knowledge development
and accumulation will be examined. The measurements of all the factors discussed above are summarised in Table 4.1.

Table 4.1 List of the Domestic Determinants of Chinese OFDI

<table>
<thead>
<tr>
<th>Factor</th>
<th>Variable</th>
<th>Label</th>
<th>Data</th>
<th>Sign</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic Development</td>
<td>GDP per capita</td>
<td>GDPP</td>
<td>Numerical</td>
<td>+</td>
</tr>
<tr>
<td>Inward FDI</td>
<td>Inward FDI stock</td>
<td>FDI</td>
<td>Numerical</td>
<td>+</td>
</tr>
<tr>
<td>Trade</td>
<td>Annual export flow</td>
<td>EX</td>
<td>Numerical</td>
<td>+</td>
</tr>
<tr>
<td>Human Mobility</td>
<td>Human mobility outflow</td>
<td>HM</td>
<td>Numerical</td>
<td>+</td>
</tr>
<tr>
<td>Knowledge Development and Accumulation</td>
<td>Annual investment in R&amp;D</td>
<td>R&amp;D</td>
<td>Numerical</td>
<td>+</td>
</tr>
</tbody>
</table>

It can be seen from Figure 4.1 that the Chinese OFDI level was not significant before 1984, but with an accumulated value of US$73.6 billion by the end of 2007. China’s uniquely gradualist reform has also produced massively high growth rate of inward FDI, GDP per capita and export. There has also been a surge of human capital mobility and investment in R&D since 1998.
Figure 4.1 Chinese OFDI, GDP per capita, Inward FDI, Export, Human Mobility and Investment in R&D (2000 constant US$)
Data for the tests proposed have been obtained from various sources. As mentioned in Section 3.2.2.3, OFDI and inward FDI stock data have been chosen rather than net investment flows. OFDI and inward FDI stocks are obtained from the UNCTAD database (2008). GDP per capita (in constant US$ 2000), GDP deflator and export (in constant US$ 2000) are drawn from the World Bank indicator (2009). Human mobility, the number of overseas students and academics, and investment in R&D are drawn from various issues of the China Statistical Yearbook (1980 – 2008). The value of OFDI, inward FDI, and investment in R&D are deflated into constant US$ of year 2000 by using GDP deflators. Constrained by the availability of the OFDI time-series, the sample period is from 1979 to 2007.

### 4.5 Empirical Results

ADF tests are first applied before the estimation procedure is chosen. In carrying out the ADF tests, the lag length is chosen by a serial correlation linear model residual test. The results from the ADF unit root tests are summarised in Table 4.2 and indicate that the null hypothesis, which is that there is a unit root in the level series, is not rejected for any of the six variables. However, all series are stationary in the first difference, so all the variables are integrated of order one. Therefore, a future regression model will be applied to the first differences of all variables.

**Table 4.2 Augmented Dickey-Fuller Tests for Unit Roots**

<table>
<thead>
<tr>
<th>Variables</th>
<th>ADF(including trend) level</th>
<th>ADF(including trend) difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>LogOFDI</td>
<td>-1.760 (6)</td>
<td>-4.678*** (2)</td>
</tr>
<tr>
<td>LogGDPP</td>
<td>-1.850 (6)</td>
<td>-3.476* (3)</td>
</tr>
<tr>
<td>LogFDI</td>
<td>0.216 (5)</td>
<td>-3.395* (1)</td>
</tr>
<tr>
<td>LogEX</td>
<td>0.513 (5)</td>
<td>-5.135*** (1)</td>
</tr>
<tr>
<td>LogHM</td>
<td>-1.591 (11)</td>
<td>-4.541*** (5)</td>
</tr>
<tr>
<td>LogR&amp;D</td>
<td>-0.693 (6)</td>
<td>-2.992** (1)</td>
</tr>
</tbody>
</table>

Note: (1) ***, ** and * denote significance at the 1, 5 and 10% levels, respectively. (2) Figures in parentheses are the number of lags used.
Following the ADF tests, the cointegration tests reported in Table 4.3, show that there is one cointegration vector existing, suggesting that long-run relations between the variables exist. The results also indicate that there are co-movement between OFDI, inward FDI, GDP per capita, export, investment in R&D and human mobility. The existence of cointegrations confirms the adoption of VECM.

**Table 4.3 Cointegration Tests**

<table>
<thead>
<tr>
<th>No. of CE(s)</th>
<th>Eigenvalue</th>
<th>Trace statistic</th>
<th>5% Critical value</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>None *</td>
<td>0.802229</td>
<td>111.4993</td>
<td>95.75366</td>
<td>0.0027</td>
</tr>
<tr>
<td>At most 1</td>
<td>0.666499</td>
<td>69.36254</td>
<td>69.81889</td>
<td>0.0543</td>
</tr>
<tr>
<td>At most 2</td>
<td>0.550193</td>
<td>40.81167</td>
<td>47.85613</td>
<td>0.1947</td>
</tr>
<tr>
<td>At most 3</td>
<td>0.394258</td>
<td>20.03929</td>
<td>29.79707</td>
<td>0.4202</td>
</tr>
<tr>
<td>At most 4</td>
<td>0.225772</td>
<td>7.005443</td>
<td>15.49471</td>
<td>0.577</td>
</tr>
<tr>
<td>At most 5</td>
<td>0.01346</td>
<td>0.352341</td>
<td>3.841466</td>
<td>0.5528</td>
</tr>
</tbody>
</table>

*** and ** denote significance at the 1% and 5% levels, respectively.

In order to select an appropriate estimation method for the determinants of China’s OFDI, system exogeneity tests are performed to detect whether OFDI feeds back on its explanatory variables. The results from the tests, presented in Table 4.4, indicate that two-way causations exist between OFDI and some independent variables, such as human mobility and investment in R&D. Therefore, simple OLS regression can only provide inadequate tests of
hypotheses because of the reverse causation from OFDI to human mobility and investment in R&D.

Table 4.4 System Exogeneity Tests:

<table>
<thead>
<tr>
<th>Variables</th>
<th>LR-test</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>LogGDPP weakly exogenous to system</td>
<td>1.407</td>
<td>0.235</td>
</tr>
<tr>
<td>LogFDI weakly exogenous to system</td>
<td>0.440</td>
<td>0.507</td>
</tr>
<tr>
<td>LogEX weakly exogenous to system</td>
<td>0.372</td>
<td>0.542</td>
</tr>
<tr>
<td>LogHM weakly exogenous to system</td>
<td>11.055**</td>
<td>0.001</td>
</tr>
<tr>
<td>LogR&amp;D weakly exogenous to system</td>
<td>9.218***</td>
<td>0.002</td>
</tr>
</tbody>
</table>

Note: *** and ** denote significance at the 1% and 5% levels, respectively.

Because of the existence of endogeneity, Equation 4.3 needs to be estimated by using the GMM in order to take into account of the properties of cointegration and endogeneity between OFDI and its explanatory variables. The GMM estimation result is reported in Table 4.5. The coefficients of most explanatory variables are correctly signed. A rise in GDP per capita, human mobility and investment in R&D is found to lead to an increase in OFDI, suggesting that the growth of GDP per capita, human mobility and knowledge development are important factors affecting Chinese OFDI growth in the short run. By contrast, export is found to be significant but with a sign contrary to expectation, as predicted in hypothesis $H3$. The negative sign of export indicates that there is a substitute relationship between China’s export and OFDI, rather than a complementary one. Inward FDI is found to be insignificant. Therefore, hypotheses $H2$ is not supported. Endogeneity between OFDI and human mobility and investment in R&D is revealed by exogeneity tests, which indicate a reverse causation running from OFDI to human mobility and investment in R&D. Each of these main findings will be discussed in more detail below.

As stated in the methodology section, the VECM permits the examination of both long-term and short-term relations among the variables. The statistically significant ECT indicates that there is a long-term relation among the
variables. This can be easily explained by the endogeneity between OFDI and the independent variables.

Table 4.5 GMM Estimation of Domestic Determinants of Chinese OFDI

<table>
<thead>
<tr>
<th>Independent variables</th>
<th>Coefficient</th>
<th>t-Statistic</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>ΔLogGDPP</td>
<td>3.350</td>
<td>5.015</td>
<td>0.001***</td>
</tr>
<tr>
<td>ΔLogFDI</td>
<td>0.203</td>
<td>1.232</td>
<td>0.234</td>
</tr>
<tr>
<td>ΔLogEX</td>
<td>-3.882</td>
<td>-10.3438</td>
<td>0.001***</td>
</tr>
<tr>
<td>ΔLogHC</td>
<td>0.236</td>
<td>2.884</td>
<td>0.010**</td>
</tr>
<tr>
<td>ΔLogR&amp;D</td>
<td>0.00013</td>
<td>4.822</td>
<td>0.001***</td>
</tr>
<tr>
<td>ECT(-1)</td>
<td>-0.704</td>
<td>-7.102</td>
<td>0.001***</td>
</tr>
<tr>
<td>C</td>
<td>0.432</td>
<td>4.081</td>
<td>0.001***</td>
</tr>
</tbody>
</table>

Adjusted $R^2$ 0.215

Note: ***, ** and * denote significance at the 1%, 5% and 10% levels, respectively.

4.6 Discussion

The main aim of this chapter is to examine empirically the domestic determinants of Chinese OFDI, and to contribute to the development of international business theory by incorporating network theory and the knowledge-based view to augment the IDP framework. Although China is one of the transitional economies with very particular characteristics, this study has demonstrated that it is possible to explain over 20% of the variance of Chinese OFDI without the unique features of Chinese institutions and economic reforms.

From the results presented in the previous section, convincing evidence is found to support hypotheses $H1$, $H4$ and $H5$, which indicate strong positive relationships between Chinese OFDI and GDP per capita, human mobility, and knowledge development and accumulation. Although the test of $H3$ is statistically significant, the relationship between Chinese OFDI and trade in export flow seems to be negative rather than positive as proposed, which indicates a substitute relationship rather than a complementary one.
Meanwhile, the test of $H_2$ is statistically insignificant. Therefore, $H_2$ is not supported by the result. The possible interpretation of these findings will be presented below.

The significant positive causal relationship between Chinese OFDI and GDP per capita underpins the traditional IDP framework, which means that Chinese OFDI is positively driven by the domestic economic development. The traditional IDP framework considers GDP per capita as an indicator of a country’s economic development which reflects the country’s O-advantage development and accumulation. In China’s case, the result indicates that as O-advantages accumulate through domestic economic reform and development, firms start to exploit those advantages overseas.

Meanwhile, it can be seen that the O-advantages possessed by Chinese firms are based on both financial capacity and strategic assets. This is evident from an interpretation of the significant positive relationship between Chinese OFDI and its economic development and its knowledge development. Although the strategic asset-seeking determinant of Chinese OFDI has been widely accepted and supported (e.g. Deng, 2009; Rui and Yip, 2009), this study proves that Chinese firms have accumulated their own strategic assets which can be exploited overseas before investing abroad. Therefore, Chinese firms may use OFDI as an effective means to achieve ambidexterity rather than simply strategic asset exploration.

The new factor introduced in this study, human mobility, has been proved to have a significant positive impact on Chinese OFDI. Human mobility in the era of globalisation has significantly promoted global network building and knowledge flow across geographical boundaries, which will facilitate Chinese OFDI in the long-run.

Nobody can deny the importance of networks in the Chinese ideology of conducting business. Although previous research based on the Chinese diaspora also considered the role of networks in promoting Chinese OFDI, dynamic changes in network formation and development have been
completely overlooked. The new networks formed by the current human mobility flows are more contemporary and relevant. The most distinctive characteristic of the current human mobility flow is at the educational level. As mentioned in Section 4.3.4, according to the Ministry of Education, more than one million Chinese students have studied or been studying abroad: this means that more international students give China as their country of origin than any other countries. This enormous amount of intelligence flow helps China to build and develop an incredible global network, which will help Chinese firms to overcome cultural barriers, promote trust, reduce transaction costs and minimise information asymmetry.

These highly-skilled and well-educated migrants from China also act as channels for direct knowledge transfer. Their enrolment in world class universities, research organisations and traditional MNEs gains them the precious opportunity to acquire advanced knowledge, cutting-edge technologies and international work experience, which can either be used by Chinese firms to enhance their own O-advantages, or become a type of strategic asset attracting Chinese firms to chase in the global market. Either way, Chinese human mobility has become a type of strategic asset which can be exploited or explored by Chinese firms in their internationalisation process.

The other variable that appears to be statistically significant is export. In this study, the coefficient of export is negative, which indicates a substitute relation between Chinese exports and OFDI rather than a complementary one. Thanks to low costs (both materials and labour) large productive capacity and government support, Chinese exports started to increase steadily after the launch of the ‘Reform and Open’ policy and surged dramatically in the new millennium (see Figure 4.1). However, China started to face pressures from developed countries because of the large trade surplus, and Chinese firms are under increasing pressure from more and more anti-dumping investigations. Therefore, it becomes increasingly difficult for Chinese firms to enter and expand their international markets through exports. Meanwhile, increasing labour costs and the strengthening of the RMB (the Chinese currency) also contribute to export difficulties.
However, all these factors discouraging exports can either be avoided or be turned to advantage by OFDI, especially for manufacturing industries. Therefore, when the position of export was threatened, more and more manufacturing firms started their international expansion. By the end of 2007, manufacturing industry had contributed 8.1% of Chinese OFDI stock with a gradually increasing trend. The proportions that manufacturing industry contributed to Chinese annual OFDI flow are 21.9%, 13.7%, 18.6%, 4.3% and 8% in 2003, 2004, 2005, 2006 and 2007 respectively (China Statistical Yearbook, 2005-2008). This significant growth in recent years may help to explain why there is a substitute relation between China’s OFDI and export.

The reverse influence from Chinese OFDI to human mobility and knowledge development and accumulation is evident from the system exogeneity tests. It is easy to understand the impact of Chinese OFDI on human mobility, since Chinese firms operating overseas will certainly transfer human resource internally from China to overseas subsidiaries, as well as recruiting locally. Moreover, more and more Chinese firms operating overseas can also increase the employment potential for Chinese students overseas thanks to their shared language and cultural background and the specialist knowledge possessed by the students (including intellectual knowledge and knowledge of the host country market and society). This increasing employment potential will in turn attract more Chinese students to host countries. However, the causal relationship between Chinese OFDI and human mobility needs to be tested in future empirical studies.

The influence of Chinese OFDI on knowledge development and accumulation may be slightly more complicated. On the one hand, internationalisation can alert Chinese firm to strategic assets oriented O-advantage building. As Chinese firms further understand the increasing importance of strategic assets in international competition, they may then invest more in domestic knowledge development, in order to develop their own intangible O-advantages. For example, Shenzhen-based Huawei, one of the most successful internationalised Chinese firms, whose overseas subsidiaries contributed 60.4% of its total annual sales revenue, 149.1 billion RMB, in
2009\textsuperscript{8}, commits at least 10\% of its annual sales revenue to its R&D\textsuperscript{9}. On the other hand, as OFDI has been adopted by Chinese firms as an approach to acquire strategic assets, many Chinese firms also start to found research centres in more technology advanced countries in order to recruit specialised personnel and enjoy the mature innovation environment. For example, on 5 January 2009, China Mobile founded its first overseas research centre in Silicon Valley, California\textsuperscript{10}. This type of OFDI in overseas knowledge development and accumulation may consume some resources which could be invested domestically. Given the growing emphasis of the government and the private sector on knowledge development and accumulation, the author predicts that Chinese OFDI will have a positive impact on this sphere. However, the relationship between Chinese OFDI and knowledge development and accumulation needs to be further tested in future research.

As stated in the research design Section 4.4.1, the ECM permits the examination of both long-term and short-term relations among the variables. The significant coefficient of the ECT indicates that the explanatory variables proposed in this study together affect the magnitude of OFDI in the long run. Therefore, Chinese OFDI is jointly driven by the level of economic development, openness and networks.

\textbf{4.7 Summary}

This study, based on the most recent dataset of China, identifies the domestic determinants of the country’s OFDI. The relationships between Chinese OFDI and five explanatory factors, namely economic development, inward FDI,

\textsuperscript{8} http://news.cnfol.com/100409/101_1587_7507934_00.shtml accessed on 2/1/2011.

\textsuperscript{9} http://www.huawei.com/cn/technology.do accessed on 2/1/2011.

\textsuperscript{10} http://labs.chinamobile.com/groups/60_779 accessed on 2/1/2011.
trade, human mobility and knowledge development and accumulation, have been tested. The interdependence and co-movement among the factors are also taken into consideration in the methods applied. The results reveal that Chinese OFDI has the tendency to increase in parallel with its economic development, human mobility and knowledge development and accumulation, and substitutes its exports.

This study makes a number of contributions to the existing literature. First, it has augmented the IDP framework by accommodating network theory and the knowledge-based view. Human mobility has been incorporated into the explanation of the OFDI wave from emerging economies for the first time. Strong evidence has been found to support the hypothesis that Chinese OFDI is positively driven by human mobility, which reveals the important role played by network in promoting Chinese OFDI. This represents an important extension of previous studies by considering a new phenomenon of two-way human mobility between China and the outside world.

Second, by considering the result of this study with the traditional strategic asset-seeking argument of OFDI from emerging economies, it can be seen that OFDI has been adopted by Chinese firms as an approach to pursue ambidexterity, which has been linked with sustained performance (Raisch and Birkinshaw, 2008, Raisch et al., 2009). Therefore, this study is among the first to discover that OFDI is not only utilised by Chinese firms to seek external factors identified in traditional international business literatures, such as market, resource, efficiency and strategic assets, but also an effective means to convert themselves to modern enterprises.

Third, compared to previous research (e.g. Liu et al., 2005), some dynamic changes of the determinants of Chinese OFDI can be found. Following Liu et al. (2005)'s suggestion, the GMM estimation technique is also applied in this study in order to take into account time trends and endogeneity between variables, which makes the comparison more reliable. Besides the finding of the new variable, human mobility, major differences include the significant coefficient of trade and the substitute rather than complementary relationship
between Chinese OFDI and exports. The existence of these dynamic changes indicates that the domestic determinants of a country’s OFDI need to be examined overtime.
Chapter 5  Locational Determinants of Chinese OFDI in OECD Countries

5.1 Introduction

This chapter identifies the possible change of patterns in the locational determinants of Chinese OFDI to OECD countries, especially the relationship between the finance capital flow and human mobility, by using the most recent dataset covering Chinese OFDI to 13 major OECD countries from 1999 to 2007. This research is based on both the traditional theory of FDI, the eclectic paradigm (Dunning, 1977, 1980, 1988), and network theory, which has been proved to be closely relevant to the internationalisation of firms, especially those from emerging economies (Filatotchev et al., 2007).

The chapter is organised as follows. First, a brief review (which refers back to the theories reviewed in Chapter 3) will lay the theoretical foundation for this study in Section 5.2. This is followed by Section 5.3, which develops the hypotheses of this study. Then, in Section 5.4, research methods and data will be discussed and described. Empirical results are presented in Section 5.5, followed by discussion in Section 5.6. A brief summary will be presented in Section 5.7.

5.2 Theoretical Background

As reviewed in Chapter 3, Dunning's (1977, 1980, 1988) eclectic paradigm is the most influential and widely used approach to studying the rise of MNEs and their locational choices. The eclectic paradigm argues that MNEs must possess certain types of O-advantages at home, which can be transferred to specific countries to explore L-advantages through internalisation via foreign direct investment (I-advantages). Dunning (1988) has updated his eclectic paradigm and proposed four motives of MNEs’ OFDI activities, namely market-, natural resource-, efficiency- and strategic asset-seeking. This implies that MNEs not only exploit their O-advantages in host countries, but
also use OFDI as an approach to explore strategic assets. These motives may either co-exist, or MNEs may prioritise their motives by engaging in strategic asset-seeking activities in host countries.

However, the traditional theoretical perspective alone may not be adequate to explain the special feature of Chinese OFDI in OECD countries (Buckley et al., 2007a; Mathews, 2006; Wright et al., 2005). Network theory has been recognised as a promising theoretical lens through which to investigate the motives behind Chinese OFDI. In particular, this approach helps to explore the role of human mobility between China and OECD countries in Chinese OFDI.

Network theory highlights the importance of human relations and networks in the context of the global economy (Adler and Kwon, 2002). Social capital in the form of networks is viewed as a relational and structural resource attained by individuals/firms through a network of social and professional relationships (Cooper and Yin, 2005). Social capital which can be exploited from the networks can generate benefits, be converted to or complement other resources, or be maintained as a long-term asset (Adler and Kwon, 2002). It is argued that network-related factors may enable Chinese firms to access knowledge of international markets and to acquire a better understanding of the institutional environments of host countries, thus influencing the locational choice of Chinese firms.

The international experience of Chinese students and academics may be associated with the development of international business networks and they may act as a bridge between China and international markets by establishing social capital in the form of international networks, which create opportunities for social capital transactions (Adler and Kwon, 2002). This kind of human mobility may play an important role in the locational choices of Chinese OFDI. Building on these theoretical perspectives in an integrated framework, a number of testable hypotheses are proposed as follows.
5.3 Hypotheses

5.3.1 Human Mobility

When firms enter a foreign market they are exposed to uncertainty, which stems from a lack of knowledge of an unfamiliar environment (WIR, 1998). Networks provide firms with an extended knowledge base and improve the quality, relevance and timeliness of information, which helps them to reduce business risk and transaction costs (Adler and Kwon, 2002; Braeutigam, 2003; Erdener and Shapiro, 2005). There is a growing literature emphasising that networks built by international human mobility facilitate bilateral economic transactions through the removal of informational and cultural barriers between home and host countries (Kugler and Rapoport, 2005). This complementary relationship between networks and bilateral economic transactions has been supported by previous researches in the field of international trade (e.g., Gould, 1994; Rauch, 2002; Rauch and Casella, 2003; Rauch and Trindade, 2002). In a similar spirit, human mobility can also create the types of business networks which lead to FDI investment in a particular location, by helping firms to reduce the uncertainty and information asymmetry when entering a foreign market.

Sociologists have found that human mobility encourages the FDI flow from the host country to the home country of the migrants, thanks to migrants taking part in business networks after they have settled in the host country society (Saxenian, 2002). Especially in the early stage of China’s ‘Reform and Open’ economic revolution, FDI from South and East Asia to China was mostly contributed by the Chinese diaspora communities in countries such as Singapore, Taiwan and Hong Kong (Chen and Chen, 1998; Ng and Tuan, 2002; Smart and Hsu, 2004).

However, the influence of human mobility on FDI from emerging economies to host developed countries has received little attention. Although Buckley et al. (2007a) find evidence that Chinese OFDI is positively associated with the proportion of ethnic Chinese in the host population, this diasporas approach is
rather static and excludes the dynamic human mobility between the home
country and host country, since new network ties can be created when people
mobilise (Adler and Kwon, 2002). Previous research (Ellis, 2000; Gould, 1994;
Reid, 1986; Zhan, 1995) finds that awareness of foreign market opportunities
can be stimulated by foreign travel and migration, because decision-makers
who have prior foreign experience are able to draw upon their networks in
foreign markets to facilitate the firm’s foreign entry (Axinn, 1988).

In contrast to the benefit of the extended network, from the perspective of the
domestic market of the home country, human mobility has been considered
as a ‘brain drain’, especially for developing countries that are in need of
intellectual capital to facilitate economic development. Just as employees
have to relocate to where jobs are, FDI will flow to places where there is
supply of qualified labour (Kugler and Rapoport, 2005). For example, it is
understandable that strategic asset-seeking FDI will flow to locations where
highly-skilled and well-educated personnel are abundant. As one of the
countries with a severe ‘brain drain’ problem, China is craving for highly-
skilled and well-educated intellectual personnel. It follows that the mobility of
Chinese brainpower to overseas countries may well stimulate Chinese firms
to invest abroad in order to capitalise on their talents.

Although it is more difficult to operate networks in developed economies
because the legal and institutional infrastructure may prevent fluid operations
of such networks (Wright et al., 2005), this vast highly-skilled and well-
educated network built by Chinese international students and academics has
the knowledge and capability to help Chinese firms overcome uncertainty and
latecomer disadvantage (Li, 2003). Thus:

H1: The higher the proportion of human capital flow from China to the host
country, the more this will encourage Chinese OFDI flow to the host country.
5.3.2 Strategic Assets

In order to develop competitive advantages, firms have a strong interest in investing in their O-advantage development (Dunning, 1996, 2000). As a theoretical development explaining the evolution of O-advantages, the resource-based view assumes that firms can achieve competitive advantages and strong performance through generating and/or possessing bundles of firm-specific assets (Barney, 1991; Peteraf, 1993; Teece et al., 1997; Wernerfelf, 1984). However, these assets constitute tacit O-advantages and take time to evolve: the more tacit the asset, the more likely it is to stay within the firm (Kogut and Zander, 2003). OFDI has been utilised as a way for MNEs to acquire or develop strategic assets in a foreign market, and explore such assets as technological know-how, reputation, and management skills (Chung and Alcacer, 2002; Dunning, 1998; Kuemmerle, 1999). OFDI is attracted towards centres of innovation located in recipient countries in order to access complementary assets with the purpose of upgrading the capabilities of MNEs (Deng, 2007).

Much empirical evidence has been found to support the strategic asset-seeking motivation. Mutinelli and Piscitello (1998) find that Italian firms entered the North America market with a clear vision of gaining access to and developing intangible and complementary assets. By analysing a few famous cases of Chinese firms investing in developed countries, Deng (2007, 2009) noted that strategic asset-seeking has been a primary determinant behind Chinese firms’ investment in developed countries, in an effort to enhance their competitive advantage in the global marketplace. Similarly, many other Asian firms are investing in developed countries with the aim to source established brand names, cutting-edge technologies and extensive networks, and to enhance their non-price competitiveness (Belderbos, 2003; Kumar, 1998; Makino et al., 2002).

This strategic asset-seeking perspective is particularly important for Chinese firms. In order to compete with MNEs from developed countries and overcome the latecomer disadvantage of possessing few firm-specific resources,
Chinese firms may consider OFDI as a quick-fix to leapfrog over problems, such as lack of technologies, international brand recognition and international management skills. Therefore, a host country with higher levels of intellectual capital and innovative capacity to help Chinese firms build up their potential O-advantages, certainly will attract Chinese firms with strategic asset-seeking intentions (Twomey, 2000).

The Chinese government is also keen to promote strategic asset-seeking investments. In 2005, the technology division of MOC published a circular on promoting technology firms ‘Go Global’ to detail the support that firms can enjoy when they are classified as technology firms. NDRC considers investing in strategic assets, alongside natural resources, export-oriented manufacture and services, as the four kinds of OFDI which are highly encouraged by the Chinese government.

