



OFDI FROM CHINA: A DELIBERATELY MACRO RE-EVALUATION.

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OFDI FROM CHINA: A DELIBERATELY MACRO RE-EVALUATION.**Abstract**

The objective of this paper is to provide a critical overview of the recent phenomenon of outward foreign direct investment (OFDI) from China, from a more macro and historical perspective. It is argued that despite the explosion of academic interest the phenomenon was neither unpredicted nor sudden. The paper also argues that OFDI from China is not yet so important and neither presents insurmountable challenges to the established literature on FDI.

KEY WORDS: Business/government interaction and relations; Evaluation of current empirical approaches; Foreign direct investment; outward foreign direct investment, emerging markets, china, state owned enterprises

JEL: F23 MULTINATIONAL FIRMS • INTERNATIONAL BUSINESS,

1 INTRODUCTION

In a very influential paper on OFDI from China, Morck et al (2008) on pages 348-349 conclude that:

“Finally, international business research is cross-disciplinary in nature, and China’s outward FDI promises a cross-disciplinary research cornucopia. As our earlier discussion indicates, the structural transition in China mandates that any sensible economic analysis of firm strategies will have to take institutional, political, and social aspects into consideration. Given the visible hands of the Chinese State and the Party in the economy, any micro-level analysis will not be complete without a macro-level background. Exciting new insights are likely to be gleaned from this rich context.” (Emphasis added by the author of this paper).

This paper will build on that advise and will attempt to provide a more macro-oriented and historical perspective on OFDI from China, which should provide an appropriate background to any micro-oriented analysis¹.

The paper will predominantly rely on a critical assessment of secondary data without carrying out any empirical work. The reason for this deliberate choice is the paucity and possibly inaccuracy of some of the data. More importantly, as noted by Sutherland and Anderson (2015), the amount of OFDI directed to tax havens and offshore financial centres (THOFCs) may cloud the ultimate destination and true motive.

In their own words Sutherland and Anderson (2015) page 21:

“The use of THOFCs to incorporate offshore companies creates serious distortions to all Chinese outward FDI data [*in terms of volume, destination and industrial breakdown – comment added by author*], making it very difficult to track and properly understand Chinese MNE activity. This article therefore serves as a timely reminder to all those who use Chinese OFDI data to explore Chinese MNE activity that the data cannot always be taken at face value”

Moreover, at firm level the web of relationships with the state do not allow to distinguish very clearly the extent of “real OFDI” by private firms.

The paper has also taken a more historical perspective, but in the opinion of the author, there is a need for some historical insights to frame current and, indeed, future development, in a balanced long-term perspective.

An important issue that has attracted a lot of academic attention is whether extant theories of international business need re-writing (or extending) in light of the experience of OFDI from emerging markets in general, although some authors pointedly refer to the Chinese experience. Peng (2012) asserts that OFDI from China may lead to the re-writing of the theoretical foundations of FDI in particular for the institution-based view and the resource-based view, given the important contribution of the state and the weak O-ownership advantages of Chinese firms engaged in OFDI. Also Deng (2013) argues that research on the international expansion of Chinese MNCs offers a unique opportunity to extend and develop extant theorizing in four primary research streams such as the latecomer perspective, the role of the Chinese state and government influences in general, dynamics of firms and institutions, and

¹ Wei et al. (2014) argue that most of the literature on OFDI from China is effectively based on very few case studies (they count ten) and that not much attention is paid to the actual financial performance of these Chinese MNEs.

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3 liability of foreignness. Cuervo-Cazurra (2012) calls for an extension of established
4 international business theories to incorporate the phenomenon of Chinese OFDI. Buckley et al
5 (2007) state that China offers 'a particularly good test case for the general theory of FDI'. Child
6 & Rodrigues (2005) argue that Chinese internationalization presents unique features providing
7 opportunities to extend existing theories and potentially develop new theories on the
8 internationalization of firms and FDI. Also Wright et al (2005), Hoskisson et al (2013),
9 Jormanainen & Koveshnikov (2012) and Yamakawa et al (2013) wonder whether the extant
10 theories applied to mature and developed economies really suit firms originating from emerging
11 markets or whether emerging markets MNEs represent a novel species of firms, whose
12 internationalization requires the development of new theoretical approaches, or whether the
13 existing theories can, in their original form or with some ad-hoc extensions provide an
14 adequate explanation (and prediction) of the advent of MNEs from emerging markets.
15 Berning & Holtbrügge,(2012) state that 77% of the sample of articles on OFDI from China
16 included in their own survey of the literature believe theories need to be extended or
17 modified.
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20 The main arguments to support the challenge to existing theories presented by Chinese OFDI
21 rest predominantly, if sometimes implicitly, on three important claims:
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- 24 1. that the aggregate outflows of FDI from China were sudden and unpredicted and, as
25 the micro counterparty of this claim, that Chinese MNEs are suddenly and rapidly
26 internationalising (Mathews 2006, Bonaglia et al (2007) Tan and Mathews (2015) for
27 accelerated internationalisation) .
- 28 2. that these flows are behaving rather differently from previous outflows of OFDI in
29 particular in terms of the puzzle of weak, or lack of, firm specific advantages (what
30 Matthews (2006) describes it as the "puzzle" to be resolved. See also Peng (2012)).
- 31 3. that the Chinese state plays an important (hitherto under-appreciated and mostly
32 positive) institutional role, unique to China, and perceived as being a benign country-
33 specific advantage (CSA), which firms may use to enhance their own firm-specific
34 advantages (FSAs) (see for instance Peng (2012)).
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37 The initial contribution of the paper is to scrutinise the relevance and validity of the three
38 claims made in the literature.
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40 In light of the analysis of the claims, the paper will focus on the implications of Chinese
41 OFDI upon the extant state-of-the art theories explaining MNEs. The first task, however, is to
42 establish which theory (or theories) should be re-assessed as Deng (2013) on page 525
43 observes that one theory may not be sufficient to entirely capture complex and nuanced
44 phenomena such as OFDI.
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47 For instance, Jormanainen and Koveshnikov (2012) highlight the fact that there is a plurality
48 of paths of internationalisation for emerging markets multinationals. Berning & Holtbrügge
49 (2012) clearly state that traditional international theories are unsuitable for explaining
50 Chinese OFDI and specifically identify OLI, resource-based view, and the Uppsala
51 "incremental internationalisation process" theories. Cuervo-Cazurra (2012) instead focuses
52 on the product life cycle, OLI, internalisation, resource-based view, and Uppsala
53 "incremental internationalisation process".
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56 To put things in the right perspective, as a general comment, most "established theories" have
57 seen challenges to their validity and relevance also stemming from the experience of
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3 developed economies. No theory has not required adjustments or refinements. Typical
4 examples are the “incremental internationalisation process” that was developed in 1977 and
5 refined in the early 1990s (the so-called “Uppsala model” (Johanson and Vahlne (1977, 1990,
6 2009) or the OLI (Dunning et al (1996); (Dunning (2001))).
7

8
9 Ironically, despite the amount of concern about the advent of OFDI from China, true new
10 theoretical developments are, in fact, rather limited, both in number and in scope. Luo &
11 Zhang (2016) in their review of the literature on emerging markets MNEs observes that only
12 6% of the papers they review focus on either the springboard perspective suggested by Luo
13 and Tung (2007) or the linkage-leverage-learning (LLL) approach developed by Mathew
14 (2006). A paper by Si et al (2013) tries to use both the OLI and the LLL approach in
15 explaining the strategy of a Chinese MNE (Sany). The most widely cited attempt, the
16 linkage-leverage-learning (Mathew (2006) is based on the study of 100 emerging markets
17 multinationals (EMMNEs), none of which is actually Chinese (Lenovo is only mentioned as a
18 case study). The main mover for the LLL is the lack of strong FSA of putative multinationals.
19 Mathews therefore proceeds to establish an alternative approach of linkage-leverage-learning
20 (LLL). The linkage somehow happens between a MNE from an emerging market (via an
21 alliance or joint-venture) with an incumbent in the host market that possesses some superior
22 advantage. Leaving aside the fact that alliances and joint-ventures are not necessarily the
23 observed preferred mode of investment, however, it remains unclear why the superior
24 incumbent should actually be willing to participate in such a linkage. Then the resources of
25 the incumbent firm are leveraged, with the repetition of the linkage-leverage steps leading to
26 learning.
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30 Another theory is the “springboard” theory suggested by Luo and Tung (2007), although the
31 authors state very clearly that they did not really attempt at replacing any existing theory, in
32 particular the OLI. In fact, the springboard theory developed by Luo and Tung, in their own
33 very words, was not meant to imply that existing theories were incapable of explaining
34 emerging markets multinationals (EMMNEs). The gist of the theory is that EMNEs use
35 outward investment as a springboard to acquire strategic assets needed to compete more
36 effectively against global rivals and to avoid the institutional and market constraints they face
37 a home. An important admission is that these firms do actually “enjoy court advantage” in
38 their own home market and they can leverage core competences at home, casting some
39 doubts that Chinese firms *really* are in a disadvantageous position.
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42 Unlike Mathews (2006), who does not really elaborate on the reasons why incumbent firms
43 in developed markets should sell assets to Chinese firms, Luo and Tung are very explicit in
44 explaining why firms in developed countries are willing to sell: financial exigencies or
45 restructuring. This claim is backed by Meyer et al (2014) who on page 1022 and in footnote
46 11 list the names of various German companies in various degrees of financial distress that
47 have been taken over by Chinese firms, J. Contractor (2013) who mentions the acquisition of
48 the bankrupted company Grundig by the Turkish company Arcelick. Another motive for
49 selling assets could be privatisation as suggested by Child and Rodrigues 2005 (see for
50 instance Ma & Overbeek (2015) who focus on acquisition, by Chinese companies, of
51 privatised companies in Southern Europe) . A further motive could be identified in the
52 enormous literature on the diversification discount, which asserts that firms are being
53 penalised when they diversify, either internationally or in terms of industry. Doukas & Lang
54 (2003) and Doukas & Kan (2006) have published papers more specifically related to the
55 diversification discount applied to FDI and although the actual existence of a discount (and
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its size) is still a matter of fierce debate, the literature appears to have influenced the decision to divest by financial and non-financial MNEs located in developed countries.

