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Enter the dragon: Policies to attract Chinese investment

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Enter the dragon: Policies to attract Chinese investment

Bala Ramasamy

Matthew Yeung

ASIA-PACIFIC RESEARCH AND TRAINING NETWORK ON TRADE

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Abstract:

Over the last ten years, Chinese enterprises have become more multi-national in nature. China's outward foreign direct investment (OFDI) has been growing at a phenomenal rate. In 2012, China became the third largest investor, after the US and Japan; and the largest investor among developing countries. How can host governments attract more of this Chinese capital? What are some short to medium term policies that host governments can initiate to make their respective nations attractive to Chinese investors? We consider these questions by utilizing a best-worst choice exercise among 114 senior corporate decision-makers of Chinese companies who have planned or are planning to globalize. Using the maximum difference scaling methodology, we rank 19 most common determinants that influence FDI location choice. We propose five "low hanging fruits" that policy-makers should consider that could ensure their countries come within the radar of Chinese multi-nationals.

JEL classification: F21, F23, F40

Keywords: Foreign Direct Investment (FDI), outward FDI, FDI policies, China, Investment, Maximum difference scaling

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Introduction

An obvious consequence of the economic crisis that started in late 2007 has been the effect on global foreign direct investment (FDI) trends. In 2012, global FDI outflows continued its downward trend, decreasing by 17 per cent from the previous year. The EU was a significant region that reduced its FDI outflow in contrast to the developing countries that became a relatively more important source of capital. The share of FDI outflows by developed economies declined from 88 per cent to 65 per cent between 2000 and 2011 while developing and transition economies increased their share from 12 per cent to 35 per cent during the same period (UNCTAD, 2013). Among developing countries, China is increasingly becoming an important source of capital. In the 1990s, the average annual FDI outflow from China was about USD 2.3 billion. In the first half of 2000s, the annual average increased to about USD 5.2 billion. Since 2006, the increase in China's outward foreign direct investment (OFDI) has been phenomenal. In 2012, China's OFDI reached USD 84.2 billion. In terms of proportion, while in the 1990s, China's outward FDI accounted for less than 1 per cent of total world FDI outflow; in 2012, this surpassed the 6 per cent mark. This is also close to 20 per cent of FDI outflow among developing countries.

The benefits that FDI brings to a nation are evident from the literature. They range from job creation to technological advancement as well as creation of new industries through the spill-over effects of FDI. The many benefits that FDI offers on one hand, and the relative scarcity of FDI outflow on the other, create a competition for foreign capital. As Chinese businesses continue their "go global" strategy, it becomes increasingly important for policy makers to identify those factors that Chinese decision-makers consider to be important location factors; and structure their policies accordingly so that their respective countries are competitive in this FDI market. The objective of this paper is to identify location factors that Chinese managers look for when making internationalization decisions and the relative magnitude of the importance of various factors. The novelty of our study lies in the type of respondents we utilize for data collection and the method of data collection. While previous studies have used China's OFDI from various sources (China's Statistical Bureau, UNCTAD, Financial Times etc.) to consider the determinants of OFDI at the macro level, we base our analysis on the choices of actual decision makers who are senior managers of Chinese companies (both state-owned and private) involved in the internationalization process of their respective companies. Furthermore, we utilize best-worst choice decisions in our questionnaire design

such that decision makers must make trade-offs between various location factors, thus creating a more realistic and closer-to-live decision-making environment.

Although geography, economic size and growth, technology and natural resources are important factors that have been identified by previous studies (Buckley et al., 2007; Kolstad and Wiig, 2011; Ramasamy et al., 2011), in this study we focus on those factors that are within the control of host governments and could be implemented through agreements and policies in the short to medium term. Our findings point to five policies that require the immediate attention of host governments, especially national investment agencies.

In the next section we provide the setting of our study namely the trends of China's OFDI over the last few years. Section two builds the hypotheses of the study, focusing on ten policy factors that attract FDI. This is followed by a description of our sample, data collection procedures and the methodology of our analysis. In section four we discuss the results of our analysis. In the subsequent section we identify five low hanging fruits that host governments should consider in their effort to attract Chinese FDI. In the final section we conclude.

1. China's OFDI: Trends, destinations and sectors

Despite the brevity of China's OFDI phenomenon, the number of studies evaluating its trends, motivations and distinctness are numerous. Previous studies have also provided detailed accounts of the growth of Chinese OFDI (see for example Voss, et al, 2008). Rather than repeat these accounts and for the sake of brevity, we focus our attention on the trends in recent years, and highlight some salient points.

Table 1 shows the size of FDI flows for selected countries in recent years. Large FDI inflows into China are a well-known fact. In the last few years, China absorbed a lion share of global FDI inflow, with nearly 18 per cent of the world total inflow in 2012. China has proved to be one of the few economic hotspots during the turbulent global economic environment since 2008. However, as an investor, China is less important in comparison to more developed countries like the United States of America and Japan. However, among large emerging countries, China is a significant player. In 2012, more than 4 per cent of global FDI outflow came from Chinese enterprises.

Table 1: FDI inflows and outflows, recent years

	2008	2009	2010	2011	2012
FDI Inflows (USD billions)					
China	175.1	114.2	185	228.6	253.4
Russia	75	36.5	31.7	36.9	31.3
Brazil	45.1	25.9	48.5	66.7	65.3
India	43.4	35.6	27.4	36.5	25.3
United States of America	310.1	150.4	205.8	234	174.7
Japan	24.4	11.9	-1.3	-1.8	2.1
FDI Outflows (USD billions)					
China	53.5	43.9	60.1	43	62.4
Russia	55.6	43.7	41.1	48.6	31
Brazil	20.5	-10.1	11.6	-1	-2.8
India	19.3	15.9	15.3	12.6	8.6
United States of America	329.1	289.5	327.9	419.3	351.4
Japan	128	74.7	56.3	114.3	122.5
China FDI Inflow (per cent of GDP)	3.9	2.3	3.1	3.1	3.1
China FDI Outflow (per cent of GDP)	1.2	0.9	1	0.6	0.8
China FDI Inflow (per cent of World)	9.9	10	13.3	13.7	17.9
China FDI Outflow (per cent of World)	2.8	4	4.2	2.7	4.4

Source: OECD (2013) available from http://www.oecd.org/daf/inv/FDI%20in%20figures.pdf

Table 2 shows the locations to which Chinese OFDI has flowed to in recent years. Data from the Chinese National Statistical Bureau highlights a number of salient points, including:

- Asia accounts for the bulk of OFDI from China, with Hong Kong, China taking the bulk of the investment;
- On average, nearly 60 per cent of FDI flows into Hong Kong, China, with accumulated FDI stock in the territory (up to 2011) reaching more than 60 per cent. However, there has been a gradual decline in the importance of Hong Kong, China since 2008. Although Hong Kong, China attracted nearly 70 per cent of China's OFDI in 2008, it was less than 50 per cent in 2011;
- Tax havens like Virgin Islands and Cayman Islands account the next most important destinations, accounting for more than 12 per cent of OFDI stock;
- Nearly three quarters of Chinese OFDI stock are located in Hong Kong, China and several tax havens, which imply that these locations act as half-way locations before capital moves on to more permanent locations and/or as a place to park profits under reduced tax rates. A cursory look at Hong Kong, China's OFDI shows that nearly half the volume is to China[1], indicating possible "round-tripping" of Chinese investment;

[1] See http://gia.info.gov.hk/general/201312/10/P201312100288_0288_121734.pdf

- Other prominent locations are Singapore, South Africa, France, Russia, United States of America and Australia. These are countries where China's FDI stock exceeds USD 3 billion.