Intellectual capital emerged as the key wealth creating asset in most industrial economies in the 1980s and 1990s (Dunning, 1998). As early as in the 1990s, the market value of intellectual assets in corporations was variously calculated (e.g., Blair, 1995 and Edvinsson, 1997) at between 2.5 and 5 times the value of their tangible assets. As China is seeking to change its labour intensive economy to a knowledge intensive one in order to achieve sustainability and competitive advantage, it is not surprising to see the various circulars and notices published by the government to promote the development and acquisition of cutting edge technologies and innovations during the time period studied by this research.

While traditional FDI motivations are based on exploiting firms’ resources and O-advantages in a host country, strategic asset-seeking is motivated by the need to gain new capabilities and acquire necessary strategic assets in a host country (Deng, 2007; Dunning, 1998). Therefore, FDI is attracted to a certain country when an investor chooses to purchase the assets created in the country and utilise these assets elsewhere (Dunning, 1998). A country’s ability to create strategic assets can be measured by the proportion of investment in R&D in its GDP. Thus:
H2: The higher the relative investment in R&D of the host country to that of China, the more the Chinese OFDI flows to the host country.

5.3.3 Cultural Distance

Hofstede (1991, p. 4-5) states that culture as ‘patterns of thinking, feeling, and acting, or … ‘software of the mind’. Culture is always a collective phenomenon…the collective programming of the mind which distinguishes the members of one group or category of people from another’. Cultural distance is the degree to which the cultural norms in one country are different from those in another country (Kogut and Singh, 1988). Cultural distance has been proved to be one of the elements that cannot be neglected in firms’ internationalisation process (Tihanyi et al., 2005).

According to network theory, networks enable firms to reduce information asymmetry, cut transaction costs and build trust (Gulati et al., 2000). However, large cultural distance creates difficulties for the building of managerial networks, which are important forces for coordination and integration across national borders (Johanson and Vahlne, 2009; Manev and Stevenson, 2001). Managers also find that great cultural distance acts as a barrier when they adapt to a different culture (Black and Mendenhall, 1992), and leads to misunderstanding and conflict with managers in host countries (Adler, 1997; Lincoln et al., 1981). This cultural dissimilarity will increase the risk of firms’ OFDI, especially when managers lack international operation experience. Therefore, firms may be less willing to invest in host countries with great cultural distance.

Cultural proximity to the home country has been identified as a significant determinant of FDI (Hofstede, 1983; Dunning, 1993; Buckley et al., 2007a). The Uppsala Model (Johanson and Vahlne, 1977, 2009) states that MNEs engage in FDI incrementally by making small investments in geographically and culturally proximate countries, and proceeding to larger investments into countries distant on both counts as they accumulate more experience.
However, previous empirical research has not reached a consensus on the conclusion of whether cultural distance is one of the FDI determinants. Loree and Guisinger (1995) analyse the FDI from the US to 48 countries in 1978, and find that cultural distance is negatively related to the FDI flow. However, the regression on the same dataset in 1982 leads to the result that there is no significant relationship between the two. Benito and Gripsrud (1992) also find that there is no evidence for the notion that FDI enters foreign countries with shorter cultural distance first, and then spreads to more distant markets.

On the one hand, cultural distance has been recognised by its negative effect on internationalisation. On the other hand, researchers find that cultural diversity encourages the learning of new routines and may result in improved performance (Ghoshal, 1987; Morosini et al., 1998; Tihanyi et al., 2005). Based on more recent samples, cultural distance has had a strong positive effect on firms’ international diversification (Tihanyi et al., 2005). In a study based on the FDI flow to Mexico from 11 countries, cultural distance is found to be positively related to the FDI flow, however, it may not be as important as other factors in explaining FDI into emerging economies (Thomas and Grosse, 2001).

In addition, networks, or ‘Guanxi’, do play an essential role in Chinese business, and the larger the cultural distance, the more difficult it is to build new networks (Johanson and Vahlne, 2009). Hence, Chinese OFDI is more likely to prefer countries with shorter cultural distance, where the operational environment is more familiar to Chinese managers. Thus:

\[ H3: \text{Chinese OFDI is negatively associated with the cultural distance between China and the host country.} \]

### 5.3.4 Market Size

Market-seeking is one of the most recognised motivations of FDI which was identified back in the 1970s. It has been identified as one of the principal determinants of US FDI into Western Europe since the 1950s (Reuber et al.,
Ever since, market size has been considered as one of the major locational determinants of FDI from newly industrialised economies to China (Filatotchev et al., 2007), from China to the world (Buckley et al., 2007a), from Korea to 68 countries (Lim, 2008), and from the US to the world (Loree and Guisinger, 1995; Sethi et al., 2003).

Recent studies highlight that the growing importance of market-seeking FDI by Chinese MNEs in developed host countries in response to policy liberalisation in China (Buckley et al., 2008b; Buckley et al., 2007a; Cross et al., 2007; Deng, 2004; Zhang, 2003). Moreover, this type of investment is increasingly directed towards large markets (Buckley et al., 2007a). Chinese market-seeking OFDI involves both defensive (import-substituting and quota-hopping) and offensive (developing new markets) initiatives (Buckley et al., 2007a). Market size is a major determinant of market-seeking FDI, especially for offensive market-seeking OFDI, because as markets increase in size, so do opportunities to exploit economies of scale and scope (WIR, 1998). In 2007, eight of the top ten countries by GDP are OECD countries (World Bank Indicator, 2009). Therefore, OECD countries cannot be neglected by any firm with a market-seeking motive, given their high GDPs. A country’s market size can be measured by its annual GDP.

**H4: The larger the relative market size of the host country to that of China, the more the Chinese OFDI flows to the host country.**

### 5.3.5 Inward FDI

OFDI may be positively affected by inward FDI if inward FDI, attracted by L-advantages, ultimately leads to the accumulation of O-advantages, which can contribute to overseas exploitation (Dunning et al., 2001). Inward FDI plays an important role in the process of China’s economic development. In 2007, China remained the top recipient of FDI among developing countries with US$83.5 billion (WIR, 2008). Inward FDI contributes to a host country’s economic development through both capital accumulation (Chang, 2005; Liu
et al., 2002) and productivity spillovers (Chang, 2005; Driffield and Love, 2007; Hegazi and Safarian, 1999; Wei et al., 2001).

As discussed in Section 4.3.2, recent studies have shown positive intra- and inter-industry productivity spillovers from foreign invested firms to Chinese indigent firms (Buckley et al., 2002, 2007b; Hu and Jefferson, 2002; Jr-Tsung, 2004; Li et al., 2001; Liu, 2002; Liu et al., 2001; Liu and Buck, 2007). It is significant that firms from OECD countries generate much more inter-industry knowledge transfer effects than investment from Hong Kong, Macao or Taiwan (Wei and Liu, 2006). In addition, Chinese firms may benefit from access to international market information through contact with their foreign counterparts (Buckley et al., 2002). Earlier studies conclude that foreign MNEs help the internationalisation of Chinese local firms by enabling them to identify target markets in the West, and knowledge transfer (Aitken et al., 1994; Buckley et al., 2002; Kokko et al., 1997; Thoburn, 1997).

Both knowledge transfer and international market information access can contribute to local Chinese firms’ O-advantage development. Chinese firms may learn the world class technologies and management skills from their foreign counterparts, which can reduce the distance between themselves and their foreign counterparts, and enable them to accumulate the experience and management skills for international operation. Local Chinese firms can also collect information about foreign markets and investment opportunities through their foreign counterparts. Therefore, the knowledge transfer and international market information access effects of inward FDI to China may well stimulate the OFDI of Chinese firms as the knowledge and experience of international operations increase. Thus:

*H5: The higher a particular country’s proportion of FDI relative to total FDI flow into China, the more that country is likely to receive Chinese OFDI.*
5.3.6 Bilateral Trade

As mentioned in Section 4.3.3, the Uppsala model (Johanson and Wiedersheim-Paul, 1975, 2009) identifies trade and FDI as two distinct stages of internationalisation process. They believe that firms start business within the local market with no regular export activities, then develop into export expansion via agents, and enter overseas markets through OFDI at a later stage. This view is in line with the conventional neoclassical trade model which considers international trade and international investment as substitutes (Farrell et al., 2004). However, the relationship between trade and FDI can be complementary or substitute in nature, and has not yet reached a consensus conclusion in the academic field (Camarero and Tamarit, 2003; Deichmann, 2001). Thomas and Grosse (2001) find that in the 1980s and early 1990s, the inward FDI to Mexico was positively related to the trade between the home countries and Mexico. Japanese OFDI also follows upon Japan’s international trade success (Drake and Caves, 1992; Farrell et al., 2004).

High foreign trade prospects can make one country more attractive to foreign investors (Liu et al., 2002). During the 1980s and 1990s, much Chinese OFDI was motivated by providing a support function for domestic Chinese exporters in the host country (Wu and Sia, 2002). Like strategic asset-seeking OFDI, OFDI with the aim of supporting domestic Chinese exporters is also among the four types of OFDI that are highly promoted by the Chinese government (see Section 5.3.2). Buckley et al. (2007a) find strong evidence to support the complementary relationship between Chinese trade and OFDI. The intensity of trade relations between a home country and a host country can be captured by bilateral trade (Buckley et al., 2007a). Thus:

H6: The higher the level of bilateral trade between China and the host country, the more this will encourage Chinese OFDI flow to the host country.

Based on theories and previous empirical research, six hypotheses have been built in this study in order to deepen our understanding of the locational determinants of Chinese OFDI, and to expand current theory, by bringing in a
new variable, human mobility. The relationship between the location of Chinese OFDI and host countries’ characteristics are summarised in Figure 5.1.

Figure 5.1 Locational Determinants of Chinese OFDI to OECD Countries

5.4 Research Design

5.4.1 Panel Data Analysis

Baltagi and Griffin (1997) point out that pure cross-sectional studies cannot control for behavioural changes occurring over time, while pure time-series studies cannot control for unobservable country effects. Panel data, which can be described as time-series cross-sectional data, are generally believed to be able to widen the database in order to ensure better and more reliable estimates of the parameters of the model. Therefore, panel datasets generally possess several major advantages compared to conventional cross-sectional and time-series datasets (Hsiao, 2003).
5.4.1.1 Poolability

Before running any regression with the dataset, it is necessary to test whether the regression parameters take values common to all cross-sectional units for all time periods, in order to satisfy the overall assumption of pooling the dataset, which is the homogeneity of the slope coefficients (Hsiao, 2003).

A Chow test is a test of whether the coefficients estimated over one group of the data are equal to the coefficients estimated over another. Using the Chow test, the question of whether ‘to pool or not to pool’ is reduced to a test of the validity of the null hypothesis $H_0: \theta_i = \theta$ for all $i$ (Baltagi, et al., 2008).

Under $H_0$, the following test statistic:

$$F_{obs} = \frac{(ess - \sum_{i=1}^{N} ess_i)/(N-1)k}{\sum_{i=1}^{N} ess_i / N(T-k)}$$  \hspace{1cm} \text{Equation 5.1}

is distributed as $F((N-1)k, N(T-k))$, where $ess$ is the error sum of squares from the pooled regression, $ess_i$ is the error sum of squares from the separate regressions of each cross-section individual, $N$ is the number of the cross-section individuals, $T$ is the length of the time-series, and $k$ is the number of the estimated parameters.

Rejection of the null hypothesis means the existence of heterogeneity across the data units, which breaks the panel data assumption of pooling observations. The existence of heterogeneity leads to inaccurate estimates and even wrong signs for the coefficients (Maddala et al., 1997). The panel data estimation should not be applied when the hypothesis of homogeneity of the coefficients is rejected. Therefore, testing for the homogeneity of the dataset should be the first step of panel data analysis. Until the homogeneity assumption is confirmed, panel data analysis could be meaningless.
5.4.1.2 Fixed or random effects estimator

In panel data analysis, one assumes that the effects of all omitted variables are driven by three types of variables (Hsiao, 2003):

- individual time-invariant: same for a given cross-sectional individual through time but variant across all cross-sectional individuals;
- period individual-invariant: same for all cross-sectional individuals at a specific point in time but variant through time;
- individual time-variant: variant across cross-sectional individuals at a given point in time and through time.

There are two common ways to deal with the unobserved effects: fixed effects estimation, which treats unobserved effects as parameters to be estimated, or random effects estimation which treats unobserved effects as variables. Whether the fixed effects model or the random effects model should be considered depends on the context of the data, the manner in which they were collected, and the environment from which they came (Hsiao, 2003). For this study, a fixed effects model cannot be used since the equation includes a time dummy variable (cultural distance).

Since no lagged dependent variables have been used as regressors in this study, the model of this study will be a static single equation panel model written as:

\[ y_{it} = \beta' X_{it} + u_{it} \]  

Equation 5.2

where \( y_{it} \) is the measure of Chinese OFDI flow, \( X_{it} \) represents the vector of explanatory variables, and \( u_{it} \) is the error term which contains the unobserved heterogeneity components. Equation 5.2 can be transformed into the estimating Equation 5.3, which provides an explicit specification of the linkage.
between OFDI flow of China to OECD countries and related country specific variables.

\[ OFD_{it} = \beta FDI_t + \chi_i GDP_i + \delta_i TRADE_t + \phi_i R & D_i + \varphi_i HC_t + \gamma_i CD_t + u_{it} \]

**Equation 5.3**

In most applications, the error component structure can be specified as a case of the following representation:

\[ u_{it} = \alpha_i + \epsilon_{it} \]

**Equation 5.4**

Where \( \alpha_i \) is unobserved heterogeneity terms, and \( \epsilon_{it} \) is i.i.d. across individuals and time periods. As discussed above, in this study the unobserved heterogeneity \( \alpha_i \) is treated as a random effect.

The two explicit assumptions for applying a random effects analysis are strict exogeneity on the unobserved effect \( \alpha_i \), which means that once \( X_{it} \) and \( \alpha_i \) are controlled for, \( X_{it} \) has no partial effect on \( y_{it} \) for \( s \neq t \), and the orthogonality between \( \alpha_i \) and \( X_{it} \) (Wooldridge, 2003).

However, the fundamental exogeneity assumption for the regressors may not be supported by the data. The consistency of parameter estimates is in doubt when some explanatory variables are correlated with the model residuals. The endogenous regressors will appear when some of the regressors in a regression equation are the dependent variables in others and consequently are correlated with the disturbances of the equation under consideration. The existence of endogeneity indicates that an alternative but more consistent estimator is needed. In situations like this, instrumental variable procedures are indispensable (Wooldridge, 2003).
5.4.1.3 Instrumental variable methods

The modern approach to system instrumental variables estimation is based on the principle of GMM (Wooldridge, 2003). "With GMM, we can consider different exogeneity assumptions related to \( \alpha_i \) or \( \varepsilon_{it} \), producing different orthogonality conditions. Apart from the difference between random and fixed effect specifications (instruments correlated or not with \( \alpha_i \)), we can also consider strictly or weakly exogenous instruments if explanatory instruments are correlated with \( \varepsilon_{it} \)' (Boumahdi and Thomas, 2008, p. 107).

Besides addressing the endogeneity problem, GMM can also provide consistent and efficient estimation under the condition of heteroscedasticity. The existence of heteroscedasticity leads to unbiased but inefficient least square estimators, and also invalidates the tests of significance since the estimates of the variances are biased (Maddala and Lahiri, 2009). Under the no conditional heteroscedasticity assumption, GMM provide equally consistent variance-covariance matrix and efficient estimation with the same instrument set, compared to traditional 2SLS or 3SLS estimators, but GMM is more efficient if the assumption does not hold (Boumahdi and Thomas, 2008).

5.4.2 Data

The dataset includes 13 OECD countries across a nine-year time period, 1999-2007, which gives 117 observations in total. During a five-year time period from 2003 to 2007, the OFDI flows from China to these 13 countries, on average, contributed 92.12% of the total OFDI flow from China to OECD countries, which can generally represent the whole population. The 13 countries and the OFDI flows from China to them during 2003 to 2007 are listed in Table 5.1.
<table>
<thead>
<tr>
<th>Country</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>30,390</td>
<td>124,950</td>
<td>193,070</td>
<td>87,600</td>
<td>531,590</td>
</tr>
<tr>
<td>Canada</td>
<td>-730</td>
<td>5,120</td>
<td>32,440</td>
<td>34,770</td>
<td>1,032,570</td>
</tr>
<tr>
<td>France</td>
<td>450</td>
<td>10,310</td>
<td>6,090</td>
<td>5,600</td>
<td>9,620</td>
</tr>
<tr>
<td>Germany</td>
<td>25,060</td>
<td>27,500</td>
<td>128,740</td>
<td>76,720</td>
<td>238,660</td>
</tr>
<tr>
<td>Hungry</td>
<td>1,180</td>
<td>100</td>
<td>650</td>
<td>370</td>
<td>8,630</td>
</tr>
<tr>
<td>Italy</td>
<td>290</td>
<td>3,100</td>
<td>7,460</td>
<td>7,630</td>
<td>8,100</td>
</tr>
<tr>
<td>Japan</td>
<td>7,370</td>
<td>15,300</td>
<td>17,170</td>
<td>39,490</td>
<td>39,030</td>
</tr>
<tr>
<td>Korea</td>
<td>153,920</td>
<td>40,230</td>
<td>588,820</td>
<td>27,320</td>
<td>56,670</td>
</tr>
<tr>
<td>Netherlands</td>
<td>4,470</td>
<td>1,910</td>
<td>3,840</td>
<td>5,310</td>
<td>106,750</td>
</tr>
<tr>
<td>New Zealand</td>
<td>640</td>
<td>3,455</td>
<td>5,945</td>
<td>3,490</td>
<td>-1,600</td>
</tr>
<tr>
<td>Spain</td>
<td>0</td>
<td>1,700</td>
<td>1,470</td>
<td>7,300</td>
<td>6,090</td>
</tr>
<tr>
<td>UK</td>
<td>2,110</td>
<td>29,390</td>
<td>24,780</td>
<td>35,120</td>
<td>566,540</td>
</tr>
<tr>
<td>USA</td>
<td>65,050</td>
<td>119,930</td>
<td>231,820</td>
<td>198,340</td>
<td>195,730</td>
</tr>
<tr>
<td>Sub Total</td>
<td>290,200</td>
<td>382,995</td>
<td>1,242,295</td>
<td>529,060</td>
<td>2,798,380</td>
</tr>
<tr>
<td>OECD Total</td>
<td>368,200</td>
<td>407,925</td>
<td>1,258,595</td>
<td>567,530</td>
<td>2,916,430</td>
</tr>
<tr>
<td>Percentage</td>
<td>78.82%</td>
<td>93.89%</td>
<td>98.70%</td>
<td>93.22%</td>
<td>95.95%</td>
</tr>
</tbody>
</table>

Source: MOC (2009b)

The data for the proposed test are obtained from various sources. GDP (in constant US$ year 2000), R&D (percent of GDP) and GDP deflator are obtained form the World Bank development indicator (2009). The OFDI flows from China to OECD countries are drawn from various issues of China Commercial Statistic Yearbook (MOC, 2000b-2009b). Inward FDI flows from OECD countries to China, export flows from China to OECD countries and import flows from OECD countries to China are drawn from various issues of the China Statistical Yearbook (2000-2008). All OFDI, inward FDI, export and import flow data have been deflated by using a GDP deflator drawn from the World Bank development indicator (2009) into constant US$ year 2000. The data about international Chinese students are drawn from the UNESCO Education Statistical Report (2009). Cultural distance is calculated following
Luo (2000), which is based on Hofstede’s culture dimension index (2001) and presented here:

\[
CD_{j/\text{China}} = \frac{1}{4} \sum \frac{(I_{ij} - I_{i\text{China}})^2}{V_i}
\]

**Equation**

5.5

where \(I_{ij}\) is the index value for the cultural dimension \(i\) of country \(j\); \(I_{i\text{China}}\) is the index value for the cultural dimension of China; \(V_i\) is the variance of the index dimension \(i\). The measurements of all the variables discussed above are summarised in Table 5.2.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Data</th>
<th>Measurement</th>
<th>Sign</th>
</tr>
</thead>
<tbody>
<tr>
<td>Human Mobility</td>
<td>Ratio</td>
<td>The ratio of the human capital flow to the host country to the total human capital flow from China</td>
<td>+</td>
</tr>
<tr>
<td>Strategic Assets</td>
<td>Ratio</td>
<td>The ratio of the R&amp;D (percent of GDP) to that of China</td>
<td>+</td>
</tr>
<tr>
<td>Cultural Distance</td>
<td>Ratio</td>
<td>The cultural difference between the host country and China</td>
<td>-</td>
</tr>
<tr>
<td>Market Size</td>
<td>Ratio</td>
<td>The ratio of the host country GDP to that of China</td>
<td>+</td>
</tr>
<tr>
<td>Inward FDI</td>
<td>Ratio</td>
<td>The ratio of the inward FDI flow from the OECD country to the total inward FDI flow to China</td>
<td>+</td>
</tr>
<tr>
<td>Bilateral Trade</td>
<td>Numerical</td>
<td>The bilateral trade value between the home country and China</td>
<td>+</td>
</tr>
</tbody>
</table>

5.5 *Empirical Results*

5.5.1 Multicollinearity

Table 5.3 reports the matrix of correlation coefficients. It shows that all explanatory variables are correlated with the OFDI flow from China. However, some of the correlation coefficients are very high, which can raise concern about multicollinearity. A variance inflation factor (VIF) test has been
performed in order to detect the possible existence of multicollinearity. The result of the VIF test, reported in Table 5.4, indicates that there is no great multicollinearity concern about the dataset, thus allowing the author to conduct an econometric analysis of the data.

Table 5.3 Correlation Matrix

<table>
<thead>
<tr>
<th></th>
<th>OFDI</th>
<th>Human Mobility</th>
<th>Strategic Asset</th>
<th>Cultural Distance</th>
<th>Market Size</th>
<th>Inward FDI</th>
<th>Bilateral Trade</th>
</tr>
</thead>
<tbody>
<tr>
<td>OFDI</td>
<td>1.0000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Human Mobility</td>
<td>0.4833</td>
<td>1.0000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strategic Asset</td>
<td>0.3297</td>
<td>0.1448</td>
<td>1.0000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cultural Distance</td>
<td>-0.2170</td>
<td>-0.2483</td>
<td>-0.6205</td>
<td>1.0000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Market Size</td>
<td>0.5118</td>
<td>0.8978</td>
<td>0.1914</td>
<td>-0.1720</td>
<td>1.0000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inward FDI</td>
<td>0.5314</td>
<td>0.7141</td>
<td>0.4632</td>
<td>0.6697</td>
<td>0.7366</td>
<td>1.0000</td>
<td></td>
</tr>
<tr>
<td>Bilateral Trade</td>
<td>-0.1103</td>
<td>-0.0547</td>
<td>-0.4425</td>
<td>0.3962</td>
<td>0.0667</td>
<td>-0.2581</td>
<td>1.0000</td>
</tr>
</tbody>
</table>

Table 5.4 Variance Inflation Factor Test

<table>
<thead>
<tr>
<th>Variable</th>
<th>VIF</th>
<th>1/VIF</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market Size</td>
<td>10.00</td>
<td>1.0000</td>
</tr>
<tr>
<td>Inward FDI</td>
<td>6.95</td>
<td>0.1439</td>
</tr>
<tr>
<td>Human Mobility</td>
<td>6.33</td>
<td>0.1580</td>
</tr>
<tr>
<td>Cultural Distance</td>
<td>3.97</td>
<td>0.2517</td>
</tr>
<tr>
<td>Strategic Asset</td>
<td>2.04</td>
<td>0.4891</td>
</tr>
<tr>
<td>Bilateral Trade</td>
<td>1.55</td>
<td>0.6470</td>
</tr>
<tr>
<td>Mean VIF</td>
<td>5.15</td>
<td></td>
</tr>
</tbody>
</table>
5.5.2 Poolability

The initial hypothesis assumes the homogeneous properties of the parameters in the regression model of the OFDI flow from China across countries. The $ess = 0.0473$ is obtained from pooled OLS, and the $\sum_{i=1}^{N} ess_i = 0.0103$ is obtained from summing the ess from 13 individual country OLS regressions. In the test for overall homogeneity, a calculated F-statistic of 1.30 is obtained from Equation 5.1. Since this value is less than the 5% of the critical value of $F(71, 39) = 1.62$, this indicates that, at this level, we can assume that the slopes and intercepts are simultaneously homogeneous among different countries in the dataset. Therefore, the data can be pooled to test the hypothesis.

5.5.3 Endogeneity and Heteroscedasticity Test

System exogeneity tests are performed in order to determine whether the endogeneity problem needs to be addressed in regression methods. Endogeneity between OFDI and human mobility, and between OFDI and inward FDI, has been revealed by system exogeneity tests (Table 5.5). Thus, the reverse causation running from OFDI to human mobility and inward FDI needs to be addressed in the analysis. In this case, Equation 5.3 should be estimated by applying instrumental variable regression methods, rather than pooled OLS.

Table 5.5 System Exogeneity Tests

<table>
<thead>
<tr>
<th>Variable</th>
<th>p-value</th>
<th>Exogeneity tests</th>
</tr>
</thead>
<tbody>
<tr>
<td>Human Mobility</td>
<td>0.0424**</td>
<td>4.118</td>
</tr>
<tr>
<td>Strategic Assets</td>
<td>0.3326</td>
<td>0.939</td>
</tr>
<tr>
<td>Cultural Distance</td>
<td>0.7122</td>
<td>0.136</td>
</tr>
<tr>
<td>Market Size</td>
<td>0.3636</td>
<td>0.825</td>
</tr>
<tr>
<td>Inward FDI</td>
<td>0.0790*</td>
<td>3.085</td>
</tr>
<tr>
<td>Bilateral Trade</td>
<td>0.3803</td>
<td>0.770</td>
</tr>
</tbody>
</table>
In order to test whether the no heteroscedasticity assumption of two-stage least square (2SLS) is valid in this dataset, a likelihood ratio (LR) test is performed to detect the existence of heteroscedasticity. The LR test returns a Chi-square value of 324.87, which is greater than the 1% critical value. Therefore, heteroscedasticity has been proved to be existent, which indicates that 2SLS is less efficient than the GMM estimator when applied to this dataset. As a result, Equation 5.3 will be estimated by using GMM, and the result is presented in the next section.

5.5.4 GMM Estimator

The result of the GMM estimator is largely consistent with the hypothesis, with some interesting twists, which will be discussed in this section. The GMM estimation result is reported in Table 5.6.