Therefore, to recap, in this paper the above mentioned three claims made in the literature will be examined in great detail and they will be linked to existing theories of FDI, to ascertain whether (or to what extent) they must be challenged.

The structure of the paper is as follows. Section 2 will investigate the claim that OFDI from China has happened quickly and in a sudden manner and was not predicted. Section 3 will investigate the claim that OFDI outflows from China are behaving rather differently from previous outflows of OFDI from other developed countries. Finally, Section 4 will investigate the claim that the Chinese state plays an important (positive) role, unique to China, and perceived as being a benign country-specific advantage (CSA), which firms may use to enhance their own firm-specific advantages (FSAs). Section 5 will discuss the main conclusions and link them to existing theories of FDI.

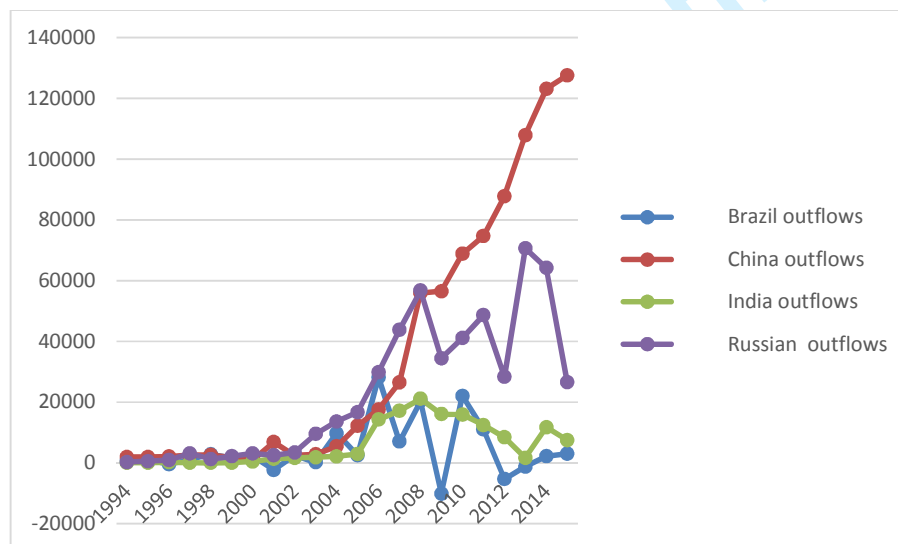
2. HAS OFDI FROM CHINA BEEN SUDDEN AND UNPREDICTED?

2.1 WERE OFDI FLOWS FROM CHINA TRULY SUDDEN?

This section will assess the claim that OFDI from China has grown quite rapidly and in a sudden manner. Figure 1, shows the scale of OFDI from China in comparison to Russia, Brazil and India, while Figure 2 shows the proportion of Chinese OFDI flows and stocks in the context of World's flows and stocks of OFDI. It is important to remind ourselves that all the outward FDI data include tax havens and offshore financial centres (THOFCs). Therefore, it could be argued that the real OFDI flows and stocks may be smaller (see Sutherland and Anderson (2015)).

Figure 1 Annual FDI outflows BRIC countries Millions US\$ (1994- 2015)

Source: UNCTAD

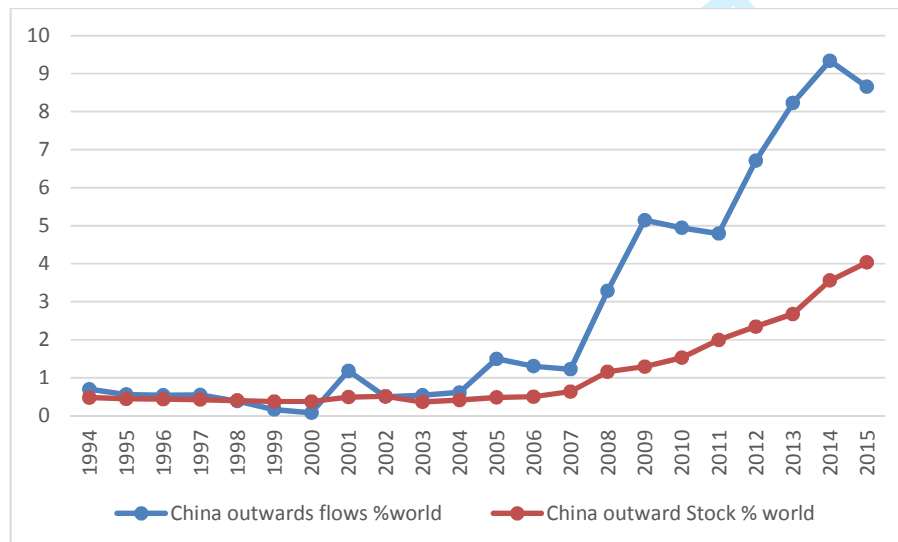


In Figure 1 it is apparent that OFDI flows from China have surpassed those of comparable economies such as Brazil, India and Russia only from 2007, which appears to have acted as an important watershed year. After 2007 OFDI from China and Russia appear to grow in

leaps and bounds, although outflows from Russia have become more volatile, while OFDI from India and in particular Brazil are falling. Kalotay and Sulstarova (2012) focus on Russia OFDI and note a high degree of round-tripping in inward FDI and note that an average of 60% of M&A are concentrated in the primary sector, of which 44% was represented by the three large oil and gas companies (Gazprom, Lukoil and BP-TNK). These two characteristics appear to be similar to China as it will be explained later. Moreover, typically most of the Russian OFDI is carried out by large firms, supported by strong competitive positions in their domestic markets, which tend to finance their overseas business operations through export revenues based in natural resources (oil and gas, mining, metallurgy etc.). On the other hand, Goldstein & Pusterla (2010) compare OFDI flows from Brazil to those from China and note a number of differences. Although OFDI from both countries have grown fast, most OFDI from China is due to SOEs. Moreover, China appears to be rather weak in the banking sector and not particularly at the cutting edge in the petroleum sector, but much better in Information and Computing Technology, although recent flagship acquisitions (especially TLC of Thompson) have not produced the expected profits. The distribution of OFDI, unreliable as it might be, shows that Chinese OFDI is rather regional (South-South), while Brazil is more South-North and broadly based.

Figure 2 shows that OFDI flows and stock from China. As a proportion of world's OFDI flows have experienced a big jump between 2007 and 2009 and then again between 2011 and 2014, while OFDI stocks have steadily increased from 1% to 4% over the period 2007-2015. Despite these big increases, OFDI from China accounts for 9% of the world flows of OFDI and 4% of the world stock, a proportion not yet in line with the role of China in the world economy (China accounts for 10% of World GDP and 16% of the World population).

Figure 2 China outward FDI flows and stock as % of World outward FDI flows and stock 1994-2015 (source UNCTAD)



It could be argued, perhaps unfairly, that it has taken the good part of almost 30 years, since the establishment of the Open Door policy in 1978, for China to reach the same level of India and Russia. India, despite being nominally a member of GATT (precursor of WTO) since 1948, actually opened up its economy only in 1991, while Russia as such came into existence

only after the USSR ceased to exist in 1991. It could also be noted that Russia was admitted to WTO only in August 2012. Brazil has had a more complex recent economic history, but it is probably right to say that only in the 1990s the economy truly opened up to international investment. In particular (see Christiansen et al (2002)) FDI were particularly boosted by the success of the 1994 “Real Plan” in cutting inflation and bringing macroeconomic stability to the country, by regulatory changes to attract FDI and by the advent of the “Mercosul” regional-integration process after December 1994, when agreement was reached with Argentina, Paraguay and Uruguay to achieve a Common Market.

Therefore, the gestation period for China has been quite long, not suggesting a sudden outburst of activity. On a macro level, even the recent jump in OFDI after 2007 has not brought China in line with its relative weight in the world economy and trade, reaching 9% of world flows and just above 4% of the world’s stock of OFDI. Incidentally, this was the result of both an increase of Chinese OFDI, but also a dramatic decrease in OFDI from most of the rest of the world due to the financial crisis.

On a more micro level, Clegg et al (2016) provide evidence that out of the 1,633 firms quoted in the Shanghai and Shenzhen Stock markets, only one in five (324) engage in OFDI. Moreover, of these 324, only 40% follow an “accelerated internationalisation approach”, while the remaining 60% follow a more gradualist approach in their internationalisation process. Finally, they provide evidence that the average age of the internationalising firms is 24 years.

Also at firm level, there seems to be limited evidence that firms internationalise very rapidly. For instance, Li (2007) studied the cases of Haier, Lenovo and TCL and show that they followed a similar pattern of establishing themselves as number one in China, in their own respective markets, albeit with a quite long gestation period (7 years for Haier from 1984, 14 for Lenovo from 1984 and 14 for TCL from 1981). This was typically followed by a multi-year period of restructuring, re-orientation, re-organisation and diversification. Finally, these companies took the initial internationalisation steps (in 1998 for Haier, in 2005 for Lenovo and in 1999 for TCL) 14, 21 and 16 years respectively after their establishment. These examples, frequently mentioned in the literature, do not appear to provide strong evidence of an accelerated process and surely not evidence of lack of some FSA as they were number one in their own established domestic markets. The same pattern was followed by the two case studies in the wind turbine sector outlined by Tan and Mathews (2015). Goldwind was founded in the late 1980s, started producing wind turbines in 1998 and took over a German company in 2008. Sinovel was founded in 2003 by a SOE and became the one of the largest wind turbine manufacturer in China. Set up subsidiaries abroad from 2012. Both benefitted from having credit lines opened by the China Development bank

Overall, Clegg et al (2016) do not seem to provide evidence of an accelerated process of internationalisation by Chinese firm, once large databases are used and ad-hoc case studies are not considered.

