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EMERGING COUNTRIES’ COMPANIES INVESTING IN CHINA: COMPARATIVE ANALYSIS OF SEZ AND OVERALL CHINA

Master’s Thesis by the 2nd year student

Concentration — Master in Management

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**ЗАЯВЛЕНИЕ О САМОСТОЯТЕЛЬНОМ ХАРАКТЕРЕ ВЫПОЛНЕНИЯ**

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**OF THE MASTER THESIS**

I, Olga Ignatyeva, second year master student, program «Management», state that my master thesis on the topic «Emerging countries companies investing in China: comparative analysis of SEZ and overall China», which is presented to the Master Office to be submitted to the Official Defense Committee for the public defense, does not contain any elements of plagiarism.

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| Ключевые слова | Компании из развивающихся стран, развивающиеся рынки, прямые иностранные инвестиции, Китай, специальные экономические зоны (СЭЗ) |

**ABSTRACT**

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| Description of the goal, task and main results | The goal of my research is to identify factors influencing decisions on investment location in China. Based on literature review I developed hypotheses and tested them using logistic regression on a sample of emerging countries’ companies. The analysis confirmed some of my hypothesis about the correlation of factors with the investment location choice in China. |
| Keywords | Emerging market firms, emerging markets, foreign direct investment (FDI), China, special economic zones (SEZ) |

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## Introduction

Decisions related to foreign direct investment (FDI) location have attracted significant attention in international business (IB) research (Dunning, 1998). Prior studies indicate that by locating their projects in FDI agglomeration areas, companies may mitigate strategic, operational and institutional risks (Lien & Filatotchev, 2015). The areas offer not only dynamism in terms of production and technology within and across sectors, but are also characterized by excellent infrastructure, financial facilities, and attractive business climate (Jindra, Hassan and Cantner, 2016).

In this paper we use the FSA construct, emphasizing on FSAs (firm-spesific advantages) and FSDs (firm-specific disadvantages) of EMNEs internationalizing to other emerging markets (Rugman, 2010). Following logic of FSA theory, EMNEs possess FSAs when investing in emerging markets, as they know how to operate in a similar institutional environment. However, under the more developed institutions offered by FDI agglomeration within emerging economies, FSAs of EMNEs are turned into FSDs.

Consequently, EMNEs face a trade-off between mentioned earlier host country CSAs (country-specific advantages), which are more evident in FDI agglomerations, and own FSAs, which help them to compete in the market. Previous literature has researched CSAs in this trade-off and has established regional institutional quality to be a major determinant of FDI locational choice (Du, Lu, & Tao, 2008). However, there were no attempts to analyze changing nature of FSAs under the context of this trade-off and its influence on FDI location decision.

China, being the largest economy in the world, represents an interesting premise for FDI location choice study. Special Economic Zones (SEZs) are often called the engine of the Chinese economy, as they attract the majority of the investment projects. At present there are over 60 New and High Technology Development Zones that offer various subsidies to the enterprises located in these zones. Unlike other areas in China, local governments in the SEZs are allowed to provide preferential policies to attract foreign investors and to undertake their own infrastructure development, as long as they can raise the funds. Major provisions of the preferential policies are lower tax rates than those for firms located outside the SEZs, tax holidays for several years, and exemptions from import licenses and customs duties on imports of machinery and equipment as well as on their export (Liou, 2009). All these notions describe SEZs as FDI agglomerations, and make it an interesting context to study the role of FSAs of EMNEs in FDI location choice.

Thus, the purpose of this study is to figure out which factors have an impact on such location choice. The issue of SEZs will be dealt with a special focus on OFDI from emerging countries, which is currently growing at a faster rate than that of their developed counterparts (UNCTAD, 2015). The context creates topical premises of emerging-to-emerging countries interaction.

The work is organized in the following way: *first*, literature devoted to development of FSA theory is analyzed; *secondly*, peculiarities of Chinese market and SEZs, in particular, are studied; *thirdly,* hypotheses related to companies` characteristics are made; *finally*, hypotheses are tested with an econometric model and results are discussed. The results indicate that technological intensity of the industry and knowledge of local partners affect the location choice in China, in or out of SEZs. The study seeks to contribute to the topical emerging market discussion among the academics and provide practical guidelines for investing in China.

## Chapter 1. Theoretical Background

First chapter aims to review existing literature on Rugman’s FSA theory and its development with the emergence of EE to EE investment trend; to study China as a host market with special focus on SEZs; to develop hypotheses regarding factors that may affect FDI location decision in China.

### Firm specific advantages theory development

Rugman (1981) was first to propose that each MNE commands a unique set of FSAs, which give it a competitive advantage relative to other firms. These FSAs arise when the MNE has developed special knowhow or a capability that is difficult to imitate or acquire. His work establishes that frequently FSAs arise from upstream research and development (R&D) expenditures that lead to new products or production processes. Other sources of FSAs lay more downstream level, generating a capability in marketing or distribution. The critical capability of the MNE can also be some unique element of its management structure or core routines that confer an FSA (Rugman, 1983, 1985; Rugman & Mcllveen, 1985).

*Firm-specific advantages* (FSA) are “firm-level factors that confer competitive advantage”; they are “unique, proprietary capabilities, build upon product or process technology, marketing or distribution skills” (Rugman, 1981). These advantages are created through internalization of assets, which are under firm’s control. In contrast, *country-specific advantages* (CSA) are unique for each country and can come from resource endowments, qualitative and quantitative labor force characteristics, country brand, as well as political, economic, social and technological factors (Rugman, 1981). MNEs create strategic opportunities upon interactions of country-specific advantages and firm-specific advantages.

Rugman (1980, 1981) notes that possessing FSAs is a necessary but not a sufficient condition for FDI to take place. MNEs strive to establish property rights over its FSAs, so that competitors do not take the competitive advantage away. Often national institutional regimes are insufficient to ensure companies’ proprietary rights, then MNEs focus on internal markets. The MNE transfers, deploys and exploits its FSAs through the use of foreign subsidiaries that monitor, meter and regulate the use of FSAs abroad. The internal market of the MNE permits it to maximize its worldwide earnings without incurring the risks of FSA dissipation by external actors such as licensing agents, franchisees, etc. (Rugman,1981). Thus, MNEs develop in response to imperfections in the goods and factor markets. The СSAs of a nation that provide a basic level of comparative advantage are augmented by FSAs, creating unique competitive advantages.

In this context, Rugman and Verbeke (2009) have suggested that CSAs of host countries may also influence the firm’s advantage construction. MNEs are impacted by both CSAs from the home and host countries; therefore subsidiaries throughout the MNE network may be critical in this resource recombination. If MNE operations in various countries can be instrumental to new knowledge generation, this enables two-way flows of FDI, sophisticated forms of parent-subsidiary relationships and complex network functioning inside MNEs (Rugman & Verbeke 2001).