Table 5.6 GMM Estimation Result

<table>
<thead>
<tr>
<th>Independent Variable</th>
<th>p-value</th>
<th>Coefficient</th>
</tr>
</thead>
<tbody>
<tr>
<td>Human Mobility</td>
<td>0.085*</td>
<td>0.1016</td>
</tr>
<tr>
<td>Strategic Asset</td>
<td>0.000***</td>
<td>0.0208</td>
</tr>
<tr>
<td>Cultural Distance</td>
<td>0.005***</td>
<td>0.0100</td>
</tr>
<tr>
<td>Market Size</td>
<td>0.638</td>
<td>-0.0014</td>
</tr>
<tr>
<td>Inward FDI</td>
<td>0.018**</td>
<td>0.3792</td>
</tr>
<tr>
<td>Bilateral Trade</td>
<td>0.164</td>
<td>0.0084</td>
</tr>
<tr>
<td>Adjusted R²</td>
<td>0.33</td>
<td></td>
</tr>
</tbody>
</table>

Human mobility, strategic assets and inward FDI are all significant and correctly signed. These findings support Hypotheses H1, H2 and H5. By contrast, cultural distance is found to be significant but with a sign contrary to expectation as predicted in Hypothesis H3. Market size and bilateral trade intensity are both found to be insignificant. Therefore, hypotheses H4 and H6
are not supported. Each of these main findings will be discussed in more detail in the discussion section below.

5.6 Discussion

This chapter empirically examines the determinants of the locational choices of China’s OFDI in developed countries. The findings show that inward FDI has a positive influence on Chinese OFDI. This indicates that the greater the direct investment from an OECD country into China, the more Chinese OFDI will flow to that country. This finding underpins existing literature showing that inward FDI has generated both significant positive productivity spillovers, and the benefits of accessing international market information (Liu and Buck, 2007; Wei and Liu, 2006). This implies that Chinese firms quickly learn from and build networks with their foreign competitors, and this prepares them for later internationalisation. The knowledge, which Chinese firms learn from the MNEs from OECD countries, includes not only technology and innovation, but also host country culture and management skills. The result may reflect the fact that the knowledge which Chinese firms learn from their foreign rivals about foreign markets can significantly lower the uncertainty level of investing in foreign markets, and help them hurdle the cultural obstacle when engaging in OFDI. This is especially significant when Chinese firms invest in OECD countries which are much more developed and have very different markets compared to China.

International knowledge spillovers, including international market information access, are promoted by not only inward FDI, but also human mobility which has been largely overlooked in previous research. Compared to inward FDI, Chinese firms can benefit from networks formed by human mobility, and with fewer communication difficulties because of the same cultural background. The result of this study shows that the coefficient on human mobility is positive and significant, indicating that a 1% increase in the variable is associated with an increase in Chinese OFDI of 0.1%. This result suggests that China’s OFDI does follow human capital flow into OECD countries. There
are three ways by which human mobility can facilitate Chinese OFDI into OECD countries.

First, Chinese students who go abroad can enrol in world class universities, research organisations and MNEs, in order to learn cutting edge technologies, innovations and management skills. Compared to the productivity spillovers and international market information spillovers of inward FDI, knowledge transfer and information access by human mobility is more direct and encompassing. Because of conflict of interest, traditional MNEs may not be willing to share new technologies with local Chinese firms in order to maintain their own competitive advantages. However, human mobility, as a new channel for international inter-firm knowledge spillovers (Song et al., 2003), can meet this need, which can directly contribute to Chinese firms O-advantage development.

Second, the study and/or work experience accumulated during their stay in OECD countries enabled these people to not only enrich their knowledge and skills, but also deepen their understanding of local culture and society. Previous research (Adler, 1997; Black and Mendenhall, 1992; Lincoln et al., 1981) has found that cultural distance can play a negative role in the internationalisation process. The experience of mingling with local society after moving from China to a host country helps to deepen a migrant’s understanding of the difference between Chinese and western culture. This in turn can help Chinese firms to better understand host country markets and smooth over communications and negotiations.

Third, human mobility can play an important ‘bridge’ role and provide the necessary networks in host countries during the internationalisation process. This group of talented people who possess advanced knowledge and understand both Chinese and western cultures, form extended international networks in host countries which will attract Chinese investment, connect Chinese firms to host countries and help them settle in local markets.
In this study, human mobility is measured by the international mobile Chinese student. It follows that such international networks are more likely to be well-educated and equipped with higher capability and advanced knowledge. Chinese firms can use these networks in OECD countries to narrow the knowledge gap (including technology and international management experience) and reduce information asymmetry. Therefore, human mobility is able to facilitate Chinese OFDI, especially in developed countries, in a significantly positive way.

The strategic asset variable, measured by percentage of investment in R&D in GDP, is found to have a highly significant and positive effect on Chinese OFDI to OECD countries. This result suggests that Chinese OFDI to OECD countries is highly driven by strategic asset-seeking over the time period studied, and provides strong evidence to support the assertion that strategic asset exploration motives firms from emerging economies at the aggregate level.

Previous research (Buckley et al., 2007a) found evidence suggesting that Chinese OFDI to OECD countries was mainly driven by market-seeking over the time period between 1984 and 2001, since the proxy used to measure the market size, GDP, was positively significant. However, the result of this study indicates that there is a shift in the motive of Chinese OFDI to OECD countries from market-seeking to strategic asset-seeking, since the market-seeking measurement, GDP, is statistically insignificant, but the strategic asset-seeking indicator, investment in R&D, is highly significant. The difference in empirical results between this study and earlier research suggests that Chinese firms have put strategic asset-seeking motives of OFDI as priority in OECD countries. As latecomers in the global market, in order to leapfrog the knowledge gap between the traditional MNEs and themselves, Chinese firms have chosen OFDI as the short-cut to acquire knowledge and information, which are profoundly important factors when competing in the global market.
Another major finding is that the positive coefficient of cultural distance indicates an increasing relationship between cultural distance and Chinese OFDI. This stands in contrast to the normal finding for this variable, which is that the further the cultural distance, the less the OFDI.

There are two possible reasons why Chinese firms are increasingly investing in culturally dissimilar countries when investing in OECD countries. First, culture is considered to be the informal institution system of a society (Peng, 2002; Peng et al., 2008). Chinese OFDI has long been considered as an approach utilised by Chinese firms to escape from home country institutional constraints (Luo and Tung, 2007; Yamakawa et al., 2008). Chinese firms searching for markets with fewer institutional restraints find that OECD countries have well established open competition and legal system, and so have become the obvious targets of Chinese firms. This positive relationship between cultural distance and Chinese OFDI to OECD countries reflects a significant trend of institution-seeking (see Section 3.3.2.5) of Chinese OFDI to developed countries.

Second, in line with the finding of strategic asset-seeking motivation of Chinese OFDI to OECD countries, Chinese firms are increasingly investing in the innovative and creative environment which hatches new strategic assets. This result is consistent with a stream of literature that associates cultural distance with innovation and creativity (e.g., Barr and Glynn, 2003; Shane et al., 1995; Shane, 1993). Cultural diversity encourages the learning of new routines, which will contribute to innovation within firms (Ghoshal, 1987, Morosini et al., 1998). As MNEs expand into culturally diverse but developed markets, they obtain access to new knowledge and resources which can lead to enhanced performance (Morosini et al., 1998). This positive association between cultural distance and innovation explains the recent trend of various Chinese MNEs to relocating their R&D units in developed countries (Yang et al., 2009). Hence, the predominant strategic asset-seeking motives of Chinese OFDI may help to explain the positive relationship between cultural distance and OFDI locational choice.
Of the variables examined, no support was found for Hypotheses H4 and H6. The market seeking variable, GDP, is insignificant, which suggests that Chinese firms have not been motivated to acquire a market share in OECD countries over the period under study, or, at least, market-seeking is not as important as other factors in explaining Chinese OFDI to developed countries. This is also supported by the insignificant result of trade intensity between host countries and China.

Besides the evidence discussed above, the endogeneity test result also reveals some interesting relationships between the dependent and independent variables. OFDI from China to OECD countries has been proved to be caused by the human capital flow from China to OECD countries and the inward FDI from OECD countries to China (Hypotheses H1 and H5). The result from the endogeneity test also proves the existence of the reverse influence of Chinese OFDI on the inward FDI from OECD countries to China and the human capital flow from China to OECD countries. Therefore, the relationships between the FDI flows between China and its OECD counterparts, and the human capital flow and OFDI flow from China and OECD countries constitute two-way traffic. The dependent variable, OFDI from China to OECD countries, will appear as an independent variable in the determinant function of the FDI from OECD to China and the human capital flow from China to OECD countries. These two-way relationships have been largely overlooked in existing studies.

### 5.7 Summary

Although researchers have long identified the factors affecting OFDI by firms from emerging economies, and strategic asset exploration as one of the major motivations behind these investments, there is still relatively little empirical research on the internationalisation of emerging economy firms into developed economies (Wright et al., 2005). Evidence to support the assertion of the exploration motive, especially at country level, is also very limited. This study, based on the most recent dataset of one of the most important emerging economies, China, provides explicit support for this theoretical
assertion. Expanding previous research on the locational choice of Chinese OFDI (e.g. Buckley et al., 2007a), the author has discovered the changing pattern of the locational determinants of Chinese OFDI, from market-seeking to strategic asset-seeking in developed economies. Meanwhile, Chinese OFDI to OECD countries is also driven by the human capital flow to the host countries, which implicitly means that international networks established in developed countries play an important role in Chinese OFDI.

This study makes a number of contributions to the existing literature. First, it shows that capital flow from China to OECD countries follows human mobility, which is an unexplored factor in locational choice for Chinese OFDI. The networks built in host countries and the ‘bridge’ role played by this human flow are precious intangible resources for Chinese firms to expand internationally. When the human capital flow is composed of highly skilled and well educated personnel, Chinese firms can boost their internationalisation by utilising the advanced knowledge and networks embedded in these talented people.

Second, this study has used the most recent data on China’s OFDI, and the results reveal some dynamic changes of motives for OFDI. After two decades of economic reformation and development, in the new millennium, Chinese OFDI has started to transform from market-seeking to strategic asset-seeking in OECD countries. In order to achieve the purpose of strategic asset-seeking, Chinese firms prefer investing in countries with a strong commitment to strategic asset creation. Meanwhile, Chinese firms are also investing in countries with further cultural distance in order to learn new routines and enhance innovation performance.

Third, this study uses advanced econometric techniques to investigate the endogenous nature of locational choices of OFDI. Most existing empirical studies fail to investigate the dynamic movements of OFDI and its locational determinants. Ignoring the endogeneity and heteroscedasticity of the data can also lead to inconsistent and inefficient coefficient estimation (Boumahdi and Thomas, 2008; Wooldridge, 2003). In this study, an instrumental variable
method, the GMM estimator, is applied in order to counter such a possibility and generate consistent and efficient coefficient estimation.
Chapter 6 Dynamic Capability, Institution-based View and Post-internationalisation Performance: A conceptual framework

6.1 Introduction

This chapter provides a theoretical synthesis of dynamic capability theory, the institution-based view and internationalisation performance research. Section 6.2 reviews the factors affecting internationalisation performance which have been identified in previous research. Section 6.3 introduces the theoretical foundations of the firm level research of this thesis: dynamic capability theory and the institution-based view. Then in Section 6.4, the conceptual framework for the firm level research is developed to show that post-internationalisation performance is influenced by the combination of internal dynamic capabilities and external institutional environments.

6.2 Literature Review on Factors Affecting Internationalisation Performance

A great deal of research has focused on internationalisation performance and identifying its contributory factors. However, despite a large number of studies that have examined the internationalisation performance, there is no consensus regarding the determinant factors for internationalisation success. Factors identified in previous studies can be classified into two categories: internal factors, such as resources, capabilities and firm specific factors (e.g. Bruton et al., 1994; Chatterjee et al., 1992; Datta, 1991; Fowler and Schmidt, 1989; Krishnan et al., 1997; Uhlenbruck, 2004), and external factors, such as host country specific and institutional factors (e.g. Luo, 2003; Demirbag et al., 2007), both of which will be reviewed in this section.
6.2.1 Internal Factors

Previous research has examined the role of various internal factors in internationalisation performance based on resource-based view, dynamic capability theory and attention perspectives (e.g. Bouquet et al., 2009; Daily et al., 2000; Demirbag et al., 2007; Luo, 2003; Uhlenbruck, 2004; Venaik et al., 2005). The factors, such as resource commitment, control flexibility, international experience and international attention, have been regarded as the main determinants of internationalisation performance.

**Resource commitment** of the parent firms helps overseas subsidiaries with the management of uncertainty and the coordination of activities, and counterbalances the subsidiaries’ vulnerability to the host countries’ unfamiliar institutional environments (Demirbag et al., 2007, Luo, 2003). Although parent firms will not be able to provide all the resources needed by subsidiaries, such support can certainly reduce the subsidiaries’ reliance on local resources such as capital and semi-products, which will increase their competitive advantages in the host countries, especially in emerging economies (Luo, 2003). However, this is not to say that subsidiaries should depend for everything on their parent firms. A combination of resources provided by parent firms and location-specific resources acquired from the host countries may provide a better balance (Demirbag et al., 2007). Child and Yan (2003) state that the quality of resource provision in host countries, especially in emerging economies, is critical in the performance of overseas subsidiaries.

**Control flexibility** concerns ‘the extent to which a parent firm’s organisational control over subsidiary activities is flexible’ (Luo, 2003, p. 295), and reflects the level of the subsidiary’s autonomy. Previous studies have well documented the fact that overseas performance and strategy implementation are significantly affected by the way in which parent firms control subsidiary operations (Baliga and Jaeger, 1984; Golden, 1992; Prahalad and Doz, 1987; Subramaniam and Watson, 2006; Varblane et al., 2005). Power delegation and parental control significantly influence the effectiveness of overseas subsidiaries (Gencturk and Aulakh, 1995; Habib and Victor, 1991; Roth et al.,
Kogut (1985) suggests that the operational flexibility of subsidiaries is developed largely based on the foundation of the flexibility of parent control. It creates many arbitrage opportunities to explore the differentials (such as financial gains, production plans and tax minimisation) and leverage opportunities (such as political risk reduction and better global coordination). Control flexibility allows subsidiary managers to better explore future changes and opportunities and to better respond to a changing market (Luo, 2003). Venaik et al. (2005) also find that performance is improved for the more autonomous subsidiary. In particular, Varblane et al. (2005) find that financial autonomy has a bigger positive impact on foreign subsidiaries’ performance compared to technology, marketing and management autonomy.

*International experience* is another commonly examined factor in internationalisation performance research (e.g. Bruton et al., 1994; Carlsson et al., 2005; Fowler and Schmidt, 1989; Uhlenbruck, 2004). In particular, previous acquisition experience has been widely recognised as a crucial factor in M&A performance (Bruton et al., 1994; Haspeslagh and Jemison, 1991; Hitt et al., 1998; Hitt et al., 2001). Hitt et al. (2001) caution that the importance of the link between managers' international experience and internationalisation success should not be underestimated. The complex integration challenges caused by internationalisation may be helped by international experience at both individual and organisational level (Haspeslagh and Jemison, 1991). At the individual level, a top management team lacking international experience can be particularly susceptible to an escalation of commitment, which can result in unreasonably high transaction costs (Haspeslagh and Jemison, 1991). Previous research finds that top management teams’ international experience is positively related to firms’ internationalisation performance (Daily et al., 2000; Haspeslagh and Jemison, 1991). Moreover, at the organisational level, international experience can build facilitating processes for the identification (Hitt et al., 1998) and integration of resources, which in turn will contribute to the improvement of post-internationalisation performance (King et al., 2004). Such experience can also help overcome the negative cultural distance effects which often cause integration difficulties (Uhlenbruck, 2004). Carlsson et al. (2005)'s research
studying Scandinavian firms’ performance in China reveals that subsidiaries in China have superior performance if their parent firms have operational experience in countries or regions similar to China, such as Hong Kong, Taiwan or Singapore.

*International attention* is defined as ‘the extent to which headquarters executives in the MNEs invest time and effort in activities, communications, and discussions aimed at improving their understanding of the global marketplace’ (Bouquet *et al.*, 2009, p. 108). International attention can be seen as a practical way to fulfil managers’ global mindset, which indicates how senior managers focus their thoughts and ideas (Bouquet *et al.*, 2009).

International attention can provide access to superior information sources in the global environment (Zaheer and Zaheer, 1997), facilitate the generation and diffusion of ideas and competencies throughout the organisation (Rugman and Verbeke, 2001), significantly affect globalisation efforts (Levy, 2005), and signal the willingness of senior managers to be open-minded toward different opinions and perspectives (Bouquet *et al.*, 2009). When senior managers of parent firms understand, respond and adapt to host country conditions, the efficiency of subsidiaries can be improved (Luo, 2003). These advantages can eventually result in better managerial decisions and improved corporate performance (Kim and Mauborgne 1993; Venaik *et al.*, 2005). Bouquet *et al.* (2009) find that international attention has a curvilinear (inverted U-shape) rather than linear relationship with MNEs’ performance, which is positively moderated by the senior managers’ international experience.

### 6.2.2 External Factors

Previous research indicates that the environment in which MNEs operate has a significant impact on their strategies and outcomes, and plays an important role in explaining the variation in their behaviour and performance (Brouthers, 2002; Makino *et al.*, 2004; Meyer, 2004; Peng, 2001; Uhlenbruck, 2004). The
existing literature has identified a number of external factors which have a profound impact on internationalisation performance.

**Political risk** is determined by the actions and policies of both home and host country governments, which plays an important role in MNEs’ operation and performance (Ahmed et al., 2002; Brouthers, et al., 2000), and measured by political, policy and macroeconomic uncertainties in the prior literatures. While political risk exists more or less in every economy, it is much more in evidence in emerging economies due to market transition and institutional conditions prevailing (Hoskisson et al., 2000, Peng, 2001). Host country governments often intervene or interfere with foreign company activities via regulations and rules (Luo, 2003). However, the frequent and unpredictable changes of these regulations and rules, especially in emerging economies, lead to environmental uncertainty and complexity (Luo and Peng, 1999). The uncertainties make subsidiaries rely more on parent resources, but weaken the contribution of the parent resources to subsidiary performance (Luo, 2003). Demirbag et al. (2007) also find that a favourable managerial perception of host country political risk, which is heavily influenced by the institutional environment in which managers function (Makhija and Stewart, 2002), positively influence the perception of subsidiary performance.

**Supportive government regulations** towards corporate tax and FDI incentives also contribute to a more favourable institutional environment and would tend to have a positive impact on firms’ performance in the host country (Child et al., 2003, Demirbag et al., 2007, Luo, 2003). Managers’ perception of the host country is in many ways influenced by the government regulations regarding competition and FDI (Demirbag et al., 2007). For example, Pangarkar and Lim (2003) find that a non-discriminatory approach from the host country government has a positive impact on MNE performance.

Very often, emerging economies are primarily concerned with facilitating an increase in employment, and in knowledge and technology transmission through FDI. They therefore tend to provide more incentives for FDI than other modes of investment (Demirbag et al., 2007). In such cases, foreign investors
are motivated additionally by these investment incentives and favourable regulations (Loree and Guisinger, 1995, Pangarkar and Lim, 2003), which feed directly into MNEs’ performance (Lim, 2005, Pangarkar and Lim, 2003).

The concept of cultural distance has been prominent since the work of Hofstede (1980, 2000), and used widely in international research. Previous research argues that as the culture dissimilarity between home and host countries increases, investment in the host country becomes riskier and the integration process becomes more difficult (Björkman et al., 2007; Cartwright and Cooper, 1995; Li et al., 2001; Lodorfos and Boateng, 2006; Morosini and Singh, 1994; Morosini et al., 1998; Newman and Nollen, 1996; Teerikangas and Very, 2006). This is because the cultural distance between home and host countries makes a foreign firm’s management techniques and procedures less appropriate (Demirbag et al., 2007). The integration problems and resource sharing difficulties caused by cultural distance will eventually result in less synergy creation (Brock, 2005). However, the available empirical evidence is far from decisive. The relationship between cultural distance and internationalisation performance has been found to be negative (Brouthers, 2002; Luo, 2003), positive (Demirbag et al., 2007) or not significant (Delios and Beamish, 2004; Pangarkar and Lim, 2003). Although the empirical evidence seems to be mixed, the argument of the negative impact of cultural distance on performance has been dominant in the discussion.

6.2.3 Summary

As reviewed in this section, factors identified in previous studies have been very selective and fragmented, focusing either on internal factors or external factors. However, more and more researchers have started to realise the importance of analysing firms’ internationalisation performance from a more integrated perspective by considering both internal and external factors, because investigating the impact of internal factors on a firm’s performance without addressing the external environment will provide an unsatisfactory explanation and can be misleading.
Moreover, although the impact of external institutional factors on MNEs’ performance has been acknowledged in previous studies, most only address the role of the host country institutional environment and ignore the role of the home country institutions. However, the impact of the latter, especially in emerging economies, cannot and should not be underestimated.

Furthermore, although many studies have been focusing on MNEs’ performance, relatively little has been done on the internationalisation performance of firms from emerging economies (Wright et al., 2005). As MNEs from emerging economies start to play a big part in the world FDI, more attention need to be given to their activities and performance (Wright et al., 2005). Therefore, this study intends to fill this research gap by investigating the internationalisation performance of firms from one of the leading emerging economies, China.

These issues will be addressed in this study by examining the post-internationalisation performance of Chinese SOEs through an integrated theoretical lens. Both internal and external factors will be investigated in order to provide a more complete picture of the factors contributing to firms’ overseas success.

6.3 Theoretical Foundation

In order to capture the influence of both internal and external factors, a combined perspective of the dynamic capability framework and the institution-based view has been chosen as the theoretical foundation for this study. Such an integrated approach brings together various theories and is expected to be more fruitful in explaining firms’ strategic decisions in a changing environment (Wright et al., 2005). The influence of dynamic capabilities on post-internationalisation performance has been well articulated in strategic management literature (Fang and Zou, 2009). The dynamic capability framework provides a flexible perspective for understanding firms’ abilities to respond to a changing business environment in order to create and/or sustain competitive advantages. Meanwhile, the institution-based view sheds light on
how firms are influenced by their remote environments. These two approaches complement each other and can be combined to examine how both internal and external factors affect post-internationalisation performance.

In this section, the dynamic capability framework and institution-based view will be reviewed and the conceptual framework developed. The author's approach mainly focuses on the influence of the combination of firms' internal dynamic capabilities and the external institutional environments on their post-internationalisation performance. By taking this approach, the author attempts to address both firm and institutional level influences on the post-internationalisation performance of MNEs from emerging economies.

6.3.1 Dynamic Capability

The dynamic capability framework has been developed as an extension of the resource-based view (Eisenhardt and Martin, 2000; Teece et al., 1997; Ambrosini and Bowman, 2009). The resource-based view is an influential and well-developed theoretical framework for understanding how firms achieve competitive advantages and sustain them over time (Peteraf, 1993; Wernerfelt, 1984). It assumes that firms can achieve competitive advantages and strong performance through generating and/or possessing bundles of firm-specific resources, including capabilities, assets and knowledge, and the heterogeneous distribution of resources across firms persists over time (Eisenhardt and Martin, 2000; Mahoney and Pandian, 1992; Penrose, 1959; Teece et al., 1997; Wernerfelt, 1984). Despite the significance of the resource-based view in strategic management research, it has been challenged because of its inability to explain the mechanisms by which resources actually contribute to created and sustained competitive advantages (Priem and Butler, 2001; Teece et al., 1997)

As an extension, dynamic capability framework was developed with respect to ‘assisting in the understanding of how and why certain firms build competitive advantage in regimes of rapid change’ (Teece et al., 1997, p. 516). As pioneers in dynamic capability framework building, Teece et al. (1997, p. 516)
define dynamic capabilities as ‘the firm’s ability to integrate, build, and reconfigure internal and external competences to address rapidly changing environments’. They identify three categories of dynamic capabilities, namely processes, positions and paths, and a list of parameters determining performance in the three categories (Teece et al., 1997, p. 518):

- **Processes**: the way things are done in the firm, or what might be referred to as its routines, or patterns of current practice and learning.
- **Position**: firms’ current specific endowments of technology, intellectual property, complementary assets, customer base, and its external relations with suppliers and complementors.
- **Paths**: the strategic alternatives available to the firm, and the presence or absence of increasing returns and attendant path dependencies.

Following the initially proposed definition of dynamic capability by Teece, et al. (1997), other researchers have also attempted to define and classify dynamic capabilities from different perspectives. A few examples are as follows.

- Eisenhardt and Martin (2000, p. 1107) define dynamic capabilities as ‘the firm’s processes that use resources – specifically the processes to integrate, reconfigure, gain and release resources – to match and even create market change. Dynamic capabilities thus are the organisational and strategic routines by which firms achieve new resource configurations as markets emerge, collide, split, evolve, and die’.

- Zollo and Winter (2002, p. 340) propose an alternative: ‘a dynamic capability is a learned and stable pattern of collective activity through which the organisation systematically generates and modifies its operating routines in pursuit of improved effectiveness’. They point out that the learning mechanisms, including experience accumulation, knowledge articulation and codification, can develop firms’ dynamic capabilities.
Winter (2003, p. 991) states that dynamic capabilities ‘are those that operate to extend, modify or create ordinary capabilities’.

Wang and Ahmed (2007, p. 35) have defined dynamic capabilities as ‘a firm’s behavioural orientation constantly to integrate, reconfigure, renew and recreate its resources and capabilities and, most importantly, upgrade and reconstruct its core capabilities in response to the changing environment to attain and sustain competitive advantage’.

Although dynamic capability has been defined by different researchers using different wordings, these definitions share some common characteristics. Dynamic capability has been considered as the ability to generate or modify the operating or strategic routines in order to more effectively configure resources in response to a rapidly or slowly changing environment with the aim of achieving a sustained competitive advantage. It is concerned with how firms create and/or access new knowledge, make investment choices, sense and seize new opportunities, and achieve necessary business model and organisational transformation (Augier and Teece, 2009).

As a theoretical framework developed to explain how firms sustain their competitive advantages in the ever changing business world, dynamic capability theory does not appear to be relevant to SOEs, which are labelled with monopoly, bureaucracy, low autonomy and drain on governmental resources (Steinfeld, 1998). However, Chinese SOEs have gone through drastic changes during the economic reform (Nolan, 2002). Unlike the past, SOEs can no longer turn a blind eye on the declining profit performance and expect the state to continuously inject resources for survival and bail them out in case of failure. Nowadays, the SASAC has an explicit requirement of performance for SOEs. Managers of SOEs in the financial red zone are under pressure to reverse the situation in a relatively short time frame. Meanwhile, although some SOEs are still enjoying institutional protection in certain industries, such as oil, railway and telecommunication, the majority has been forced to compete in the open market with private firms and foreign rivals, especially after China joined the WTO in 2001. Besides, when SOEs start to
invest abroad, the institutional protections that they enjoy at home, can hardly be extended to cover their operations in host countries. The above changes require Chinese SOEs to transform themselves from bureaucratic organisations to modern enterprises and fight for survival in increasingly fierce competition. As a result, dynamic capabilities become ever more relevant to Chinese SOEs’ daily operation and performance as they are going through changes and confronting a changing environment. In this sense, Chinese SOEs also need to utilise their dynamic capabilities to adapt to the changing business environment, especially in the internationalisation process. Therefore, in this study, dynamic capability is chosen as a key theoretical framework which guides the search for factors leading to overseas success of Chinese SOEs.