Figure 2 also shows that OFDI flows have experienced some peaks before 2007, which were not sustained for a long period. These peaks coincide with some of the different political phases, through which OFDI policy has gone. Buckley et al., 2007, Tan (2013), Cheung & Qian (2009) and Luo et al (2010) offer a detailed overview of the development of the administration of OFDI, which has always been very carefully managed by the state, while Li & Ding (2013); (Wei et al, 2013) describe in detail the “Go Global” policy launched in 2001.

2.2 WERE OFDI FLOWS FROM CHINA TRULY UNPREDICTED? OFDI FLOWS FROM CHINA AND THE IIPD

A further reason for stating that perhaps OFDI from China is not really challenging existing theories as such is due to the fact that predictions of incoming flows of investment were already made long time ago and in general, outflows of FDI from developing countries (then labelled LDCs) were predicted, at least in theory by Lecraw (1977), Ghymn (1980), Agarwal (1985), Kumar (1982), Lall (1982), Lall (1983), Yeung (1994), Zhan (1995), Lecraw (1993), Lecraw (1977), and Tolentino (2004) and more broadly were envisaged by the International Investment Development Path (henceforth IIDP) developed by Dunning (1988), Dunning & Narula (1996) and Dunning et al (2008). The IIDP envisaged a stable (and therefore predictable) relation between the level of development of one country (approximated by its GNP per capita) and the amount of net outward investment (NOI). Indeed, the initial version developed by Dunning (1982, 1988) envisaged a J-shaped relation between NOI and GNP per capita. NOI is given by the difference of the stock of outward investment and inward investment.

The initial version developed by Dunning (1982, 1988) envisaged a J-shaped relation between NOI and GNP per capita. Being a difference between two separate entities, an infinite number of combinations of inward and outward investment can basically give the same NOI. Therefore, Dunning broke down the J-shaped relation into four phases. During the first phase, a country is basically barely able to attract any FDI and companies located in the country are totally unable to invest abroad. Therefore NOI is very close if not equal to zero. The second phase sees some significant inward foreign investment of the resource seeking kind. This is due to the fact that man-made comparative advantage is still overwhelmed by the natural comparative advantage of possessing some primary commodity (natural assets). Since domestic companies are supposed to be still unable to invest abroad, the NOI of the country becomes negative. During the third phase the amount of resource-seeking investment increases and is accompanied by cost-cutting investment, while domestic companies are tentatively investing abroad to accompany and support the export effort. The NOI is still negative, but tends to reduce. Finally, during the fourth phase, domestic companies intensify their investment abroad and inward investment switch to more technical-oriented sectors. Now NOI becomes positive. These trends are then confirmed during the subsequent phases or to infinite (Dunning classifies this as fifth phase). The new comparative advantage, based pre-eminently upon knowledge, will make any prediction on the sign of NOI very difficult.

As shown in Figures 3a, it is apparent that China is still in phase 3, when the inward stock of FDI far exceed outward stock, although the gap between the outward stock of FDI and the inward stock is narrowing. This is due to the fact that, as shown in figure 3b, outflows of FDI are almost matching inflows.

Figure 3a Net outward Investment of China based on stocks (1982-2015)

Source: UNCTAD (millions of US Dollars)

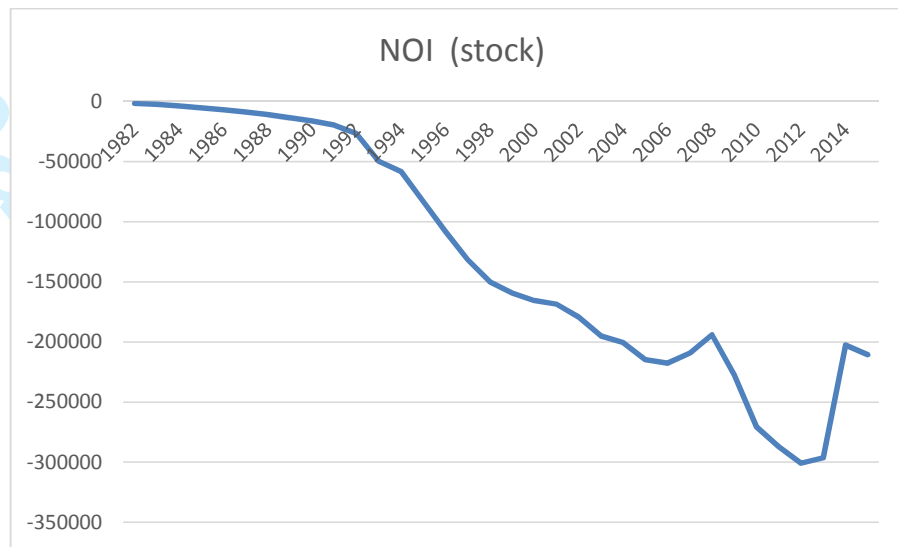
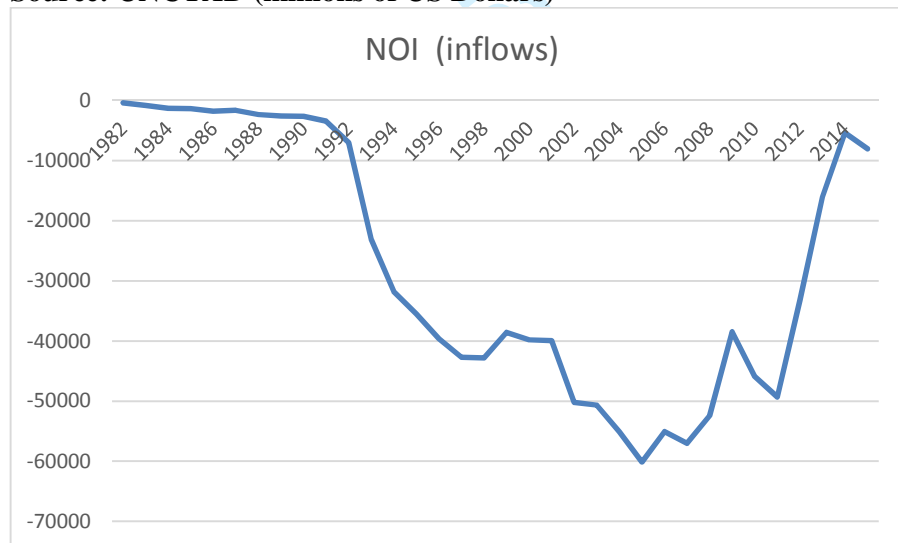


Figure 4b Net outward Investment of China based on flows (1982-2015)

Source: UNCTAD (millions of US Dollars)

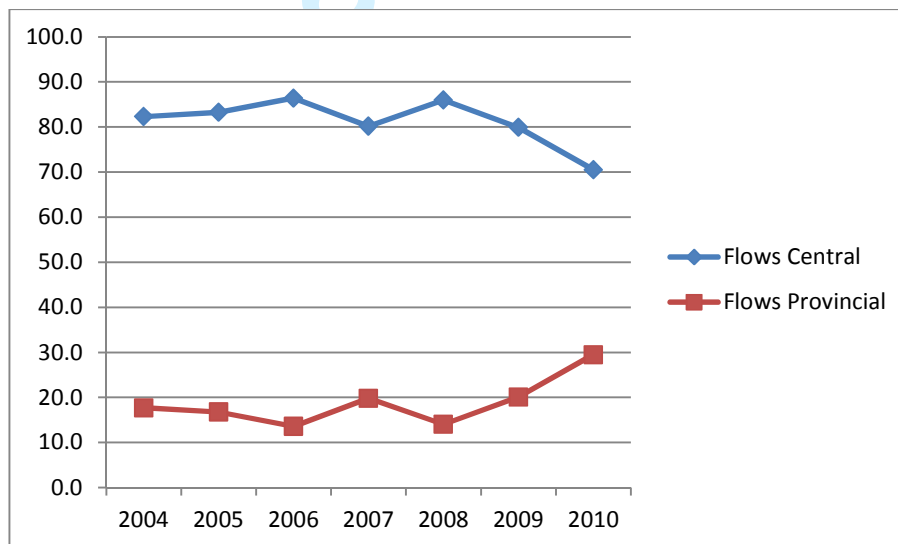


The next step is to analyse flows of inward and outward FDI by the relevant Province of origin and destination. Voss (2011) explains in great details the strengths and most definitely the limitations of Chinese OFDI data in particular at Province level. In a nutshell, Provinces have, and do exercise, some degree of discretion (“flexibility” in the words of Voss) in terms of what they disclose and how they measure it. This problem extends to GDP data at Province level and data on population as migrant workers are not counted as resident of the Province where they work, but as residents of their native Province. Therefore the attribution of inflows and outflows of FDI by Province must not be considered an exact science. However, the following analysis is still deemed to be useful, in order to provide some tentative evidence that most FDI activity takes place in the richest Provinces.