One could argue that once we remove Hong Kong, China and tax havens from the list of locations that Chinese OFDI has ventured thus far, the size of FDI outflows reduces to a relatively insignificant amount (compared to other large economies like the United States of America, Japan, Germany etc.). Two points are worth noting in this regard.

Table 2a: Significant destinations of OFDI from China

	in USD 10 000				
Year	**2008**	**2009**	**2010**	**2011**	**FDI Stock**
Total	**5590717**	**5652899**	**6881131**	**7465404**	**42478067**
Asia	**4354750**	**4040759**	**4489046**	**4549445**	**30343470**
Hong Kong, China	3864030	3560057	3850521	3565484	26151852
Indonesia	17398	22609	20131	59219	168791
Japan	5862	8410	33799	14942	136622
Macao, China	64338	45634	9604	20288	267589
Singapore	155095	141425	111850	326896	1060269
Republic of Korea	9691	26512	-72168	34172	158268
Thailand	4547	4977	69987	23011	130726
Viet Nam	11984	11239	30513	18919	129066
Africa	**549055**	**143887**	**211199**	**317314**	**1624432**
Algeria	4225	22876	18600	11434	105945
Sudan	-6314	1930	3096	91186	152564
Guinea	832	2698	974	2455	16843
Madagascar	6116	4256	3358	2310	25363
Nigeria	16256	17186	18489	19742	141561
South Africa	480786	4159	41117	-1417	405973
Europe	**87579**	**335272**	**676019**	**825108**	**2445003**
United Kingdom	1671	19217	33033	141970	253058
Germany	18341	17921	41235	51238	240144
France	3105	4519	2641	348232	372389
Russia	39523	34822	56772	71581	376364
Latin America	**367725**	**732790**	**1053827**	**1193582**	**5517175**
Bahamas	-5591	100			160
Cayman Islands	152401	536630	349613	493646	2169232
Mexico	563	82	2673	4154	26388
Virgin Is. (E)	210433	161205	611976	620833	2926141
North America	**36421**	**152193**	**262144**	**248132**	**1347243**
Canada	703	61313	114229	55407	372756
United States of America	46203	90874	130829	181142	899303
Oceania	**195187**	**247998**	**188896**	**331823**	**1200744**
Australia	189215	243643	170170	316529	1104125
New Zealand	646	902	6375	2789	18546

Source: China Statistical Yearbook, various years.

First, Chinese investments in several countries are quite significant. Apart from the countries listed in Table 2, China was the fifth largest investor in Mozambique and the ninth largest investor in Viet Nam. China's FDI stock in Cambodia is more than 12 per cent of total FDI stock while in Kazakhstan it is more than 4 per cent of total FDI stock[2]. Second, the rate at

[2] Based on Investment Climate Statements 2013 issues by the US Department of State, http://www.state.gov/e/eb/rls/othr/ics/2013/index.htm

which OFDI from China has increased since 2007 has been impressive, making it the third largest source of FDI in 2012 (UNCTAD, 2013). In addition, foreign investments by private Chinese companies are also increasing. Ramasamy et. al (2011) for instance found that more than 47 per cent of FDI projects undertaken by their sample Chinese companies listed on the Shanghai and Shenzhen stock exchanges were privately owned. Thus, understanding the determinants of China's OFDI, in anticipation of greater involvement of Chinese businesses, particularly private ones, in international investments in the future is definitely warranted

Table 2b: Shares of China's OFDI by destinations

	Percentage of total					
Year	2008	2009	2010	2011	Average Annual FDI Flow 2008-11	FDI Stock
Total						
Asia	**77.89**	**71.48**	**65.24**	**60.94**	**68.89**	**71.43**
Hong Kong, China	**69.12**	**62.98**	**55.96**	**47.76**	58.95	**61.57**
Indonesia	**0.31**	**0.40**	**0.29**	**0.79**	0.45	**0.40**
Japan	**0.10**	**0.15**	**0.49**	**0.20**	0.24	**0.32**
Macao, China	**1.15**	**0.81**	**0.14**	**0.27**	0.59	**0.63**
Singapore	**2.77**	**2.50**	**1.63**	**4.38**	2.82	**2.50**
Republic of Korea	**0.17**	**0.47**	**-1.05**	**0.46**	0.01	**0.37**
Thailand	**0.08**	**0.09**	**1.02**	**0.31**	0.37	**0.31**
Viet Nam	**0.21**	**0.20**	**0.44**	**0.25**	0.28	**0.30**
Africa	**9.82**	**2.55**	**3.07**	**4.25**	**4.92**	**3.82**
Algeria	**0.08**	**0.40**	**0.27**	**0.15**	0.23	**0.25**
Sudan	**-0.11**	**0.03**	**0.04**	**1.22**	0.30	**0.36**
Guinea	**0.01**	**0.05**	**0.01**	**0.03**	0.03	**0.04**
Madagascar	**0.11**	**0.08**	**0.05**	**0.03**	0.07	**0.06**
Nigeria	**0.29**	**0.30**	**0.27**	**0.26**	0.28	**0.33**
South Africa	**8.60**	**0.07**	**0.60**	**-0.02**	2.31	**0.96**
Europe	**1.57**	**5.93**	**9.82**	**11.05**	**7.09**	**5.76**
United Kingdom	**0.03**	**0.34**	**0.48**	**1.90**	0.69	**0.60**
Germany	**0.33**	**0.32**	**0.60**	**0.69**	0.48	**0.57**
France	**0.06**	**0.08**	**0.04**	**4.66**	1.21	**0.88**
Russia	**0.71**	**0.62**	**0.83**	**0.96**	0.78	**0.89**
Latin America	**6.58**	**12.96**	**15.31**	**15.99**	**12.71**	**12.99**
Bahamas	**-0.10**	**0.00**	**0.00**	**0.00**	-0.02	**0.00**
Cayman Islands	**2.73**	**9.49**	**5.08**	**6.61**	5.98	**5.11**
Mexico	**0.01**	**0.00**	**0.04**	**0.06**	0.03	**0.06**
Virgin Is. (E)	**3.76**	**2.85**	**8.89**	**8.32**	5.96	**6.89**
North America	**0.65**	**2.69**	**3.81**	**3.32**	**2.62**	**3.17**
Canada	**0.01**	**1.08**	**1.66**	**0.74**	0.87	**0.88**
United States of America	**0.83**	**1.61**	**1.90**	**2.43**	1.69	**2.12**
Oceania	**3.49**	**4.39**	**2.75**	**4.44**	**3.77**	**2.83**
Australia	**3.38**	**4.31**	**2.47**	**4.24**	3.60	**2.60**
New Zealand	**0.01**	**0.02**	**0.09**	**0.04**	0.04	**0.04**