6.3.2 Institution-based View

The institution-based view has become an increasingly relevant and insightful tool when considering the international strategy and performance of firms from emerging economies (Hoskisson et al., 2000; Peng, *et al.*, 2008; Wright *et al.*, 2005). Although formal and informal institutions have been featured as ‘background’ conditions in international business research, the deficiency of this attitude emerges in research into understanding firms’ strategic behaviour and performance in developed economies (Oliver, 1997), and becomes even more striking in research concerning emerging economies (Child and Tsai, 2005; Chung and Beamish, 2005; Narayanan and Fahey, 2005; Wan, 2005). In previous research, there has been inadequate consideration given to the unique contexts of the emerging economies (Wan, 2005).

Institutions are commonly understood as the ‘*rules of the game in a society*’ (North, 1990, p. 3), which do not just sit quietly in the background. Instead, ‘*institutions directly determine what arrows a firm has in its quiver as it struggles to formulate and implement strategy and to create competitive advantage*’ (Ingram and Silverman, 2002, p. 20). As Wan and Hoskisson (2003, p. 28) put it: ‘*the environment opportunity set is determined by*
production factors and institutions, and firms seek to capture the profitable opportunities defined by the opportunity set'.

Although ‘institutions matter’ is hardly debatable, ‘how institutions matter’ is of more interest and still relatively under-investigated (Peng, et al., 2008; Smith, 2003). This is especially true concerning the mechanism by which institutional factors (both in the home and host countries) influence performance in overseas market. The institutional approach is highly relevant when examining firms from emerging economies, since the strategic behaviour and strategic outcomes of these firms are largely influenced by home government policies and regulations. This is why the institutional-based view has been chosen as an additional theoretical lens in order to take the special features of the Chinese institutional environment into account.

6.4 Conceptual Framework

6.4.1 Internal Factors

There is no consensus classification of dynamic capabilities. Dynamic capabilities have been classified from different perspectives, such as competence (Teece et al., 1997), opportunity (Augier and Teece, 2009) and resources (Eisenhardt and Martin, 2000). In this study, a resource perspective has been adopted to identify dynamic capabilities as dynamic capability framework is considered as an extension of resource-based view.

Eisenhardt and Martin (2000) identify three categories of dynamic capabilities, namely, integration of resources, reconfiguration of resources, and the gain and release of resources. However, this classification ignores the difference between different types of resources. The author argues that firms deal with internal resources and external resources by different routines. Internal resources can be allocated, reallocated and coordinated within the firm. In contrast, external resources first need to be identified, accessed or acquired in order to be brought into the firm. Therefore, in order to emphasise the different types of resources, incorporate competence and opportunity perspectives,
take consideration of factors identified in previous studies, and achieve a more comprehensive approach, in this study, dynamic capabilities have been disaggregated into four categories: internal resource (re-)allocation, external sourcing, coordination and integration, and managerial mindset.

6.4.1.1 Internal Resource Allocation and Reconfiguration

How firms allocate and reconfigure resources according to rapidly changing environments is vital in creating value and minimising the cost of changes (Amit and Schoemaker, 1993; Teece et al., 1997). Reconfiguring firms’ tangible and intangible assets enables them to sustain the competitive advantages that support their superior long-lasting performance (Teece, 2007). In particular, when firms invest in foreign markets, newly-established subsidiaries have to compete against local rivals who have already built local recognition and reputation, and who possess strong customer, supplier and distributor networks in the local market. This will put the overseas subsidiaries at a vulnerable and competitive disadvantage position. Resource support from the parent company counterbalances the vulnerability, stabilises subsidiary operations, and increases a subsidiary’s competitive advantages in the local market (Luo, 2003). Therefore, parent resource support can be invaluable for the success of overseas subsidiaries in local markets.

As well as initial resource investment, firms need to upgrade and reconfigure existing resources and capabilities in an environment of rapid political, economic and institutional changes in order to survive in the long run, especially in emerging economies (Jantunen et al., 2005; Wright et al., 2005). Managers’ flexibility in re-configuring, developing and using resources has been identified as a crucial factor in achieving success in emerging economies (Uhlenbruck et al., 2003; Wright et al., 2005). However, high power distance, which is a common characteristic of emerging economies, such as China (Hofstede, 2001), can cause more resource sharing difficulties (Brock, 2005). When investing in emerging economies, the capability to reconfigure the allocation of existing resources may well distinguish the successful from the unsuccessful firm.
International experience, a key factor in overseas success, can also be allocated to overseas subsidiaries through human resource reconfiguration. Managers with previous international experience can help overseas subsidiaries reduce transaction costs and facilitate the identification and integration of resources (Haseslagh and Jemison, 1991; Hitt et al., 1998; Hitt et al., 2001). Therefore, such managers can apply and adapt the knowledge and skills learnt from previous experience to improve overseas subsidiaries’ operational efficiency and performance.

6.4.1.2 External Sourcing

Different from firm-specific assets, external resources are resources which are used by the firm in its pursuit of growth, but over which it has no direct ownership (Jarillo, 1989), such as networks (e.g. Jarillo, 1989) and market opportunities (e.g. Luo, 2003; Teece, 2007). Once such resources have been identified, firms may decide to explore them directly, such as network and market opportunities, or to acquire and integrate the resources into the firm to convert them into internal resources, such as technologies and human resources.

External sourcing, which brings into the firm new resources which are unavailable internally has been identified as a key dynamic capability which may drive superior performance and growth (Eisenhardt and Martin, 2000; Jarillo, 1989; Teece et al., 1997). The integration of the external resources, including activities and technologies, has become increasingly important in creating strategic advantages (Teece et al., 1997). Therefore, the ability to identify and access valuable external resources has become crucial to achieving competitive advantages.

When entering a foreign market, a firm may not have all the resources and knowledge needed for the local operation, including finance, human resource, and local market knowledge. Being able to externally sourcing the resources needed to meet the local market demand is important for overseas subsidiary to survive and integrate in the local market.
6.4.1.3 Coordination/Integration

Coordination/integration, representing a dimension of dynamic capability, refers to the ability of managers/entrepreneurs to coordinate economic activities across various parts of the firm in order to synergise internal and external resources (Augier and Teece, 2009; Eisenhardt and Martin, 2000). Firms operating in multinational markets rely extensively on intra-firm coordination across business units to achieve corporate performance (Kim and Mauborgne, 1991).

After identifying, accessing and acquiring external resources, firms need to internalise these resources in order to integrate them with the existing internal resources to enlarge their resource pool. This type of dynamic capability has two facets. One is the coordination of operations of different parts of the firm, based on the internal resource allocation to address the changing environment. The other is the integration of the acquired external resources before they can be utilised and reconfigured within the organisation. Integration of acquired resources has become a required capability to improve firms’ internationalisation performance (King et al., 2004).

Firms’ resources and their uses are dynamic in nature (Volberda, 1996). ‘Flexibility in coordinating the use of resources’, combined with ‘the inherent flexibility of resources available to the firm’, leads to strategic flexibility (Sanchez, 1995, p. 138). This in turn should help firms take advantage of existing and new strategic opportunities to address continuously changing market conditions (Uhlenbruck et al., 2003). The coordination and integration of internal and external resources enable firms to take advantage of market conditions, or even to adapt market conditions to their own interests (Augier and Teece, 2009; Chandler, 1990; Teece, 1993; Simon 1991).

6.4.1.4 Managerial mindset

Managerial mindset, or the cognitive capabilities of key decision-makers, is a critical success factor affecting various organisational outcomes and a key
source of long-term competitive advantage (Gupta and Govindarajan, 2002; Levy, 2005; Levy et al., 2007). As Govindarajan and Gupta (1998, p. 2) argue: ‘success is all in the mindset’. Global mindset has been defined by Levy et al. (2007, p. 244) as ‘a highly complex cognitive structure characterised by an openness to and articulation of multiple cultural and strategic realities on both global and local levels, and the cognitive ability to mediate and integrate across this multiplicity’.

As globalisation intensifies, senior managers of MNEs are simultaneously dealing with integrating and coordinating geographically dispersed operations globally (Bartlett and Ghoshal, 1990), and managing inter-organisational relationships with governments, strategic partners, customers and suppliers locally (Rosenzweig and Singh, 1991). The complex task of meeting demand at both global and local levels requires senior managers to possess a global mindset. This includes proactiveness on international markets, commitment to an international vision and internationalisation, all of which have been proved to be related to international performance (Nummela et al., 2004).

However, managers from emerging economies may not have necessarily developed such a positive global mindset thanks to their limited international experience (Nummela et al., 2004). Therefore, in dealing with the complexity caused by multiple organisational environments and cultural heterogeneity, it is crucial that managers have developed their cognitive capability to adjust to the change and complexity that are intrinsic to the internationalisation process.

### 6.4.2 Institutional Factors

International business literature has clearly established the relevance of country characteristics to firms’ performance (Goldszmidt et al., 2009). It is undeniable that MNEs are influenced by the institutional environments in both home and host countries. The importance of incorporating both home and host country institutions into frameworks of international strategy studies has been demonstrated in previous research (Bonardi, 2004). However, most existing literatures on internationalisation and institutions consider either home
country institutions or host country institutions but seldom consider both simultaneously (Luo et al., 2010; Meyer et al., 2009). Early literature on internationalisation and institutions has largely focused on the institutional environments in host countries (Henisz and Zelner, 2005; Ramamurti, 2001). In more recent years, the importance of home country institutions has also been investigated and acknowledged (Buckley et al., 2007a; Child and Rodrigues, 2005; Hawawini, et al., 2004; Luo and Tung, 2007; Witt and Lewin, 2007; Wright et al., 2005). Therefore, in this study, the author takes both home and host country institutional environments into consideration while examining the factors leading to Chinese firms’ overseas success.

6.4.2.1 Home country institutional environment

The characteristics of MNEs’ home countries play a role in their performance which is at least as important as the characteristics of the foreign countries that host their operations (McGahan and Victer, 2010). The institutional environment of the home country, especially emerging economies, can determine the ability and willingness of domestic firms to invest abroad (Buckley et al., 2007a). However, how the institutional factors and the environmental dynamics in home countries, especially emerging economies, influence domestic firms’ internationalisation has been largely overlooked in previous research (Wright et al., 2005).

Emerging economies have a different institutional and economic environment from developed countries (WIR, 2007). The former are in the process of undergoing rapid growth and industrialisation whereas the latter enjoy more stable market conditions. Institutional and economic environments of emerging economies are undergoing rapid changes, and raise challenges to indigenous firms. Previous research finds that firms from emerging economies have to deal with not only the changing economic environment, but also the changing institutional environment, which can influence their performance both directly and indirectly (Luo, 2003). The evolution of modern corporate governance in emerging economies is accompanied by the new ‘rules of the game’ set by the government and its agents, which are also redefining their
roles and developing monitoring systems according to the changing environment (North, 1990; Peng, 2004; Phan, 2001).

Although the changing home country institutional environment poses many challenges to firms from emerging economies, some researchers argue that the experience of dealing with these changes can be exploited by these firms when entering a new market (Holburn and Zelner, 2010; Morck et al., 2008). Moreover, the capabilities developed from their home country experience are idiosyncratic and not easily imitated (McGahan and Victer, 2010).

The institutional environment of emerging economies plays a more active role in internationalisation strategies and post-internationalisation performance than that in developed countries (Luo et al., 2010). On the whole, government intervention represents an important factor affecting the economic behaviour of firms from emerging economies, including China which is in the process of transition from a central planned economy to a market one. The institutional environment in China is not market-oriented, and the government has great power to influence firm strategies through regulations, policies and even direct state intervention. Since the implementation of the ‘Go Global’ strategy, the Chinese government has established a set of guidelines to promote OFDI by simplifying administrative procedures, easing capital control, informing firms investment opportunities, and reducing political and investment risks (Buckley et al., 2008).

The role which the Chinese government plays in the development, strategies and performance of SOEs cannot and should not be underestimated. Their strategies and performance are largely shaped by government policies and state direct interventions. This is because there is a special relationship between Chinese SOEs and the government.

On the one hand, SOEs are supported by the central and provincial governments. Chinese SOEs are financially supported by preferential loans offered by the central policy bank, EIBC, when investing abroad. The Chinese government also provides information about potential host countries through
local embassies, and it publishes general guidelines on overseas investments. All these approaches help mitigate the disadvantages of Chinese SOEs' late arrival in host markets. Moreover, Chinese SOEs are often the preferred contractors of Chinese foreign aid projects in developing countries. This liaison provides Chinese SOEs with an opportunity to explore the host markets, generate stable cash flows and prepare for later investments.

On the other hand, SOEs are subject to the supervision and restraint of the Chinese government. Besides the entrepreneurial pursuits behind the OFDI strategy, they are often obliged to follow development strategies at the macro level, and they are responsible to their supervisor, the SASAC. Therefore, compared to private firms, Chinese SOEs have to deal with bureaucracy more often, as the government and its agents all want to have their say in the investment projects (Buckley et al., 2007a). This is especially true of foreign aid projects which Chinese SOEs are obliged to engage in for social responsibility reasons. These tend to become a burdensome responsibility which cannot be declined.

It is clear that the institutional environment has a profound and long-lasting impact on Chinese SOEs' internationalisation process, from project initiation to post-internationalisation performance. Whilst supportive institutional environment will provide resources needed for overseas success, a burdensome home country institutional environment provides Chinese SOEs with a training ground for dealing with similar host country institutions, especially in other emerging economies and developing countries (Morck et al., 2008).

6.4.2.2 Host country institutional environment

The institutional environment created by the host country government and its agents for foreign investments plays an essential role in impacting the success of foreign subsidiaries (Pangarkar and Lim, 2003). Government policies and institutional arrangements have important implications for survival
and success of foreign investors, especially in emerging economies (Chung and Beamish, 2005; Gomes-Casseres, 1990; Hoskisson et al., 2000).

Researchers have found that changes in FDI policy influences MNE investment strategies, which results in a significant material impact on subsidiary performance (Hoskisson et al., 2000; Peng, 2002, 2003). Firms with the capabilities and corporate strategies appropriate for a specific country environment are more likely to achieve higher levels of performance (Wan, 2005). Therefore, the host country institutional environments directly influence firms’ strategies and performance in local markets. The host country government can build the country’s L-advantages by improving the institutional environment in order to attract foreign investors who are looking to prosper in local market. Child et al. (2003, p. 243) argue that ‘firms operating under more favourable external circumstances have a better chance of prospering’. Child and Markoczy (1993) find that lower political risk means that firms need to expend fewer resources to counter government-induced dysfunction and hence exhibit better performance.

The host country institutional environment can affect foreign subsidiaries’ performance in a number of ways. First, the general institutional environment sets ‘the rules of the game’ in the local market, including financial and legal systems, for all foreign investors. While entering a new market, Chinese firms are likely to be subject to a series of unfamiliar legal, financial and industrial regulations, which may be significantly different from those of their home country. Therefore, Chinese firms will have to prepare themselves for the different operational environment and be willing to spend extra resources in order to gather the information necessary for adaptation. However, this different institutional environment can also help Chinese firms perform when OFDI is utilised by Chinese firms to escape from certain home country institutional restraints.

Second, besides the tangible policies and regulations set by the host government and its agents, Chinese firms also need to deal with the intangible underlying rules of the local markets, such as local customs, culture and
corruption, especially in emerging economies and developing countries where the institutional environment is underdeveloped or unstable. Lack of familiarity with the unwritten rules of the host country’s institutional environment may cause many difficulties for the performance and survival of Chinese MNE subsidiaries, especially if they are newcomers in the local economy.

Third, the host country government’s positive attitude towards Chinese investors may reduce political risk and investment uncertainty for Chinese firms. A friendly bilateral relationship between the host country and China can generate bilateral treaties which will lead to better treatment of Chinese firms, especially in host countries with undeveloped institutions. Such a close relationship between host country and China’s governments will certainly reduce the uncertainty and operational risks coming from the undeveloped institutions (Lu et al., 2010b; UNCTAD, 2007). Rangan and Sengul (2009) find that bilateral treaties improve the development of trust among countries and help MNEs resolve disputes which eventually contribute to their successful performance in host countries.

6.5 Summary

Based on the discussion above, the proposed theoretical framework is presented in Figure 6.1.
Figure 6.1 Proposed Conceptual Framework of Factors Influencing Post-Internationalisation Performance

- **Internal Factors**
  - Resource Allocation
  - External Sourcing
  - Coordination/Integration
  - Managerial Mindset

- **External Factors**
  - Home Country Institutional Environment
  - Host Country Institutional Environment

**Post-internationalisation Performance**
The aim of the second part of this thesis is to conduct a multilevel study to investigate how firms from an emerging economy, China, achieve overseas success from a combined perspective of dynamic capability framework and the institution-based view. It proposed that the performance of a firm’s overseas operations is influenced by the combination of its internal dynamic capabilities and the external institutional environment. Factors which could influence the post-internationalisation performance include internal resource allocation and reconfiguration, external sourcing, coordination and integration, managerial mindset, the home country institutional environment and the host country institutional environment.

This study makes two contributions to the literature on post-internationalisation performance. First, it is among the first to apply an integrative approach, which combines the dynamic capability theory and the institution-based view to examining factors affecting the post-internationalisation performance of firms from emerging economies. It integrates internal dynamic capabilities to face the changing environment and external institutional factors into the same model. It also considers how factors at both firm and country levels jointly influence the post-internationalisation performance of Chinese SOEs. This multilevel analysis will provide a more comprehensive picture of the post-internationalisation performance of firms from emerging economies.

Second, the findings of previous studies are largely limited to the performance of MNEs from developed economies. Despite the significant increase of OFDI from emerging economies, our knowledge about post-internationalisation performance of emerging economy firms is still limited. This study focuses on the post-internationalisation performance of firms from the biggest emerging economy, China, and helps to provide a better understanding of the issue from the perspective of emerging economy MNEs.
Chapter 7  Influence of Dynamic Capabilities and Institutions on the Post-Internationalisation Performance of Chinese SOEs

7.1 Introduction

The aim of this chapter is to analyse the influence of dynamic capabilities and institutional environments on the post-internationalisation performance of Chinese SOEs. The case study research method is applied in order to gather rich information to achieve a better understanding of the mechanism how firms’ post-internationalisation performance is impacted by their dynamic capabilities and institutional environments, and to provide some new insights into the factors leading to overseas success.

This chapter is organised as follows. First, the research design section (Section 7.2) will describe the qualitative research method chosen for this study, the data collection procedure and data analysis method. This is followed by Section 7.3, which presents the individual case analysis. A cross case analysis will be discussed and propositions put forward in Section 7.4. A brief summary will conclude the chapter in Section 7.5.

7.2 Research Design

7.2.1 Case Study Research Method

The qualitative research method is very commonly applied in social and behavioural sciences and is very suitable for studying organisations, groups and individuals (Strauss and Corbin, 1990). Qualitative research ‘emphasizes episodes of nuance, the sequentiality of happenings in context, the wholeness of the individual’ (Stake, 1995, p. XII). In contrast to the explanation and control pressed by quantitative researchers, qualitative researchers pursue an understanding of the complex interrelationships among the research objects and their contexts (Stake, 1995).
Qualitative research is especially important in describing and understanding ‘the actual human interactions, meanings, and processes that constitute real-life organizational settings’ (Gephart, 2004, p. 455). It is more suitable for addressing ‘how’ questions; for understanding the research questions from the perspective of those researched; and for examining and articulating processes (Pratt, 2009). Qualitative research enables researchers to seek accurate reports of experience which lie inside people’s heads (Silverman, 2010). It allows researchers to gather rich information and seek explanation of a particular interesting phenomenon from a limited number of individuals (Gill and Johnson, 1991). In comparison, quantitative survey research uses a predefined, fixed set of questions, which are normally drawn from pre-tested measures in previous research, to collect data in order to test the relationships among a group of variables (Silverman, 2010). Qualitative methods are more appropriate to serve the research objectives of this study, as they can lead researchers to propositions building and explanations (Ghauri and Gronhaug, 2005). Therefore, considering the explorative nature of this study and the lack of pre-tested measures for survey design, qualitative research is chosen for this study, with a view to seek in-depth explanations of the influence of dynamic capabilities and institutions on the internationalisation performance of Chinese SOEs.

Qualitative data can be collected using one or more of the following research methods: case studies, interviews, observations, grounded theory, and textual analysis (Gephart, 2004). Considering the research object of this study, which is to examine the factors leading to overseas success which are drawn from previous literatures and theories, and the limited time and resource for conducting this study, case studies and interviews are chosen as the main methods for data collection. The author takes the postpositivism perspective, which believes that reality can be know only probabilistically and cannot be verified (Gephart, 2004), and aims to find empirical evidence to support or reject prior findings of literatures and generate a series of propositions for future large sample tests.

Limited data availability also leads the researcher to the case study approach. There is no database tracking the factors which influence post-internationalisation performance at the firm level. The sensitive nature of strategic and personal aspects implies that firms may be reluctant to publish any information regarding their internal
operational and strategic problems, and mechanisms applied to overcome them. The complex relationship between Chinese SOEs and their ‘supervisor and supporter’, the government, may also limit the managers’ willingness to publicly give opinions on the influence of the institutional environment on firms’ internal operations.

The case study approach will provide the researcher with an opportunity to dig deep into the case in order to gather abundant first hand information to achieve the objective of this study. Therefore, in order to answer the ‘how’ question posed in Chapter 1, a case study qualitative approach has been chosen for this study, with the aim of developing theoretical propositions based on priori assumptions derived from earlier literature and field observations.

7.2.1.1 Case study designs

Single case design is appropriate when the single case is the critical case for testing a well-established theory, an extreme or unique case, a representative or typical case, a revelatory case, or a longitudinal case (Yin, 2003). However, one of the biggest fears of conducting a single-case study is that it may later turn out not to be the case as expected. In contrast to a single-case design, a multiple-case design intends to replicate the results across a number of cases (Yin, 2003). In a multiple-case design, each case must be carefully selected so that it will predict similar results or contrasting results but for predictable reasons (Yin, 2003).

In both single-case designs and multiple-case designs, the study for each case can be either holistic (single unit of analysis) or embedded (multiple units of analysis). A holistic design would be preferable, if the case study examined only the universal nature of the case selected (Yin, 2003). The obvious trap of a holistic design is that the case study may be too general and lack any specific measures or data. On the other hand, an embedded design may focus only on the subunit level and fail to provide a big picture for the whole case. The four variations formed by combining single/multiple-case design and holistic/embedded case study are summarised in a two by two matrix (Figure 7.1).
For this study, a multiple-case holistic design has been chosen for the following reasons. First, the analytic benefits from having multiple cases can be very significant, thanks to the possibility of direct replication. Second, common conclusions under the rich contexts of multiple cases, compared to those of a single case, will significantly expand the external generalisability of the findings. Third, because the standpoint of this study is set at the headquarters of firms studied and each firm is considered as one individual rather than a group of subsidiaries, a holistic design is preferred in order to study the influence of the firm’s dynamic
capabilities and institutional environment on its post-internationalisation performance as a whole, rather than that of individual overseas investment projects or subsidiaries.

7.2.1.2 Pilot case study

As a final preparation for case study data collection, conducting a pilot case study will help researchers refine and finalise data collection plans, including the content of the data and the procedures to be followed (Yin, 2003). The pilot case or cases can be selected in less scientific manner by mainly considering convenience, accessibility and geographic proximity, for the main purpose of the pilot case study is to develop relevant lines of questions, clarify concepts relevant to research design, and even build a prolonged relationship with interviewees (Yin, 2003).

For this research, one SOE, the biggest mobile telecommunication service provider in China, was chosen as the pilot case for the following reasons. First, this case very closely resembles the other cases which will be studied at a later stage. Therefore, this pilot case will provide the author with a context similar to the later cases in order to further develop relevant lines of questions and clarify concepts which have been previously developed based on theories. Second, this is a convenient case to choose because of accessibility. A personal relationship between the head of the international department and the author made this firm an easy access. This relationship also generated many informal conversations which can provide rich information about the general setting of Chinese SOEs’ OFDI.

The interviewee was first contacted in November 2007, briefed about the purpose and scope of this research, and invited to participate. After the initial agreement, a telephone conference was conducted in December 2007 to gather more information about the pilot study and arrange a more formal face-to-face interview in the firm’s headquarters in Beijing in January 2008.

According to Yin (2003, p. 80), ‘the inquiry for the pilot case can be much broader and less focused than the ultimate data collection plan’, and should cover both ‘substantive and methodological issues’. During the face-to-face interview conducted
in January 2008, various areas were covered, including the background of the pilot study, the history of the firm's internationalisation, the progress and performance of SOEs' internationalisation, the capabilities influencing the performance of the firm’s internationalisation, and the domestic and international institutional environments.

The pilot case study helped to clarify the conceptual framework which was based on the literature review and theories. One more factor, managerial mindset, which has a major role in influencing the performance of the firm’s internationalisation, was identified during the interview and added into the conceptual framework accordingly. The pilot case study, together with the literature review, provides the dual sources of information to ‘ensure that the actual study reflected significant theoretical or policy issues as well as questions relevant to contemporary cases’ (Yin, 2003, p. 80).

One methodology issue that arose during the pilot case is the use of a digital recorder. This was denied by the interviewee in the pilot study, because the interviewee, as a manager of a SOE, is very sensitive about the information disclosed by him to anyone outside of the organisation. The author chose to respect this constraint but nevertheless to collaborate with the interviewee in doing later cases, since he indeed showed great interest in the research topic. The benefits of this collaboration include the network which the interviewee has with senior managers in other SOEs, and the extra manpower provided by the interviewee to do note taking in later data collection.

Therefore, as a result of the pilot study, a clarified conceptual framework (see Figure 6.1) and more focused and detailed interview question guidelines were developed for later case studies. Meanwhile, the interviewee and his personal assistant were added to the later interview panel, in order to minimise the information lost during note taking.