Figure 4 shows the proportion of OFDI (by value) approved at Central Government and Province level. The central Government through the SDRC, in conjunction with the MOC, approves large scale OFDI projects in industries like natural resources and infrastructure development and those involving large amounts of money (30 million dollars for resource-oriented investments and 10 million dollars for others). These are typically the type of investment carried out by SOEs. OFDI by Private Enterprises are predominantly approved by Foreign Economic Relation & Trade (FERT), which are organisations at Province level delegated by MOC to approve OFDI.

Therefore the distribution by Province reflects the 30% of the value of OFDI flows carried out by private firms (Wei (2012) provides a similar estimate of the proportion of private sector OFDI). The flows of inward FDI are almost by definition attributable to foreign Private firms, making the two flows comparable. It is also very likely that `most large and successful SOEs are, themselves, located in the richer Provinces.

Figure 5 OFDI flows (by value) approved at Central Government level and Province level

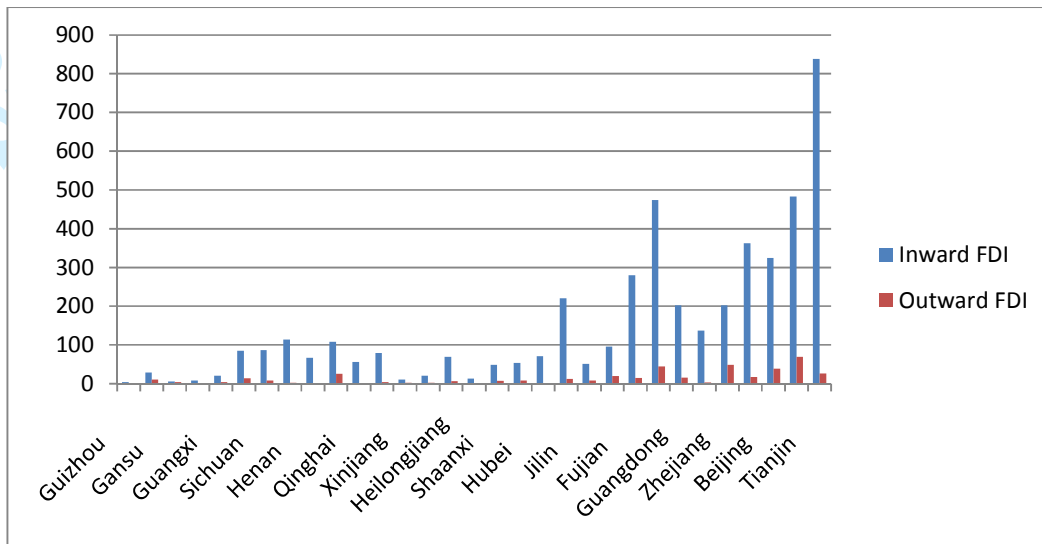


Source: MOFCOM Ministry of Commerce 2010 Statistical Bulletin of Outward Foreign Direct Investment for OFDI

In Figures 5 and 6 the net outward investment per capita flows for 2010 from the Provinces, with the Provinces ranked according to their regional gross output per capita, seem to provide some visual, admittedly tentative, evidence that quite a significant amount of investment (both inward and outward) actually takes place in a limited number of (richer) provinces².

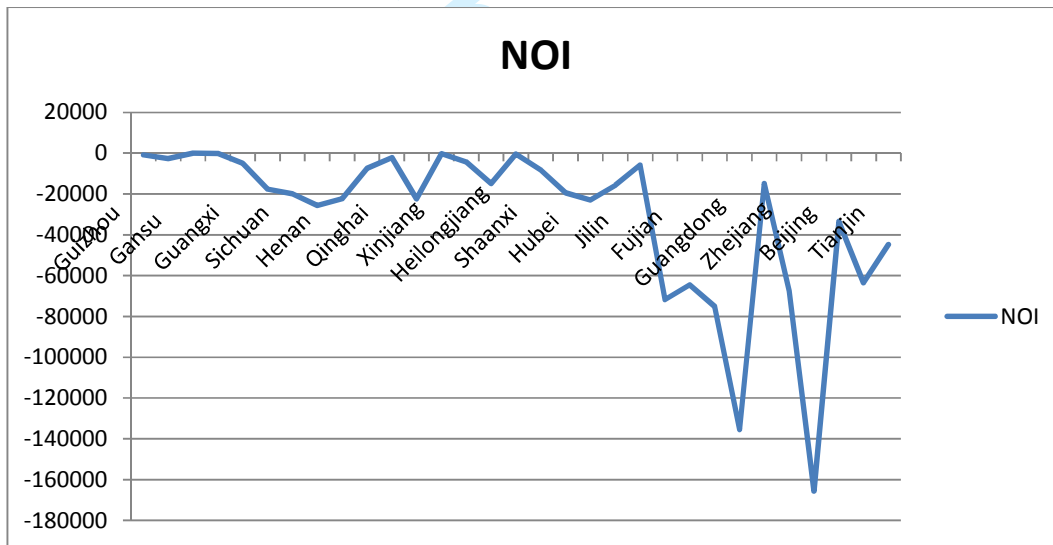
² Typically SOEs are also located in more developed areas. Furthermore, as pointed out by Burghart and Rossi (2009) Chinese OFDI in the UK tends to cluster around London, while Gattai (2012) and Pietrobelli et al (2010) observe that Chinese OFDI in Italy is concentrated in few regions of the North-east of Italy (Lombardy and Piedmont) and tend to originate from a selected number of provinces in China.

Figure 6 Inward and outward flows FDI per capita by Province (millions of US\$)



Source: China Statistical handbook for data on Gross Regional Product and inward FDI at Province level and Almanac of China Foreign Economic Relations and Trade for data on outward FDI at Province level

Figure 7 Net Outward Investment (stock) by Province (millions of US\$)



Source: China Statistical handbook for data on Gross Regional Product and inward FDI at Province level and Almanac of China Foreign Economic Relations and Trade for data on outward FDI at Province level.

If data from China are organised in the appropriate manner and we sub-divide the origins of OFDI at sub-national level as it is done in Table 1 based on data derived from the China Statistical handbook, it could be noted that the proportion of flows of OFDI by Province, quite closely correlate with the share of total GDP apportioned to each province. The correlation between the two variables is 0.87 for the sample of Provinces included in the table and 0.72 for all Provinces.

Table 1 Distribution of Gross Regional Product and OFDI by Province

	% GRP	% OFDI
Guangdong	10.2	15.4
Shandong	8.7	10.5
Jiangsu	9.4	9.6
Zhejiang	6.2	7.9
Shanghai	3.7	7.8
Hainan	0.5	5.2
Shanxi	2.1	5.0
Beijing	3.1	5.0
Liaoning	4.3	4.9
Tianjin	2.2	3.0

Source: National Bureau of Statistics of China; China Statistical Yearbook (2012) Table 2-14 National Accounts Gross Regional Product for Gross Regional Product at province level.

MOFCOM Ministry of Commerce 2010 Statistical Bulletin of Outward Foreign Direct Investment for OFDI at Province level

Finally, to give some further historical perspective, according to Ramamurti (2012) in Table 1 page 43 of his paper, in 1914 the stock of FDI owned by the USA was equal to 6% of the world stock (the UK owned 50% on its own). According to data provided by the Maddison Project the GDP per capita for the USA (in constant 1990 International Geary-Khamish GKS Dollars) in 1914 was equal to GK\$ 5,301. The same income per capita was reached by France in 1951; Germany 1955, Japan in 1964, South Korea in 1984 and China in 2005, while India has yet to reach that threshold (see Bolt & van Zanden (2013)).

Moreover Dunning (1979), in Table 1 page 271, note that (the then) West Germany, Japan and Switzerland reached the 6% threshold of world stock in 8 years between 1967 and 1975 (from 2.8%, 1.4% and 4.2% respectively), a truly accelerated achievement, although, as in the case of Japan, these “achievements” continued well into the 1990s, but went into reverse after the 1990s.

Again from Figure 2 it can be shown that OFDI stock as a proportion of the world OFDI stock increased to 4% in 2015. Therefore, it does not appear that OFDI stocks have either developed much earlier than in other, then, emerging countries such as the USA pre-1914 or as fast as other more mature economies like Japan at the time when they had reached the level of income per capita enjoyed by China today in the late 1960s- early 1970.

Therefore, in terms of the first claim, contrary to what alleged in the literature, it does not appear that the flows of OFDI from China have really grown unexpectedly and particularly fast. Admittedly, a sudden jump in OFDI did take place in 2007-2009, but this could be explained by a set of specific circumstances (investment of foreign reserves, channelling of credit by a handful of big state-owned banks in the context of financial repression, large availability of cash by “dividend-averse” SOEs, the financial crisis, which allowed the purchase of developed countries firms at affordable prices), whose desirability and sustainability are very doubtful and clearly must be put in the wider context of a rather long gestation period, since the launch of “Open Door” policy in 1978 and the more recent launch of the “Go Global” policy and the membership of the WTO in 2001. In terms of the predictability of the flows, the IIDP appears to be sufficiently robust as a predictor, with China as a whole being between phase two and three of the IIDP.

3 DO OFDI FLOWS FROM CHINA BEHAVE VERY DIFFERENTLY FROM PREVIOUS ONES FROM DEVELOPED COUNTRIES?

3.1 CHINESE OFDI TO “TAX HAVENS”

Moreover, a large proportion of OFDI from China flows actually go to known (or alleged) “tax havens” or Offshore Financial Centres (OFCs) such as Cayman Islands and British Virgin Islands, not to mention Hong Kong and Luxembourg, while Europe and indeed the USA have attracted a smaller proportion of OFDI flows.