Source: China Statistical Yearbook, various years.

In terms of sectoral distribution of OFDI, Table 3 shows that about a third of China's overseas investments are in leasing and business services and about 16 per cent in financial intermediation. These two sectors account for about half of China's OFDI stock and are most likely related to destinations like Hong Kong, China and the tax havens mentioned

earlier. The other important sectors are mining and wholesale & retail trade. Manufacturing FDI makes up 6.3 per cent of OFDI stock. Thus, natural resources and servicing trade activities seems to be important motivations for the outflow of capital.

Table 3: China's OFDI, sectoral distribution

	in USD 10 000					% of total				
Sector	**2008**	**2009**	**2010**	**2011**	**Stock as at end of 2011**	**2008**	**2009**	**2010**	**2011**	**Stock as at end of 2011**
Total	5590717	5652899	6881131	7465404	42478067					
Agriculture, Forestry, Animal Husbandry and Fishery	17183	34279	53398	79775	341664	0.3%	0.6%	0.8%	1.1%	0.8%
Mining	582351	1334309	571486	1444595	6699537	10.4%	23.6%	8.3%	19.4%	15.8%
Manufacturing	176603	224097	466417	704118	2696443	3.2%	4.0%	6.8%	9.4%	6.3%
Production and Supply of Electricity, Gas and Water	131349	46807	100643	187543	714056	2.3%	0.8%	1.5%	2.5%	1.7%
Construction	73299	36022	162826	164817	805110	1.3%	0.6%	2.4%	2.2%	1.9%
Transport, Storage and Post	265574	206752	565545	256392	2526131	4.8%	3.7%	8.2%	3.4%	5.9%
Transmission, Computer Services and Software	29875	27813	50612	77646	955324	0.5%	0.5%	0.7%	1.0%	2.2%
Wholesale and Retail Trades	651413	613575	672878	1032412	4909363	11.7%	10.9%	9.8%	13.8%	11.6%
Financial Intermediation	1404800	873374	862739	607050	6739329	25.1%	15.5%	12.5%	8.1%	15.9%
Real Estate	33901	93814	161308	197442	898616	0.6%	1.7%	2.3%	2.6%	2.1%
Leasing and Business Services	2171723	2047378	3028070	2559726	14229002	38.8%	36.2%	44.0%	34.3%	33.5%

Source: China Statistical Yearbook, various years.

2. What attracts Chinese investments: Hypotheses development

Research into the determinants of China's OFDI started to gained momentum in the mid 2000s. Studies by Buckley et. al (2007) and Cheung and Qian (2009) for instance attempted to identify the general locational factors that influenced China's FDI outflows, highlighting if the prevalent international business theories were sufficient to explain the China phenomenon. In more recent years, the focus has shifted towards more specific determinants like culture and political risks (Quer et. al, 2012; Ramasamy et. al, 2011; Kolstad and Wiig, 2011). Our focus in this paper is to identify those determinants that are

within the control of policy makers in the short to medium term. Although market size and growth as determinants of FDI outflow generally (Chakrabarti, 2001) as well as in China's case (Buckley et. al, 2007 and others) is well established, these are factors that can only be influenced in the longer term. On the other hand, negotiating a free trade agreement with China, or encouraging more trade flows are policies that could be affected in the short to medium term. These and other relevant policies are the hypotheses that we develop in the following paragraphs.

If the purpose of FDI is to circumvent high import tariffs, Regional Trading Arrangements (RTAs) involving China would reduce FDI to partner countries as arms length business transaction may become a cheaper option. However, this could be true only for country-specific market seeking FDI. On the other hand, if RTAs are designed to increase economic activity of the region because of a larger common market and improved overall efficiency, potential growth could be FDI enhancing (Blomstrom and Kokko, 1997). Case studies on RTAs and FDI tend to show that these are indeed investment enhancing policies. In the case of the NAFTA for instance, Mexico attracted large amounts of FDI both before and after the agreement came into effect (Kokko, 1994 and Blomström et al., 1994). However, RTAs are rarely included into empirical studies. In studies that included it as a determinant, there has been strong support (Blonigen and Piger, 2011). It should be noted however, that FDI flows between partner countries are only enhanced if the RTA allows for liberal FDI policies including offering national treatment to foreign enterprises (Berger et. al, 2012). Medvedev's (2012) study indicates that RTAs formed in the last two decades tend to be more inclusive of investment components and so are FDI enhancing.

In the context of Chinese businesses, RTAs can be attractive because it allows an extension of the supply chain abroad to take advantage of capabilities available in partner countries. This may include cheaper labour in relatively less developed economies like Myanmar and Cambodia (as per Collie's (2011) export platform variety) as well advanced technology in more developed economies like the United Kingdom and Germany. Reduced barriers to trade and investment via these RTAs can create an impetus for more investments into partner countries. Given this, we hypothesize that:

H1: Chinese managers consider countries that have a trade agreement with China as relatively more attractive investment locations.

The notion that increased trade and FDI flows between countries reduces the probability of nations going into conflicts is well accepted. This proposition, also known as the liberal peace hypothesis states that countries trading intensively with each other are less prone to engage in bilateral conflict because it is easier to acquire goods through trade than through armed conflicts (Rosecrance, 1986). In addition, the trading relationship increases contacts between individuals, businesses and governments of both countries, and so political co-operation is promoted. In the case of FDI, the argument that political relationships are enhanced is even more compelling since FDI has positive effects on both host and home countries and is longer term in nature (Polachek et. al, 2005). However, inter-state relationship as a determinant of bilateral FDI has received limited attention. The focus in international business and international political economy literature has been the role of country specific attributes like political stability of a nation (Sethi et. al, 2003; Globerman and Shapiro, 2003; etc.) or democratic institutions (Garland and Biglaiser, 2009; Jensen, 2008).