### 7.2.1.3 Case selection

A prime question for a multi-case study is how to select cases and how many cases to select, which links with the challenges of the generalisability, validity and rigor for the case study approach (Denscombe, 1998). Doing justification to each individual
case is a researcher’s first and foremost responsibility and the foundation of the whole research (Patton, 2002). Yin (2003, p. 10) provides an answer to the generalisation issue: ‘the short answer is that case studies … are generalisable to theoretical propositions and not to populations or universes’. Therefore, the case study is not to represent a sample and enumerate frequencies (statistical generalisation), but to expand and generalise theories (analytic generalisation) (Yin, 2003). Three notable social scientists describe the goal of their single case study is to do a ‘generalising’ and not a ‘particularising’ analysis (Lipset et al., 1956, p. 419-420). Eisenhardt (1989, p. 537) advises that it ‘makes sense to choose cases as extreme situations and polar types in which the process of interest is transparently observable’. Stake (1995) also states that maximising what can be learnt should be an important criterion when selecting cases.

As indicated in Chapter 1, SOEs, as a special and specific type of firm, have been chosen as the research target in this study. In 2007, the existing 20,680 SOEs employ 17.43 million people in mainland China (China Statistic Year Book, 2008). Although the state share of industrial output declined to 29.54% in 2007 comparing to 78% in 1978 (China Statistic Year Book, 2008), SOEs still hold much of the life line of China’s economy, thanks to the political protection from the government. SOEs are still monopolies in many fundamental industries and sectors, such as railways, telecommunication service, steel, mining, electricity, and oil. These SOEs dominate China’s OFDI, as their average investment size is much larger than that of enterprises of other ownership types (OECD, 2008). All of the ten largest Chinese MNEs by OFDI stock are SOEs, and the services sector has attracted the largest sectoral share of Chinese OFDI, followed by the primary and manufacturing sectors (China Statistic Yearbook, 2009; OECD, 2008). Therefore, it is important to study the post-internationalisation performance of SOEs in order to deepen our understanding of Chinese OFDI activities and shed light on the theoretical development of OFDI from emerging economies.

All these SOEs have been through some transformation, big or small, since the day they were created. It must also be born in mind that the external environment, China’s economy, has changed dramatically since 1978 when the ‘Reform and Open’ policy was firstly established. The changes in both internal and external
environments require SOEs to response promptly and appropriately in order to survive increasingly fierce competition. Therefore, Chinese SOEs provide rich resources to shed light on the contribution of dynamic capabilities to firms' success in a changing environment.

During the last thirty years of economic reform and transition, many medium and small SOEs have been privatised and transformed. However, SOEs in some fundamental industries and sectors have been preserved, and developed into giant enterprises through merger and restructure. These SOEs are supervised (directly or indirectly) and regulated by the SASAC of the State Council. Many of these SOEs were previously government institutions before becoming enterprises. Therefore, they inherit many characteristics from their ancestors, the government institutions, such as bureaucracy and high power distance. Since these SOEs are supervised by the government, or even constitute an extension of a government department, they provide a perfect sample to study the influence of institutions on firms' performance. This is because the SOEs will be the first group of firms to respond to government's regulations thanks to their close relationship.

Another reason why SOEs are chosen in this study is that SOEs in China are normally giant corporations and have better stability in the uncertain business world, because of their strong financial foundation and government support. In order to conduct further follow up research, the stability of the firms needs to be taken into consideration. Moreover, when researchers plan to study a specific and complex issue, it is wise to study a bigger firm, as they experience complex problems in their daily operations and have expertise that can provide in-depth information on particular issues (Van der Meer-Kooistra, 1993; Ghauri and Gronhaug, 2005).

The following criteria have been applied when selecting cases for this study. First of all, primary industry has been eliminated from the research. International investments from primary industry are mainly natural resource-seeking, which may have national security reasons regardless of business performance. Therefore, this type of investment is more a political issue than a business one. Because this research mainly focuses on the influence of firms' dynamic capabilities and
institutional environments on post-internationalisation performance, firms from the primary industry do not fit with the research objective.

Second, the chosen firms are industry or sector leaders, who may have a considerable impact on industrial development and the national economy. Industry leaders normally possess leading technology and have abundant finance resources and human capital, and they are also most likely to be the pioneers in exploring the international market. Selecting firms with a similar position within their own industry or sector increases comparability among the cases, and furthermore increases analytical generalisability.

Third, the firms should have been investing internationally for more than three years and in more than two continents. Operating in more than two continents will ensure the rich experience of post-internationalisation management when they operate in different business environments with different institutional backgrounds. SOEs, which can meet this requirement, will provide abundant information about the research question.

Fourth, cases should be selected across industries and sectors in order to guarantee the rich contexts of multiple cases, which will expand the external generalisability of the common conclusions across cases.

Bearing in mind the above criteria and considering the time and resource limitation of completing this study, four Chinese SOEs have been chosen for this study. The first is a white goods manufacturing company with overseas manufacturing plants in Europe, North America, Asia, Oceania and Africa. The second is a leading telecommunication company with a global network and overseas subsidiaries in Asia, Europe and America. The third is a trade company, with 14 overseas subsidiaries, one international trade centre and eight overseas representative offices in Asia, Latin America and Africa; and the fourth is a telecommunication construction company with 11 overseas subsidiaries in Asia, Africa and Europe. Table 7.1 contains a list of cases studies in this research.
Table 7.1 Description of Cases Studied

<table>
<thead>
<tr>
<th>Case</th>
<th>Industry</th>
<th>Time of Internationalisation*</th>
<th>No. of Overseas Branches</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>White Goods Manufacturing</td>
<td>1996</td>
<td>14</td>
</tr>
<tr>
<td>B</td>
<td>Telecommunication</td>
<td>2000</td>
<td>5</td>
</tr>
<tr>
<td>C</td>
<td>Trade</td>
<td>1994</td>
<td>23</td>
</tr>
<tr>
<td>D</td>
<td>Telecommunication</td>
<td>1995</td>
<td>11</td>
</tr>
</tbody>
</table>

Note: * The year when the first overseas subsidiary was founded.

All four firms described above meet the criteria set for the case selection. They are all industry leaders with abundant internationalisation experience. They all have overseas subsidiaries in Asia and Europe. Some of them have subsidiaries in Africa, Oceania and/or North America. They all had at least seven years internationalisation experience (starting from the establishment of the first overseas subsidiary) by the time of the first round interview. The firms selected are from various industries and sectors of the national economy, covering manufacturing, service, trade and construction.

7.2.2 Data Collection

Creswell (1998) suggests that the researcher choose individuals who are accessible, willing to provide information, and distinctive for their accomplishments and ordinariness or who shed light on a specific phenomenon or issue being explored. All interviewees were carefully selected in order to increase the validity and reliability of the data collected.

There are many similarities among the interviewees. They were all born in the early 1970s and joined the firms in the early 1990s promptly after they graduated. In other words, they were all brought up and educated in China, went through the whole fast development era brought by the ‘Reform and Open’ policy, and served their own firm for more than 15 years. They have been involved in the internationalisation process
of their own firms from the very beginning, and are the first generation of international management expertise brought up during the internationalisation process of Chinese firms. They hold vital positions, such as the head of the international department or chief executive officer (CEO) of a major overseas subsidiary. Therefore, the selection of the firms and interviewees will, to a large extent, guarantee to provide abundant, valid and reliable information in order to answer the research question.

Semi-structured interviews were conducted in this study, which gave respondents the freedom to talk and give their opinions and understanding of the topic. This freedom may help researchers to identify the hidden factors to explain the issues under investigation in this exploratory study. As directors of the international business departments at headquarters, or CEOs of major overseas subsidiaries, the interviewees’ abundant experience and involvement in Chinese SOEs’ internationalisation enabled them to provide rich information for this study.

The first round of interviews was conducted in March, 2008. In order to gather more information, especially firms’ attitude towards the financial crisis, which turned into a worldwide economy downturn in the second half of 2008, the author revisited the four companies in January, 2009. The second round of interviews provided the author with the opportunity to double check the preliminary findings, dig deeper in research questions, and collect information about new developments in the firms’ internationalisation strategy when the external business environment had changed rapidly. Because of the nature of the theoretical foundations, dynamic capabilities and the institution-based view, it is necessary to conduct the second round interview by taking account of the economy downturn in order to identify firms’ response to this uncertainty and the possible influence of changing institutions.

All interviews were conducted face to face in Mandarin in order to free the interviewees from the language constraints and generate a comfortable medium of conversation. As expected, none of the interviewees agreed to be recorded. Therefore, in order to ensure the accuracy of the transcription, three or four researchers participated in each interview, with the leading researchers focusing on interviewing and the rest taking notes. Transcriptions were done shortly after each
interview and reviewed by all the researchers who participated in order to guarantee the integrity of the transcriptions. The interview schedule is presented in Table 7.2.

Table 7.2 Description of Interview Schedule

<table>
<thead>
<tr>
<th>Case</th>
<th>Respondent Position</th>
<th>Interview Locations</th>
<th>First Round Interview Date</th>
<th>Second Round Interview Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Director of Strategy Development Department and Secretary of the Board</td>
<td>Beijing, China Face-to-face Interview</td>
<td>20/3/2008</td>
<td>6/1/2009</td>
</tr>
<tr>
<td>B</td>
<td>Director of International Business Department</td>
<td>Beijing, China Face-to-face Interview</td>
<td>21/3/2008</td>
<td>6/1/2009</td>
</tr>
<tr>
<td>C</td>
<td>Uganda Subsidiary CEO</td>
<td>Beijing, China Face-to-face Interview</td>
<td>25/3/2008</td>
<td>8/1/2009</td>
</tr>
<tr>
<td>D</td>
<td>Director of International Department</td>
<td>Beijing, China Face-to-face Interview</td>
<td>27/3/2008</td>
<td>8/1/2009</td>
</tr>
</tbody>
</table>

Besides the first hand data collected in the two rounds of interviews, secondary data was also used in this study in order to provide more information and details to enrich the analysis. The secondary data includes existing academic research, websites, press releases, newspaper reports, internal company presentations, and company annual reports. The suitability and validity of all the data used was evaluated, taking into consideration the reliability of the sources and possible existing bias. The advantages of the secondary data include their tendency to be more comprehensive and less subject to memory-based bias. These documents also serve as substitutes for records of activities which cannot be observed directly by researchers (Stake, 1995). This use of multiple sources of evidence creates a more convincing and accurate case study (Yin, 2003). The amount of relevant documents differed by firm because of the limitation of accessibility and availability of data.
7.2.3 Case Study Analysis

Analysing case study evidence is especially difficult because strategies and techniques have not been well defined in the past. Case study analysis transforms data into findings. Although various guidelines, procedural suggestions and examples have been described by researchers, these guidelines are not rules, which means that it requires researchers’ judgement and creativity to apply them (Patton, 2002).

Yin (2003) identifies three general strategies for case study research, namely relying on theoretical propositions, setting up a framework based on rival explanations, and developing case descriptions. The strategy of relying on theoretical propositions has been used lead the case study. This strategy is consistent with the analytic induction nature of case studies which do not claim to produce generalised theory; the aim is to identify the predicted variables and its causal relations - answers to ‘how’ and ‘why’ questions - within the pattern (Patton, 2002; Yin, 2003).

Specific analytic techniques can be used as part of and along with the general analytic strategies in order to develop internal validity and external validity in doing case studies (Yin, 2003). These specific analytic techniques include pattern matching, explanation building, time-series analysis, logic models, and cross-case synthesis (Yin, 2003). This study has chosen pattern matching technique, which uses a pattern matching logic (Trochim, 1989) to compare an empirically based pattern with a predicted one (Miles and Huberman, 1994; Yin, 2003). Patterns are identified through content analysis, which refers to the qualitative data reduction and sense-making effort that attempts to identify core consistencies and meanings (Patton, 2002). These core consistencies and meanings are referred to as patterns. As a result, if the patterns coincide, this can help a case study to strengthen its internal validity (Yin, 2003).

7.2.4 Measurement of Internationalisation Performance

The cross-border variations in accounting standards, the nature of firm boundaries, and the geographic scope of operations have made measuring performance in the
international business context particularly difficult (Hult et al., 2008). Therefore, in the international business field, scholars have not yet developed a consensus way to measure firms’ international performance. Hult et al. (2008) have done a thorough review of the measurement of performance in 96 journal articles between 1995 and 2005 and found that previous research had mainly adopted three types of measure, namely financial performance, operational performance and overall effectiveness performance, or a combination of the three.

Financial performance is mainly measured by secondary data such as sales based data (including sales volume, sales growth, foreign sales and growth in foreign sales), return on assets/investment, and profitability. Operational performance is reflected by market share, product/service quality and productivity, which can be measured by either primary subjective perceptions or secondary quantitative data. Overall effectiveness performance is mainly measured by primary subjective perceptions such as reputation, performance relative to competitors and perceived overall performance.

Although secondary measures of performance are considered to be more objective than primary measures, they are subject to many limitations. Different accounting standards across countries can cause substantial problems when performance is measured based on financial data. Meanwhile, secondary data are difficulty to access when private firms or sub-business units are studied, or where managers are reluctant to provide secondary data due to competitive or proprietary concerns (Hult et al., 2008). Therefore, measuring financial performance is discarded in this study because of the difficulty in obtaining comparable financial data of each overseas subsidiary, and the unwillingness of managers to disclose sensitive financial data.

The validity of primary data sources for performance measurement has also raised concern among some researchers who believe that bias may be introduced with subjectivity. Moreover, perceptual differences among managers across countries, across firms and across functional areas can be caused by the different institutional environments in which managers function (Leung et al., 2005, Makhija and Stewart, 2002). However, primary data can be more reliable than secondary data in the international business contexts, especially in emerging economies such as China,
where objective measures are often unreliable (Hult et al., 2008; Lukas et al., 2001). The use of primary data in international business will also enable researchers to understand the interpretation of an organisation’s performance goals by managers (Brouthers, 2002), and the values that a manager may place on specific financial, operational, or overall effectiveness performance measures (Hult et al., 2008). Furthermore, subsidiaries may have various roles within a MNE’s network, indicating that performance outcomes should not be based solely on financial indicators (Demirbag et al., 2007). Managerial perceptions are important in determining firm strategy and assessing performance (Demirbag et al., 2007; Walsh, 1995).

Therefore, in this study, the author follows Hult et al. (2008)’s advice to improve performance research in international business by measuring multiple types of performance, including operational and overall effectiveness performance, using primary data sources. Since this study focuses on the non-financial performance of Chinese SOEs, interviewees were asked about their perceptions of overall effectiveness and efficiency, and two factors of operational performance, namely knowledge acquisition and the subsidiary’s position in the local market.

### 7.3 Individual Case Analysis

#### 7.3.1 Case 1: Firm A

Of the four firms, Firm A is the only one that does not hold a monopoly position in its industry. The white goods manufacturing industry is also the one with the fiercest competition and the most open policy towards both domestic and foreign investments. Although Firm A has to compete against many domestic rivals as well as many famous MNEs from developed countries, it has firmly established itself in both the domestic and international markets, and is continuously ranked among the top ten of the top 100 white goods firms in China.

Nowadays, Firm A can confidently state that it has the capability to compete with most famous MNEs, such as Sony and Panasonic, in the international market, especially the African market. As early as the year 2000, Firm A sold more than 100,000 TVs in South Africa alone, and exported to more than ten countries and
regions in Africa. Firm A has set up a global R&D system, with R&D centres located in China (Qingdao, Beijing and Shenzhen), South Africa, the US and the Netherlands. Around the world, Firm A has production bases in South Africa, Hungary, France and Egypt, and sales offices in the US, the EU, Australia, North Africa and Japan. Firm A’s products are exported to over 100 countries and regions all over the world.

7.3.1.1 Internal factors

7.3.1.1.1 Internal resource allocation

Firm A has been very generous towards local knowledge acquisition in terms of resource allocation, including finance, time and human resources. Long-term research about overseas markets has been considered as integral and necessary, and given high priority by Firm A’s management team in Firm A’s international investment strategy.

“Local research is related to not only one project, but also the firm’s international investment experience and post-entry integration.”

-----Interviewee A (2008)

In order to gather adequate information about overseas markets, Firm A normally commits two to three years to conducting research in the local market, starting long before the investment takes place. Many senior managers are sent to overseas subsidiaries, not only for research purposes, but also for training purposes. Firm A’s regional specialists are all brought up in local markets. Many experienced managers have been sent to overseas subsidiaries in order to “bring Firm A’s good ‘genes’ to” overseas subsidiaries.
“We always try to improve human capital structure and allocate specialists to key positions……the subsidiary CEOs sent by the headquarters must be specialists in both management and accounting.”

----Interviewee A (2008)

Besides allocating resources for the marketing purpose, Firm A has also heavily invested in R&D in order to achieve technological advantage by building innovation centres in different countries. For example, in recent years, Firm A has invested five percent of total revenue in R&D each year. Now, Firm A has six R&D centres located in China, the USA, the Netherlands and South Africa, which provide 24/7 non-stop R&D support. The localised R&D team has served the local market effectively by meeting specific local customers’ needs. As a result, Firm A has built its reputation and consolidated its market position in the EU, Australia and South Africa in a very short time period.

7.3.1.1.2 External sourcing

Besides internal resource allocation, Firm A also satisfies overseas subsidiaries’ needs through external sourcing, especially when acquiring knowledge of local markets and expertise in international operation.

As well as doing its own local research, Firm A often acquires local market knowledge using the following two approaches: government agents of the home country and local business partners. Firm A often seeks guidance from the MOC and overseas Chinese embassies. Information from government agents helps Firm A have a clearer picture of the macro economic situation of overseas markets, investment policies and political relationships between China and host countries. This type of information is essential when it comes to evaluate investment risks and prepare the firm for integration.

Firm A has been learning from MNEs from Japan, the US and the EU who have accumulated much experience from previous internationalisation. A business alliance is often used by Firm A to learn from the mature MNEs and benefit from their existing international networks.
Alongside such external network building, Firm A chases talents in the international human resource market in order to bring in international professional managers to help complete the firm’s internal internationalisation. In order to speed up the internationalisation process, Firm A made some essential moves in hunting for specialists in the international human resource market, and as a result, some specialists in international production have been invited to join the firm. For example, in November 2007, quality management specialist Mr. Aa, who experienced the boom in the Japanese electronic industry in the 1980s and 1990s, joined Firm A with his 30 years’ front line management experience. In April 2008, Japanese liquid crystal display (LCD) specialist Mr. Ab joined Firm A to take charge of managing Firm A’s LCD technology innovation and organising an international level LCD innovation branch. In May 2008, Japanese telecommunications technology specialist Mr. Ac joined Firm A and became the head of Firm A’s digital technology R&D department.

By bringing in such international professional managers, Firm A started its internal internationalisation alongside its international investment. These managers have brought in new perspectives, advanced technologies and management knowledge, and their international experience, which helped Firm A to strengthen its international competitive capability and improve its overall effectiveness.
7.3.1.1.3 Coordination/Integration

“At the early stage of our internationalisation, Firm A’s international expansion is project-driven. We paid much attention to project organisation and execution, but ignored the research of local market, which indeed caused some difficulties later.”

----Interviewee A (2008)

Firm A’s investment department was set up specifically in order to plan, organise and execute international investments. It was set up as a long-term mechanism to organise pre-investment research, support investment decision making, implement international investments, and supervise post-investment integration. After several years’ development, the investment department has changed from a purely executive team to a strategic international expansion department, in charge of pre- and post-investment coordination. Because of increasing international investment experience and awareness of the importance of market research, the investment department started to take on the responsibility of coordinating the whole international investment process, including market selection, market research, feasibility reviews, project initiation, investment execution and post-investment operations.

Setting up the investment department has certainly helped Firm A to conduct international investments more effectively and efficiently. The department acts as a coordinator, collecting all the information about international investments, gathering all the resources needed, and reallocating the required resources to overseas subsidiaries. Since international investments need to draw resources from various departments, including finance, human resources, and production, the investment department takes the responsibility and leads all the coordination, in order to ensure the efficient and smooth execution of the investment projects.

After thirteen years of international investment, Firm A has identified three tests that it needs to pass in post-internationalisation integration. The first test is the internal integration within the expatriate team from its headquarters. Since Firm A believes in strictly controlling the human resources and finance of overseas subsidiaries, the
expatriate team is normally composed of personnel from different departments or different subsidiaries. Although they are all from China, they do not have much experience of working with each other. This internal integration will iron out the possible conflicts among team members and straighten priorities. The second test is the professional integration of the expatriate team and local employees. The different cultural background has increased the difficulty of communication in daily operations, and the language barrier makes the situation even worse. The expatriate team and local employees have to be patient and try to understand each other fully in order to make sure that the subsidiaries will function well. The third test is the integration of the overseas subsidiaries and the local markets. Firm A operates its overseas subsidiaries and markets its products according to the local market environment in order to overcome ‘culture shock’ and settle in the local market.

“Passing the three tests is the objective requirement of overseas operation success.”

----Interviewee A (2008)

Since Firm A identified the areas that need managerial attention in the integration stage, it has taken various measures to pass the three tests stated above. First of all, the investment department was set up to coordinate the whole integration process. Second, Firm A has given local research high priority in order to identify problems and provide solutions. Third, Firm A has prepared itself to adjust its organisational culture and management mechanism according to host country’s conditions.

7.3.1.1.4 Managerial mindset

“Firm A is very market-oriented now. The credit should go to our CEO. He is very open-minded. He has developed the firm to be highly market-oriented.”

----Interviewee A (2008)

The openness of the CEO initiated the revolution of Firm A’s internal internationalisation. If SOE managers withhold approval and support, the execution
of long-term strategies, and of daily management and communication, can be delayed and impaired. As the top management team becomes more open towards new perspectives, new management styles and new cultures, coordination and integration have become easier, even in situations where conflicts are in place, especially in overseas markets.

Since managers have devoted much of their attention to overseas market demand, it is easy to understand why they strongly emphasise the importance of local market research. This has led to high priority being placed on market research when it comes to resource allocation, which in turn can significantly accelerate the execution process. Procrastination is eliminated in order to boost efficiency.

7.3.1.2 External factors

Although developed countries provide a better operational environment, Firm A has to face many latecomer disadvantages, such as low reputation and fierce competition. Firm A has been focussing on emerging economies in its internationalisation strategy, especially since the 2008 global financial crisis. Although the financial crisis has influenced Firm A’s cash flow, Firm A has a strong belief in itself and the future. It has therefore paid more attention to emerging economies because of their fast growing markets.

Nevertheless, Firm A has been very cautious in all its international investments, especially those in emerging economies, because of the unstable institutional environment. Its technological advantages and sound product quality have given Firm A the confidence to take the dominant position in its international investment negotiations. Firm A always goes ahead steadily and cautiously due to the underdeveloped character of emerging economies. It normally starts exporting technologies and components and using local brands, later taking control of the joint venture and using both local partner’s and Firm A’s own brands. At a later stage, if Firm A is satisfied with the local environment, it would inject capital to take complete control, and in that case, only Firm A’s brand will be used.
“For example, in Egypt, we allow the local partner to use our brand, our technology and our components. This is a test. If the cooperation is able to produce synergies, we will expand the investment at a later stage.”

----Interviewee A (2008)

Unlike the other three firms chosen for this study, Firm A is not directly supervised by the central government, but by the provincial government. The pressure from the central government on Firm A is far less than that on other SOEs which are directly under the microscope of the central government.

“In Firm A’s internationalisation, the influence from the government is much smaller than the SOEs supervised by the central government.”

----Interviewee A (2008)

Less attention from the government has created a relatively loose environment which allows Firm A to focus on its business development rather than spend much of its energy dealing with the government.

Besides less pressure from the central government, Firm A also benefits from the support of its provincial government. As a star contributor to local economic development, Firm A has enjoyed some preferential treatment from the local government, such as the efficient approval of investment projects and preferential loans.

7.3.1.3 Summary

Thanks to the openmess of the white goods manufacturing industry in China, Firm A has to face increasingly fierce competition, with much less political protection comparing to industries under state control. This has been especially true since the ‘Reform and Open’ policy was set as the fundamental economic strategy of the country. After 15 years of international operation, Firm A has significantly improved its overall effectiveness and built a sound foundation in the international market. The
knowledge accumulated about overseas markets has become precious resource which can be exploited in later investments.

Now, Firm A has developed into an enterprise with internal capabilities of resource acquisition and allocation, network building, international management coordination and integration. Firm A is very confident and proud of its open-minded internal management system, which has led to more effective overseas operations. Managers’ supportive and positive attitude, towards international investments, has certainly boosted the delivery of the firm’s dynamic capabilities in the internationalisation process.

The institutional environments of host and home country have also had a great impact on Firm A’s post-internationalisation performance, although the immature institutional environment in emerging economies has caused some complications. The complex institutions in emerging economies have prolonged the time Firm A needed to build its market position. In terms of home country institutions, the privilege of enjoying local government support with less constrain of the central government has benefited Firm A in improving overall effectiveness and efficiency.

7.3.2 Case 2: Firm B

After a decade of overseas investment and development, Firm B has successfully built up its international telecommunications cable network and international business network, serving overseas Chinese firms and local customers. From 2000 to 2005, Firm B set up many overseas subsidiaries, including Firm B (USA) Corporation, Firm B (Hong Kong) International Limited and Firm B (Europe) Limited. In 2006, Firm B also established a Central Asia Office and Firm B (Singapore) Limited. Now, the US, Hong Kong and Europe subsidiaries have formed the main frame of Firm B’s overseas operation network, in charge of the international expansion in North America, Asia and Oceania, and Europe, the Middle East and Africa, respectively. All subsidiaries have settled in local markets and been providing services based on the international networks built up by the firm. The US subsidiary is particularly strong, and is composed of a regional headquarters in the Virginia State, representative offices in Los Angeles, San Francisco, New York and Toronto,
and sales offices in Los Angeles, Boston, New York, New Jersey, Austin, Houston, and Washington.

“In 2006, the USA subsidiary had the fastest growth rate. It was the best year in terms of total revenue and financial health.”

----Interviewee B (2008)

7.3.2.1 Internal factors

“We try to improve our competitive capability and management skills, penetrate the market and encourage innovation, in order to become the main provider of information services between China and overseas markets, and to contribute to the development of our firm.”

----Interviewee B (2008)

7.3.2.1.1 Internal resource allocation

As the firm with the shortest international investment history among the four cases, Firm B’s resource allocation for its overseas subsidiaries has been focused on infrastructure development. In the past fifteen years, Firm B invested enormous amount of resources into network building, which provides the infrastructure foundation for its international service operations.

In 2006, Firm B increased investment in international data services, which attracted more international operators to use its network to provide services to their international customers. This effort resulted in a large increase in the revenue of the international data service business. In the same year, Firm B built various data ports for its international network in Europe, Asia and North America, which led to the establishment of its international network covering the three most developed regions for internet services.

Firm B’s overseas subsidiaries make full use of the strong resource support from the parent firm to provide telecommunication services, such as international audio services, international line rental and internet connection and exchange. This
substantial and solid resource support gives overseas subsidiaries the confidence and capability to establish themselves and compete in overseas markets.