These flows present a serious problem of interpretation because they could be caused by round-tripping, tax-arbitrage or other forms of diversion such as tax evasion, corruption, money laundering, and crime. Sutherland and Mathews (2009), Sherman (2012), Vlcek (2013) and Sutherland and Anderson (2015) believe that it is unlikely that OFDI from China to THOFCs can be predominantly explained by these reasons. For instance, Sutherland et al (2010) and Sharman (2012) argue that the tax advantage of being a foreign owned firm in China has been eroded, although thanks to a tax-treaty with Hong Kong, it is still advantageous to be incorporated there. Sharman (2012) rules out the idea that flows to tax havens are predominantly linked to stolen or embezzled funds as typically they are hidden in private real estate holdings, private bank accounts, luxury goods, not in publicly traded companies with stock market listing. Sutherland and Mathews (2009), Sherman (20102) and Vlcek (2013), however, note that inbound FDI flows from OFCs into China are almost twice as big as the outbound FDI flows from China to OFCs suggesting that “round-tripping” of capital is at best a very partial explanation of these flows.

However, the ultimate owner and the ultimate destination of these OFDI from China are difficult to establish for certain, making any statistics about final destination at best opaque and surely highly unreliable.

As previously mentioned, Sutherland and Mathews (2009), Sherman (20102) and Vlcek (2013) note that inbound FDI flows from OFCs into China are almost twice as big as the outbound FDI flows from China to OFCs suggesting that the amount of OFDI from China is not fixed and that the inbound flows are mixed with (augmented by) funds raised in the financial markets, in particular in the USA, with the assistance of the internationally active banks, major accounting companies and reliable courts present in these OFCs. In other words, Chinese firms unable to access capital in China, incorporate in one of the OFCs with a view to raising funds via IPOs (or selling bonds) in the USA.

Sutherland and Mathews (2009) suggest that OFDI from China into OFCs can be explained by the “institutional arbitrage” motive (Boysot and Meyer 2008) whereby “...Chinese firms avail themselves of more efficient institutions outside of China and thus engage in a form of arbitrage whereby they exploit the superior institutions of foreign markets.... OFDI from China is not so much ‘strategic entry’, but rather ‘strategic exit’ from China”. They also argue that “when [domestic] transaction costs are high and the cost of crossing domestic borders exceed those of international borders, firms internationalise at a relatively earlier stage of development”. The fact that China is not a fully established single market and some firms may try to escape the highly fragmented internal market and take refuge in investment abroad has also ben remarked by Morck et al (2008). As a matter of fact, Boisot & Meyer (2008) argue that China, despite not being a federal state as such, has created a complex system of fiscal devolution that they describe as “neo-feudalism”. In this system, institutions at county and Province level have incentives to get involved in OFDI decisions.

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4 These distortions have led some authors to describe what really constitutes an exit strategy as
5 opposed to a “voice strategy”. The theme of an “exit” strategy (as opposed to a Voice
6 strategy à la Hirschman) intrinsic to Chinese OFDI is also mentioned by Hoskisson et al
7 (2013), while Witt & Lewin (2007) mention it in the context of OECD countries. It could be
8 almost described as “liability of foreignness in reverse”, whereby firms may actually prosper
9 abroad better than in the domestic market.
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11
12 As a result of this, the actual final destination of the OFDI cannot be known for certain and
13 might even involve an amount of round tripping back to China, to receive the favourable
14 treatment given to inward FDI, if not an outright diversion into private bank accounts,
15 making any strong conclusion from OFDI a bit premature. Therefore, the amount of “real”
16 OFDI, real defined as investment aimed at acquiring local firms, building factories and
17 competing with local rival, which Hoskisson et al (2013) quite correctly observe should be
18 the true object of study in fields such as Strategy and International Business, is surely smaller
19 than the headline figures.
20

21
22 In a recent paper, Lu et al (2014) in table 1 page 7 identify 364 out of 702 instances of firms
23 engaged in OFDI as being directed into “tax havens” in their paper.
24

25
26 For the purposes of this paper, though, the most compelling issue is that OFDI into tax
27 havens does not allow a clear identification of the final destination and therefore obfuscates
28 any empirical analysis. Wang et al (2012a) on page 436 acknowledge this when they state
29 that “... the results should be interpreted with caution” as they refer to possible inaccuracies in the collection
30 of data, in particular with round-tripping in mind”.
31

32
33 Wang et al (2012a) and Peng (2012) suggest that Chinese MNEs are not very global and are
34 very regional, in fact centred on Asia, suggesting that perhaps the demise of the “incremental
35 internationalisation process” is perhaps premature in the context of Chinese OFDI and
36 “psychic” distance is still a relevant variable. For the sake of completeness, it must also be
37 noted that according to UNCTAD (2013) table I6 page 33) the rate of returns of FDI over the
38 period 2006-2011 in developed economies (4.8%), West Asia (5.1%) and Latin America and
39 Caribbean (7.1%) were clearly below the World average (itself declining), while the rates of
40 returns in other regions such as Africa (9.3%), Asia (8.8%), East and South-East Asia (9.2%)
41 and transition economies 13% were clearly well above the World average. Therefore, at
42 times it is not clear whether OFDI from China is actually dictated by proximity
43 (regionalisation) and/or by perceived economic opportunity.
44

45 3.2 OFDI FROM CHINA INTO THE UK IN COMPARISON TO BRAZIL, INDIA AND 46 RUSSIA 47

48
49 In this section, the specific case of the UK will be examined in more detail by searching the
50 Bureau Van Dijk Financial Analysis Made Easy (FAME) database, which provides numerous
51 financial statistics about companies located in the UK and, crucially, classify firms at 4-digit
52 Standard Industrial Classification (SIC) codes. Moreover, FAME identifies the ultimate
53 global owner of companies. Therefore, it is possible to search the database by looking at
54 firms owned by Russian, Chinese, Indian and Brazilian ultimate owners.
55

56
57 To the best of my knowledge this is the first time that Bureau Van Dijk Financial Analysis
58 Made Easy (FAME) database is used for this purpose, although Chinese FDI in the UK has
59
60

already been examined by Burghart & Rossi (2009). They observe that apart from very few notable exceptions in the automotive industry, the investments appear to be rather small. Similar research was conducted by Gattai (2012) and Pietrobelli et al (2010) on Chinese OFDI in Italy, while Clegg & Voss (2012) look at the UK in the context of the European Union.

In brief, the patterns of investment in different countries of Europe are quite similar. For instance, Pietrobelli et al (2010) conclude that the evolution of the Chinese pattern of entry to Italy is in line with the model followed by Chinese firms in other European countries and it involves starting with small-scale operations in trade-related activities, and evolving towards the acquisition of tangible and intangible resources deemed necessary to increase the Chinese presence in international markets and, more generally, to upgrade its technological and production capacities.

Chinese investments in Italy are increasingly targeting the acquisition of design and brands in key Italian sectors of specialization, and technological capabilities in sectors such as metalworking. Chinese multinational enterprises also are investing in Italy to get access to local competitive advantages in sectors such as automotive and home appliances. This location choice is clearly linked to the intention to tap local competences available at the cluster level.

Gattai (2012) find that FDI from China in Italy is predominantly concentrated in the in the North-east of the country (basically Lombardy the region of Milan and Piedmont the region of Turin) and predominantly in sales and marketing.

After identifying the relevant firms, they were classified by certain criteria like nature or status of owner (for instance State-Owned) and turnover³.

As Table 2 shows, the vast majority (quasi totality) of the firms identified by FAME as having a Chinese global ultimate owner and for which turnover is reported appears to be related to the Chinese State, with the single biggest investment being operated by Sinochem Europe Holdings PLC owner of Sinochem International Oil (London) CO; Limited.

Table 2 CHINESE OFDI IN the UK BY OWNER as (%) of total turnover

State-owned Assets Supervision & Administration Commission (SASAC) of the State Council	90.58
State-owned Assets Supervision Commission of Shanghai Municipal Government	2.03
Government of China - The People's Republic of China	1.68
The Central People's Government of China	1.15
China Telecommunications Corporation	0.16
Agricultural Bank of China limited	0.024
China State Construction Engineering Corporation limited	0

Source: FAME computations by the author

³ Beugelsdijk, S., Hennart, J.-F., Slangen, A. & Smeets, R. (2010) Why and how FDI stocks are a biased measure of MNE affiliate activity. *Journal of International Business Studies*, 41(9), 1444-1459. note that FDI stocks are a biased estimate of MNE affiliates.