For a multinational, a soured bilateral relationship between home and host countries can increase the risk of doing business as the fear of the host country expropriating the assets of the multinational as an instrument of retaliation increases (Boehmer et al., 2001; Desbordes and Vicard, 2005). Nigh (1985) argues that host country officials and citizens do not differentiate the interests of the public and private sector of the home country, and so inter-state relationships provide valuable information to the investor on the business environment of the host country. This was proven in the case of manufacturing FDI by US firms to 24 countries over a period of 21 years, where inter-nation cooperation increases FDI flows and vice versa for inter-nation conflicts. Further evidence was provided by Li and Vaschilko (2010), in particular for FDI involving low-income countries. More recently, territorial disputes between China and Japan on the islands of Diaoyu/Senkaku and the establishment of an Air Defence Identification Zone by China damaged trade relationship between the countries including a call for boycott of Japanese goods in China (Financial Times, 29 Nov. 2013).

In China, there is significant influence of government in OFDI. The biggest source of FDI is known to be from state-owned enterprises (SOEs) (Morck, et. al, 2008) while private Chinese firms invest in locations that already host Chinese SOEs for strategic reasons (Ramasamy et. al, 2011) i.e. to act as important suppliers. With continued sponsoring or even direct funding by the state (Buckley et. al, 2007; Zhang, 2003), the importance of host locations that have cordial relationship with China cannot be overstated. Thus we argue that:

H2: Chinese managers consider the international relationship that host countries has with China an important factor when choosing investment locations.

A related issue within the broader area of international relationships is visa requirements of Chinese citizens, particularly business people, to enter foreign countries. Neumayer (2011) argues that potential gains from FDI can only be discovered after personal contact and multiple face-to-face meetings. Thus, visa restrictions can damage FDI by increasing the risk of doing business. Estimates show that unilateral and bilateral visa restrictions can reduce FDI by about 25 percent. An evidence of the negative impact of visa restrictions is reported to be the shift of Huawei's headquarters from the UK to Germany, which was due to the Schengen visa facilities offered by Germany among other reasons (The Telegraph, 2011). The importance of relaxing visa restrictions was also highlighted in a policy memorandum of the US's Council on Foreign Relations as a means towards attracting greater Chinese FDI (Marchick, 2012).

Given the above arguments, we propose that:

H3: Chinese managers are attracted to invest in countries and territories that offer relatively easy entry (visa) permits.

The institutional approach of explaining FDI location choices suggests that MNCs require an institutional legitimacy to survive and succeed in a foreign environment (Kostova and Zaheer, 1999). It has even been suggested that institutions affect all three components of Dunning's eclectic paradigm (Dunning and Lundan, 2008). Studies have shown that decisions of Chinese MNCs on FDI locations are shaped by the institutional forces both at home (Buckley et.al, 2008; Alon and McIntyre, 2008) and host locations (Globerman and Shapiro, 2002; Rui and Yip, 2008).

In traditional FDI literature, locations that are institutionally less repressive to FDI would be favoured (Kang and Jiang, 2011). However, in the context of Chinese MNCs, the evidence thus far has been mixed (Quer et. al, 2012). Duanmu (2011) and Duanmu and Guney (2009) suggested that these MNCs are no different than their counterparts from other parts of the world in that they would be reluctant to invest in countries that are institutionally unpredictable. Others like Cui and Jiang (2009) found that institutional risks do not affect the decision choices of Chinese MNCs while Buckley et. al (2007) did not confirm the negative association between outward FDI and high levels of political risks in host countries. However, there are also several studies that report the preference of Chinese MNCs for countries that

are institutionally risky (Kang and Jiang, 2011; Malhotra and Zhu, 2009; Ramasamy et. al, 2011; Kolstad and Wiig, 2011). Ramasamy et. al (2011) found that the affinity to institutional risks is ownership dependent i.e. Chinese MNCs owned by local government are attracted to natural resource rich countries with weak institutional systems but private Chinese firms are more risk averse.

Given the mixed results from previous studies, we propose that:

H4: Chinese managers consider institutional risks in host locations to be a significant determinant of location choice decisions.

The FDI Report 2013 alluded to the role of host country taxation on FDI inflows (Financial Times, 2013). At a multilateral level, low corporate tax paid by MNCs in some countries irks other high tax home country governments. Nevertheless, tax incentives can act as an attraction for FDI inflows. Using a sample of 46 countries (accounting for 80 per cent of world GDP in 2011; and 70 per cent of FDI projects between 2010-12), the Financial Times showed a clear correlation between lower tax rates and stronger performance in attracting FDI even when economic size was controlled for. A study of 25 cities in Europe found that a one-point decrease in corporate tax increased FDI job creation up to 4 per cent, depending on the starting level of corporate tax (Financial Times, 2012).

In a global survey of tax incentives, UNCTAD (2000) explain that incentives are only secondary to more fundamental determinants like market size, access to raw materials and availability of skilled labour. Thus, investment incentives come at the second stage of the country choice decision process. Nevertheless, because of the speed and ease at which these incentives can be changed, tax incentives are popular among many governments (85 per cent of the surveyed 45 countries offered some form of tax rate reductions). Blomstrom and Kokko (2003) argued that investment incentives are not necessarily an efficient way to increase national welfare. The important motive for providing financial incentives i.e. spillovers of foreign technology and skills to the domestic economy is not guaranteed, particularly if local firms and labour force does not have the capability to absorb these positive spillovers. The investment incentive policies among many Investment Promotion Agencies (IPAs) in the European Union for instance tend to be nationality neutral. Thus, foreign firms receive the same treatment as local firms (Clegg and Voss, 2012).

For Chinese MNCs, tax and investment incentives can act as a deal-breaker because investment outflows could take place as a way to circumvent higher tax rates at home. Since

domestic tax rates could go as high as 33 per cent of sales revenue, managers can be motivated to move their more profitable aspect of their business abroad (Korniyenko and Sakatsume, 2009).

We propose that:

H5: Chinese managers are relatively more attracted to countries that offer lucrative tax and investment incentives.

Both Dunning's eclectic paradigm and the Transaction Cost theory tend to suggest that national cultural distance is a significant determinant of FDI (Dunning, 1993; Shenkar, 2001). Cultural similarity increases FDI flows between two countries due to more efficient communication and lower managerial costs (Edwards and Buckley, 1998). Cultural similarity also reduces uncertainties over investment prospects and facilitates learning about both countries (Kogut and Singh, 1988). The close cultural distance provides some explanation to the large amount of inward FDI flow into China from Hong Kong, China and Taiwan Province of China, particularly in the early years of economic reforms, despite the vast differences in political systems.