Taking into account this complex subsidiary web, FSAs can be created anywhere in the MNE network, both in the parent company at home and in the foreign subsidiaries (Rugman & Verbeke, 1992, 2001, 2003). FSAs can be location-bound (LB) or non-location bound (NLB). The LB FSAs reflect strengths deployable and exploitable in a limited geographic area, such as a single country or a limited set of countries or region, but cannot be profitably exploited outside of this area, whether as an intermediate output (e.g., managerial skills, R&D knowledge) or embodied in final products. LB FSAs may include an excellent local reputation, a well-positioned retail network, privileged relationships with domestic economic actors, etc.

In contrast, NLB FSAs represent company strengths that can easily be transferred across locations at low cost, deployed and profitably exploited, with only limited need for resource recombination. Such NLB FSAs typically include the upstream patented technological knowledge, and the downstream brand names. The actual transfer across borders can again occur in the form of intermediate products or embodied in final outputs. Moreover, Rugman and Verbeke (2001) have shown that subsidiary initiatives may lead to the development of LB FSAs but these can be transformed into non-location bound (NLB) FSAs, namely when being augmented with best practice attributes inside the MNE network (e.g., as a result of productivity increases and added differentiation).

### FSA theory development under EEs to EEs investment trend

During the last two decades Emerging Markets have become the growth engine of the global economy: relatively low income countries, such as Brazil, Russia, India and China have shown their potential as both consumer markets and as a source of global competition. The international expansion of Emerging Market Multinationals (EMNEs) have been triggered by the market liberalization and institutional reform in the home markets, which increased competition at home and, in turn, opened international opportunities for EMNEs (Gaffney, Kedia, Clampit, 2013). Nowadays, EMNEs are competing on par with enterprises from developed countries as well as with “born-globals” on the world arena.

FSA theory has received new wave of attention from scholars after EMNEs were successfully competing on a global scale, questioning whether theory is able to explain competitive advantage for these companies. Current literature on the EMNEs strategies explains that those companies usually lack FSAs, often referred to as firm-specific disadvantages (FSD) (Cuervo-Cazurra & Genc, 2008), but they are globally competitive due to strong CSAs (Rugman, 2009; Ramamurti, 2009). The latter include government support, access to cheap capital and oligopolistic market position (Kumar, 2007; Liu, Buck, & Shu, 2005; Morck, Yeung, & Zhao, 2008; Rui & Yip, 2008). Also, EMNEs usually have access and can rely on cheap intermediate materials, raw resources and production facilities in their home countries (Buckley et al., 2007).

EMNEs are able to transform FSDs into FSAs largely thanks to their familiarity with the more complicated institutional conditions, and their expertise in managing in such environments (Cuervo-Cazurra & Genc, 2008). Basically, EMNEs are better adapted to other developing markets in terms of clients’ specific needs, production facilities and distribution network. They are also more efficient in challenging institutional environment, namely flawed mechanisms, inefficient judicial system, frequently changing regulations, heavy bribery and bureaucracy (Ghemawat & Khanna, 1998).

In this sense, EMNEs can still be reliant on asset-exploitation to be internationally competitive, at least in the short term. However, many researchers point out, that in the desire to ensure long-term competitive advantage EMNEs internationalize to overcome the lack of FSA, by acquiring the resources (Kedia, Gaffney, & Clampit, 2012; Luo & Rui, 2009; Luo & Tung, 2007; Mathews, 2002, 2006; Peng, Wang, & Jiang, 2008; Ramamurti, 2009). Recent EMNE-specific FDI theory (the Alternative LLL framework, the Springboard Perspective, and the Ambidexterity Perspective) highlights the desire and need of EMNEs for augmenting assets to become and remain globally competitive (Mathews, 2002, 2006; Luo & Rui, 2009; Luo & Tung, 2007).

The main motivations for EMNEs are strategic resource seeking: to acquire foreign targets as well as fast entry to foreign markets (Buckley, Elia, Kafouros, 2014). EMNEs internationalization strategies are very quick and efficient: the acquisition brings the firm FSAs, already developed by the target company, and the market share of the target market. This view is also supported by a large number of more recent studies indicating that EMNEs often engage in cross border acquisitions to address this comparative disadvantage, source new intangible resources and knowledge, and become more competitive in the global arena (Athreye & Kapur, 2009; Deng, 2009; Guille´n & Garcı´a-Canal, 2009; Luo & Tung, 2007; Mathews, 2006; Rui & Yip, 2008).

After having discussed motives for outward investments, let us look at the potential reasons to invest in emerging markets. Expansion to emerging markets can open up many opportunities, such as fast growing markets, rich sources of inputs/resources and lower costs. Specifically, over four billion potential consumers at the bottom of the purchasing power parity (PPP) pyramid present both tremendous opportunities and unique challenges in emerging markets (International Finance Corporation, 2007). Moving further, firms investing in emerging markets have an opportunity to exploit market imperfections through regulatory system and tax arbitrage, internalize markets, increase flexibility, avoid trade barriers and obtain natural resources. Moreover, direct access to low cost labor or raw materials encourage internationalization to emerging markets (Barbopoulos, Marshall, MacInnes, McColgan, 2014).

However, academics do not neglect difficulties, associated with doing business in emerging markets, which is operating in turbulent institutional environment. In the contest of significant environmental uncertainty FDI imply substantial agency costs due to managerial conservatism and the opportunism of transactional partners. From this perspective, FDI location decision is affected by local institutional environment as well as the firm`s risk preferences and ability to minimize local partners` opportunistic behavior (Lien & Filatotchev, 2015).

Proving the emerging-to-emerging countries investment trend, the data on inward and outward FDI reports the highest levels of flows in and from emerging markets in 2014. Inward FDI to developing countries reached $681 billion that represents 55% of the global FDI (UNCTAD, 2015). China became the world’s largest recipient of FDI, and among the top 10 FDI recipients in the world, 5 are developing economies (UNCTAD, 2015). The outward investment (OFDI) from emerging markets account for 35% of the global value, a significant increase from 13% in 2007 (UNCTAD, 2015). Investments by EMNEs also reached a record level: developing Asia now invests abroad more than any other region. 9 of the 20 largest investor countries were from developing or transition economies and they continued to acquire developed-country foreign affiliates in the developing world (UNCTAD, 2015).

### Changing nature of FSAs under the context of FDI agglomeration

Many emerging countries are geographically vast (i.e. Russia, China, India) with various regions that are not equally economically developed and possess different institutional characteristics. Even culturally regions vary, for example, research has found evidence that Hong Kong has moved away from traditional Chinese culture and nowadays operates under different from Shenzhen cultural paradigms (House et al., 2004). This results in different levels of risks and opportunities for investing companies even within the same country (Li, Tan, Cai, Zhu, Wang, 2013). Therefore, the same capability of a company can be viewed as FSA or FSD, when investing in certain area within the market. This concerns both MNEs, which strive to secure their FSAs, and EMNEs, which are able to compete successfully under the familiar institutional environment.