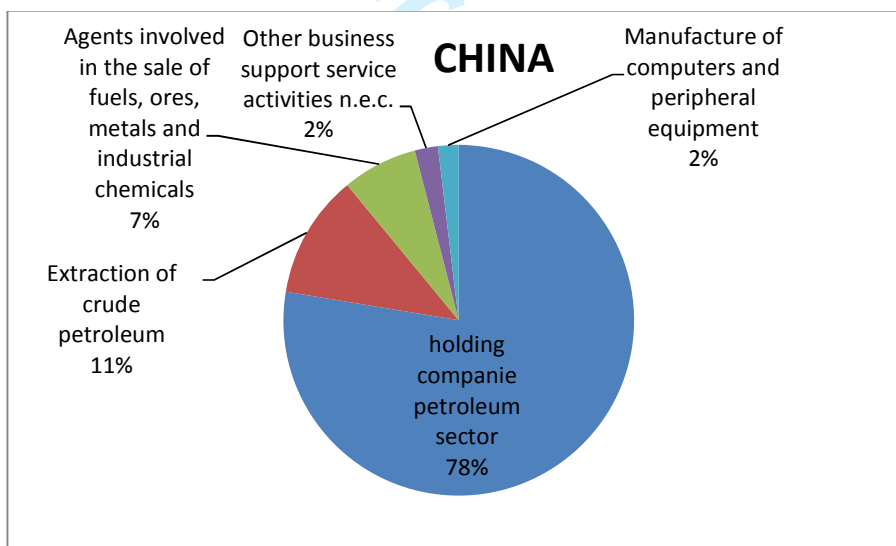
The comparison among China with Brazil, Russia and India shows that the turnover of the firms owned by India is much higher (36 billion Pounds) than the turnover of firms owned by the other BRICs countries combined, with the investment by Brazilian firms generating only less than a billion Pounds. With the magnitude of the investment in mind, it is clear that few large (r) firms take the lion's share of turnover

Table 3 Total turnover, top 10 (%) and Top 5 (%)

	Total turnover ('000 £)	Of which top 10	Of which top 5
BRAZIL	898,791	100.0%	93.0%
CHINA	22,111,338	94.6%	89.3%
INDIA	36,590,044	90.4%	85.8%
RUSSIA	5,552,840	94.0%	79.4%

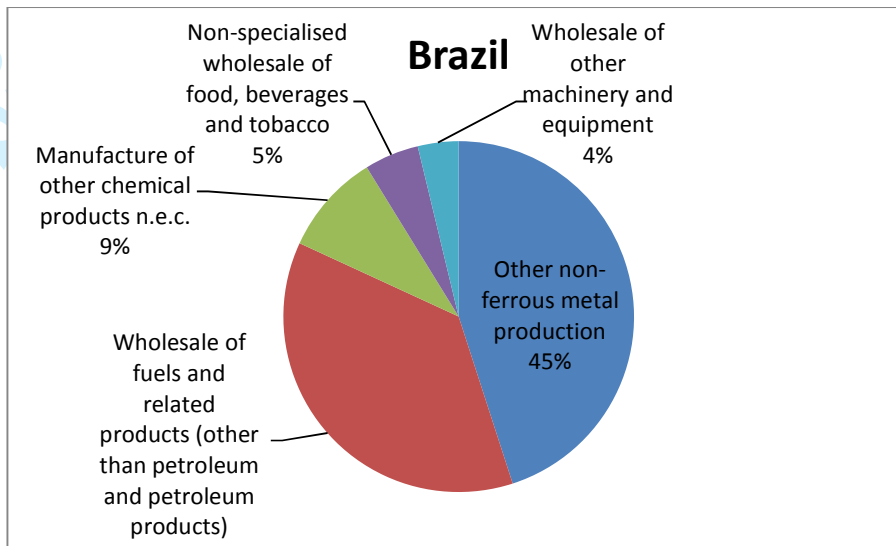
Figures 7-10 show the top 5 sectors for firms coming from the BRIC countries. It is evident that in the case of China activities related to the management, extraction, distribution and sale of oil take the lion's share. In fact, Sinochem is by far the largest firm. This appears to imply that asset-seeking is quite prominent for China and the relative competitive advantage offered by the UK (the North-sea oil) is quite attractive.

Figure 8 Top 5 Sectors (SIC 2007) for China



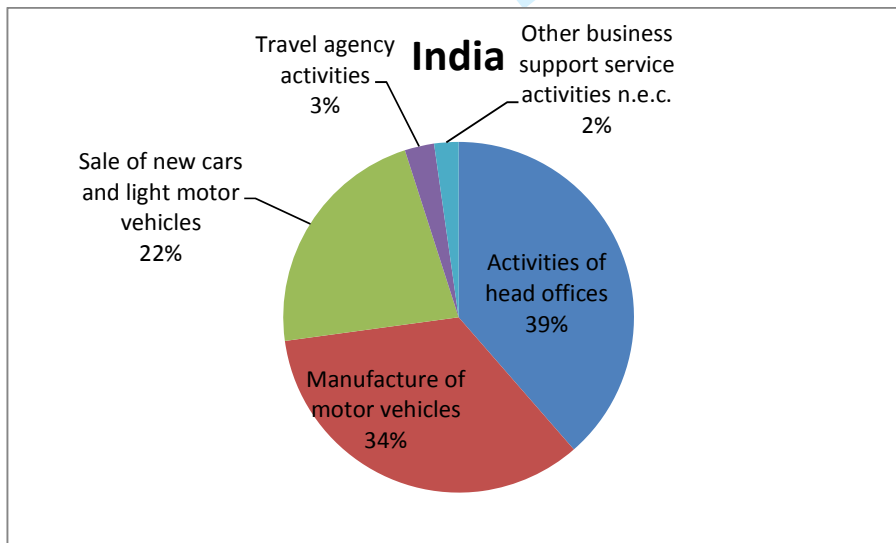
In the case of Brazil intermediate stage of sales (wholesale) takes a large proportion of turnover (almost half of the top 5 turnover), while production of metal and chemical products also features.

Figure 9 Top 5 Sectors (SIC 2007) for Brazil

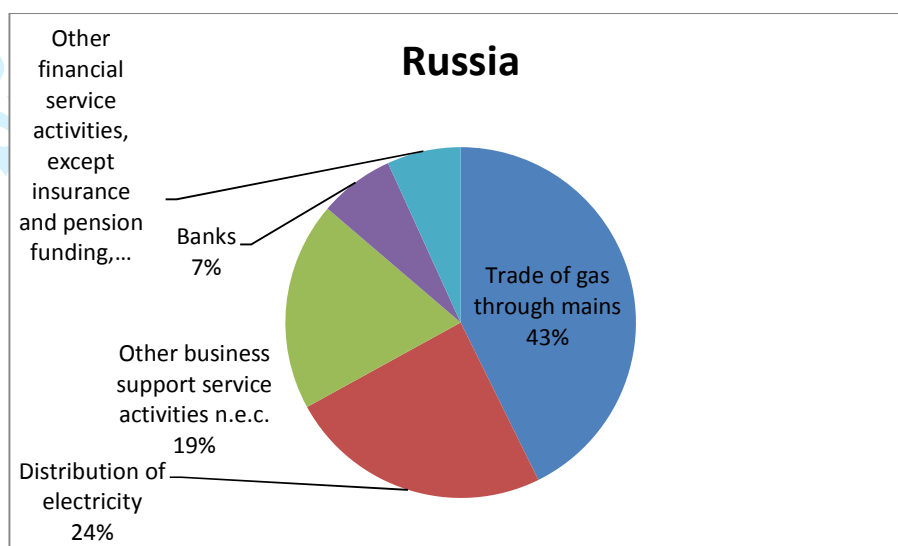


In the case of India (see Figure 9) activities related to the motor industry cover more than half of the top 5 turnover, while the rest is related to activities of head offices and service industry.

Figure 10 Top 5 Sectors (SIC 2007) for India



Finally, in the case of Russia (see Figure 10) trade of gas and distribution of electricity cover almost two third of turnover. Services account for a fifth of the turnover, while the rest is taken by banks and financial services.

Figure 11 Top 5 Sectors (SIC 2007) for Russia

It is pretty clear from the above, admittedly tentative, analysis that the BRIC countries are not very homogenous and they exploit different areas where the UK has a comparative advantage (oil industry, finance, automotive). The element of resource-seeking is quite strong, in particular in the case of China. Moreover, the lions' share of OFDI from China into the UK seems to be supported by different agencies belonging to the Chinese state, both at national and Province level.

In the next section attention is reverted back to China only and the alleged CSA (i.e. the role of the State) affecting the FSA of Chinese firms are examined.

4. THE PERVASIVE ROLE OF THE STATE AS A DRIVER FOR OFDI FROM CHINA

4.1 THE STATE AS REGULATOR AND THE ROLE OF FOREIGN RESERVES

Chinese OFDI are extensively guided and managed, both by political and regulatory institutions. Briefly, these institutions are the State Council, Ministry of Commerce (MOC), People's Bank of China, State Administration of Foreign Exchange (SAFE), State-owned Assets Supervision and Administration Commission (SASAC), and State Development and Reform Commission (SDRC).

The State Council effectively decides the long-term goals and long-term strategy, with the support of the State Development and Reform Commission (SDRC), but leaves policy initiatives and administration of OFDI to other bodies. SDRC, in conjunction with MOC, also lists which industries and which countries the Chinese government encourages Chinese firms to invest in and what measures, including financial incentives, the government can provide. Furthermore, SDRC needs to approve large scale OFDI projects in industries like natural resources and infrastructure development and those involving large amounts of money (30 million dollars for resource-oriented investments and 10 million dollars for others). SAFE is primarily responsible for monitoring foreign exchange inflows and outflows and among other activities, manages China's foreign exchange reserves. Ministry of Commerce (MOC) oversees policies related to OFDI, including approval of projects, in particular by SOEs, and

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3 negotiations of treaties at international level. MOC delegate some authority at provincial
4 level to Foreign Economic Relation & Trade (FERT), which predominantly approve OFDI by
5 Private enterprises.
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7 The gist is that approval for OFDI in China has to be sought from different bodies, at
8 different geographical levels, depending on the size and the nature of the investment to be
9 approved. Wang et al (2012b) empirically tested the impact of different government levels
10 have on the decision of firms to invest abroad. In particular, they consider how affiliation at
11 different levels influences both the willingness and the ability of EMEs to internationalize. In
12 their own words, Wang et al (2012b) page 655:
13

14
15 “provide evidence that government involvement (at different levels) influence not only the willingness and
16 ability of EMEs to invest abroad but also location choices (investment in developed or developing countries)
17 and the type of overseas investment (resource-seeking or market-seeking)”.
18

19 Tan (2013) on page 753:
20

21 “unlike in OECD countries where FDI decisions follow primarily a market behavior, China's outward
22 investment involves a high degree of coordination between government and business. There are three major
23 players: government agencies, policy and commercial banks, and Chinese companies which range from wholly
24 state-owned, to joint-stock, to privately owned companies. However, it is important to note that state-owned
25 enterprises dominate all outward investment, especially in the energy and resources sector.”
26