Besides the investment in infrastructure, Firm B also commits itself to the internationalisation by allocating resource towards human capital development, especially in the early stages. Certain resources have been committed to local market information collection, research and networking. By doing so, overseas subsidiaries have become the frontier of market knowledge acquisition and specialist training centres. However, because of the high uncertainty and risk accompanying international expansion, Firm B is reluctant to allocate senior managers to overseas subsidiaries. Although Firm B possesses a physical cable network which is capable of providing worldwide telecommunication services, the lack of human resource investment has significantly limited the expansion of its overseas subsidiaries. At the current moment, Firm B’s overseas operation is merely supporting expatriate customers, rather than exploring local customers.

Since the global financial crisis, although Firm B is still committed to its internationalisation strategy, it has become more cautious about the amount of resources allocated to the overseas investments in order to avoid the risk of capital loss.

“The internationalisation strategy has not been changed. However, for SOEs, the government has clearly defined the requirement of return on capital (ROC). ROC has been raised as a key indicator, which means that no SOEs can steer clear of the specified indicator.”

----Interviewee B (2009)

7.3.2.1.2 External sourcing

Firm B has mainly externally sourced three types of resources in its internationalisation process: the physical cable network, its relationship network and the experts who can understand both the host country and Chinese culture.
In terms of physical cable network expansion, Firm B started by cooperating with telecommunication operators in surrounding countries and building more cross-border underground cables, in order to make Firm B the data exchange centre of Asia-Pacific telecommunications. Meanwhile, by acquiring a large capacity and highly efficient seabed cable network, Firm B successfully connected its own cable network with the North American network. This worldwide network coverage provided a solid foundation for overseas subsidiaries to provide a high quality ‘one-stop’ service to their customers.

Firm B joined 15 international organisations and forums. It has generated influence through participation in regulation establishment and obtained technology support from international organisations. Through such relationships, Firm B has thus further enhanced its position in the international telecommunications market.

Firm B has more than 80 internet business partners and more than 40 international data service business partners globally. These are situated in Asia, North America, South America, Europe and Oceania. Such cooperation not only helps Firm B learn about overseas markets, but is also one of the reasons to set up overseas subsidiaries in the first place.

“The central Asia office mainly focuses on becoming the bridge and increasing the cooperation between us and other telecommunication operators in the central Asia region.”

-----Interviewee B (2008)

When establishing overseas subsidiaries, Firm B intended to copy its management system abroad rather than adapt its organisational behaviour to the overseas markets. Therefore, in order to keep the overseas subsidiaries’ organisation behaviour coherent with that of the headquarters, Firm B’s overseas subsidiaries prefer hiring employees from the Chinese ethnic group. The shared cultural background can reduce communication barriers and develop common understanding. Those personnel who understand both Chinese and the local culture also help Firm
B understand local market customs and overcome the culture shock in the early stage of internationalisation.

7.3.2.1.3 Coordination/Integration

Firm B has been struggling with its international operation because of its internal bureaucracy and low efficiency. When Firm B invested in foreign markets with different cultures from its own, the firm encountered significant culture shock. However, instead of being open-minded to readjust its management mechanism according to local markets, Firm B’s inflexible management system and its management team which lacks international management experience and capability are incapable of responding to the changing environment in an appropriate manner.

“Some Chinese overseas managers cannot even do the most basic daily management because of the changing environment and different culture.”

-----Interviewee B (2009)

Although Firm B has committed itself to the process of internationalisation, and has done well in the necessary infrastructure investment and international network building, more efforts are needed for the development of its capability of coordination and integration in order to improve its overall effectiveness and efficiency.

“Chinese firms have not developed a very efficient overseas management capability or international organisational culture. Even the very simple and effective management model is still under development.”

-----Interviewee B (2009)

Although Firm B has been supporting overseas subsidiaries successfully through internal resource allocation and external sourcing, its coordination and integration capability development is still far from satisfactory. Because of its lack of overseas management experience and open-minded organisational culture, overseas subsidiaries and offices have difficulty in settling in different cultures, and have struggled with low management efficiency. These struggles have clearly added to
managers’ concerns about further international investment. When talking about possible ‘bargain hunting’ during the economic downturn, Interviewee B has stated that “even if we hunted bargains, I am not sure whether we have the capability to manage the operation.”

Development at an individual level has proceeded further than at an organisational level. Some top managers with more international experience, have started to emphasise the importance of coordination and integration after experiencing the frustration and disappointment resulting from overseas difficulties because of low efficiency and the close-minded Chinese style management.

“Individual capability, development and internationalisation levels are higher than those of the firm as a whole. That is why we say that the problems of human resources are not the problems of individuals, but of the organisation. The development of group efficiency depends on the arrangement and vision of the organisation.”

----Interviewee B (2009)

Despite the concerns of managers, over the past decade Firm B has improved its ability to serve ‘Go Global’ Chinese firms through its wider involvement in international cooperation. As a result, Firm B has established itself in the international data services sector, and the volume of data service business has increased substantially.

7.3.2.1.4 Managerial mindset

Although Firm B is very committed to international investment in terms of financial capital, it is very conservative about a high level of human resources commitment. It is especially concerned about experienced managers.
“We have many concerns about sending managers to overseas representative offices to do the exploratory work.”

----Interviewee B (2008)

This may be related to the uncertainty avoidance element in Firm B’s organisational culture. Considering the huge amount of risk and uncertainty accompanying international investments, there is a high possibility that expatriate managers will not be able to create immediate returns. Meanwhile, most managers, who are capable of being in charge of the overseas subsidiaries and offices, work at a higher level in the organisation’s hierarchy. This unprofitable work can have negative impact not only on the managers’ confidence and attitude, but also on their future promotion opportunities. SOEs have a low level tolerance of failure, so managers may put their jobs at risk if they cannot improve the financial performance of the subsidiaries within a short time frame.

With the global financial crisis, the Chinese government started to tighten the supervision of SOE finance. As a result, the emphasis on financial performance overshadows the importance of increasing future enterprise value in managers’ attention. Therefore, support for further finance and investment in human resource has started to decline. Managers have become more cautious about the risks associated with international investment.

“SOEs with overseas investment deficit are under huge pressure, especially the managers in charge. Managers start to reflect (on past investments) and become more cautious. This economic downturn will definitely influence future decision making.”

----Interviewee B (2009)

7.3.2.2 External factors

The complexity of the local institutional environment puts Firm B in a comparatively vulnerable position in the local market, and it has been forced to do more local research in order to reduce risk levels. From Firm B’s point of view, this has not
caused too much trouble, since most of its overseas investments are in developed countries. However, it is undeniable that the complex institutional environment in developing countries and emerging economies is causing considerable investment difficulties for subsidiaries operating in these countries.

“The political, cultural and operational environments in emerging economies and developing countries are very complicated. In order to ensure the success of M&A and later operation, we must send expatriates to gain a deeper understanding about the local situation and gather information.”

----Interviewee B (2008)

Home country institutions have also played an important role in Firm B’s internationalisation. There are mainly two types of influence on SOEs from the central government: providing support and guidance, and supervising performance.

“We need more instructions and guidance from the central government in terms of the general economic environment.”

----Interviewee B (2009)

Although in 2008, the EIBC published An Analysis of Investment Risks by Country, which is a very useful reference, Firm B has a very strong preference for more official guidance from the government. One major reason is that managers believe that the more guidance they receive from the government, the less responsibility they take in performance evaluation at a later stage. This is because, if overseas investments are unsuccessful, managers can argue that their decisions were made based on guidance from the government. Since the financial crisis, the SOEs’ supervision body, SASAC, is paying more attention to the financial performance of overseas investments.
“The main effect of the financial crisis on our internationalisation strategy is that managers have become even more cautious.”

-----Interviewee B (2009)

Being cautious in a volatile market may not necessarily be a bad thing for a multinational firm. However, this cautiousness has clearly restrained Firm B’s development. Because of the high priority given to financial stability, managers start to pay more attention to numbers on the balance sheet rather than the all-round development of the firm’s capabilities. The evaluation system for managers and the definition of entrepreneurship have been distorted.

Because the career future of managers is based on the evaluation of SASAC, the emphasis of finance performance of SASAC has induced managers to focus on short-term return on capital rather than long-term firm development. This change of focus has significantly added to managers’ hesitation to gain local knowledge, which is a long-term project possibly without short-term returns.

“The political and career future of SOE managers is directly related to the performance of the firm. Managers will first consider whether they can meet the requirement of finance performance, which focuses more on now than on the future.”

-----Interviewee B (2009)

7.3.2.3 Summary

After a decade of development, Firm B has successfully achieved its first step in internationalisation. Its strong capital and human resources have built the foundation for successful international investments. Firm B has also accumulated knowledge about overseas markets through its own research and many types of external sourcing. Although its capabilities of internal resource allocation and external sourcing have enabled Firm B to gain knowledge of overseas markets and settle in local markets, the low coordination and integration capability has created barriers to achieving further success. Moreover, although Firm B has developed both its internal
resource allocation and reconfiguration, and external sourcing, the change of managerial attitude, due to the change in SASAC’s policy, has clearly negatively impacted its established dynamic capabilities, which contribute to overseas success.

In the first decade of its internationalisation, Firm B has mainly invested in developed countries where the institutional environment is relatively stable and comprehensive. However, subsidiaries and representative offices in developing countries and emerging economies have been influenced by the complex local institutions. As a SOE supervised by SASAC, Firm B can never escape from the influence from the home country institutions. This interventionist strategy has restrained the autonomy of Firm B as an enterprise. Although a certain level of government support has helped Firm B to learn about the macro and political environments, too much intervention has prevented Firm B from taking any investment risks in order to seize opportunities and accumulate knowledge.

### 7.3.3 Case 3: Firm C

Among the four firms studied in this research, Firm C is the one with the longest overseas investment history. In 1994, having been approved by the State Council to be one of the 100 pilot corporations adopting modern corporate structure and governance systems, Firm C began to carry out a series of reforms. By doing so, Firm C steadily pushed forward its internationalisation, industrialisation and specialisation. Meanwhile, by taking over Firm C Import & Export Corporation Limited and raising funds directly from the stock market, its capital base was expanded and capital structure improved. Since 1996, Firm C has been honoured as one of the top 225 international contractors by *Engineering News Record*.

After fifteen years’ hard work, Firm C has firmly established itself in many developing countries and regions. Among the 23 overseas subsidiaries and representative offices, thirteen are in Africa, eight in Asia and two in Latin America. Through the foreign-aid projects authorised by the Chinese government, Firm C has accumulated international experience, trained a group of international regional specialists, and built up competitive capabilities. Now, Firm C is trying to explore international projects on a commercial level rather than through government aid.
7.3.3.1 Internal factors

“In the early stages, SOEs neither have international experience nor international human resources. We used our imagination in order to try to understand international markets. The fact is that SOEs’ capabilities, especially the ‘soft capabilities’, were, and still are, far behind mature international MNEs. Compared to the latter, SOEs lack financial resources, and lack experience of international financial operations.”

----Interviewee C (2008)

7.3.3.1.1 Internal resource allocation

In the very early stage of its internationalisation, Firm C recognised the importance of all-round resource support for the survival of its overseas subsidiaries. This included not only financial support, but also human resource investment and autonomy.

“We need to give international investments more support and unveil the mystery of international investment through long-term local research and proactive involvement.”

----Interviewee C (2008)

Firm C’s headquarters provides a great deal of support to its expatriates, especially the freedom to make independent decisions. Overseas expatriate employees are not under pressure to generate immediate returns, which allows them to adjust to the working conditions and living environment, and to learn about the local culture gradually. Although overseas subsidiaries have independence in their operations and headquarters’ support in resources, they are still in the radar of the headquarters. Firm C strictly controls its overseas subsidiaries’ financial management in order to lower the risk of corruption. Accountants are rotated by the headquarters on a regular basis. By doing so, the headquarters can have a clear picture of the overseas subsidiaries’ financial situation without interfering in the overseas operations.
Besides the operational independence enjoyed by overseas subsidiaries, Firm C also invests generously in human capital building. Firm C sends a number of senior managers to overseas subsidiaries. This is not a short-term overseas training scheme, but a major part of Firm C’s long-term global human capital reserve scheme.

“We give our overseas expatriate employees training in local culture, in order to have our own expertise. They not only understand the cultural differences, but also work according to local customs.”

----Interviewee C (2009)

All the internal resource support happens for the sake of long-term local research, which helps Firm C to learn and accumulate knowledge about local markets. Since Firm C’s main target is the African market, which is still under development and with limited published official data sources, Firm C has committed large amounts of time, money and human resources to collecting information and learning about the local market, culture and customs. Therefore, its overseas subsidiaries have become not only a market-seeking vehicle, but also a resource for knowledge acquisition and information gathering.

All these generous resource investments and reconfigurations have helped Firm C’s knowledge accumulation about overseas markets, and provided a solid and secure foundation for overseas expansion.

### 7.3.3.1.2 External sourcing

Firm C’s overseas targets are developing countries and emerging economies, and it has competitive advantages in technology, project operational experience and financial capital, compared with local rivals. What is missing in order to achieve success in the local market is that Firm C lacks knowledge about the local market and the reputation in local customers. Therefore, Firm C has been cooperating with local firms in order to understand the local situation more quickly and comprehensively. By doing so, Firm C can not only accumulate knowledge, but also build up its relational networks in the local markets.
Firm C has a strong preference for direct external sourcing, rather than through agencies such as investment banks. The firm believes that, although investment banks can help firms gather information, they do not provide enough details to advance Firm C’s specific interests, nor do they give enough attention to international political relationships, which is Firm C’s great concern. Therefore, working with local partners has become the main knowledge acquisition approach for Firm C’s overseas subsidiaries.

Besides closely working with local firms for knowledge learning, Firm C also recruits local specialists in order to reduce the costs of training firm’s internal specialists about the local market.

“Overseas subsidiaries should rely more on local employees, and it has been proved to be easier to solve local conflicts through local employees.”

----Interviewee C (2008)

Firm C’s African subsidiaries not only bring in local market specialists, but also invite local distinguished figures to join the board of subsidiaries in order to boost the subsidiaries’ reputation and recognition in local markets.

“In Africa, Chinese do get some respect for being the investors. However, they show much more respect to local leaders and heroes. It can be more efficient if we invite these people to join the firm to be managers.”

----Interviewee C (2008)

After years of international investments, Firm C has become more open towards recruiting senior managers from local markets, rather than solely relying on expatriates sent out from China. If a certain kind of management style and principle is widely accepted in the host country, Firm C’s local subsidiary will adapt to that.

“In some Arab countries, some princes want to not only become shareholders, but also get involved in management, because they think
that their authority can only be shown off by being involved in management. In this case, we will invite them to join the management team.”

----Interviewee C (2009)

7.3.3.1.3 Coordination/Integration

As one of the traditional SOEs born from the government, Firm C was more like a bureaucratic governmental department than an efficient, profit-seeking enterprise when it was established in the late 1950s. The so-called state-owned ‘enterprise’ was merely an executive arm of government. Although Firm C has been restructured into a more modern enterprise group, it is still under the heavy influence of the old government management system.

“SOEs have never really separated from the government management system. Even the organisational structure is still an extension of the government supervision department.”

----Interviewee C (2008)

Firm C has been struggling with its inherited management system throughout the internationalisation process. Because of organisational duplication and overstaffing, decision making is often a complicated compromise which attempts to satisfy the interests of many different departments. Coordination among departments within the firm has been difficult because few were willing to compromise or follow another department’s lead.

“Sometimes, strategies are set by several different departments, which lead to a very low level of management and executive efficiency.”

----Interviewee C (2008)

In the early years of its international investments, Firm C was clinging on to its very old management ideology and had very limited coordination capability. Although the firm was a pioneer SOE in the internationalisation process, it did not have the capability to coordinate operations at the international level. This lack of coordination
capability explains its extremely low efficiency, which has lead to the loss of some very good investment opportunities, and some unsuccessful overseas operations.

Fortunately, under the pressure of profit generation and future development, Firm C started a process of transformation from the top management team down. After conducting long-term local research, summarising the experience of its own and other firms’ international investment, Firm C started to improve its management ideology and coordination capability in order to build an appropriate organisational structure, adopt marketable strategies and develop an emergency response system. The headquarters also improved its decision making procedure based on the feedback from overseas subsidiaries. Although this transformation has not happened overnight, Firm C has already started to see some positive results, such as improved efficiency and a more open-minded organisational culture.

Besides shaking up its internal system, Firm C also tried to take the external environment into consideration.

“In some countries with a strong culture and religious background, such as Arab and Islamic countries, we cannot just force local employees to accept our Chinese culture.”

----Interviewee C (2009)

Firm C’s overseas subsidiaries’ management principles always follow local customs. This adaptation has significantly helped Firm C’s overseas subsidiaries to settle in local markets and lay the foundation for smooth operations.

7.3.3.1.4 Managerial mindset

Firm C has a very active and positive attitude towards allocating the necessary resources to overseas subsidiaries and cooperating with local firms in overseas markets in order to gather information and learn about local customs. Although this is a positive sign towards external sourcing, it does not mean all resources acquired externally have been treated appropriately.
In Firm C’s culture, there is a very deep belief in ‘ZI JI REN’, which means ‘one of our own’. This mainly refers to personnel who have been working for the firm for a long time, or who are at least Chinese. Foreigners recruited from the international market will not be considered as ‘ZI JI REN’, in other words, not trusted. Therefore, although Firm C relies on local employees to solve certain local issues, they do not get the opportunity to explore their full potential since they are not fully trusted.

“SOEs believe in and trust ‘people’ rather than the ‘system’, which means that SOEs do not have any real trust in foreign professional managers.”

-----Interviewee C (2008)

As Firm C becomes more deeply involved in the international market, more and more top managers are starting to accept international conventions and become more open-minded. As a result of further internationalisation, foreign employees have been more accepted by the firm since ‘we are starting to realise that international investment does not follow managers’ will, and the rules of the game are not set by us (Interviewee C, 2008)’.

7.3.3.2 External factors

In the interview, interviewee C mentioned policies or political relationships 21 times in total. This strong emphasis shows how important the institutional environment is in Firm C’s internationalisation.

“The international political situation is the first compulsory lesson. The international political situation is normally the issue that we consider first (in international investments), but do not have a very clear idea about it.”

-----Interviewee C (2008)

Firm C always tries to follow the Chinese government’s policies and win the support of both the home and host governments in order to ensure the success. Meanwhile, attention has also been given to the influence from western countries and local religion, especially in Muslim countries.
“We must have a very clear idea about host countries’ policies in order to do business in local markets.”

----Interviewee C (2008)

A good long-term political relationship between China and host countries helps Firm C to avoid the hostile attitude of local people and the negative intervention of host countries, because China may have more influence on these countries’ policies. Firm C can benefit from this positive relationship by enjoying a more favourable investment environment, and the acceptance of more foreign aid projects initiated by the Chinese government. As a government contractor, Firm C will have more investment opportunities in the host country to further increase its market share.

However, Firm C is aware of some uncontrollable risks linked to host country institutions. So far, Firm C’s international investments have all been made in developing countries and emerging economies, mainly in Africa and Asia. For some developing countries, especially in Africa, after a change of regime may herald a policy change from ‘for China’ to ‘against China’. This has added a huge amount of uncertainty to Firm C’s investments. Unstable and unpredictable host country institutions have increased the difficulty in consolidating the firm’s market position in those host countries.

7.3.3.3 Summary

Firm C has successfully built its base in the international market, especially in Africa. It has gone through the painful launch stage, and is looking for steady development and expansion in the international market. Firm C has been very generous in its human capital investment, including training its existing employees and employing suitable personnel from local markets. Being able to send the right person to the right position, or recruiting the right person for the right position, has helped Firm C to solve overseas management problems. Now Firm C relies on local employees to solve local problems. Although Firm C did experience some difficulties in the early stage of its internationalisation, the situation has been improved due to the fast
development of its coordination capability, which has been effected through an internal transformation.

Besides pursuing overseas success by developing its dynamic capabilities, Firm C has also taken the international political situation and government policies into consideration while pursuing stable market development. Good political relationships between host countries and China and the stable political environment of the host countries have certainly helped Firm A to settle in local markets.

7.3.4 Case 4: Firm D

Firm D started to accumulate its international experience by contracting government aid projects and labour exports ever since it was established. In 1995, the first overseas subsidiary was established in Thailand, which signalled the beginning of the international investment of Firm D. Eleven overseas subsidiaries, in the form of wholly owned subsidiaries, joint ventures, overseas administrative bodies and training bases, have been established. Firm D has also participated in telecommunication projects, economic aid and technical labour cooperation in Tanzania, Mali, Zambia, Albania, Vietnam, Korea, Equatorial Guinea, Angola and Ghana. More than 1000 senior technicians have worked in 10 countries, including the US, the UK, France, Germany, Japan, Canada, Spain, Italy and Thailand.

After one and a half decades of development, Firm D has become a well-known telecommunications infrastructure builder in the international market. The international business has become a very substantial part of the firm’s sustainable development strategy and is expected to grow sharply in 2008.

“Firm D has achieved initial success in international expansion. Our technology, management style, behaviour and thinking style have all changed. This up-side-down transformation has shaped Firm D’s competitive advantages and increased Firm D’s international competitive capabilities.”

----Interviewee D (2009)
7.3.4.1 Internal factors

7.3.4.1.1 Internal resource allocation

In terms of internal resource allocation, Firm D has established a successful mechanism within the organisation in order to allocate the appropriate resources where they are most needed.

Firm D started this system of reconstruction by breaking the rules set by the government supervision department, SASAC, in order to give overseas subsidiaries and expatriate employees financial support. As early as 2003, Firm D reset the standard allowance for overseas expenses claims as set by the central government. The old standard meant expatriate employees could not even afford accommodation and subsistence. The removal of this restriction freed all expatriate employees from worrying about the cost of living whilst working abroad. Thenceforth, all expatriate employees could focus on the work rather than worrying about filling in the over-standardised expenses claim form.

“The out-of-pocket expenses claim standard was reset based on the real situation.”

----Interviewee D (2008)

While Firm D is further down the line of international expansion, this process has changed the entire management perspective concerning international business. Previously, international business trips were considered as ‘benefits’ related to higher level management positions, which took a long time to organise and were very costly. Now, international business trips have been down-graded to normal business trips, which means Firm D will respond to the situation as quickly as possible, send as few people travelling as possible, and spend as little money as possible. Resources will be allocated to where they are most needed.

“Relevant people hold valid visas all year round. If there is any need, one or two people will go to the ‘frontline’ by going through an easy application..."
process within the shortest time frame. Even if senior managers visit abroad, everything is based on project needs.”

----Interviewee D (2008)

Beside changes to the allocation of financial resource, Firm D has also allocated a certain amount of human resources to overseas subsidiaries to support local research in order to gather comprehensive knowledge about local markets.

“We invest certain human resources, materials and financial resources into overseas research, pay necessary tuition fees for going abroad, and provide support for local research.”

----Interviewee D (2008)

Firm D not only allocates resources to overseas subsidiaries for knowledge acquisition and information gathering, but also contributes to local welfare creation. Firm D often gets more involved locally through charities and helping with local infrastructure development, which has helped the firm to build its reputation and increase favourable publicity.

7.3.4.1.2 External sourcing

In the early stage of internationalisation, Firm D experienced many difficulties because of its limited understanding of local culture and customs.

“From paying the deposit for a rental agreement to paying government commission according to local customs, no matter how small or big the issue is, it is extremely difficult for the expatriate employees in overseas subsidiaries to work efficiently.”

----Interviewee D (2008)

Besides investing human and financial resources into overseas market research, in order to hasten the process of understanding the overseas market, Firm D has been
cooperating with local partners who have a strong local background and competitive advantage. By doing so, Firm D has been able to understand local markets better, settle in local markets more quickly and share potential operation risks with its local partners.

“We form cooperation relationship based on common interests with local firms, and use their local advantages to penetrate local markets and share risks.”

----Interviewee D (2008)

Local partners can not only help Firm D to gather detailed information about the local market, but also introduce Firm D to the local government and other local firms. All these help Firm D extend its networks. This learning process generates benefits in both the pre- and post-investment stages. After the overseas subsidiary is set up in the host country, local partners are very helpful in understanding local culture, solving conflicts and improving the relationships with the local government and local firms.

Firm D’s overseas subsidiaries often employ local people to solve local problems and to ease conflicts. Although expatriate managers from the headquarters still hold overall control of the overseas subsidiaries, local professional managers are very much welcomed in Firm D’s overseas subsidiaries in order to improve the managerial efficiency.

“We employ some local professional managers in order to manage local employees more effectively and efficiently.”

----Interviewee D (2009)

7.3.4.1.3 Coordination/Integration

Firm D set up the international department to coordinate its internationalisation process. The department’s responsibilities include exploring opportunities, executing projects, providing supports, and monitoring overseas subsidiaries’ performance. By
setting up this specialist department, Firm D is able to avoid the frustration and inefficiency which occur when issues arising from overseas subsidiaries are bounced between departments and not resolved promptly. The establishment of the international department is also a signal showing that Firm D has proceeded from passive response to active planning regarding its internationalisation strategy.

“At the beginning, we were forced to go abroad in order to survive, but now, we have changed from passive response to the market to actively planning (according to market condition).”

----Interviewee D (2008)

Before setting up its first overseas subsidiary, Firm D had gained a certain amount of international experience by winning contracts for government foreign aid projects. This initial experience plus the positive experience of the early stage of international investments boosted the firm’s capability and confidence in international operations. Now Firm D has a clear idea about the process of international bidding, investment and execution, which enables it to draw on resources from different departments in order to achieve smooth execution of international investments.

Moreover, inspired by the efficiency achieved by the international department, Firm D has started a transformation from the top down. The headquarters in China have become more pragmatic, flexible and supportive in order to keep up with the international expansion.

“As the central government gradually loses its control of SOEs, we have become more and more market-oriented. The management and organisational culture have been following the market, for example the efficiency of decision-making and the decentralisation of authority.”

----Interviewee D (2008)

This revolution has granted overseas managers power and obligation to achieve higher efficiency and successful internationalisation by responding appropriately to local markets.
While Firm D was still in the exploratory stage of internationalisation, there were many conflicts between Firm D’s expatriate managers and local employees because of the different working practices, management style and culture. After a period of adapting and compromising, conflicts were gradually reduced. This conflict-resolution process has taught Firm D a precious lesson in their post internationalisation integration.

“The adaptation has brought Firm D shocks and changes to organisation culture and our perspectives.”

----Interviewee D (2008)

In one of Firm D’s main overseas markets, Africa, although Firm D has technological advantages compared to its local competitors, it cannot just copy its Chinese management style to the African market, because of different culture and development paths. Firm D has learnt to adopt appropriate approaches and strategies according to the local situation by doing local market research.