Buckely et. al (2007) argued that since the Chinese diaspora in East Asia largely contributed to the globalization of China, the guanxi networks that Chinese managers had built over the years are used to identify business opportunities abroad. The size of Chinese population in host countries as a determinant of OFDI finds empirical support in Buckley et. al (2007). Similar results also turn up in Ramasamy et. al (2011) and Quer et. al (2012) although in the former, the cultural distance variable is not significant among private Chinese companies.

Given the dominant support by previous literature, we suggest that:

H6: A sizeable overseas Chinese population in host countries is an important factor influencing the OFDI location choice of Chinese managers.

Exports to and import from the home country as a determinant of FDI inflows has been addressed in previous literature to explain if FDI and trade are substitutes or complements. Horizontal FDI is considered as a substitute for imports from the home country while vertical FDI is complementary to imports (Markusen, 1984; Brainard, 1997; Markusen and Venables, 2000). Rather than considering trade as a determinant, perhaps it should be thought of as a consequence of FDI inflows. However, in the context of our research, trade flows to the host country can be seen as a way to decrease the perceived "liability of foreignness" (Zaheer,

1995). Host countries that are important trading partners of China will be more familiar with Chinese brands, Chinese companies and Chinese people. In like manner, the tendency for foreign investors to agglomerate near other firms from the same country of origin (Head et. al, 1999; Shaver and Flyer, 2000) also implies that managers would prefer those locations that have already attracted other Chinese investments.

Thus we propose that:

H7: Chinese managers are attracted to host countries that are significant destination of Chinese exports and/or source of Chinese imports.

H8: Chinese managers are attracted to host locations that have already attracted a significant amount Chinese OFDI.

Efficiency seeking FDI flows to countries that offer labour cost advantages (Dunning, 1993). This is especially true for manufacturing based FDI and the offshoring of labour intensive services activities. However, Chakrabarti's (2001) review of empirical studies provided a mixed set of results i.e. positive, negative and insignificant relationship between wages and FDI inflows. Studies that considered the FDI inflows into China, especially during the 1990s, tend to show a negative relationship between wages and FDI inflows when productivity is controlled for (Coughlin and Segev, 2000). This was particularly true for the inland provinces of China (Ramasamy and Yeung, 2010). Although cheap labour had been an attractive characteristic of the Chinese economy, in recent years, rising labour costs has been stated as a reason for the shifting of labour intensive activities to neighbouring countries including Viet Nam and Cambodia (Wang and Wang, 2011). By investing in countries that are relatively less developed, Chinese firms are able to exploit their existing competitive advantage, and defend their positions as low cost producers (Parmentola, 2011). Thus it is likely that cheaper labour cost in other locations could attract Chinese FDI, especially labour intensive production processes. We suggest that:

H9: Chinese managers are attracted to locations that offer cheaper labour resources.

Similar to lower labour cost, FDI would also flow to locations that are able to provide quality public infrastructure, including paved roads, ports, telecommunication networks and stable electricity supply. Such infrastructure can reduce the cost of doing business and provide an incentive for vertical FDI and efficiency seeking FDI (Markusen, 1984). Empirical evidence to support this determinant is robust (Coughlin et. al, 1991; Wheeler and Moody, 1992). As a

recipient of FDI, China was able to become an attractive location because of the impressive network of roads it offered (Cheng and Kwan, 2000). However, it should be noted that a recent study of FDI inflows into various districts in India suggest that a significant positive relationship between FDI and infrastructure only takes effect after a certain threshold level of infrastructure has been reached (Subramanian et. al, 2011).

We propose that:

H10: Chinese managers consider the quality of infrastructure in host locations as an important determinant when selecting location for foreign investment.

3. Data and method

Previous research that studied the determinants of China's OFDI tend to rely on secondary data for the LHS variable. Buckley et. al (2007) for instance relied on the total amount of foreign exchange approved by China's State Administration of Foreign Exchange. Cheung and Qian (2009) use OFDI approved by the Chinese authorities, while Kolstad and Wiig (2011) use data from UNCTAD. Ramasamy et. al (2011) on the other hand use data based on actual number of investment projects reported in the annual reports of listed Chinese companies while Amighini et. al (2011) use the Financial Times' FDI database comprising all new cross border greenfield investments. The novelty of our study is in the primary data collection method used. We went to the source of the decision-making process, i.e. the managers.

The population we based our study on was a pool of senior managers studying for an Executive MBA (EMBA) programme at a leading business school in China. The school recruits about 750 EMBA students a year, divided into 12 classes of about 65 students each, based in Shanghai, Beijing and Shenzhen. Nearly 85 per cent of the students of the 2012 and 2013 intake claim to be in a senior management position. Four and three classes from the 2012 and 2013 intakes respectively were chosen for this study, representing about 450 students. A preliminary survey was handed out comprising questions related to the experience of the manager/company in international investment, the role of the manager in such a decision-making process and also the willingness of the manager to take part in a further study. A total of 128 managers were found suitable in that they fulfilled all three

above-mentioned criteria. An email was sent out to these managers inviting them to do an online choice survey. After several reminder emails, a total of 114 surveys were successfully completed. The online survey comprised of two parts: eight general questions on respondents' backgrounds and a 12-round Maxdiff tasks described below. A summary profile of our respondents is provided in Table 4. Our respondents come from various industries although about a quarter are linked to the manufacturing industry. About a quarter are from state-owned firms while two thirds are from private companies. Table 4 also shows that our respondents mainly come from large companies with more than 40 per cent linked to companies with annual average turnover of more than RMB 1 billion and an employee size of more than 1000 people. About 60 percent of our respondents will be venturing into investment abroad for the first time.

We designed our survey according to the maximum difference scaling methodology (Maxdiff) (see Sawtooth, 2013[3] ; Louviere et al., 2013; Adamsen et al. 2013). Maxdiff studies are designed to determine the relative importance among a large number of attributes of a particular subject. Because the data collection process asks respondents to select their best and worst choice among sets of alternatives, it is also known as best-worst choice experiment. Maxdiff has a number of methodological advantages when compared to many traditional methods. Cohen and Orme (2002) showed that Maxdiff performs better in terms of predictive accuracy when applied to any sort of evaluation. It could also offer some information that normal econometric analysis is incapable of handling.

