

# China's outward foreign direct investment: Location choice and firm ownership

Bala Ramasamy<sup>a,\*</sup>, Matthew Yeung<sup>b</sup>, Sylvie Laforet<sup>c</sup>

<sup>a</sup> China Europe International Business School, 699 Hong Feng Road, Pudong, Shanghai, PR China

<sup>b</sup> Lee Shau Kee School of Business and Administration, Open University of Hong Kong, 30 Good Shepherd Street, Homantin, Kowloon, SAR, Hong Kong

<sup>c</sup> University of Sheffield, Management School, 9 Mappin Street, Sheffield S1 4DT, United Kingdom

## ARTICLE INFO

### Keywords:

China  
Chinese firms  
Outward FDI  
Firm ownership  
Locational determinants

## ABSTRACT

This article evaluates the international location decisions made by public listed Chinese firms during the period 2006–2008, using a Poisson count data regression model. Further, we categorize the firms into state-controlled and privately owned according to majority ownership. We find that the determinants of internationalization differ based on ownership. State-controlled firms are attracted to countries with large sources of natural resources and risky political environments. Private firms are more market seekers. Although all firms have strategic intent, the attraction is commercially viable technology rather than core research content. Our findings also show that existing theories can sufficiently explain the actions of private Chinese firms, but adjustments are needed to understand the behavior of state-controlled multinationals.

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## 1. Introduction

Outward FDI from emerging economies has been considered to be one of the “big questions” in the 21st century International Business research agenda (Mathews, 2006). Two reasons motivate this agenda. First, FDI outflow from developing countries (e.g. China, India, and Malaysia) has increased dramatically in recent years. They accounted for 16% of global outward FDI in 2008, up 13% from 2007 (UNCTAD, 2009). Second, the ability of multinationals (MNCs) from the developing world to invest abroad seems to defy the fundamentals theories of internationalization (Child & Rodrigues, 2005). How could firms without obvious ownership advantages succeed to become among the world's largest firms in their respective industries? This predicament has mooted several researchers to develop new theories. At the very least an overhaul of existing theories is warranted (Buckley et al., 2007; Liu, Buck, & Shu, 2005; Mathews, 2006).

No emerging economy has received as much attention as China—whether by researchers or popular media. Three reasons explain the limelight that China gets. First, until recently, China has been known as a destination of global investment. However, since 2003, investment abroad by Chinese firms has increased substantially (see Fig. 1). In 2008, outward FDI from China surged to USD 52 billion, up 132% from 2007, making it the 13th largest source of

capital in the world and third among developing countries (UNCTAD, 2009). However, the size of China's OFDI has to be seen in perspective. Averaging the amount between 2006 and 2008, China's OFDI is a little more than a tenth of FDI from the US, about a fifth of the UK and Germany, and a little more than a half of Hong Kong. Despite the relatively small volume of investment, a great deal of publicity has been generated by the actions of Chinese companies, particularly through M&As of several high profile targets.<sup>1</sup>

Second, Chinese firms seem to be investing into countries that do not fit the standard profile of host locations. Since 1991, there have been some dramatic changes in the geographical distribution of China's OFDI. In the 1990s, Canada, the U.S. and Australia hosted about 40% of Chinese OFDI, but by 2005, the proportion had reduced to 10%. In contrast, developing countries, particularly in Asia and South America, accounted for nearly 90% in 2005. In 2008, Asia continues to dominate (mainly due to flows to Hong Kong) while countries in the African continent accounted for nearly 10% of investment flows (see Table 1). A cursory look at the top destinations of China's OFDI reveals a rather strange set. As shown in Table 2, OFDI tends to flow to tax havens like Cayman Islands, neighboring territories like Hong Kong as well as untypical destinations like Laos, Nigeria and Mali. Third, the change in the

\* Corresponding author.

E-mail addresses: [bramasamy@ceibs.edu](mailto:bramasamy@ceibs.edu) (B. Ramasamy), [myeung@uhk.edu.hk](mailto:myeung@uhk.edu.hk) (M. Yeung), [S.Laforet@sheffield.ac.uk](mailto:S.Laforet@sheffield.ac.uk) (S. Laforet).