This notion makes the investment landscape of a single state extremely differentiated across regions, the issue that has brought attention of the academics. Interestingly, not only economic and cultural factors affect the FDI location decision, but also, unexpectedly, location of other companies in the target country. The first set of research explain the impact of local clusters, which is the group of firms from the same or related industries, located in close geographical proximity (Folta, Cooper, & Baik, 2006). Local clusters affect the firm performance positively due to improved access to specialized suppliers, qualified workers and knowledge spillovers (Du, Lu, & Tao, 2008; Li, 2004). The other set of research focuses on FDI agglomerations, which are firms with similar characteristics that prefer to locate in close proximity to each other (Belderbos & Carree, 2002; Chadee, Qiu, & Rose, 2003). Based on the nature of the common attribute, FDI agglomerations can send different messages to the investing firms. For example, a study by Liao (2015) confirmed that for investing companies a cluster of privately owned enterprises (POEs) indicates the development of free market mechanisms aimed at increasing the efficiency of market transactions, along with high level of entrepreneurship.

Research by Filatotchev, Strange, Piesse, and Lien (2007) shows that FDI agglomeration is particularly common in emerging markets, characterized by inefficient and less-developed local institutions. Researchers have put forward some ideas concerning the motivation to engage with these vastly invested zones. Firstly, investors choose the regions with less OFDI risks, while presence of other similar firms signals the existence of relevant supply and demand factors, thus reducing uncertainty for the new entrants (Devereux, Griffith, & Simpson, 2007; Guimara˜es, Figueiredo, & Woodward, 2000). Secondly, for knowledge-seeking OFDI agglomeration economies mean R&D concentrations and knowledge spillovers, which are of considerable importance in foreign locations as an input into the joint learning process of foreign subsidiaries, their suppliers, customers or partners (Jindra, Hassan, Cantner, 2016).

It is important to mention that some companies despite all the advantages of agglomeration economies choose to pursue investment opportunities in less-explored areas, where they often have to face greater environmental and operational risks. Those companies attempt to gain first-mover advantages by capitalizing on unexplored opportunities in less-explored areas outside existing FDI agglomerations in a host country (Lien & Filatotchev, 2015).

Converting this into FSA-CSA view, for EMNEs FDI agglomeration signals host country advantages, such as improved access to specialized suppliers, qualified workers and knowledge spillovers; however, it also diminishes their FSAs, since the business environment is closer to one of a developed market. Hence, FSAs of EMNEs are turned into FSDs under the often more developed institutions offered by FDI agglomeration. Consequently, EMNEs face a trade-off between offered CSAs and own FSAs, which they can bring to the market. Previous literature has researched CSAs of this trade-off and has established regional institutional quality to be a major determinant of FDI locational choice (Du, Lu, & Tao, 2008). However, there were no attempts to analyze changing nature of FSAs under the context of this trade-off and its influence on FDI location decision.

### 1.1.4. Investments in Chinese SEZ: opportunities and challenges

China was chosen as the host market for this research for the two major reasons: economic development and regional differentiation. First of all, China is the world`s largest emerging market and the largest recipient of FDI globally accounting for $129 billion in 2014 (UNCTAD, 2015). Secondly, China spans a vast geographical area, resulting in varying investment risks from province to province (Wang, Gu, Tse, Yim, 2013). Therefore, FDI projects in China provide a unique laboratory to examine the factors that influence location decisions.

The success of Chinese economy is often connected to the FDI inflow in the country and its preferential treatment of the foreign investors. Basing their views on the positive impact of FDI for the host economy, Chinese government has given FDI a high priority on the development agenda. Thus, there are a number of incentives including investment subsidies, lower taxes, duty exemptions, and local market access (Meyer & Sinani, 2009). Of course, China does not blindly follow the openness agenda: there are mechanisms at place to track concerns about national security and growth strategy arising from inbound acquisition. Government has a final say in M&A control through enforcing laws and regulations, and reviewing and approving deals. The decision depends on the structure of the deal, the nature of the target and the industrial sector, and the value of the transaction (Zhang & He, 2014).

Coming back to the investment location question, China provides a perfect premise for analyzing the factors influencing decision because the government has established territories within China with preferential conditions for investors, called SEZ - short for Special Economic Zones, which can be treated as FDI agglomeration with extra advantages.

The basic concept of a special economic zone includes several specific characteristics: (a) it is a geographically delimited area, usually physically secured; (b) it has a single management or administration; (c) it offers benefits based on physical location within the zone; and (d) it has a separate customs area (duty-free benefits) and streamlined procedures (World Bank, 2009). Moreover, an SEZ normally operates under more liberal economic laws than those used for regular companies in the country. For the host-country SEZs offer two main types of benefit, which explain their popularity: “direct” economic benefits, such as employment generation and foreign exchange earnings; and the “indirect” economic benefits, which are summarized in table 1.1.

Table 1.1 Potential benefits for the state derived from SEZs

|  |  |  |
| --- | --- | --- |
| ***Potential benefits*** | ***Direct benefits*** | ***Indirect benefits*** |
| Foreign exchange earnings | ■ |  |
| Foreign direct investment | ■ |  |
| Government revenue | ■ |  |
| Export growth | ■ |  |
| Skills upgrading |  | ■ |
| Testing field for wider economic reform |  | ■ |
| Technology transfer |  | ■ |
| Demonstration effect |  | ■ |
| Export diversification |  | ■ |
| Enhancing trade efficiency of domestic firms |  | ■ |

Source: Zeng, 2010 [World Bank Staff]

Under the term SEZ there are a broad range of zones, such as free trade zones, export-processing zones, industrial parks, free ports, enterprise zones, and others. As used in China, however, the term SEZ refers to “a complex of related economic activities and services rather than to a unifunctional entity (Wong, 1987). Therefore, Chinese SEZs are typically more functionally diverse and cover larger land areas than other types of economic zones. In China, SEZ normally refers to seven specific zones: Shenzhen, Zhuhai, Shantou, Xiamen, Hainan, Shanghai Pudong New Area, and Tianjin Binhai New Area. Generally speaking, Chinese SEZs operate in more technology- and capital-intensive industries and enjoy greater government support, more FDI, and stronger links to the global market.

Most SEZs in China are located along the coastline or near major cities with well-established of foreign trade or business connections, and thus are better linked to the international market. They also have good access to major infrastructure, such as ports, airports, and railways. The location advantage is especially obvious for the SEZs in the Pearl River Delta region (close to Hong Kong) and the Min Delta region (close to Taiwan). Hong Kong has provided capital, logistical support, access to world markets, management know-how, technology, and management skills. The Pearl River Delta region has provided labor, land, and natural resources. It is this interaction that has allowed the Greater Pearl River Delta region to develop relatively quickly as one of the world’s major manufacturing bases (Enright, Scott, and Chung, 2005).