Firm D has made a great effort to localise its overseas subsidiaries in order to integrate them with local markets. The management team sent from headquarters is required to operate the subsidiary according to local culture and customs.

“The local team helps the headquarters and local employees to understand each other better and localise the subsidiary in order to build a solid foundation for the development of the overseas subsidiary.”

----Interviewee D (2008)

This localisation is particularly important for the first generation of expatriate employees from the headquarters.
“The subsidiary would not survive if we had just exported the SOE way of doing business.”

----Interviewee D (2009)

Firm D has not only successfully integrated its overseas subsidiaries into local markets, but also provided a flexible internal environment where different management styles can coexist. While overseas subsidiaries, which are normally more performance-oriented and efficient, work according to local culture, the headquarters is still strictly following the Chinese management style, which is more power-oriented and bureaucratic. However, since the top-down transformation started, the gap between the headquarters and overseas subsidiaries has narrowed rapidly.

7.3.4.1.4 Managerial mindset

“SoEes are risk averse. Before they decide to set any strategy, managers are first concerned as to whether they could take responsibility for the outcome. Success or failure is related not only to ‘face’ and reputation, but also to the position and job. Therefore, at the initial stage, Firm D just exported its Chinese style of management to its subsidiaries, and was very cautious due to the fear of losing control.

Clearly, even when the firm has the resources to support overseas investments and the capability to coordinate overseas operations, it is difficult for subsidiaries to succeed if top managers are not on their side.

7.3.4.1.4 Managerial mindset

“The closer headquarters managers’ perception is to the reality, the easier overseas managers’ work is. If top managers only sit in the headquarters and give orders, overseas subsidiaries cannot even survive. First, senior managers have to be pragmatic and have the willingness to do business. Second, managers need to comprehensively understand the situation on the ground. These are the two premises for a firm’s overseas success.”

----Interviewee D (2009)
Thanks to a few open-minded managers, such as the CEO of Firm D and the ex-CEO of the Wuhan subsidiary (who is the current director of the international department), opportunities have been provided for the firm and individuals to explore and expand the overseas markets by the top managers.

“The reformation started in the international department. The involvement of our CEO (of Firm D) has influenced the whole firm.”

----Interviewee D (2009)

7.3.4.2 External factors

“Political relationships can affect economic relationship to a large extent. Therefore, we should learn about the political relationships between China, potential host countries and western countries.”

----Interviewee D (2009)

Firm D prefers to invest in countries with a stable political environment because this normally leads to a stable investment environment. In these countries, economic development is the focus of the government, which sends out positive messages towards investors. Firm D has been paying attention to the host country’s politics and trying to build a deep connection with local governments in order to get more support.

“In Africa, without host country government support, projects with an investment of over $10 million are hardly likely to succeed.”

----Interviewee D (2008)

In order to generate support from the host country government, Firm D often invites the local government to become shareholders, even if it already has enough financial resources. By doing so, Firm D can easily obtain the government’s attention by taking it on board, and it can share the investment risk with the local government, especially in developing countries where there is a higher level of potential political risk.
As discussed in Section 7.3.4.1.1, many rules set by SASAC, such as the expenses claim standard, have caused many difficulties in Firm D’s overseas operations. Although Firm D did benefit from the close relationship with the Chinese government by being the preferred contractor of foreign aid projects, its overseas operations have been interfered by the government, which has caused many frustrations and severe inefficiency.

7.3.4.3 Summary

Firm D has committed itself to doing whatever is needed in order to compete in the international market. The firm even broke some of the rules set by the SASAC, such as the overseas expenses allowance. Necessary changes have been made to ensure that resources are allocated to where they are most needed.

Firm D’s overseas subsidiaries have opened its door to local professional managers, though these managers have not yet reached high management positions. This approach and cooperation with local firms have opened up the local markets for Firm D, and helped its network building.

The efficiency achieved by setting up the international department has encouraged Firm D to reform the ideology of the firm. This pragmatic, flexible and supportive internal environment has allowed different management styles to coexist and created space for overseas managers to do whatever is needed to integrate into local markets.

Political relationships between host countries and China are also emphasised by Firm D, because the firm prefers host countries with a good political relationship with China in order to obtain more support from host countries’ government, especially in developing countries.

7.4 Cross-case Discussion and Propositions

In Section 7.3, factors that influence Chinese SOEs’ overseas success have been discussed from the perspective of dynamic capability and the institution-based view.
The findings have been summarised in Table 7.3 and Table 7.4. Based on these findings, similarities and differences among the cases will be discussed in this section, and propositions will be put forward.
Table 7.3 Summary of Case Study Findings

<table>
<thead>
<tr>
<th>Dynamic capabilities</th>
<th>Firm A</th>
<th>Firm B</th>
<th>Firm C</th>
<th>Firm D</th>
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</thead>
<tbody>
<tr>
<td><strong>Internal resource allocation</strong></td>
<td>Generous resource allocation towards local knowledge acquisition: finance, time and human resources</td>
<td>Invest in physical network building</td>
<td>Financial support</td>
<td>Huge commitment towards international investment in terms of resource allocation, especially finance</td>
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<td></td>
<td>Five percent of total revenue to R&amp;D</td>
<td>Reserved commitment towards investing human capital to local market research</td>
<td>Independence</td>
<td>Invest human capital and other resources in local research</td>
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<td></td>
<td></td>
<td>Become cautious since the financial crisis</td>
<td>Human capital</td>
<td></td>
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<tr>
<td><strong>External sourcing</strong></td>
<td>Acquire knowledge from government agents and business partners</td>
<td>Acquire physical cable network building international network</td>
<td>Cooperating with local firms to acquire knowledge about local markets</td>
<td>Cooperating with local firms to acquire knowledge</td>
</tr>
<tr>
<td></td>
<td>Bring in international professional managers</td>
<td>Bring in local experts with Chinese background</td>
<td>Employ local specialists</td>
<td>Build local network</td>
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<td></td>
<td></td>
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<td></td>
<td>Bring in local managers</td>
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<tr>
<td><strong>Coordination/Integration</strong></td>
<td>Set up international department Be able to integrate at three levels: within expatriate team; expatriate team and local employees; overseas subsidiaries and local market</td>
<td>Set up international department Low coordination and integration capability, but improving Struggle with low efficiency</td>
<td>Set up international department Low coordination capability at the beginning Coordination capability improved as experience accumulated Integrate with local culture</td>
<td>Set up international department Transformation of ideology Localisation of overseas subsidiaries Open-minded internal environment</td>
</tr>
<tr>
<td>Managerial attitude</td>
<td>Open-minded towards changes, new perspectives and new cultures</td>
<td>Hesitation toward high end human capital commitment</td>
<td>Positive towards external sourcing</td>
<td>Cautious at the beginning Positive and open-minded towards investing in overseas markets</td>
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<td>Committed to local market research</td>
<td>High uncertainty avoidance by holding back investment</td>
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<tr>
<td>Institutional Environments</td>
<td>Host country</td>
<td>Cautious in emerging economies because of complicated institutions</td>
<td>Complicated institution in emerging economies are causing more difficulties</td>
<td>Political relationship with China is very important</td>
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<td></td>
<td>Home country</td>
<td>Fewer restraints from central government</td>
<td>Heavily influenced and restrained by central government</td>
<td>Government support at early stage</td>
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<th>Firm A</th>
<th>Firm B</th>
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<tbody>
<tr>
<td>Overseas market</td>
<td>Both developed countries and emerging economies</td>
<td>Mainly developed countries and some emerging economies</td>
<td>Emerging economies and developing countries</td>
<td>Mainly emerging economies and developing countries; some developed countries</td>
</tr>
<tr>
<td>Overseas investment type</td>
<td>Commercial</td>
<td>Commercial</td>
<td>Mainly foreign aid projects; some commercial</td>
<td>Started with foreign aid projects; now more commercial</td>
</tr>
<tr>
<td>Performance</td>
<td>Satisfactory</td>
<td>Partially satisfactory; needs improvement</td>
<td>Satisfactory</td>
<td>Satisfactory</td>
</tr>
<tr>
<td>Dynamic capabilities</td>
<td>Strong</td>
<td>Weak</td>
<td>Strong (developed during internationalisation)</td>
<td>Strong (developed during internationalisation)</td>
</tr>
<tr>
<td>Managerial Mindset</td>
<td>Open</td>
<td>Closed</td>
<td>Open towards investment; close towards foreign employees</td>
<td>Has changed from closed to open</td>
</tr>
<tr>
<td>Host countries institutions</td>
<td>Difficult in developing countries</td>
<td>Difficult in developing countries; smooth in developed countries</td>
<td>Difficult in developing countries; relies on political relationships</td>
<td>Difficult in developing countries; relies on political relationships</td>
</tr>
<tr>
<td>Home countries institutions</td>
<td>Fewer restraints; plenty of support</td>
<td>More restraints; some support</td>
<td>Government contractor but under restraints</td>
<td>Government contractor but under restraints</td>
</tr>
</tbody>
</table>
All four firms have committed themselves to international investments, even after the world economy slid into recession in the aftermath of the financial crisis. Various resources, including finance, human capital, and materials have been injected into overseas subsidiaries in order to support their daily operations.

OFDI requires a large amount of initial capital investment, compared to other internationalisation routes, such as export. All four firms have allocated the necessary financial resources for internationalisation. They have been investing heavily in infrastructure, R&D and marketing research. After more than a decade of internationalisation, these firms are able to identify the need for financial resources, and are capable of meeting the needs with a sufficient capital supply. These factors provide the financial foundation for the success of overseas subsidiaries in local markets.

Besides the financial investment, human capital has been recognised as a key resource in the success of overseas subsidiaries in local markets. Assigning the right person to execute the strategy is as important, if not more so, than choosing the right strategy. Firm A, C and D have all been generously investing in overseas human resource building by assigning senior managers to overseas markets and setting up overseas training centres. However, Firm B hesitates to invest in high-end human resources in overseas markets in order to avoid the high cost. As a result, Firm B is the one with the smallest international investment scale among the four cases, and is struggling with its international expansion.

Time is another resource which has been identified to be crucial to firms’ overseas success. Because of the low tolerance of failure in SOEs, managers of overseas subsidiaries and their line managers in headquarters are under pressure to generate profits relatively soon after the subsidiaries are established. This short-term orientation forces managers to focus solely on profits and suppresses the learning curve necessary for long-term success in local markets. Firm B is particularly focused on ROC. In order to achieve a good ROC, Firm B’s overseas subsidiaries are mainly focused on serving
expatriate customers, because these projects can generate a steady cash flow without massive investment in market exploration. In comparison, the other three firms do not put emphasis on short-term returns. Managers have been given time (normally two to three years) to learn about local markets. The knowledge and experience accumulated in a particular market is not only used to serve this market, but also contributes to the firm’s international expansion in other similar markets.

Therefore, in order to achieve post internationalisation success, it is necessary for firms to identify resource requirements, including finance, human resource and time, and to meet those needs promptly. These investments are essential for achieving long term success. All these resource commitments help overseas subsidiaries to accumulate knowledge and experience and expand in overseas markets. This leads to the following proposition:

P1: The capability to allocate the necessary resources, including finance, human capital and time, to overseas subsidiaries helps them to achieve better performance.

When Chinese firms enter a foreign market, they do not necessarily possess all the resources and knowledge required for international operations. The information asymmetry problem is especially severe compared to the shortage of other resources. In order to compensate for the disadvantages caused by the shortage, all four SOEs have cooperated with local firms and government agents to acquire local market knowledge and extend their networks in local markets. These SOEs have also tried to bring in international professional managers and local employees in order to boost the internal internationalisation and smooth local operation.

In all four cases, local partners have played an important role in these SOEs’ international investment. Cooperating with local firms has not only helped SOEs with knowledge acquisition in local markets, but also opened up the
door to the local networks. Local governments have also been playing a key part in SOEs' local network building, especially in some African countries.

Although all four firms have brought in a certain amount of external human capital, they have gone down different routes to recruit the human resources needed to meet the firm's strategy. For example, Firm A recruited managers from the international human capital market, and appointed many experienced managers from developed countries. These high-end professional managers helped Firm A develop its own management system based on internationally accepted principles, and utilised their experience to familiarise Firm A with complex international operations. Firm A then applies this strategy to overseas markets with minor adjustments.

Firm B, which has a much smaller scale of international investment than the other three, has started to recruit local employees with a Chinese cultural background, but has not yet to bring in more experienced professional managers. Firm B generally exports or transfers its own management system developed in China to its overseas subsidiaries. The thinking is that local employees from the Chinese ethnic group can better understand the established management system according to Chinese culture, which makes communication within the firm easier.

Firms C and D prefer to appoint local managers to manage local employees. These managers bring in more knowledge about local markets, and help solve local problems. Although the top management team assigned by the headquarters still holds control of the overseas subsidiaries, middle-level managers and other employees recruited locally help to readjust the operation and management strategy of overseas subsidiaries according to the local culture and market environment.

Knowledge and information that SOEs have acquired through their external networks including local business partners, government agencies and international organisations, help them understand local markets in order to serve local consumers better. Employees with extensive experience of
international operations and local knowledge contribute to SOEs’ understanding and help overseas subsidiaries to settle in local markets. Hence, the author proposes:

**P2:** The capability of externally sourcing knowledge, through business partners, governments and local personnel according to the host country culture, helps overseas subsidiaries to achieve overseas success.

As latecomers in the global market, Chinese SOEs have limited capability of coordination and integration due to the lack of international operation experience. Bureaucracy and low efficiency have cost Chinese SOEs many good investment opportunities and led to some unsuccessful overseas investments, especially at the early stage of their internationalisation.

All firms apart from Firm A explicitly admitted that, at the early stage of their internationalisation, they suffered from the low efficiency caused by a lack of coordination capability. Firm A’s coordination capability has been developed in midst of the fierce competition of the Chinese white goods manufacturing industry, before the firm went international. Furthermore, it is undeniable that the capability to coordinate different departments to meet the requirements of overseas operations is essential for overseas success. The organisational structure of the original SOEs is confusing and bureaucratic. Firm’s strategies were generated by different departments or subsidiaries, with much conflict of interests or of resource demands. How to coordinate different departments to serve overseas investments has been a struggle for many SOEs. As discovered in these four cases, in order to enhance international investments, it is essential to establish a department to take responsibility for coordination and to persuade different departments to compromise and make the firm’s overall welfare the top priority.

In addition, firms also need effective post-internationalisation integration in order to achieve overseas success. Three levels of integration have been identified in the cases studied. The first level is the integration within the
expatriate team sent from the headquarters. The second level is the integration between the expatriate team, managers and employees recruited from local markets. The third level is the integration of the overseas subsidiaries and local markets. This leads to the following proposition.

**P3: The capability of coordination and integration contributes to a high level of efficiency and smooth overseas operations.**

The mindset of managers in Chinese SOEs plays a decisive role in daily operations. The traditional SOEs manager’s mindset is highly risk-averse and bureaucratic. They are not willing to take any risk which could possibly lead to capital loss, because any capital loss will be considered as a failure which would leave a negative mark on their career development path. Not only is this because of a low tolerance of failure, but also because of the short-term oriented evaluation system. Unfortunately, these standards are set by top managers who do not have a real understanding of front line daily operations. As a result, in some cases (Firm B especially), firms are reluctant to send senior managers to overseas subsidiaries. Meanwhile, managers are unwilling to take on the responsibility of overseas operations because of the potential risk of a negative effect on their individual career development. This conservative character has significantly limited firms’ overseas expansion.

However, some top-tier managers have started to realise the negative effect of the traditional mindset on firms’ internationalisation. As top-tier managers have started to become more market-oriented and more aware of the real situation of overseas operations, there has been a chain reaction in the firm. First, top-tier managers have become more open-minded and understanding, and willing to give managers the opportunity and time to explore new markets. Second, overseas managers and employees are gradually receiving more effective and efficient support from the headquarters, thanks to top management team’s attention and understanding. This is because tasks which top-tier managers give more attention to are often given higher priority and accomplished more efficiently.
This study reveals that the managerial mindset has been playing the role of catalyst in the process of utilising dynamic capabilities to achieve overseas success. If managers do not have the positive and collective attitude towards resource allocation, the resources acquired externally, and coordination and integration, the contribution of these dynamic capabilities to overseas success will be weakened. Hence, the following proposition is put forward.

**P4: The managerial mindset concerning dynamic capability development and application influences the extent to which those factors contribute to overseas success.**

Complicated institutional environments in host countries, especially some developing countries and emerging economies, has posed a serious challenge to Chinese SOEs because the issues need to be addressed and solved by investing a great amount of resources. However, this negative impact can be reduced by the positive political relationship between China and the host country.

The formal institutions in some host countries, especially some developing countries and emerging economies, can be lack of transparency, consistency and stability. Poorly established and executed legal and regulative systems add to the insecurity and uncertainties accompanying OFDI projects. In some extreme situations, the host government’s attitude towards Chinese investors can take a U-turn after the change of regime. As a result of such complicated institutional environments, Chinese SOEs have had many difficulties in establishing market positions in these host countries, and become more cautious about investments under such conditions. In comparison, investments in developed countries with well-established institutions are much easier to operate. Firms A and B, who have invested in both developed countries and developing countries, have a strong sense of the difference of the institutional environments. The more transparent and stable institutional environments in developed countries create more favourable investment conditions.
The informal institutions in host countries, local culture and customs, have also caused trouble as Chinese SOEs settle into local markets. The dissimilarities between host country culture and Chinese culture lead to low efficiency in the early stages of the overseas subsidiaries’ operations, and time loss in building market position. The mismatch of culture also requires Chinese SOEs to commit more resources to acquire knowledge about local markets in order to overcome the difficulties caused by such unfamiliarity.

However, the negative effect of the host country institutional environment can be balanced by a positive political relationship between China and host countries, which can lead to a positive attitude of the local government towards Chinese investors. This is especially important in developing countries and emerging economies. Local government support can give Chinese SOEs certain advantages in the complicated unfamiliar institutional environment.

**P5a:** The complicated host country institutional environment increases the difficulty of firms achieving success in local markets.

**P5b:** A positive political relationship between a host country and home country creates a more favourable institutional environment for firms to achieve better performance.

Chinese SOEs cannot avoid the influence of the Chinese government and its agencies. All SOEs (central and provincial) are under the direct or indirect supervision of SASAC. Created as an extension of government departments, SOEs are normally the first group influenced by and responsive to domestic institutional changes. After thirty years of economic reforms, most existing SOEs are giant corporations holding monopoly positions in their own industries or sectors.

Because of this special relationship with the government and their important position in the national economy, SOEs are generously supported and subsidised by the government. The government in turn provides not only
supportive policies, but direct financial support through the EIBC plus information via agencies, such overseas embassies and the SASAC. Thus SOEs are equipped with the resources needed for overseas expansion, and contribute to their post-internationalisation performance.

However, there is no free lunch in this world. SOEs are restrained by the regulations set by the SASAC. Many regulations set by the SASAC are out-of-date and not compatible with the contemporary business world. Sometimes, SOEs have to endure the low efficiency caused by these regulations. Meanwhile, the SASAC also monitors the performance of SOEs. Once the financial performance of SOEs’ overseas investments slips into the red zone, SOEs are under huge pressure to justify their performance and turn the situation around in a short space of time. When the government becomes too interventionist, SOEs become very conservative, and are reluctant to take on any opportunity that bodes of uncertainties.

The home institutional environment formally and informally enforced by the Chinese government affects the norms and perceptions which influence managers’ decision making process. The profit and loss of Chinese SOEs is not only interpreted in business terms, but has a significant potential influence on managers’ future political career development. As a result, the managerial mindset may follow the changes of the government’s attitude towards international investments.

**P6a:** Home country government support is helpful in achieving overseas success. However, too much intervention leads to firms being cautious about international resource commitment.

**P6b:** Home country institutions have a significant impact on managerial mindset, which has a mediating effect on the influence of dynamic capabilities on post-internationalisation performance.

Based on these findings, the conceptual framework proposed in Section 6.5 has been updated in Figure 7.2.
Figure 7.2 The Conceptual Framework of Factors Influencing Post-Internationalisation Performance

- Home Country Institutional environment
- Managerial Mindset
- Dynamic Capability
  - Resource allocation
  - External sourcing
  - Coordination/Integration
- Performance:
  - Overall effectiveness and efficiency
  - Knowledge acquisition
  - Position in the host country market
7.5 Summary

To answer the key question ‘how do dynamic capability and the institutions influence Chinese SOEs’ post internationalisation performance?’, this study has systematically investigated the effect of resource allocation, external sourcing, coordination and integration, managerial mindset and the home and host institutional environments on the performance of SOEs’ overseas subsidiaries, in terms of their knowledge acquisition and market position.

When Chinese SOEs enter unfamiliar foreign markets, it is essential that they are able to support overseas subsidiaries by identifying the resource needs and satisfying these needs promptly through internal resource allocation or external sourcing in order to settle in the local markets. The resources needed for overseas subsidiaries’ success include finance, human capital and time. Meanwhile, coordination among different departments within the firm, and the integration of overseas subsidiaries at multiple levels, are also important for firms to succeed in overseas markets. However, the extent to which dynamic capabilities determine overseas success is influenced by managerial mindset towards them.

In terms of the influence of the institutional environment on Chinese SOEs’ post-internationalisation performance, the study finds that the complicated unfamiliar host country institutional environment has a negative impact on overseas subsidiaries’ development. But a positive relationship between the host and home countries will help Chinese SOEs settle in the local market. This study also reveals that it is not a linear relationship between the Chinese government’s consideration of overseas investment and the international success of SOEs. The government’s support to SOE overseas investments, especially in the early stages, has a positive impact on SOEs’ overseas performance. However, too much interference from the government significantly restrains SOEs’ freedom to be entrepreneurial. Furthermore, home country institutions also influence the performance indirectly through the managerial mindset.
Chapter 8  Conclusion

8.1 Introduction

This chapter concludes the findings of this thesis, acknowledges its limitations, and proposes possible future research. In order to accomplish these tasks, the author will provide arguments that can elicit various macro and micro elements, which form an in-depth picture of this empirical study. The discussion in this chapter starts in Section 8.2 by reviewing the conclusions, which will be compared with the objectives laid in the introduction chapter. Section 8.3 presents the major contributions of this study. Section 8.4 considers the limitations while Section 8.5 provides a summary of the implications of its main findings.

8.2 Main Findings

Chinese OFDI has recently become a striking phenomenon. This study has investigated the internationalisation of Chinese firms by studying the determinants of Chinese OFDI at the country level, and the factors influencing Chinese firms’ post-internationalisation performance at the firm level. In doing so, three research objectives (see Chapter 1) have been proposed to examine this phenomenon.

To investigate the first objective of this research which examines the trends of Chinese OFDI over time and explores whether any pattern exists, the author firstly conducted a comprehensive review of the literature on the IDP framework, one of the most widely applied frameworks explaining a country’s FDI position, and its empirical applications. It has indicated that previous empirical studies of the domestic determinants of a country’s OFDI have mainly focused on economic factors, such as economic development, market openness and trade. Although the rationale behind these studies and the profound interpretations of the variables determining a country’s OFDI are rather synonymous (i.e. the economic factors contribute to a country’s OFDI
activities), the explanatory power of previous established factors is still limited. This indicates that some key factors have previously been overlooked.

Earlier studies have found that several economic factors (i.e. economic development, inward FDI, trade) affected generic OFDI activities, and demonstrated a linkage between macro activities and OFDI patterns across different countries. This extensive review of empirical studies concerning the domestic determinants of a country’s OFDI has revealed a research gap, namely that the majority of studies have focused on economic factors, and neglected the potential impact of human mobility on OFDI activities under globalisation. More critically, it appears that a number of these empirical studies have employed a research strategy and research techniques that cannot elicit substantive confirmation of the measurement reliability, construct validity and the hypothesis-testing results, which may be due to issues, such as the sample size, location, time frame, appropriate econometric methods. As a result, the first research objective of this thesis is to extend previous empirical findings to the largest emerging economy, China, and enrich them by investigating the relationship between Chinese OFDI and human mobility, and by employing a rigorous research method in order to increase the reliability and validity of the results.

Based on a critical review of the literature, a judgment has been made to adopt the most widely used research strategy to explore the relationship between macro-level factors and China’s OFDI. To improve the rigour of the results, the author conducted a series of econometric tests, including the unit root test, cointegration test and system exogeneity test, using time-series data. Appropriate estimation method, the GMM model, was chosen because of the existence of system endogeneity.

The results from the econometric analysis are largely consistent with previous empirical findings. Chinese OFDI has been linked with several economic factors which were identified in previous empirical studies, such as economic development and trade. Chinese OFDI is strongly driven by its economic development, and has a substitute relationship with export. Meanwhile, the
significant positive relation between Chinese OFDI and human mobility confirmed the author’s expectation that a country’s OFDI activities are positively motivated by its global networks. And, the significant relationship between OFDI and the domestic knowledge development and accumulation indicates that Chinese OFDI is also strategic-asset-driven. Therefore, Chinese OFDI has been adopted by Chinese firms as a way to exploit existing strategic assets.

Therefore, a conclusion could be reached that a comprehensive review of the literature, and an econometric analysis of the time-series data at the country level, have jointly delivered the results regarding the first research question.

In line with the second objective of this research, to examine the distribution of Chinese OFDI in OECD countries over time, in order to identify the locational determinants of Chinese OFDI in developed countries, the author has used the same research strategy, such as econometric analysis. The literature review in Chapter 3 reveals that empirical studies of the locational determinants of Chinese OFDI have found that several economic factors (i.e. market size, trade flows and cultural proximity) of the host countries affected the OFDI flows from China to these countries. However, similar research gaps have been discovered as those in the first part of the country level study of this thesis. The relationship between human mobility and OFDI has been overlooked, and the misapplication of econometric tools has reduced the reliability and validity of the empirical results, and consequently the interpretation and theoretical framework development. Meanwhile, although researchers have proposed that OFDI from emerging economies may be motivated by strategic asset exploration (rather than the strategic asset exploitation characteristic of OFDI from developed countries), little empirical evidence at the aggregate level has been found to support that claim.

A series of econometric tests, including the multicollinearity test, poolability test, system exogeneity test and heteroscedasticity test, were carried out in
order to determine the appropriate econometric model. As a result, a GMM estimator has been proved to be the most appropriate econometric tool to analyse the panel dataset of 13 countries over nine years.