<sup>1</sup> For instance, Lenovo's acquisition of IBM's PC operation in 2004, CNOOC's attempt to acquire Unocal in 2005 and more recently an unsuccessful attempt by Chinalco to increase its stake in Rio Tinto. In March 2010, Geely (a Zhejiang based car company) successfully signed a deal to acquire Volvo from Ford. For more high profile deals involving Chinese companies in 2009 see

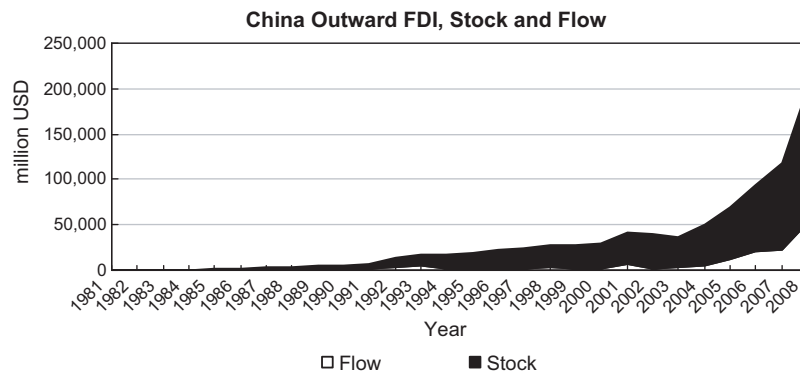


Fig. 1. China OFDI: stock and flow, 1981–2008. UNCTAD, FDI Statistics, [www.unctad.org](http://www.unctad.org).

industrial distribution of OFDI in recent years is also equally dramatic. Manufacturing accounted for nearly 60% of OFDI in the 1990s (Cheung & Qian, 2009), but had dropped to a mere 3% by 2008. Despite sensational media reports, the mining sector accounted for only about 10% of OFDI in 2008 (see Table 3). Sectors that seem to be gaining momentum are in the services sector, particularly business services, finance and retail.

The objective of this paper is to consider one aspect of China's OFDI, namely its locational determinants. Despite a few attempts by others (Buckley et al., 2007; Cheng & Ma, 2008; Cheung & Qian, 2009; Kolstad & Wiig, 2009) to consider this issue systematically, results are inconclusive. The scarcity of such studies is due to limited time series in Chinese OFDI on the one hand,<sup>2</sup> and the type of outflow data used on the other.<sup>3</sup> Perhaps it is for these reasons that other researchers have resorted to case based analysis to unravel the motivations behind the internationalization process of Chinese firms (Deng, 2007, 2009; Rui & Yip, 2008). In this paper, we attempt to merge these two aspects – where and why – of Chinese OFDI by using a unique dataset of listed Chinese companies. Our dataset, which comprises the location of individual firm's FDI, allows us to segment internationalizing Chinese firms into state-owned and private. Thus, the determinants of location decisions based on ownership can be examined. In addition, by utilizing count data, i.e. the number of investment projects in country *i*, we avoid the tax haven problem that has plagued other similar studies (Cheng & Ma, 2008; Kolstad & Wiig, 2009; Morck, Yeung, & Zhao, 2008). Our findings suggest that there is indeed a need to reconsider the existing theories of international location choice, particularly when OFDI of firms from developing country like China is brought into the equation. More specifically, we find that some determinants of location choice among state-owned Chinese firms are inconsistent with existing theories. Our results have a direct implication to host countries intending to attract greater Chinese FDI. Given the differences between state-owned and private firms, targeting the right type of firms based on their locational determinants becomes imperative.