The SEZs have massively contributed to China’s success: they successfully tested the market economy and new institutions and established role models for the rest of the country to follow. By 1992, the concept of openness had been extended to the entire coastal region and to all capital cities of provinces and autonomous regions, and various types of SEZs had begun to spring up throughout the country (Zeng, 2010). Economically, SEZs have contributed significantly to national GDP, employment, exports, and attraction of foreign investment and new technologies, as well as adoption of modern management practices. In 2006, the five initial SEZs accounted for 5 percent of China’s total real GDP, 22 percent of total merchandise exports, and 9 percent of total FDI inflows. At the same time, the 54 national SEZs accounted for 5 percent of total GDP, 15 percent of exports, and 22 percent of total FDI inflows (see table 1.2).

Table 1.2 Performance of initial 5 Special Economic Zones, 2006

|  |  |  |
| --- | --- | --- |
| ***Indicator*** | ***SEZ*** | ***China*** |
| Total employment |  |  |
| Millions | 15 | 758 |
| As % of China Total | 2.0 | 100 |
| Real GDP |  |  |
| RMB 100 millions | 9,101 | 183,085 |
| As % of China Total | 5.0 | 100 |
| Utilized FDI |  |  |
| US $100 millions | 55 | 603 |
| As % of China Total | 9.1 | 100 |
| Merchandise export |  |  |
| US $100 millions | 1,686 | 7,620 |
| As % of China Total | 22,1 | 100 |
| Total Population |  |  |
| Millions | 25 | 1,308 |
| As % of China Total | 1,9 | 100 |

Source: Zeng, 2010 [National Statistical Bureau, 2006]

To encourage firms to invest in the zones, the SEZs offered various preferential policies, including inexpensive land, tax breaks, rapid customs clearance, the ability to repatriate profits and capital investments, duty-free imports of raw materials and intermediate goods destined for incorporation into exported products, export tax exemption, and a limited license to sell into the domestic market, among others (Enright, Scott, and Chung, 2005). Favorable policies were also in place to attract skilled labor, including the overseas diaspora, such as the provision of housing, research funding, subsidies for children’s education, and assistance in “Hukou” transfer (Zeng, 2010).

Further, the SEZs were given greater political and economic autonomy. They had the legislative authority to develop municipal laws and regulations on top of national laws and regulations, including local tax rates and structures, and to govern and administer these zones. That discretion allowed them more freedom in implementing the new policies and the needed development measures to attract investment. For instance, SEZs were the first to establish a labor market. Companies operating inside the zones could enter into enforceable labor contracts with specific term limits, could dismiss unqualified or underperforming employees, and could adjust wage and compensation rates to reflect the market situation (ProLogis, 2008). These factors were critical to attracting the right talent.

The central government had tried to decentralize its power and help create an open legal and policy environment for the SEZs. Meanwhile, the local governments made a great effort to build a sound business environment. They not only put in place an efficient regulatory and administrative system but also good infrastructure, such as roads, water, electricity, gas, sewerage, telephone, and ports, which in most cases involve heavy government direct investments, especially in the initial stages. Beyond the basic infrastructure, local governments also provide various business services to many SEZs, these include, accounting, legal, business planning, marketing, import-export assistance, skills training, and management consulting (Zeng, 2001).

In addition, the SEZ governments are able to make timely adjustments to relevant policies and regulations based on business needs and market conditions, as well as on development stage. For example, after the zones were successful, the governments began to put more emphasis on the technology-intensive or high–value-added sectors and to adjust their FDI policies to create a level playing field for both foreign and domestic firms.

As we can see from the investment advantages offered by the typical emerging market, Chinese SEZs are the examples of common benefits, such as large customer base and lower costs, plus extra unique benefits, available only in those territories. The following table 1.3 summarizes all the preferential treatment in place in SEZs:

Table 1.3 Preferential treatment in SEZs by controlling body

|  |  |  |
| --- | --- | --- |
| ***Preferential treatment*** | ***National Government*** | ***Local Administration*** |
| Tax breaks, export tax exemption | ■ |  |
| Lower duties/ fast customs | ■ |  |
| Inexpensive resources | ■ |  |
| Skilled labor | ■ |  |
| Local infrastructure |  | ■ |
| Business services |  | ■ |
| Timely interaction with officials |  | ■ |

### 1.2 Hypothesis development

### 1.2.1. Host country CSAs as factor of FDI location choice

CSAs presented by the host country are available for both companies from developed and developing markets. Within China companies have two different sets of CSAs, dictated by FDI location types: SEZs – areas with better PRP system, more qualified labor and better infrastructure, and other areas of China, offering fast market growth and typical emerging market institutional environment. Therefore, when investing in China companies always weigh CSAs against FSAs, which companies can deploy in the particular location. Let us explore CSAs of SEZs in depth to make hypotheses on which firms are affected in their FDI location choice.

### 1.2.1.1. Target firm’s industry and its technological intensity

Companies in technologically intensive industries often engage in FDI for technology-seeking motives, which imply quick access to technological innovations and advanced marketing and management know-how. For firms with technology-seeking motives or high-tech firms that bring new technologies in the target market, weak PRP (property rights protection) system in developing countries become a strong factor against the investment. This is because they are likely to encounter knowledge leakage there and thus shorten their time horizon of capitalizing on their core technologies, even if the capabilities have just been acquired (Allred & Park, 2007; Falvey, Foster, & Greenaway, 2006).

Acquisitions of the controlling rights (more than 50% shares) of local targets can help to lower the opportunism of local partners (e.g., knowledge leakage) and thus decrease the risks and costs of exploiting their core technologies in local markets (Papageorgiadis et al., 2013). Yet, such internalization is not able to completely reduce uncertainties and risks in such weak PRP environments, where transactions with external stakeholders such as competitors, consumers and suppliers are necessary (Zhu, Qian, 2015).

However, because weak PRP system inhibits innovation and technological development (North, 1990; Tsang & Yip, 2007), huge market opportunities for advanced technologies are available for international companies in emerging countries (Chari et al., 2010; Tsang & Yip, 2007). Often, target firms – largely the ones in weak PRP environments – lack, and thus desire to possess, advanced technologies in order to survive and gain profits in local markets. Hence, these targets are more willing to collaborate and integrate with acquirers after acquisitions (Hillman et al., 2009; Wry et al., 2013).

All in all, companies that need to protect technology usage in the country are expected to choose SEZs, as they value host country CSA – intellectual property protection – more than deployment of any of the FSAs. Moreover, their major FSA – technological know-how – is dependent on that particular CSA. This expectation is consistent with the assumption that SEZs are closer to developed countries in nature, although offer the opportunities of an emerging market. Consequently, cautious companies choose SEZs, whereas more risky ones invest in other areas in China. Therefore, firms with sophisticated technologies choose extra protection offered by SEZs in China to ensure the safety of its competitive advantage.