Asking respondents to rate the importance of a large number of attributes has many weaknesses including respondent fatigue. To overcome the associated weaknesses, an alternative is to offer a pair of attribute, and respondents are asked to choose the more significant one. All possible pairs need to be compared by respondents. In such a case, respondents are loaded with a large number of repeated tasks especially when the numbers of attributes are large. In contrast, in a given Maxdiff study each respondent evaluates only a fraction of all possible subsets of attributes. Buckley et al. (2007) applied the choice experiment to a group of managers from Australia, Denmark and the US to determine the relative importance among 12 attributes that would be relevant to making a location choice decision. Their data collection was done via a paper-and-pencil method. However, Jaeger

[3] http://www.sawtoothsoftware.com/downloadPDF.php?file=maxdifftech.pdf (accessed on Jan 2014)

and MacFie (2010) recommended to collect Best-Worst choice data via electronic data collection methods because respondents are more likely to miss out one of the two

Table 4: Profile of respondents

Profile	Categories	Percentage
Industry	Agriculture, Forestry, Animal Husbandry and Fishery	4.4
	Mining	2.6
	Manufacturing	25.4
	Production and Supply of Electricity, Gas and Water	1.8
	Construction	4.4
	Transport, Storage and Post	3.5
	Information Transmission, Computer Services and Software	14.9
	Wholesale and Retail Trades	2.6
	Hotels and Catering Services	3.5
	Financial Intermediation	9.6
	Real Estate	9.6
	Scientific Research, Technical Service and Geologic Prospecting	0.9
	Management of Water Conservancy, Environment and Public Facilities	1.8
	Services to Households and Other Services	2.6
	Health, Social Security and Social Welfare	0.9
	Culture, Sports and Entertainment	4.4
	Others	7.0
Type of Company	State owned, listed	8.8
	State owned, unlisted	17.5
	Private, listed	18.4
	Private, unlisted	46.5
	Joint venture	1.8
	Other	7.0
Annual turnover value	10to 100 million	14.0
	100 milion to 1 billion	45.6
	More than 1 billion	40.4
Number of employees	Less than 100	13.2
	100 to 499	30.7
	500 to 999	12.3
	More than 1000	43.9
Previous investment experience	Yes	40.4
	No	59.6

Note: Total respondents: 114

selections when completing the best-worst tables, leading to increased difficulties in exploring preference heterogeneity. In addition, conducting choice experiment via electronic data collection methods allows the researcher to ensure that one task is completed before moving on to the next task. Unlike collecting choice data electronically where choice sets are displayed in a sequential order one set at a time (for example, see Table 6), paper-and-pencil studies display all choice sets to the respondents at once. In this regard, the former method makes each choice task more independent from each other, while the latter allows the possibility for the respondents to make references to their own selections in the previous choice tasks when completing the current choice task.

From the literature, we identified 19 determinants of FDI (see Table 5). Ten of these are related to the hypotheses we developed in the previous section. We also included other common determinants like geographic location, market size and growth, purchasing power as well as availability of technology and natural resources. We generated our research plan according to Orme's (2005) recommended settings.

We asked respondents to complete 12 best/worst choice tasks; each task comprising of five attributes. For each task, respondents were asked to indicate which of the five attributes (items) was the most important and the least important when deciding on an investment location. In a real life situation, managers must make trade-offs, and our survey attempts to replicate reality in a small way. Thus, the importance of an attribute is measured relative to other selected attributes. This kind of response provides adequate discrimination to help the researcher identify real priorities (see Finn and Louviere, 1992).

The entire survey was done in Chinese. An example task, translated into English, is displayed in Table 6. Asking respondents to select both the most- and least-preferable option can capture information from respondents efficiently. For example, if a respondent selected *A* and *D* as his most- and least-preferable option among four items (A to D), the specific task reveals six relationships: A>B, A>C, A>D, B=C, B>D, C>D. Applied researchers find this method to be versatile and extremely efficient as it saves respondents' time, effort, and fatigue (e.g. Garver *et al.* 2010). In our study, running 12 tasks with five country specific attributes per task results in each attribute appearing at least three times per respondent. All attributes were shown an equal number of times. All settings satisfied Orme's (2005) recommendations.

Table 5: The choice of determinants included in the study

1	This country is located in the Greater China region
2	This country is located in South Asia
3	This country is located in the US or Europe
4	This country is located in Africa
5	This country has a large Chinese population
6	This business environment in this country is relatively less corrupted.
7	This country offers a simple visa application process
8	This country has a large market size

9	This country has strong economic growth
10	This country has a higher purchasing power compared to China
11	This country has good infrastructure
12	This cost of labour in this country is cheaper than China
13	This country has trade agreements with the China
14	This country has rich natural resources
15	This country is known for advanced technology and innovation
16	This country is popular among other Chinese investors
17	This country is an important trading partner of China
18	This country has good diplomatic relations with China
19	This country provide attractive tax incentives

Table 6: A sample of most/least important evaluation task

Consider the following 5 factors. Select the most important factor and the least important factor that influence your overseas investment decision.		
Most important	Least important	Factors
		the recipient country has good diplomatic relationship with the Chinese government
		the recipient country provides strong economic growth
		the recipient country provides simple visa applications procedures for investors
		the recipient country has good physical infrastructure
		the recipient country has a large Chinese population

After collecting the choice data, we used the hierarchical Bayes (HB) methodology to estimate the item scores for each respondent under the logic rule using Sawtooth built-in HB algorithm.

4. Results

The summary statistics of individual scores for each attribute are reported in Table 7. The mean value shows the relative importance of each of the considered country attribute, in order of importance.

Table 7: Summary statistics of relative importance of factors that influence investment decisions

Rank	Factor	Mean (per cent)	Accumulated Mean (per cent)	S.D.	Min	Max
1	Market size	11.616	11.616	2.053	0.008	15.055
2	Economic Growth	10.549	22.165	1.930	0.016	13.052
3	Relatively less corrupted business environment	8.052	30.217	4.853	0.023	16.183
4	Availability of Advanced technology	7.957	38.174	2.202	0.003	13.937
5	Good diplomatic relationship with China	7.347	45.521	4.204	0.004	15.899
6	Trade Agreement with China	6.914	52.435	4.583	0.566	16.078
7	Attractive tax incentives	6.616	59.051	1.991	0.028	9.164
8	Availability of natural resources	6.588	65.639	4.032	1.324	16.962
9	High purchasing power	6.373	72.012	3.938	1.070	17.545
10	Important trading partner	5.515	77.527	4.803	0.032	15.279
11	Good infrastructure	4.904	82.431	3.586	0.212	14.637
12	Popular among Chinese investors	3.921	86.352	3.595	0.019	14.524
13	Located in US or Europe	3.837	90.189	3.891	0.368	15.449
14	Lower labour cost	2.831	93.02	5.837	0.012	18.035
15	Large Chinese Population	2.727	95.747	5.112	0.170	16.590
16	Simple visa procedures	1.871	97.618	3.287	0.225	15.273
17	Located in Africa	0.900	98.518	4.370	0.118	15.058
18	Located in South Asia	0.750	99.268	4.565	0.185	16.532
19	Located in Greater China	0.733	100.00	3.653	0.294	15.210