27 It emerges quite strongly from the literature that China suffers from a number of institutional
28 and structural distortions, which perversely may be exploited and/or may enhance the
29 incentive for internationalisation (OFDI) by Chinese firms, in particular politically well-
30 connected firms. As these distortions may be temporary, let alone undesirable and sub-
31 optimal, it is very difficult to imagine that they really represent an advantage and that theory
32 should be re-written.
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35 These distortions have led some authors to describe what really constitutes an exit strategy as
36 opposed to a “voice strategy”. It could be almost described as “liability of foreignness in
37 reverse”, whereby firms may actually prosper abroad better than in the domestic market.
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39 Furthermore, Morck et al (2008) emphasise the fact that China is not a fully established
40 single market and some firms may try to escape the highly fragmented internal market and
41 take refuge in investment abroad. It is an established fact that China, without being a federal
42 state as such, has created a complex system of fiscal devolution (described as “neo-
43 feudalism” by Boisot & Meyer (2008)), which incentivises the involvement in OFDI
44 decisions, in particular at county and Province level. The role of the state ownership and
45 political affiliation of firms on the decision of firms to invest abroad as well as the location
46 choices (developed or developing countries) and the type of overseas investment (resource or
47 market-seeking) has been empirically studied by Wang et al (2012b). In particular, they
48 provide some evidence that the degree of political affiliation and the extent of state ownership
49 are negatively correlated with each other and affect OFDI decision in different ways.
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53 They provide evidence that firms with high state ownership focus on countries with weak
54 institutions, typically developing countries, where the state support may be very helpful,
55 while a high degree of state ownership could be an obstacle when investing in developed
56 countries. Firms affiliated to a higher government level and private firms find it more
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3 difficult to operate in countries with unstable institutions. They typically would increase
4 OFDI in developed countries.
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6 The theme of an "exit" strategy (as opposed to a Voice strategy à la Hirschman) intrinsic to
7 Chinese OFDI is also mentioned by Hoskisson et al (2013), while Witt & Lewin (2007)
8 mention it in the context of OECD countries.
9

10 One important form of distortion is the so-called "financial repression". This may take
11 different forms, but in the case of China the clear symptoms are low nominal interest rates, in
12 particular for deposits, widespread government ownership of the major banks, high reserves
13 requirements, possibly the web of controls for investment abroad, both by firms and
14 individuals, and the high degree of control of the stock markets. Some would add a distorted
15 exchange rate, but evidence of this is more mixed.
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18 The consequences of this financial repression is that some, politically connected, firms can
19 enjoy privileged access to funding. Chan et al (2012) find that out of 1347 firms listed on
20 Shenzhen and Shanghai stock markets, 330 are considered to be politically connected. To be
21 politically connected, the CEO of a firm must have been a government official or a military
22 officer or a political ranking at the provincial or ministerial level. Chan et al (2012) provide
23 evidence that politically connected firms appear to be free from financial constraints in their
24 investment decisions.
25

26 Guariglia & Mateut (2013) use a dataset containing 65,706 Chinese firms over the period
27 2000–2007. They show that firms with a political affiliation manage to gain easier access to
28 short-term external finance suggesting that gaining political affiliation help alleviating their
29 financing constraints.
30

31 Therefore, these imperfections may mean that some firms may have (privileged) access to
32 funds, that borrowing could be offered at very competitive interest rates and that there may be
33 soft-budget constraints, in particular on SOEs.
34
35

36 Despite the low interest rates, saving rates have been particularly high (see Morck et al
37 (2008) for a detailed explanation of the reasons for such a high saving rate). This has led to
38 surpluses in the balance of payment and a significant accumulation of foreign reserves,
39 predominantly invested in US Dollars.
40
41

42 Cheung & Qian (2009) provide robust evidence that Chinese international reserves
43 significantly influence OFDI (stock of OFDI per inhabitant of host country) in particular for a
44 sample of developing countries (the R-squared increased from 0.45 to 0.61).
45

46 It is important, therefore, to investigate the actual mechanism linking reserves and actual
47 decision to invest abroad. One possible mechanism is a Sovereign Wealth Fund (SWF).
48 Sovereign wealth funds are state-owned investment funds set up for the investment of excess
49 foreign exchange reserves or natural resource export surplus. SWFs are part of the large
50 collection of sovereign investment tools, including state-owned pension funds. In the case of
51 China this fund is the China Investment Corporation (CIC), which was established on 29
52 September 2007 (see Corporation (2012)).
53
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55 For a detailed explanation of SWF of China see Zhang & He (2009) and Wu et al (2012), for
56 a broader overview on SWFs see Griffith-Jones & Ocampo (2008).
57
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CIC was established in 2007 with an initial capital fund of US\$200 billion. Zhang & He (2009) explain that this capital endowment was taken from the foreign reserves and the main objectives of CIC were to diversify risk away (at home and abroad) from the US\$ (particularly Treasury bonds) and increase the return of the reserves⁴. Zhang & He (2009) explain in great detail the issues surrounding the governance structure of CIC and the circumstances of the establishment of CIC, including what they dub as the myth of the capital endowment as they claim that the US\$200bn were in fact a loan that must be repaid and the acquisition of Central Huijin Investment Company, effectively now a wholly-owned subsidiary of CIC. Central Huijin is a typical domestic strategic investor, whose main objective is to promote the restructuring and listing of state-owned financial institutions. Currently Central Huijin holds a portfolio with 47.63% of China Development Bank, 35.46% of Industrial and Commercial Bank of China, 40.21% of Agricultural Bank of China, 67.72% of Bank of China, and 57.2% of China Construction Bank (Table 3 page 35 Annual Report 2012). The investment performance on the global (overseas) portfolio is 5% over the period 2007-2012. CIC also established CIC International in September 2011 with a mandate to invest and manage the entire overseas investment portfolio of CIC.

According to the Annual Report, since CIC International was established, an additional \$49 billion has been provided to the company, although the origin of this sum is not disclosed. Furthermore, in November 2010 CIC opened CIC International (Hong Kong) Co, while in January 2011, CIC opened a representative office in Toronto, Canada. According to the 2012 Annual Report, total assets under management had increased to US\$ 575.2.

According to Zhang & He (2009) out of the initial US\$ 200 billion only one-third was clearly earmarked for OFDI, although this figure was subsequently raised to US\$90 billion, because some of the other capital destined to the restructuring of the Agricultural Bank of China was not needed. However, another third was invested in China Development Bank, in which Central Huijin has a large stake.

This can lead to believe that CIC may have two effects upon OFDI. A potential direct one, as a proper SWF, is due to the acquisition of firms operating abroad. To put things into the right perspective, the flows of FDI over the period 2007-2012 have oscillated between 40 and 60 billion US Dollar per annum (see Figure 1). Therefore, a potential fund of US\$ 60-90 billions to be invested surely could make quite a significant impact. However, it looks as if CIC predominantly acquires stakes of up to 9.9%, the threshold for the acquisition to be classified as OFDI, therefore this direct channel may, actually, not have an important statistical role as such. However, there might an indirect channel, through the potential lending of state-owned banks belonging to Central Huijin to firms planning to invest abroad.

4.2 THE ROLE OF SOEs IN CHINESE OFDI

This leads us to the next topic, which is the role of SOEs in Chinese OFDI.

As Morck et al. (2008) observe the biggest sources of Chinese outward FDI are highly profitable listed SOEs, whose source of profits is officially sanctioned monopoly in some major industry, such as natural resources or telecommunications. These SOEs also happen to be rather “dividend-averse” as they do not “disgorge” those profits to shareholders and to compound problems the ownership structure of these SOEs is rather murky, with a limited

⁴ Before the establishment of CIC, the State Administration of Foreign Exchange (SAFE), under the People’s Bank of China (PBOC), was the only management authority of Chinese foreign exchange reserves.

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3 floating of shares (the role of SOEs is also emphasised by Peng (2012) and Hoskisson et al
4 (2013) and in the energy sector by Tan (2013)). Huang et al (2017), by purely using a sample
5 of 507 SOEs in the manufacturing sector argue that those SOEs with a higher percentage of
6 state ownership are less likely to engage in OFDI. However, unfortunately, the paper does not
7 address the issue of whether SOEs are more likely than non-SOEs to engage in OFDI.
8

9
10 The distinction between state-owned and private enterprises is a bit blurred in the case of
11 firms seeking an affiliation with the state, the so called “red capitalists” (see Du & Girma
12 (2010)), to circumvent problems associated with the lack of secure property rights and
13 institutional discrimination, such as the lending bias of China’s state-dominated banking
14 system against indigenous entrepreneurs, heavy government regulations. This type of
15 behaviour is consistent with the “helping hand” theory of government-business relationship.
16 These political connections can take place at local, middle level (prefecture and town level)
17 or high level (regional and central) government agencies. Du & Girma (2010) estimated that
18 among the 106,000 private firms that entered the market between 1999 and 2004, 23% were
19 politically affiliated in the sense defined above. Chan et al (2012) find that out of 1347 firms
20 listed on Shenzhen and Shanghai stock markets, 330 are considered to be politically
21 connected.
22

23
24 Also the mode of investment may be affected by the involvement of the state. Cui & Jiang
25 (2012) study the moderating effect of state ownership on the decision to establish joint-
26 ventures or sole ownership in OFDI by interviewing 132 Chinese outward investing firms.
27 Their main finding is that increasing state ownership has a strong moderating effect in terms
28 of establishing joint-venture rather than sole ownership venture abroad. Duanmu (2012)
29 analysed the investment decision of 194 firms from the Jiangsu province in China,
30 distinguishing between SOEs and non-SOEs. Unsurprisingly SOEs are less concerned about
31 political risk but more responsive to depreciating exchange rates against the Renminbi.
32