**H1:** *Companies acquiring targets in technology-intensive industries are more likely to invest in SEZs than overall China regions.*

### 1.2.1.1. Target firm’s industry and its strategic importance to China

Another differentiation of target entities in China is the strategic importance of the industry it belongs to, as seen by the Chinese government. In 2006, seven industries were designated as *‘strategic’* in China, namely, *defense, electricity generation and distribution, petroleum and petrochemicals, telecommunications, civil aviation, water transport, and coal,* which means that the state would have these industry players under control (Johnson, Mackie, & Morris-Suzuki, 2015). China also targeted *machinery, automobiles, electronics and information technology, construction, steel, base metals and chemicals* as *‘pillar’* industries, over which the state would exercise strong influence (Johnson, Mackie, & Morris-Suzuki, 2015). While entry barriers into *‘pillar’* industries are informal and low compared with the barriers to *‘strategic’* industries, they are high compared with other non-targeted industries and are designed to accept some private operations but discourage private-sector competition. In 2012 the state owned 30 of the biggest 42 corporations in China and controlled 85 per cent of assets of the 39 sectors that the state considers to be most important (Johnson, Mackie, & Morris-Suzuki, 2015).

One reason why state intervenes in Chinese industry is the nation’s great regional variation. Applying economic theory, China is more effectively treated as a country comprising several economies that range from the least developed to the most advanced instead of one homogeneous developing economy. Underdeveloped regions in China that are well endowed with unskilled labor should specialize in low-technology products while developed regions well endowed with skilled labor should specialize in high-technology products. Hence, short-term state assistance to high-technology industries in China’s advanced economic regions could actually be viewed as following country’s comparative advantage (Johnson, Mackie, & Morris-Suzuki, 2015).

Returning to FSA-CSA approach, state intervention has created artificial division of sectors, which state would like to control to different extent. The *‘strategic’* and *‘pillar’* industries were given special priorities, by concentrating them in areas with skilled labor and other superior CSAs and called SEZs. For instance, Chinese policy makers back in 1997 placed greater emphasis on "old economy" industries, such as the chemical industry including pharmaceuticals, and dedicated well-known SEZs – Shanghai chemical industry (SCIP), Nanjing chemical park (NCIP) and Ningbo chemical industry zone (NCIZ) - to these sectors (Zeng & Bathelt, 2009). Specific CSAs developed in these areas by the government were developed regional linkages (raw materials and Guanxi), international linkages (higher internationalization and foreign corporate networks) and research / advanced services (investments in research, including universities) (Zeng & Bathelt, 2009).

Therefore, we assume that acquirer companies interested in target firms in strategically important industries will be inclined to invest in SEZs, dedicated to their specific industry, due to availability of such firms in SEZs as well as due to superior CSAs, developed specifically for the benefit of MNEs from these industries. We hypothesize that industry-specific CSAs would in this case overweigh any of the FSAs, that can be challenging to apply under more developed institutional context of SEZs.

***H2****: Companies acquiring targets in strategically important industries are more likely to invest in SEZs than overall China regions.*

### 1.2.2. FSAs as factors of FDI location choice

EMNE’s FSAs are perceived to bring benefit to the firms only in the context of other emerging markets due to knowledge of local institutions and how to do business in turbulent environment. Within China EMNEs are presented with two different opportunities for investment: SEZs – areas with more developed business environment, which is closer in nature to developed markets, and other areas of China, operating under developing market institutions. Therefore, the same FSAs can be beneficial in other areas of China or lose their differentiating characteristics in SEZs. Let us explore in depth EMNE’s FSAs and make hypotheses on how they affect the FDI location choice.

### 1.2.2.1. Previous international experience

Home experience is stated to be a valuable resource to be exploited in other, similar foreign markets (Niosi & Tschang, 2009). For example, Cuervo-Cazurra and Genc (2008) show that EMNEs enjoy a competitive advantage over their developed economy counterparts when they seek to enter and operate in other EEs, because they have gained experience with operating in environments characterized with underdeveloped institutions and difficult governance conditions (Gaur, Kumar, Singh, 2014).

Similarly, Kostova and Zaheer (1999) suggest that the more similar the institutional profiles of the multiple countries in which a firm has experience, the easier it is for a multinational firm to correctly make sense of its environment and to appropriately respond to the requirements of local institutions. Given the fact that the institutional contexts of EEs bear some notable similarities (in terms of underdeveloped institutional environments and unstable political, social, and economic environments), experience accrued in an EE will tend to bring some knowledge that may benefit group members entering into other emerging economies (Carlsson, Nordegren, & Sjo¨holm, 2005). International experience from developed countries (DCs) might help firms develop a useful set of practical problem-solving skills, but the differences in DCs’ and EEs’ cultures and institutions will reduce the likelihood of institutional understanding (Dow & Larimo, 2009).

Due to the profound differences in DCs’ and EEs’ institutional environments, it is critical that the context in which international experience occurs be taken into account. DCs are typically characterized by stable markets and well-established legal systems; EEs are typically characterized by high rates of economic growth along with dramatic structural change, considerable economic and political uncertainty, and weak institutions (Hoskisson et al., 2000). Such differences mean that international experience from EEs or DCs may result in extreme variation in firms’ regulatory, cognitive, and normative capabilities, which may in turn affect firms’ abilities to interpret local institutional requirements, as well as the degree to which they must readjust to meet the requirements of the new environment (Liao, 2015).

Based on the research, results indicate that prior investment experience is not always beneficial for the performance, and that, in fact, only specific types of investment experience enhance the performance of target firms (Buckley, Elia, Kafouros, 2014), so we suggest to measure only EEs experience of companies. Therefore, companies with relevant experience in emerging markets are expected to invest to overall China to take advantage of the intangible resources that they possess - ability to operate in a turbulent environment.

**H3:** *The more experience in EEs the firm possesses, the more likely will the firm invest in overall China than SEZs.*

### 1.2.2.2. Knowledge of local partners

In the context of difficult institutional environment in China, local partners contribute a wide range of resources including access to local markets, distribution channels, personnel, knowledge of local regulations, and government relations (Lu & Ma, 2008). To obtain preferential access to such resources while at the same time mitigating potential collaboration hazards, foreign investors benefit from information about local partners’ intentions, resource endowments, prior collaboration experience, and past behavior (Meschi, Wassmer, 2013).

A deeper level of collaboration, very popular in China, alliance can confer numerous benefits to an organization, such as providing resources or learning opportunities, opening up new markets, and offering links to key government officials (Ahlstrom, Bruton, & Yeh, 2008). Despite these and other potential benefits, organizations can face as well many obstacles in forming alliances, and a substantial number of new alliances fail (Ahlstrom, Levitas, Hitt, Tina, 2014).