These average scores were derived from the analysis of both best and worst scores. Market size and market growth were ranked the top two factors influencing the respondents' investment decisions. A high purchasing power (ranked ninth) contributes 6.4 per cent of the

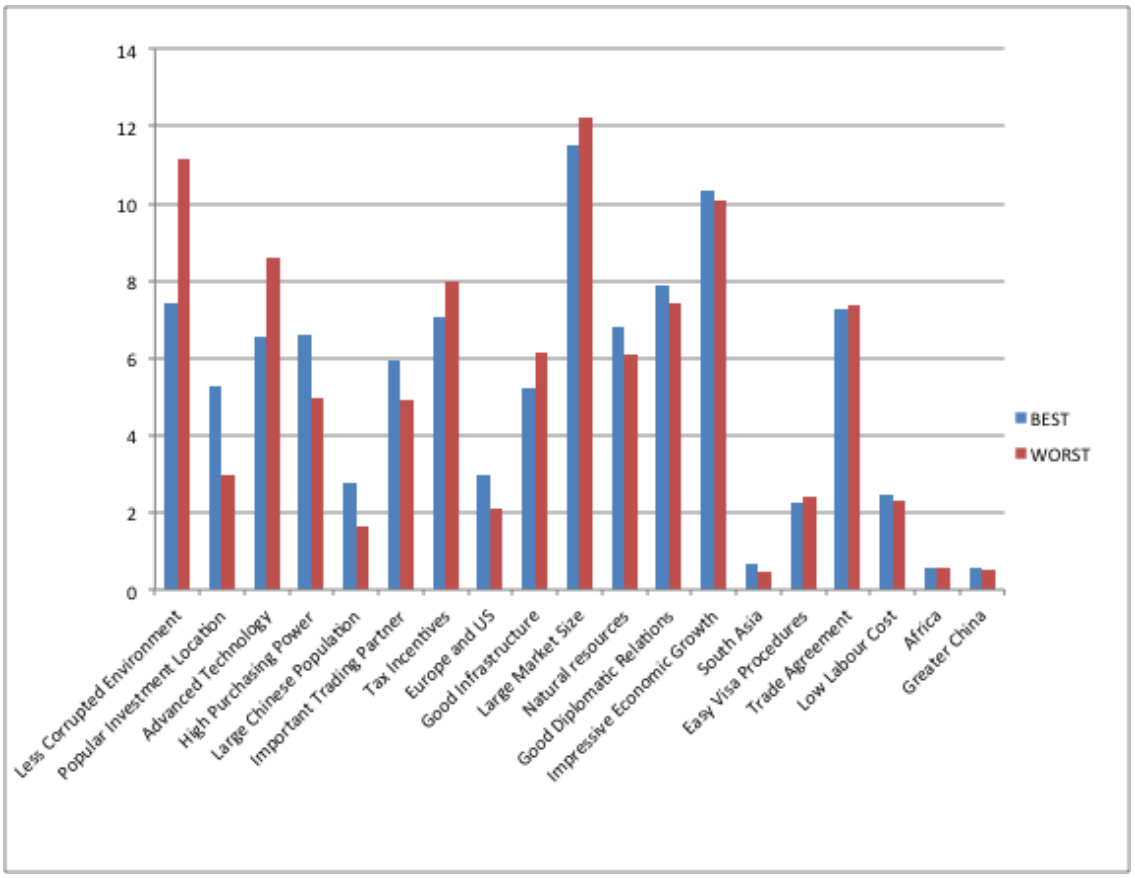
importance. Thus, market related factors (size, growth and purchasing power) accounted for more than 28 per cent of the overall importance. Although previous studies (for example Buckely et. al, 2007; Ramasamy et. al, 2011; Amighini et. al, 2011) also showed the significance of these market factors in determining location choices of China's OFDI, we are able to show the extent to which they influence the decision-making. At the other end, our respondents do not consider geographic location to be relatively important. Locations closer to home and in developing economies in South Asia and Africa are among the least significant determinants. The US and Europe however are relatively more attractive.

Turning now to our hypotheses, we find that the ten determinants of location choice are important in varying degrees. If we use 80 per cent accumulated mean score as the cut-off for evaluating the degree of importance, our results provides support for H1, H2, H4, H5, H7 and H10. There is some amount of justification to reject H3, H6, H8 and H9. Considering the order of importance, institutional risks, operationalized in our study by a less corrupted business environment, is the most important determinant among our hypothesis. Countries with good diplomatic relationship and those that have trade agreements with China are also among the preferred locations for Chinese investment. This is irrespective of the geographic location. Chinese managers are also looking for incentives from the host government. Prior international business experience does count, even arms length relationship through trade. On the other hand, visa restrictions and a sizeable Chinese population in host countries are relatively less important. Labour costs that are relatively cheaper than China is also relatively unattractive. The implications of the supported and unsupported hypotheses are discussed in the next section.

As a robustness test, we also analyzed the best-only and worst-only choice data to check if any discrepancy exists when preferences are analysed separately. In other words, a choice that is most preferred should also be the one that is least rejected. The average relative importance based on most preferred and least preferred is shown in Figure 1. The least preferred choice has been rescaled such that it represents the extent to which a particular determinant is *never* rejected. As shown in the figure, choices are consistent for most determinants. Three determinants with the highest degree of inconsistency are: a relatively less corrupted environment, popular investment location, and advanced technology. This can be interpreted as follows: Though a relatively less corrupt environment has been ranked as a very important determinant of location choice, the extent to which it has never been