## 2. Previous literature and hypotheses development

Previous research on China's OFDI can be divided into three types. The first type tends to be descriptive and provide some justifications as to the state of OFDI at different time periods (Cai, 1999; Hong & Sun, 2004). The second type provides more strategic emphasis and uses case studies of well-known Chinese firms to

explain the motivations behind the global outreach of Chinese firms (Deng, 2007, 2009; Rui & Yip, 2008). The third uses macro level data to unravel location choice and factors that push the Chinese firms to go abroad (Buckley et al., 2007; Cheng & Ma, 2008; Cheung & Qian, 2009). In this paper we attempt to merge the latter two types to show locational determinants using firm level decisions.

### 2.1. Motivations behind China's OFDI

Dunning's eclectic paradigm conveniently explained the motivations behind international investments of firms from developed countries as market, efficiency (or cost reduction) or resource (or strategic asset) seeking. In a much quoted study, Chakrabarti (2001) found that market seeking motivations (especially per capita GDP) seems to be the most robust while other variables are "highly sensitive to small alterations" (p. 108). However, a sound theoretical justification can still be used to explain the determinants of FDI. Now, whether the eclectic paradigm can still explain the motivations behind those firms from

Table 1  
China's OFDI—destination, 2003–2008.

| Year    | Destination of outward FDI flow (%) |               |        |        |               |         |
|---------|-------------------------------------|---------------|--------|--------|---------------|---------|
|         | Asia                                | Latin America | Europe | Africa | North America | Oceania |
| 2003    | 52.5                                | 36.5          | 5.3    | 2.6    | 2             | 1.1     |
| 2004    | 54.6                                | 32            | 3.1    | 5.8    | 2.3           | 2.2     |
| 2005    | 35.6                                | 52.6          | 4.2    | 3.3    | 2.6           | 1.7     |
| 2006    | 43.5                                | 48.0          | 3.4    | 2.9    | 1.5           | 0.7     |
| 2007    | 62.6                                | 18.5          | 5.8    | 5.9    | 4.3           | 2.9     |
| 2008    | 77.9                                | 6.6           | 1.6    | 9.8    | 0.6           | 3.5     |
| Average | 54.44                               | 32.37         | 3.90   | 5.06   | 2.21          | 2.02    |

Statistical Bulletin of China's Outward Foreign Direct Investment, 2008 accessed from <http://hzs2.mofcom.gov.cn/accessory/200909/1253869308655.pdf>.

Table 2  
Top ten China's OFDI location, 2000–2008.

| Country      | Year 2000 |           | Year 2006          |           | Year 2008         |      |
|--------------|-----------|-----------|--------------------|-----------|-------------------|------|
|              | Country   | % of OFDI | Country            | % of OFDI |                   |      |
| Hong Kong    | 55.1      |           | Cayman Islands     | 44.4      | Hong Kong         | 69.1 |
| Myanmar      | 3.3       |           | Hong Kong          | 39.3      | South Africa      | 8.6  |
| Australia    | 3.2       |           | Virgin Islands (E) | 3.1       | Virgin Island (E) | 3.8  |
| South Africa | 3.2       |           | Russia             | 2.6       | Australia         | 3.4  |
| Mali         | 2.9       |           | United States      | 1.1       | Singapore         | 2.8  |
| Lao PDR      | 2.4       |           | Singapore          | 0.7       | Cayman Island     | 2.7  |
| Canada       | 2.3       |           | Algeria            | 0.6       | Macao             | 1.2  |
| Brazil       | 2.1       |           | Australia          | 0.5       | United States     | 0.8  |
| Mexico       | 2.0       |           | Germany            | 0.4       | Russia            | 0.7  |
| Viet Nam     | 1.8       |           | Nigeria            | 0.4       | Germany           | 0.3  |

China Statistical Yearbook, various years; The Almanac of China's Foreign Trade and Economic Cooperation, 2000.

<sup>2</sup> China's OFDI data that is consistent with the OECD and IMF are only available from 2003 onwards (Cheung & Qian, 2009).

<sup>3</sup> Buckley et al. (2007) and Cheung and Qian (2009) use approved FDI outflow, while Cheng and Ma (2008) and Kolstad and Wiig (2009) use actual FDI flows.

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