However, keeping in mind the lower PRP system of China, the benefits of the local partners can be overweighed by the local partners’ opportunism, which brings us to the first hypothesis that suggests investments in better-known locations of OFDI agglomerations (Lien, Filatotchev, 2015). Nevertheless, if a company has access to a trusted collaboration with a partner company in China, it is more advantageous to make use of this FSA, by doing business in regular business environment in China, thus they tend to invest more into overall China rather than in SEZs.

**H4:** *The firms with knowledge of local partners are more likely to invest in overall China than SEZs.*

### 1.2.3. Project-level attributes as factors of FDI location choice

Previous studies have demonstrated that FDI location in emerging markets are determined by factors related to country, industry, firm, and project levels of analysis (Luo, Park 2001), therefore, we should not neglect the last set of factors. In the light of our construct, project-level attributes include firms’ considerations of both host country CSAs and their own FSAs. They signal why and to what extent the company wants to be engaged with this market. In this section we explore whether particular project-level behavior is consistent with the choice of SEZs or other regions of China for FDI location choice.

### 1.2.3.1. Purpose of the investment

As it has been highlighted previously, EMNEs are better adapted to other developing markets in terms of doing business in turbulent environment, clients’ specific needs, production facilities and distribution network. In this sense, EMNEs can still be reliant on asset-exploitation to be internationally competitive. These EMNEs have to ensure the possibility to deploy existing FSAs, thus they are more likely to invest in other regions of China.

However, EMNE-specific research shows that in the desire to ensure long-term competitive advantage EMNEs internationalize to overcome the lack of FSA, by acquiring the resources (Kedia, Gaffney, & Clampit, 2012; Luo & Rui, 2009; Luo & Tung, 2007; Mathews, 2002, 2006; Peng, Wang, & Jiang, 2008; Ramamurti, 2009). Asset-seeking behavior implies importance of surrounding companies’ development level and other CSAs, such as qualified labor and accessibility of supply. Hence, these EMNEs would prefer doing business in SEZs.

**H5:** *The firms following asset-exploitation purposes are more likely to invest in other regions on China than in SEZs.*

### 1.2.3.2. Investment commitment

Lien and Filatotchev (2015) conducted the study on the impact of ownership on the FDI location decision in the context of emerging markets. The results revealed that equity stake in a subsidiary, owned by the parent company, is positively associated with FDI location decisions in less-explored and risky areas. Keeping in mind that the study has been done in the similar EE to EE premises, these findings can be interpreted as higher commitment facilitating investment in less-explored areas due to the desire to learn how business is conducted in a typical region. The higher proportion of the ownership in the subsidiary, the more the firm is committed to the long-term relationship with the country, the more it wants to learn about the business practices in place.

Another proof of the investment commitment has traditionally been the value of FDI associated with the project. However, in the case of Russian TNCs, for example, there is a robust correlation between the growth of the domestic market and investment abroad, so the FDI value does not necessarily signal commitment to the market. For example in the period 2004-2006 high growth of the foreign assets of the top 25 Russian TNCs was accompanied by a simultaneous increase in their assets and sales in the Russian Federation (by 60%) and in employment at home (by approximately 20%) (Skolkovo and CPII, 2007). This means that for investing companies value of FDI may depend not only on the perceptiveness of the destination, but rather on the current success of the home economy overall and the companies` financial position, in particular.

On the other hand, market size of host countries is among the main motivations of outward FDI, therefore the commitment to the market is one of the major criteria when settling on an investment value. The same Russian TNCs aim for a presence in large and growing markets by establishing production and/or distribution units directly in such markets (Kolotay and Sulstarova, 2010). This motivation on the contrary supports the idea that FDI value signals the commitment to the target country. Thus, we neglect the misleading result of the FDI value by combining it with the ownership type to express commitment level of the investing firm.

**H6:** *The more committed to the country the company is, the more likely it invests to overall China than in SEZs.*

## Summary of Chapter 1.

In the first chapter existing literature on Rugman’s FSA theory development has been analyzed; typical FSAs and FSDs for EMNEs investing in emerging markets were identified; China as a host market has been studied with special focus on SEZs; finally, a set of hypotheses have been developed for further analysis in empirical part.

MNE commands a unique set of FSAs, which give it a competitive advantage relative to other firms. FSAs are created under the specific home and host country CSAs and then distributed throughout the MNE subsidiary network. As opposed to developed market MNEs, EMNEs possess advantages connected with underdeveloped institutional environment of their home markets, which makes it easier for them to operate in other emerging markets. EMNEs choose to internationalize to exploit home country CSAs and to acquire FSAs that can ensure global competitiveness. Companies invest in EM to get an access to a large growing consumer market, exploit market imperfections, internalize markets for such reasons as avoidance of trade barriers and to get direct access to low cost resources.

Emerging markets often cover large territories, so the regions within those markets are not equally developed in terms of their economic and institutional characteristics. Thus, for foreign investors different locations within one country present different levels of risks and opportunities. Current literature has studied peculiarities of local clusters and agglomeration of FDI, which is an agglomeration of firms from related industries that ensure different economic factors in the area. These zones often present a better institutional environment, under which EMNE’s FSAs may turn into FSDs. Thus, companies face a trade-off between local CSAs and their own FSAs, which they can deploy.

China is a great example to see regional differences, as government has established business-friendly territories, called SEZ. Among major preferential conditions within SEZs are reduced taxes and import duties, superior technology and skilled workforce, extensive infrastructure. Based on literature review conducted in the first chapter six hypotheses regarding factors that may affect FDI location decision in China have been developed for further testing in the empirical part of the study; summary of the hypotheses is provided in Table 1.4.

Table 1.4 Summary of the hypotheses to be tested

|  |  |
| --- | --- |
| ***H*** | ***Description*** |
| *H1* | *Companies acquiring targets in technology-intensive industries are more likely to invest in SEZs than overall China regions.* |
| *H2* | *Companies acquiring targets in strategically important industries are more likely to invest in SEZs than overall China regions.* |
| *H3* | *The more experience in EEs the firm possesses, the more likely will the firm invest in overall China than SEZs.* |
| *H4* | *The firms with knowledge of local partners are more likely to invest in overall China than SEZs.* |
| *H5* | *The firms following asset-exploitation purposes are more likely to invest in other regions on China than in SEZs.* |
| *H6* | *The more committed to the country the company is, the more likely it invests to overall China than in SEZs.* |

## Chapter 2. Research Design

This chapter aims to establish the methodological basis for analyzing the impact of CSA, FSA and project-level factors on the location decision in China. The empirical study is a logistic regression analysis, therefore, the sample, variables and variable calculation are described and then the econometric model used to conduct the analysis is presented.