The findings support the key hypothesis that the flows of Chinese OFDI to OECD countries are positively affected by human mobility between China and the host countries. The extensive local networks built by human mobility and the advanced knowledge possessed by these personnel have become major factors attracting Chinese OFDI. The ‘bridge’ role played by human mobility, especially that of highly skilled and well educated personnel, should be acknowledged. Meanwhile, by comparing to previous studies, the author has discovered a dynamic change of Chinese OFDI to OECD countries, namely that the motive has shifted from market-seeking to strategic asset-seeking in recent years. The positive significant relationship between Chinese OFDI flows and cultural distance between China and host countries further support the strategic asset-seeking motive. This is because Chinese firms invest in countries with further cultural distance to learn new routines and enjoy more innovative environments.

Therefore, a conclusion could be reached that a comprehensive review of the literature, and the econometric analysis of the panel data at the country level, have jointly delivered the results regarding the second objective of this research which focuses on the locational determinants of Chinese OFDI flows to OECD countries in recent years.

In line with the third objective of this research, to develop a conceptual model of factors impacting the post-internationalisation performance of Chinese firms from the viewpoints of dynamic capability and the institution-based view, with primary focus on Chinese SOEs, the author has developed a research model including both internal and external factors influencing firms’ post-internationalisation performance.

The case study analysis, which is based on interviews with the senior managers of four Chinese SOEs, leads to several important findings. By
carefully investigating the four cases, the author recognises the importance of firms’ capabilities to respond to the changing external environment in their overseas success. It is essential that they are able to support overseas subsidiaries by allocating existing resources, externally sourcing necessary resources, coordinating the process and integrating overseas subsidiaries at multiple levels. Meanwhile, the application process of these dynamic capabilities is heavily influenced by the managerial mindset of the top management team. Managers’ attitude towards certain strategies can become the underlying ‘rules’ which promote or restrain the execution of the strategy.

By studying the influence of internal dynamic capabilities within the external institutional environment, the author emphasises that, in such a changing and turbulent world, firms should not and cannot overlook the influence of the institutional environments of both home and host countries. Home country government support is a favourable boost to firms’ overseas performance. However, too much intervention from the government can significantly restrain firms’ overseas development. In the case of host country institutional environments, a positive relationship between China and the host country can lead to a favourable government attitude towards Chinese investors, which can create a platform for easing their settlement into the local markets. However, the unfamiliar institutional environment of the host countries, especially in some developing countries and emerging economies, will impede the success of Chinese SOEs.

Therefore, a judgement can be given as follows: the case study strategy is appropriate to examine the third research objective of this thesis, by not only presenting rich information about the factors influencing the post-internationalisation of Chinese SOEs based on the theoretical framework, but also proposing a series of propositions for future research.
8.3 Major Contributions

In this thesis, the author has systematically examined the determinants of Chinese OFDI at the country level, and has taken a first step in exploring the factors influencing Chinese firms’ post-internationalisation performance at the firm level. This represents an important extension of previous studies. Both parts of the thesis help to contribute to a good understanding of OFDI activities from emerging economies, and the main findings help to provide new insights into issues related to the internationalisation of Chinese firms. The main contributions are specified below.

8.3.1 Country Level Study

The findings of this study at the country level confirm that a country’s OFDI activities are largely driven by the country’s domestic macroeconomic factors, and the distribution of a country’s OFDI has a linkage with host country macroeconomic factors. The major theoretical contribution of the first part of this thesis is the linkage discovered between OFDI activity and human mobility, which has not been discussed in previous studies, especially those based on the OFDI activity of developed countries. This finding provides new insights into the OFDI activity of emerging economies, which has become a striking phenomenon for both practitioners and academia. Traditional theories which have been used to explain the motives of OFDI need to be augmented in order to explain the OFDI activities of emerging economies. Network theory is an especially important perspective which needs to be incorporated concerning the OFDI activities of emerging economies. In this era of globalisation, people are more freely to travel than ever. Networks created in this human mobility can be linked to the networks of their home countries. Extended global networks will help firms from home countries to gather information, acquire knowledge and accelerate their internationalisation.

In addition, this study discloses some dynamic changes in the distribution pattern of Chinese OFDI compared to previous research. The analysis based
on the most up-to-date macroeconomic data draws the conclusion that the motive of Chinese OFDI in OECD countries has shifted from market-seeking to strategic asset-seeking. This finding provides evidence to support the strategic asset exploration assertion concerning the OFDI of emerging economies.

More technically, the econometric procedures applied to both time-series data analysis and panel data analysis are the most appropriate ones given the existence of certain characteristics, such as endogeneity and heteroscedasticity, which is often the case with time-series and panel measurements. The appropriate econometric procedures improve the validity and reliability of the results. This contrasts with previous research, whose reliability was questionable because of the application of inappropriate econometric models.

8.3.2 Firm Level Study

To the author’s best knowledge, this thesis is among the first to study the post-internationalisation performance of Chinese firms, especially Chinese SOEs that contributed 70 percent of Chinese OFDI stock by the end of 2008 (MOC, 2009a). This high percentage emphasises the important role which Chinese SOEs play in Chinese OFDI. Therefore, it is of the most interest to investigate the factors which can lead to Chinese SOEs’ overseas success.

This study combines the resource-based view, dynamic capability and the institution-based view to comprehensively explore both internal and external factors affecting firms’ overseas success. The previous research on factors impacting firms’ post-internationalisation performance is rather fragmented, using partial and incomplete theoretical lenses. This study contributes to the knowledge of firms’ overseas performance by analysing their internal dynamic capabilities within the context of the external institutional environment.

The cross-case analysis reveals that firms from emerging economies should carefully consider the alignment of firms’ own capabilities and the institutional
environments of both home and host countries. Dynamic capabilities, which firms possess in order to deal with the changing environments when entering foreign markets, are a necessary condition, but not sufficient condition for overseas success. The institutional environments of both home and host countries should be carefully examined and taken into consideration in overseas operations. By analysing both internal and external factors, this study presents a fuller picture of factors leading to overseas success.

Another contribution of this study is that, based on the propositions drawn on the primary data collection, a series of hypotheses regarding potential influential factors can be developed. This is particularly valuable for future empirical research to test the statistical relationships in this field.

8.4 Limitations

The limitations of the study should be acknowledged, considering the validity, reliability and generalisability issues. Although the author has given utmost attention to ensuring that the research procedure is scientific and systematic, there are still a series of limitations embedded in this study concerning theoretical modelling and methodological strategy.

8.4.1 Limitations of Theoretical Modelling

For the first part of this study, the research objectives were to apply relevant theoretical frameworks to explain the domestic determinants of Chinese OFDI and locational distribution of Chinese OFDI to OECD countries. This study aims to extend previous empirical studies by incorporating new variables into empirical tests. Although traditional FDI theories, such as the IDP framework and the eclectic paradigm, can provide a basic foundation for this study, the variables included in the models are still fragmented. Even though this study has integrated the traditional FDI theories, network theory, knowledge-based view and the cultural perspective, there is still a lack of pure theoretical explanations for the variations of Chinese OFDI over time.
The conceptual framework at the firm level deals with the post-
internationalisation performance, which is influenced by both the internal
dynamic capabilities and the external institutional environments. However,
even though the framework aims to integrate ideas from different theoretical
frameworks, such as the resource-based view, dynamic capability and the
institution-based view, it still suffers from the problems of either overlapping
certain theoretical lenses or neglecting some relevant conceptual aspects. For
instance, the model only concerns the internal dynamic capabilities which are
needed when responding to a changing environment, but misses the physical
resources needed, such as financial capital, materials and human resources.
Moreover, the external environment factors discussed in this study only
concern the institutional ones, but neglect others, such as market conditions
and consumer behaviours. Therefore, future research is needed to improve
the conceptual framework by investigating the factors leading to overseas
success from different perspectives.

8.4.2 Limitations of Methodological Grounds

Discussion in this section focuses on the limitations of the research strategy,
variable measurement, data collection and case study analysis employed in
this study. This thesis has presented two levels of studies, employing
empirical tests as well as in-depth multiple-case analysis research methods,
bearing the risks of limitations due to the availability of data, time and funding
issues.

The choice of a suitable methodology for this study is based on the evaluation
of the nature of each research question. The first two research questions of
the country level study aim to examine the pattern of Chinese OFDI and the
relationship between Chinese OFDI and a series of influential factors, both
domestic and locational determinants. Therefore, a quantitative research
method has been chosen in order to provide a statistical exploration of the
research questions and empirical evidence. As a result, this part of the
research is based on secondary data collected from various databases and
national statistic yearbooks. However, information contained in secondary
data is limited, which constrains the researcher to investigate macro factors in more detail. Proxies used to measure the variables have been carefully chosen in order to reduce the potential problem. However, the proxies employed in this study are subject to limitations, mainly due to the availability of the data. There are mainly two factors that limited the size of the dataset tested in this study: first, the time frame of the dependent variable, Chinese OFDI; second, the data availability of some independent variables.

After the Chinese government adopted the ‘Reform and Open’ policy and determined to gradually change the economy from planned to market-oriented in 1978, Chinese firms started their challenging internationalisation process. Therefore, the earliest recorded aggregate Chinese OFDI data is available from 1979. Since the time-series is relatively short, the time frame of the dataset is restrained and the number of the variables that can be tested is limited.

The availability of the independent variables also adds to the limitations of this study. For instance, when testing the locational determinants of Chinese OFDI in OECD countries, the time period covered by this study is limited due to the availability of human mobility data. In order to preserve the special characteristics of human mobility in this era of globalisation, the human mobility variable is measured by the international students from China to each OECD countries. However, these data are only available for a time frame of nine years, and these cover only one-way human mobility flows from China to OECD countries. Therefore, even though a panel data analysis is adopted to answer research question Q2 in order to increase informative data, variability, degrees of freedom and efficiency (Hsiao, 2003), this particular panel dataset especially lacks a large number of observations and a wide time frame. This constrains the number of variables tested.

The primary data collection, based on the choice of the qualitative research method for the third research question, has some limitations too. This study chooses to conduct an in-depth multiple-case analysis by interviewing the top managers in the selected case firms. The selected case firms cover different
industries but possess similar characteristics, such as their leader position in their own industry, the size, the scale of internationalisation. In order to increase the comparability among the cases, the scope of this study is limited to focus on Chinese SOEs, which leads to concerns of the generalisability of the results, especially when applying the findings to the private sector.

Meanwhile, the data collection process also has its own limitations. Due to delicate circumstances, limited questions were permitted in the interviews. Interviewees were hesitant about releasing information about certain delicate areas, such as corruption. Besides, the request to record the interviews was rejected by all interviewees. Although precautions (such as increasing the interview panel members and transcribing within 24 hours of the interviews) were taken to prevent information loss, it is likely that some information was not recorded.

8.5 Implications

This study has some important implications for managers, policymakers and researchers. The discussion will be divided into two sections. Implications for practitioners will be presented in Section 8.5.1. Section 8.5.2 notes the foundation built by this study for future research.

8.5.1 Implications for Policy-making and Managerial Practices

There are six implications for policy making and managerial practices which should be highlighted. First, according to the empirical results, two-way human mobility can significantly boost Chinese OFDI. Therefore, this could be a positive side of the so-called ‘brain drain’ concern of the Chinese government. The government should not worry too much about the human resources moving abroad. Instead, the government should think carefully about how to make the most out of this precious global intelligence network. If used wisely, this global network, especially formed by well-educated personnel, can help China to accelerate its internationalisation and global involvement.
Second, the evidence from the in-depth case study analysis shows that the Chinese government is playing an essential role in Chinese firms’ internationalisation, especially concerning SOEs. Chinese SOEs benefit from the government support in terms of regulations, information and finance. However, they are also restrained by the controls imposed by SASAC. This intervention from the central government significantly reduces the autonomy and efficiency which is fundamentally necessary for success in the global market. Therefore, how to provide firms with sufficient support without too much intervention is a critical task for policy makers.

Third, for host countries, or potential host countries, of Chinese OFDI, this study offers a few suggestions which need to be looked into. A good reputation for innovation and a favourable investment environment will certainly attract Chinese investors. The bilateral relationship and the host government’s attitude towards Chinese investors both play an important role in Chinese firms’ post-internationalisation performance. A good relationship between the host country government and the Chinese government can increase the confidence of Chinese firms to achieve success in local markets.

The implications for the managerial practices are mainly drawn from the firm level research of this study. There are three major implications for managerial practitioners. First, managers should never underestimate the influence of the institutional environment on firms’ performance. In China, the government can directly get involved in a firm’s operations, besides regulating the market and monitoring the economy. Especially for SOEs, the government is not only the regulator, but also the supervisor whom they are responsible to. Being able to operate effectively and efficiently under the bureaucratic intervention of the government is a difficult task which managers need to face. Managers also need to pay attention to the international political relationship between China and host countries, and the host countries’ attitude toward Chinese investment. These external institutional conditions are crucial factors which contribute to the formation of the investment environment.
Second, Chinese firms need to develop their dynamic capabilities before engaging in internationalisation in order to respond to the changing environment effectively and efficiently. As latecomers in the global competition, Chinese SOEs do not have the necessary capabilities needed for successful internationalisation. All four cases reflected on their internationalisation history and summarised it as ‘learning it by doing it’. However, this ‘trial and error’ process can be troublesome and costly. It will be much more beneficial for Chinese firms to fully prepare themselves by developing the dynamic capabilities needed for successful international operation.

Third, Chinese SOEs need to transfer themselves from power-oriented to market-oriented. Chinese SOEs, which are directly under the supervision of the central and provincial governments, have inherited many characteristics of a governmental bureau rather than modern enterprises. SOEs need to be more entrepreneurial, rather than serving as a route for managers to climb up the political ladder. Managers should prioritise their firms’ success, rather than taking precautions to protect their own backs, when they need to take certain risks in order to promote the firm’s development.

8.5.2 Implications for Future Research

This study aims to answer three main research questions by applying different research strategies. Although the three research questions are quite integrated within this thesis, they also stand alone. Therefore, it makes more sense to discuss the theoretical and methodological implications for future research by looking into each individual research question.

The results of Chapter 4 strongly support the attempt to augment the IDP framework with network theory and the knowledge-based view. The results suggest that new theoretical accommodation should be made for emerging economies, though more tests on other emerging economies may be needed to provide more evidence to enhance the generalisability of the conclusion. This study suggests that a new theory is needed for emerging economies, or at least, new variables specific to these economies are needed in order to
explain the OFDI wave from these economies. Furthermore, the investment development path of a country needs to be examined over time. As the time-series extends, more variables, such as institutional variables and more economic variables, can be added to the model in order to increase its explanatory power.

The examination of the locational determinants of Chinese OFDI to OECD countries in Chapter 5 discloses some dynamic changes in the pattern over time. This result suggests that the locational determinants need to be tested over time, as emerging economies’ locational determinants may shift in order to satisfy their particular needs. Meanwhile, more independent variables could be added, such as institutional variables and financial variables.

For research into post-internationalisation performance at firm level, much also needs to be done in the future. This study calls for a synthesis of a multifaceted theoretical framework, by integrating the fields of strategy, economics, finance, marketing and human resource management. It has endeavoured to provide an integrated perspective by combining the dynamic capability and the institution-based view. However, it is not sufficient to present a sophisticated conceptual framework because this study focuses only on internal dynamic capabilities and external formal institutional environments. Future research may investigate factors influencing post-internationalisation performance through different theoretical lens in order to provide more insights in this field. Besides developing a more comprehensive theoretical framework, it may be of greater interest to conduct research on private firms in order to compare and contrast. Moreover, quantitative research can add value to the field by analysing a large sample size in order to increase the generalisability of the findings.

8.6 Conclusion

Chinese OFDI activity is still in its infant stage, even though this has speeded up due to the government promotion and the fast economic development in recent years. In this era of globalisation, China, the largest emerging economy
and the second largest economy in the world, will certainly get more involved in the global economic development. Chinese OFDI has been considered as a special approach for Chinese firms to compete in the global market and seeking scarce strategic assets to consolidate their position in the fierce competition.

This thesis first investigates the determinants of Chinese OFDI at the aggregate level. The findings indicate the importance of domestic economic development, human mobility and knowledge development and accumulation in driving Chinese firms investing abroad, and the trend that Chinese firms started to replace exports by OFDI. Meanwhile, it is also discovered in the country level study that Chinese firms invest in more developed countries because of international human mobility, strategic asset development of the host countries, cultural distance and FDI flow from host countries to China. The results were drawn from the GMM model applied to the up-to-date macroeconomic data.

Following the country level study, this thesis continued to explore the factors influencing Chinese firms’ post-internationalisation performance from the combined perspective of dynamic capability and the institution-based view. Based on the primary data collected through two rounds of interviews with four SOEs, the findings emphasise the importance of firms’ capabilities to adapt to the changing environment and the interference of the external institutional environments of both host and home countries in achieving overseas success.

Although there are some limitations and much more could be done in future research, this study provides some new insights into the determinants of OFDI from an emerging economy, China, and gives an initial glimpse into the factors influencing the post-internationalisation performance of Chinese firms.
Reference


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Appendix I: List of OECD Countries

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<th>Australia</th>
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Note: Countries in bold and italic are included in the panel dataset.
Appendix II: Statistical Package

The time series data is tested using the EView 5 package.

The panel data is tested using the STATA 10 package.
Appendix III: Description of Cases

1. Case 1

1.1. Firm A

Firm A is a large professional white goods manufacturing SOE. From its humble origin as a local radio factory founded in 1969, Firm A has emerged as the market leader in many facets of China’s white goods manufacturing industry. Firm A has a major footing in various industries and sectors, including household appliance, telecommunication, information, real estate, and commercial industry, with white goods manufacturing as its core business.

The sales revenue in 2007 increased to US$ 6.7 billion (RMB 46.9 billion), ranking Firm A among the top 10 white goods manufacturers in China. It is the only domestic company owning three famous Chinese brands. In 2001, Firm A was granted the first “National Quality Management Award”. All Firm A’s products, including TV, air-conditioner, computer and mobile phone, are well-known in China thanks to the high quality and relatively low price. Firm A’s TV, air-conditioner and refrigerator are commodities exempt from inspection due to the high quality level recognized by the Chinese government. Moreover, Firm A’s TV product is the first to achieve this privilege.

Firm A is one of the first group innovative business pilots promoted by a national innovative program. It owns a state-level R&D centre, a post-doctoral research workstation, a state 863 project industrialisation base, a state torch plan software base and a state-class digital multimedia technology laboratory.

1.2. Interviewee A

Born in 1971, Interviewee A graduated from University of Electronic Science and Technology of China and joined Firm A ever since. He later achieved MBA degree (part-time) from China Europe International Business School. He has been the secretary of the board ever since he joined Firm A. He has been
in charge of international investment of Firm A for many years. He has organized or participated in nearly all international investment projects of Firm A. As a supporter of practice, he believes that firms need to get hands dirty rather than just talking about the ideas. He pays utmost attention to review and research in international investment projects, and has deep understanding of the aim and execution of international strategy.

2. Case 2

2.1. Firm B

Firm B is a giant state-owned telecommunication service operator reformed according to China's telecommunication industry reformation scheme. As the principal telecommunication enterprise of China, Firm B owns the largest fixed-line telephone network in the world that covers both urban and rural areas of China and connects many countries and regions all over the world. Firm B has 31 domestic subsidiaries which provide telecommunication services nationwide. Firm B owns one of the three 3G licence authorised by the Chinese government.

Managed by the central government of China, Firm B is an experimental state holding corporation in which investments are subject to the approval by the State Council. With a registered capital of 158 billion RMB, Firm B's main businesses currently include:

- operating domestic and international fixed-line telecommunication networks;
- providing telecommunication network-based voice, data, image, multimedia and information services;
- carrying out account settlements for international telecommunication services and developing overseas markets;
- providing services related to telecommunication and information businesses such as system integration, technology development,
technical service/advice, information service consultation, advertisement and publishing;

- importing and exporting telecommunication equipment;
- designing and implementing telecommunication service projects;
- operating other services which are required by the market development provided that provision of such services would have been authorized or permitted by the government of the country.

2.2. *Interviewee B*

Born in 1972, Interviewee B graduated from Beijing University of Posts and Telecommunications. He worked in the Ministry of Posts and Telegraphs until the reformation of the ministry and telecommunication industry. He was resigned to Firm B and joined the construction and domestic investment department. In 2005, he was resigned to the new international investment department.

He took part in Firm B’s internationalisation process and visited more than ten emerging markets. He has good knowledge about the development of the world CDMA and GSM operators, and has accumulated abundant experience about international investments in telecommunication service sector.

3. **Case 3**

3.1. *Firm C*

Firm C was founded in 1959. Until 1993, Firm C functioned internally as government agency to organise and manage all Chinese foreign aided projects, and externally as a general contractor. With more than 1400 large and medium-sized projects organised and accomplished in developing countries in Asia, Africa and Latin America, Firm C had made significant contribution in establishing friendly and cooperative bilateral ties between China and those developing countries, and received high praise from recipient nations and their people.
In 1993, Firm C was reorganized into a foreign trade enterprise with independent accounting. From then on, Firm C started to hold sole responsibility for its profits and loss on a self-operation basis. Now, as one of the SOEs under direct supervision the SASAC, Firm C is moving steadily into a creative and competitive multinational corporation with increasing quality of capital and advanced management, by combining its traditional advantages with its developing strategy, controlling risks, standardizing its operation and deepening its reformation.

3.2. Interviewee C

Interviewee C was born in 1973 and graduated from University of International Business and Economics. He also obtained a MBA degree (part-time) from the same university. He joined Firm C as a fresh graduate and started his career in trading department. He got involved in Firm C’s international investments in 2003 and became the head of the Uganda subsidiary.

He has worked in Uganda for a long period of time and visited many African countries. He has thorough understanding of African market and Chinese firms in this market, and very deep knowledge about the difficulties of SOEs’ international expansion.

4. Case 4

4.1. Firm D

Firm D is the largest construction enterprise nationwide. Firm D has business relationships with many famous companies in 35 countries over the world. Firm D has now four basic business lines: engineering, designing, consultancy and network communication plus import & export as ancillary services.

Firm D has over 5500 employee; more than 4,200 are engineering staff and specialized management personnel. The firm has high management quality, powerful technological capability and advanced equipment. The revenue of
international business contributed 20% of the firm’s total revenue in 2007. The firm planned to increase this proportion up to 50% in 2008.

4.2. Interviewee D

Interviewee D was born in 1971. He has a similar experience as Interviewee B. After graduating from Beijing University of Posts and Telecommunications, he joined the Ministry of Posts and Telegraphs. During the reformation of the ministry and the telecommunication industry, he was resigned to Firm D. Later in his career, he was sponsored by the firm to obtain his MBA (part-time) degree from Beijing University of Posts and Telecommunications. He was given the task to build the international department of Firm D and became the first director of the new department.

He takes responsibility of exploration and expansion of Firm D’s international business and provides operational support to overseas subsidiaries. He spends half of his time doing research, investigation and inspection overseas every year.
Appendix IV: Interview Guideline (Chinese)

March 2008

Section One: 海外投资情况

1. 贵公司是从哪一年开始海外投资的？
2. 目前，贵公司在哪些国家有投资？
3. 目前海外投资运营状况如何？对此状况是否满意？

Section Two: 资源投入

4. 贵公司对海外分公司有哪些资源上的支持？（资本，人力资源，时间）
   a. 贵公司在资本投入上对海外分公司有哪些支持？
   b. 贵公司会派高级经理前往海外公司吗？为什么？
   c. 贵公司对海外公司的盈利有时间要求吗？
5. 贵公司在开始海外投资时是否拥有了支持海外投资的所有资源？对于公司内部无法提供的资源，贵公司是通过何种渠道获得的？
6. 贵公司是怎样协调各部门对海外分公司的资源支持的？
7. 领导态度对公司对海外分公司的资源支持有什么样的影响？

Section Three: 海外运营

8. 贵公司如何获得关于海外市场的信息？
9. 海外公司的运营遇到过哪些困难？
10. 这些问题是怎样解决的？
11. 海外分公司在当地是否遇到了文化冲击？
12. 贵公司是如何解决这些冲突的？
13. 贵公司的海外投资有哪些经验教训？
14. 这些经验教训对后来的海外投资有什么样的影响？
Section Four: 政府影响

15. 国家对企业海外投资有怎样的支持？
16. 国家对国企的监控对企业的海外投资和运营有怎样的影响？
17. 当地政府对贵公司在当地的投资有怎样的影响？

- January 2009

  ○ 金融危机对企业的现有海外投资经营状况有怎样的影响？
  ○ 金融危机对企业的海外投资战略有怎样的影响？
  ○ 在这个非常时刻，贵公司对海外分公司有什么支持吗？
  ○ 贵公司是否会趁此时机进行海外扩张？
  ○ 金融危机对公司高层对海外投资的看法有何影响？
  ○ 国家在金融危机后对国企对外投资的态度有什么改变？
  ○ 这种改变对贵公司的海外投资有什么影响？
Appendix V: Interview Guideline (English)

- March 2008

Section One: Overseas Investments

1. When did the firm start to invest abroad?
2. How many countries do the firm invest in? What are they?
3. How are overseas subsidiaries performing, in terms of knowledge acquisition, settlement in local markets and overall effectiveness and efficiency? Is the firm satisfied with the performance?

Section Two: Resource commitment

4. How does the headquarters support overseas subsidiaries?
   a. How does the headquarters financially support overseas subsidiaries?
   b. Will the headquarters assign senior managers to overseas subsidiaries? Why?
   c. Does the headquarters require the overseas subsidiary to become profitable within a certain time frame?
5. Did the firm have all the necessary resources for overseas investment at the beginning of internationalisation? How did the firm acquire the external resources needed for internationalisation?
6. How did the firm coordinate different departments to support the overseas subsidiaries?
7. Does the top managers’ attitude towards resource support for overseas subsidiaries influence the actual process? How?

Section Three: Overseas Operation

8. How do the firm acquire information about overseas markets?
9. What difficulties did the firm encounter in overseas operation?
10. How were the difficulties resolved?
11. Did the overseas subsidiaries encounter any culture conflicts in local markets?
12. How were these conflicts dealt with?
13. Have the firm learnt any lessons from past overseas investments? What are they?
14. How did these lessons influence later overseas investments?

Section Four: Institution Influence

15. Does the Chinese government provide any support towards SOEs’ internationalisation? What are they?
16. How does the supervision from the SASAC influence the firm’s overseas investment and operation?
17. What role does the host country government play in the firm’s investment in this country? How does it influence the local operation?

• January 2009

  o What influence did the financial crisis have on the firm’s overseas investments?
  o How did the financial crisis influence the firm’s internationalisation strategy?
  o At this difficult time, what support does the headquarters provide to overseas subsidiaries?
  o Will the firm take this opportunity to expand overseas?
  o How does the financial crisis influence the top managers’ mindset towards internationalisation?
  o How did the government react to the financial crisis, in terms of its attitude towards SOEs’ internationalisation? How does this influence the firm’s overseas investment?