33
34 Another mode of investing abroad is through mergers and acquisitions (M&As).
35 Unsurprisingly, the entanglement between state and firms and OFDI and SOEs does not help
36 OFDI. For instance, Sun et al (2012) compare the behaviour and performance of Chinese and
37 Indian firms with respect to M&A. The comparison highlights important differences: China is
38 more oriented towards Asia, while India towards Europe and USA and the most prominent
39 firms engaged in M&A from China are SOEs, while in India are predominantly private firms.
40 The average size of Chinese M&As is significantly larger than Indian ones (622 cases for
41 US\$130bn for China, 893 for US\$ 60.5), while firms for both countries tend to engage in
42 friendly take-overs and tend to pay high premia. Announcing high-profile deals is one thing,
43 but completing them is another matter. Chinese MNEs have particularly poor records in
44 completing the overseas acquisition deals they announce. For instance (Sun et al (2012)
45 report than from 2000 to 2008, only less than half (47%) of the overseas acquisitions
46 announced by Chinese MNEs were completed, while Indian MNEs’ managed to successfully
47 complete 67%. Among the reasons for this discrepancy, there might be lack of ability and
48 experience in due diligence and financing, but also the political backlash and resistance they
49 encounter, especially in developed economies.
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53 Chen & Young (2010) examine cases of M&A involving foreign companies and find that
54 SOE produce lower post-merger returns. Based on some evidence it is quite plausible to
55 imagine that Chinese firms may be tempted to over-bid during the pre-acquisition period
56 (Hope et al (2010) provide evidence of this phenomenon for firms from `emerging markets).
57 This phenomenon could be explained by inexperience and possibly availability of substantial
58

and cheap funding⁵. Li et al (2016) provide some evidence that cross-border merges by Chinese companies result in creation of value for companies with prior experience, while acquirer size (a proxy for an SOE) and use of cash have a negative impact.

However, there might be a further agency motive: managerial hubris, bordering national pride for acquiring high profile “trophy” and leading to empire building, entrenchment of managers and, as result, wasteful investments. Chen & Young (2010) highlight the possibility of principal-principal conflict between the majority owners and the minority shareholders, in particular when the majority owner is the state as it happens in the case of several listed SOEs in Shanghai and Shenzhen stock markets.

Given the important role played by SOEs in Chinese OFDI the temptation could be to modify the theory to accommodate their behaviour.

A quick review of the literature can reveal that FDI from SOEs have, in fact, happened before, in particular in the 1970s and 1980s, despite the generally less favourable circumstances, in countries such as France (for instance the Bureau de Recherches de Petrole explored in Morocco, Algeria and Tunisia) and Italy (on ENI see Carnevali (2000) who explained in details the experience of ENI). Useful references on this topic would be Wilkins 1974 (especially pages 365-370), Mazzolini (1979), Vernon (1979)), but also more recently, for a general overview see Estrin (2012), while for SOEs operating predominantly in the oil sector, Bass and Chakrabarty (2014) provide an extensive analysis of SOEs (especially in Figures 1 and Figure 3), while for OFDI from China by SOEs see Morck et al. (2008), Peng (2012), Hoskisson, Wright et al. (2013) and for OFDI from China by SOEs in the energy sector see Tan (2013)).

Therefore, it is possible to argue that OFDI investment by SOEs is not a new phenomenon, in particular in the energy sector, and the literature would most definitely benefit from taking a more long-term historical approach.

5. DISCUSSION AND CONCLUSION: DOES OFDI FROM CHINA REQUIRE NEW THEORIES OF FDI?

5.1 Implications and contributions

The main objective of this paper was to investigate whether OFDI from China really challenges extant theories of FDI. In particular, the attention of the literature on two important aspects - the alleged lack of strong FSAs by Chinese multinationals and the strong institutional role played by the Chinese state - could justify an attempt at revisiting the RBV and Institutional-based view. Another alleged characteristic of Chinese OFDI is the fact that it has not behaved in the same way as OFDI from more developed countries. In particular, it is argued in the literature that Chinese OFDI has targeted more developed markets at a quite early stage. After assessing the evidence the view is that Chinese OFDI may force scholars to carefully rethink the basic assumptions of the main theories of FDI and by extension, the

⁵ Aybar and Ficici (2009) then observe that completed M&As (of admittedly a large sample of emerging markets) are not very successful (i.e. they are value-destroying) in more than 50% of the case studies they examine.

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3 main assumptions behind the call for new or revised theories, but not support a wholesale re-
4 writing of existing theories.
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6 Recent clear examples of this approach are papers by Narula (2012) and Hennart (2012).
7 (Narula, 2012) and Cuervo-Cazurra (2012 page 162) believes that “infant MNEs” are not
8 different in developed and emerging markets. In other words, it is not correct to compare
9 MNEs from developed countries, which have had a long period of time to refine their own
10 FSAs and acquire international experience, with MNEs from emerging markets, which may
11 be novices. Hennart (2012) argues that CSA (country-specific assets) are not freely transacted
12 in open and transparent markets and therefore may give rise to further, monopolistic, FSA
13 (firm-specific assets). Once this, rarely specified assumption, is taken into proper
14 consideration, the alleged advantage of Chinese MNEs, in particular SOEs can be seriously
15 eroded.
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18 This paper has deliberately provided a more macro and historical approach to provide some
19 evidence that the three main pillars upon which most of the literature on OFDI from China
20 rests are not as strong as they are generally portrayed.
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23 As clearly shown, Chinese OFDI is a much recent phenomenon, very clearly in line with the
24 development in countries at similar levels of income per capita. The paper has also made a
25 strong argument that OFDI from China, were actually predicted by the IIPD and that China
26 as a whole is still at the early stages of the development path, while some (richer) Eastern
27 Provinces might have tentatively moved to more advanced stages.
28

29 The concentration of OFDI from a limited number of Provinces also put the idea that Chinese
30 firms have poor FSAs in a wider context. Stalk & Michael (2011) provide a comprehensive
31 assessment of the sophistication of Chinese consumers and the strengths of domestic firms in
32 a variety of industries. In many cases, those firms are established big local brands and,
33 originating from the more developed Provinces where incidentally they encounter also the
34 competition by foreign firms, they are also quite competitive.
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37 The paper has provided evidence that OFDI from China was neither sudden nor unpredicted.
38 Until 2007, Chinese outflows were barely undistinguishable from those of other emerging
39 countries and only after 2007 they have grown quite substantially.
40 The clear jump experienced after 2007 can also be explained by the worldwide recession
41 triggered by the financial crisis and by the decision of the Chinese government to diversify
42 the portfolio of assets held as foreign reserves by setting up a SWF (CIC), whose remit is to
43 increase OFDI.
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46 It was also shown that a large proportion of OFDI goes to THOFs, limiting somewhat the
47 amount of “real OFDI”. The fact that most OFDI flows are directed to “tax havens” or the
48 “near abroad” of Hong Kong surely complicates the picture. Although it would be unwise to
49 write off the entire stock of OFDI to “tax havens” as caused by round-tripping or other forms
50 of diversion, the fact that the ultimate owner and the ultimate destination is not known for
51 certain, surely renders any statistics about final destination at best opaque and surely highly
52 unreliable. The OFDI flows with a clear destination do not appear to contradict existing
53 theories as most of them are directed to other countries within the same region. Therefore, in
54 terms of the strategy, the “incremental internationalisation process” (The Uppsala approach
55 as in Johanson and Vahlne 1977, 1990, 2009) appears to be supported by the data (headline
56 takeovers in some developed countries apart) even once OFDI to Hong Kong is removed
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3 from the picture. It is also worth remembering that the initial seminal work was based on
4 empirical research based on a sample of Swedish firm in the context of a world economy,
5 which was significantly less globalised and integrated than today.
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7 Furthermore, the model assumed that due to limited knowledge of markets firms would take
8 small incremental steps, before fully committing to a particular market. It is possible to argue
9 that today, relatively speaking, knowledge of markets is more diffuse and possibly cheaper.
10 One missing ingredient of the original model was the (opportunity) cost of investing in
11 related countries, which might have presented lower returns than a more distant country. In
12 this sense the investment decision by Chinese OFDI appears to be perfectly reasonable as
13 most of it is directed to areas with high(er) returns, including China itself in case of round-
14 tripping.
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18 On the institutional level, one important characteristic of OFDI from China is represented by
19 the widespread presence of the state. As explained in the paper, the role of the state is quite
20 complex, not always entirely benign and sustainable, and can take the form of direct
21 involvement in terms of OFDI by SOEs, indirect influence in terms of the rules and
22 regulations and through the action of the SWF.
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24 This paper argues that OFDI investment by SOEs is not a new phenomenon, in particular in
25 the energy sector, and the literature would most definitely benefit from taking a more long-
26 term historical approach. The state (and all its representatives at more local level) also
27 intervenes in the economy with a variety of regulations. In particular, the interferences in the
28 financial sector (stock markets and banking sector) are quite widespread and have a direct
29 effect on OFDI. On past experience is reasonable to argue that periods of financial
30 repressions, eventually, come to an end and in many cases they end up badly, leaving behind
31 an inextricable legacy of misallocation of resources. Therefore, it might be unwise to
32 consider financial repression, at a macro level, as a reliable and sustainable country specific
33 advantage.
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36 On the evidence provided by the paper it is difficult to suggest a wholesale re-writing of the
37 current literature stemming from the experience of Chinese OFDI, although this phenomenon
38 may force a more careful consideration of the assumptions (explicit or implicit) of various IB
39 theories.
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