### 2.1. Sample description

In order to the test the hypotheses, a sample of FDI projects into China from emerging countries’ companies are to be gathered. We focus on the individual FDI projects, rather than aggregate FDI data, because location choices are strategic decisions made by individual firms, and it thus makes sense to focus on the determinants of these individual decisions rather than the combined flows of FDI. It should be understood, that there are two types of investment: greenfield investment, building company’s subsidiaries from scratch, and brownfield, which is essentially M&A activity. The latter group presents data that is easily available in the databases, whereas greenfield activities are only briefly mentioned in company reports. Yet, we assume that location choice factors do not differ between these categories. Thus, a list of M&A projects of emerging countries’ companies targeting Chinese companies is to be gathered.

My research aims to draw conclusions about all emerging countries’ companies, however, a list of all historically recorded M&A deals satisfying the criteria is too long. Therefore, a representative sample of the whole population is to be collected. Timeframe sets a natural limitation on the number of projects, yet, keeps good representation of different home countries and industries. Thus, it has been decided to take a sample of 131 M&A deals in the time period from 2005 till 2017, in which emerging countries’ companies fully or partially acquired a Chinese entity. The data was derived from Thomson Reuters Datastream database and open sources, such as company websites and reports.

131 M&A deals are performed by 102 companies from 15 countries. The home countries of the companies may be divided by regions: Latin America, CEE and Southeast Asia. The distribution of deals by the home regions you may see on the Figure 2.1. Industries of acquirers can be grouped by technology-intensity, according to OECD classification (see Appendix 1), into high-technology, medium-high-technology, medium-low technology, low-technology and non-manufacturing. The distribution of deals by industry type you may see on the Figure 2.2.

Target companies are located in different provinces of China, the distribution of the deals by provinces you can find on Figure 2.3. As for SEZ, 48 target companies are located in SEZ, representing 36,6% of the sample. As for target’s industry, the firms are distributed by technological intensity the following way (Figure 2.4). The distribution of the sample on different parameters is in line with that of the whole population, thus the findings of the study can be extrapolated to the whole population.

Figure 2.1. Distribution of FDI projects by home region

Figure 2.2. Distribution of FDI projects by acquirer industry

Figure 2.3. Distribution FDI projects by provinces

Figure 2.4. Distribution FDI projects by target’s industry

### 2.2 Variables and measurement

The dependent variable concerns location of the investment in China. As long as the SEZs are studied in contrast to other regions of China, the variable is binary – 1, if investment is in SEZ, 0, if investment is in other areas in China. Data on location/address of the target company was gathered through open sources, such as company websites, company information aggregators and then associated with SEZs, operating in the area.

The six hypotheses represent six different independent variables: target’s industry technology-intensity, target’s industry strategic importance, previous experience in EM, knowledge of local partners, purpose of the deal and company’s commitment to Chinese market. Now, the measurement for each of the variables is to be discussed.

As has been mentioned in sample description, industry is viewed in the research through the prism of technological intensiveness, in line with OECD classification. Particularly, high-technology industries are labeled 4 in the study, medium-high-technology industries - 3, medium-low technology industries - 2, low-technology industries - 1 and non-manufacturing industries – 0. As the value of the variable also reflects growing level of technological intensity, the variables are regarded as ordinal numerical, as opposed to nominal. More detailed information on which industries fall under which category you may find in the Appendix 1.

The next industry differentiation criterion is strategic importance, which is also coded according to the list of industries discussed in the hypotheses development section. *‘Strategic’* industries are labeled 2, *‘pillar’* industries - 1 and non-targeted industries – 0. Similar to the previous variable measurement, these values show the trend of strategic importance for China, therefore the variable type is ordinal numerical. More detailed information on which industries fall under which category you may find in the Appendix 2.

Previous experience in EM is reflected by the number of the acquirer’s subsidiaries in emerging countries at the time of the deal, excluding China and home market. It is a discrete interval numerical variable ranging from 0 to 20. Data was collected using open sources, such as company websites, and Thomson Reuters Datastream.

As for knowledge of local partners, this information is difficult to estimate. Thus, the following assumption is taken: if the firm has had any previous experience with China, namely trade or investment project, it is assumed that before the current deal company had access to local counterparts. This assumption is valid due to special attention in Chinese business environment to personal relations (guanxi). This practically means that if the company operated in the environment and was successful (decided to invest more), it created useful contacts for future ventures. Thus, we employ binary variable: 1, if the acquirer had experience in China and had access to local partners, 0 – if it had no previous experience in China.

Purpose of the deal is a strategic piece of information that is available only via conducting in-depth interviews with company representatives. However, Thomson Reuters Datastream had self-reported purposes for some of the deals, which were then coded for the research. All purposes were divided into asset-seeking strategies (including strengthen operations, create synergies), labeled 1, and asset-exploitation strategies (including concentrate on core business/asset, expand presence in new markets, take advantage of investment), labeled 0. Therefore, it is a binary variable

Finally, companies’ commitment is measured through investment value multiplied by purchased share in the target company. Commitment to the market variable has previously been used by Lien and Filatotchev (2015) to emphasize, whether the company is seeing the target entity as strategic and important rather than opportunistic and for a short period of time. Thus, the variable is continuous numerical.

For the convenience, all variables are gathered in Table 2.1 with the respective descriptions.

### 2.3. Methodology

As study aims to identify factors influencing the dependent variable and the latter is binary, logistic regression is to be conducted. As there are more than one predictable variables forced entry approach to building the model should be used, which is entering predictors altogether. This approach is stated to be more appropriate for the regression; however, non-significant factors will be taken out of the model by hand. This will give us the opportunity to control the process, by reviewing such model fit parameters as significance of Chi-square and -2LL, Cox & Snell R square, Nagelkerke R square. This process will help in choosing best-fitting model for the data.

After choosing the model, logistic regression with more in-depth parameters, such as predicted percentage, Wald statistics and odds ratio, should be run. Further, a number of tests should be run to control the explanatory power of the model: assumptions of linearity and absence of multicollnearity among the predictor variables are to be confirmed, analysis of residuals should find outliers and influencing cases, which should be addressed in the discussion section.Table 2.1. Variables in the regression model

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| # | **Concept** | **Measurement** | **Variable type** | | **Name in SPSS** |
|  | **Dependent variables** |  |  | |  |
| 1 | FDI location | 1 – if the location is SEZ, 0 – if other areas in China | Binary | | SEZ |
|  | **Independent variables** |  |  | |  |
| 2 | Target’s industry technological intensity | Value of 0-4, according to OECD technology intensiveness classification | Numerical, ordinal | | target\_ind\_tech |
| 3 | Target’s industry strategic importance | Value of 0-2, according to CCP classification | Numerical, ordinal | | target\_ind\_strat |
| 4 | Previous experience in EM | Number of EM subsidiaries | Numerical, discrete | | prev\_exp |
| 5 | Local partners | 1 – if company knows local partners, 0 – if there are no local partners involved | Binary | | local\_part |
| 6 | Deal purpose | 1 – if asset-seeking strategy, 0 – if asset-exploitation strategy | Binary | | purpose |
| 7 | Commitment to the market | FDI value\* purchased share of the target | Numerical, continuous | commitment | |

## Summary of Chapter 2.

In this chapter methodology of the research has been established, variables and their measurement have been outlined, sample for the empirical study has been described. In order to conduct the empirical analysis quantitative research method, namely, logistic regression is to be performed. The sample for the study is a set of 131 M&A deals over the time period of 2005-2017 with acquirers from 15 emerging countries and target companies in China. The sample is representative for all M&A activities from emerging countries to China, thus, the results of the study can be extrapolated to the whole population, unless proved otherwise in the empirical tests.