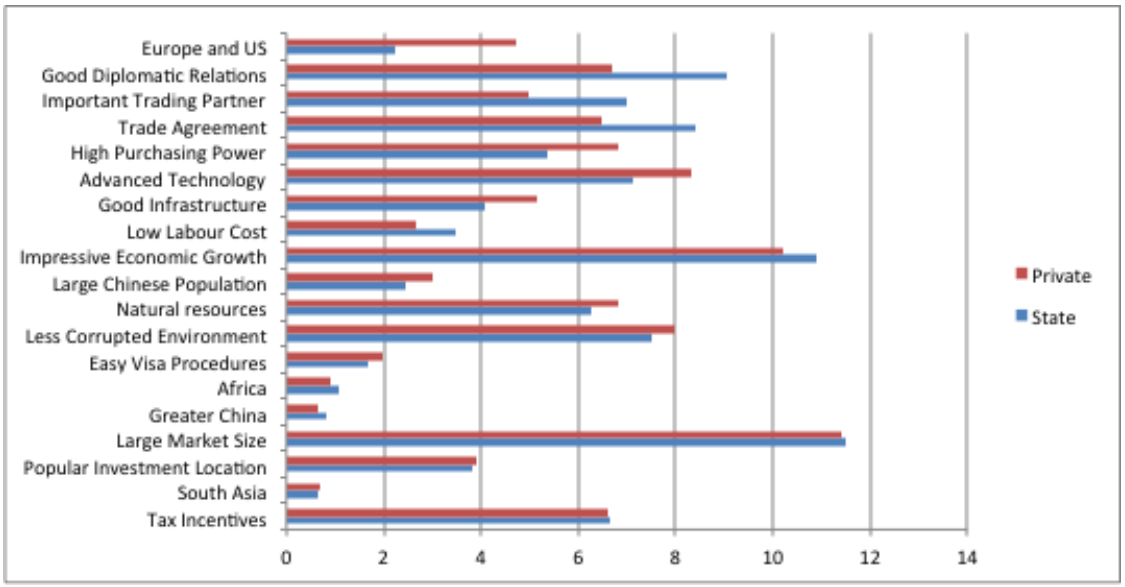
ranked as a worst choice is even greater. Overall, our data collection and the ranked choices are robust.

Figure 1: Best-worst ranking of determinants



In addition to the analysis above, we also separated our sample according to the type of firm ownership i.e. private (74 respondents) and state owned (30 respondents). Since previous studies have not dwelled too much into location choice and firm ownership (the exception being Ramasamy et. al, 2011), building and justifying hypotheses of such relationship seems premature. Nevertheless, we provide the rankings of the determinants based on ownership in Figure 2. Our results show that generally, there is little difference among the choices of the sub-samples. However, ANOVA test reveals four significant differences. There is a clear preference to locate in more developed countries in the West among private enterprises. Not surprisingly, state-owned firms on the other hand, have a relatively greater preference to locate in countries that have good diplomatic ties, are important trading partners and have trade agreements with China.

Figure 2: Private vs. state-owned ranking of determinants



5. Implications for policymakers

What can a host country government do to attract a portion of the nearly USD 100 billion capital that leaves the shores of China annually? This has been the motivating question of this study. In particular, we are interested in short to medium term policies that host governments can implement that could make their respective countries attractive enough such that their nation would appear in the radar of Chinese companies seeking to internationalize their business. No doubt, having a large and growing market with high purchasing power attracts market seeking Chinese firms, while countries offering advanced technology would attract these companies with a strategic interest. In addition to these factors, or despite not having them, our study offers five key policies that host country governments should consider.

a) Minimize institutional risks – Although previous studies based on macroeconomic data (Ramasamy et. al, 2011; Kolstad and Wiig, 2011) suggest that Chinese companies are attracted to countries with weak institutions or rather corrupted systems, our study suggest otherwise. Our respondents reveal that they prefer a business environment that is less corrupted, and rank this high on their wish list. The relatively significant importance placed on this factor applies to both private and state

owned companies. This change in preference suggests that Chinese companies are reaching a point where they possess some form of ownership specific assets that they wish to protect. Host government efforts in raising the level of integrity in B2B and B2G relationships will attract the necessary investment. Countries that already have a relatively clean business environment may wish to highlight this fact when dealing with Chinese prospects.

b) Promote international relations with China – Political relationships between China and the host country seems to matter to Chinese managers. This could be due to the important role the state plays in the Chinese economy, particularly in promoting the outward expansion of Chinese enterprises and the engineering of selected industries at home. Chinese managers may also be fearful of the risks involved when political relationships turn sour. The huge investments made in Africa by Chinese enterprises on the one hand, and the boycott by certain quarters of Japanese products on the other, are two clear examples of how politics and business are intertwined.

c) Initiate trade agreements with China – Trade agreements can be seen as a way in which political relationships are taken one notch higher. In an era where tariffs are relatively low historically, trade agreements can ease the way in which business is done by businesses domiciled in two or more countries. The ease at which good and services can move across borders, reduction in red-tapes as well as the movement of managers between two countries can encourage greater economic relationships. China, in particular, has been active in establishing trade agreements since 2000. The China-ASEAN FTA, China-Chile FTA, China-New Zealand FTA, and others are examples of the rigor at which the Chinese authorities are promoting trade and investment relationships in the absence of a WTO initiated multilateral framework.

d) Offer and promote tax and investment incentives – Although a McKinsey (2003) study suggests that investment and tax incentives are not the primary drivers of an MNCs location choice, our study shows otherwise. Perhaps the subsidy and incentive culture is strong in China that managers expect these in overseas locations as well. Similarly, the relatively high tax environment in China may make tax incentives exceptionally attractive. Additionally, given the brevity of the global expansion of Chinese enterprises, any form of reduction in the cost of doing business may be seen as attractive. This is particularly true for low-tech industries like garments, footwear and other labour intensive industries that are cost-driven. Lower

wage countries like Viet Nam, Laos, Cambodia, Bangladesh and others keen in attracting Chinese low end manufacturing will need to offer tax and investment incentives to make up for other barriers (eg. weak infrastructure and logistics) that may exist.

e) Encourage more trade with China – In a typical stages approach towards internationalization, arms length relationship is a pre-cursor to deeper equity based relationship. A host country that has established sound trade relationships with China provides confidence to managers that Chinese goods and services are accepted by the local market. The liability of *Chineseness* is minimized and deeper relationships can be considered. “Crossing the river by feeling the stones” – a famous saying of Deng Xiaopeng – has been a mainstay of Chinese economic reforms. In like manner, Chinese managers are pragmatic in their internationalization decisions.

6. Conclusion and limitations

Governments, both from the developed and the developing world, are actively pursuing Chinese businesses to invest in their countries. Since investors from China may be different in terms of their motivations and objectives, identifying those location factors that Chinese managers consider to be relatively more important, is essential for host governments. Although market related factors are very important in location choice decision, some interesting results surfaced in our study. Chinese managers are becoming increasingly aware of the need to have a business environment that follows the rule of law with strong institutions. A relatively less corrupted environment appears as a significant factor in choice decisions among Chinese managers. On the other hand, simpler visa procedures are not considered to be much of an obstacle among Chinese managers. Economic and political relationships between China and host governments are also important considerations. Our study points to the critical need for strong government to government (G2G) relationships that need to be cultivated to attract more FDI from China.

Obviously, the main limitation of this study is the size of our sample. Nevertheless, the quality and seniority of our respondents makes the study meaningful. Due to the smallness of our sample, evaluating country-specific attributes based on the motivation behind the

investment decision or geography was not possible. Future studies may wish to extend the study into those areas as well.

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