For the purpose of this study 7 variables are used: 6 independent variables, namely, target’s industry technology intensity, target’s industry strategic importance, experience in EM, knowledge of local partners, commitment; and 1 dependent variable – location. The empirical study will include logistic regression and tests to assess explanatory power of the model: linearity of the logit, multicollinearity and analysis of residuals.

## Chapter 3.Research Findings

This chapter aims to find out, whether the hypotheses have been supported by the logistic regression, interpret results of the analysis and discuss results. Based on the findings, theoretical contribution and managerial implication should be emphasized.

### 3.1 Descriptive statistics

First, descriptive statistic of the dataset is to be analyzed. In the Figure 3.1 IBM SPSS descriptive statistics output is depicted. One can see that the sample consists of 131 observations; there are one categorical dependent variable and six explanatory variables. Dependent variable, local partners and purpose are dummies, technology and strategic industry variables range from 0 to 4 and 0 to 2, respectively, previous experience - from 0 to 20 and commitment from 0 to 83600, representing highest standard deviation among all variables - 8434.

Figure 3.1 Descriptive statistics

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Descriptive Statistics** | | | | | |
|  | N | Minimum | Maximum | Mean | Std. Deviation |
| SEZ | 131 | 0 | 1 | ,37 | ,484 |
| Target\_ind\_tech | 131 | 0 | 4 | 1,52 | 1,332 |
| Target\_ind\_strat | 131 | 0 | 2 | ,52 | ,649 |
| Prev\_exp | 131 | 0 | 20 | 3,08 | 4,094 |
| Local\_part | 131 | 0 | 1 | ,57 | ,497 |
| Commitment | 131 | ,00 | 86300,00 | 1893,1983 | 8433,81928 |
| Purpose | 131 | 0 | 1 | ,19 | ,394 |
| Valid N (listwise) | 131 |  |  |  |  |

Mean value of the dependent variable explains that there are more out-of-SEZ investments in the sample. Industry variable mean means bring to the conclusion that on average the target firms belong to medium-technology intensive industries and strategically non-targeted industries. Previous experience mean shows that companies from the sample have significant experience in EM, by operating on average on 3 emerging markets. Local partner variable reports almost equal distribution of companies knowing local partners and operating without one. Purpose variable mean reports that majority of FDI projects are of asset-exploitation nature. Finally, commitment mean is difficult to interpret, yet it shows that sample is skewed to the right with only few project towards the maximum of the range.

### 3.2 Model findings

Following a systematic and theory-driven approach, model-building starts with testing all predictor variables from the hypotheses in a forced entry manner. This approach is preferred for logistic regression, as well as for the linear regression over the stepwise method, which should be avoided in case of hypotheses testing. Thus, we proceed with the model by manually looking at the explanatory power of the model and significance of different variables. When the variable does not explain the dependent variable (significance level) and does not harm the overall fit of the model (Chi-square significance), the parsimony principle if followed and the variable is taken out of the model. This approach is similar to backward stepwise method, however, the process is controlled, and therefore, informed decisions are taken.

Let us begin with reporting the model with all 6 predictors. SPSS output for this model one may see in the Figure 3.2. Although the model is significant, there are variables that do not explain the dependent variable, thus can be excluded, if the model does not lose its explanatory power. As long as Chi-square significance almost stays the same across all reduction steps, -2LL, Cox & Snell R square, Nagelkerke R square parameters are also monitored. If these parameters grow slightly with the exclusion of predictor variable, this is not critical, following the parsimony principle.

Figure 3.2 Model-building, step 1 – 6 variables.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Omnibus Tests of Model Coefficients** | | | | |
|  | | Chi-square | df | Sig. |
| Step 1 | Step | 58,773 | 6 | ,000 |
| Block | 58,773 | 6 | ,000 |
| Model | 58,773 | 6 | ,000 |

|  |  |  |  |
| --- | --- | --- | --- |
| **Model Summary** | | | |
| Step | -2 Log likelihood | Cox & Snell R Square | Nagelkerke R Square |
| 1 | 113,366a | ,362 | ,494 |
| a. Estimation terminated at iteration number 5 because parameter estimates changed by less than ,001. | | | |

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Variables in the Equation** | | | | | | | |
|  | | B | S.E. | Wald | df | Sig. | Exp(B) |
| Step 1a | Target\_ind\_tech | 1,376 | ,296 | 21,596 | 1 | ,000 | 3,960 |
| Target\_ind\_strat | -,592 | ,506 | 1,368 | 1 | ,242 | ,553 |
| Prev\_exp | -,034 | ,068 | ,253 | 1 | ,615 | ,966 |
| Local\_part | -1,211 | ,484 | 6,258 | 1 | ,012 | ,298 |
| Commitment | ,000 | ,000 | ,010 | 1 | ,920 | 1,000 |
| Purpose | ,156 | ,618 | ,064 | 1 | ,800 | 1,169 |
| Constant | -1,852 | ,517 | 12,842 | 1 | ,000 | ,157 |
| a. Variable(s) entered on step 1: Target\_ind\_tech, Target\_ind\_strat, Prev\_exp, Local\_part, Commitment, Purpose. | | | | | | | |

Therefore, commitment variable is taken out, as it leads to no harm for the overall model. Each step of the model-building is reported in Figures 3.3 - 3.5, but for the reason of keeping the study less technical and more results-oriented, we skip to the best fitting model, that is taken for further examination in the study. That is the model depicted in the Figure 3.6 with 2 significant predictor variables, namely, target industry technological intensity and local partners.

Figure 3.3. Model-building, steps 2 – 5 variables.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Omnibus Tests of Model Coefficients** | | | | |
|  | | Chi-square | df | Sig. |
| Step 1 | Step | 58,762 | 5 | ,000 |
| Block | 58,762 | 5 | ,000 |
| Model | 58,762 | 5 | ,000 |

|  |  |  |  |
| --- | --- | --- | --- |
| **Model Summary** | | | |
| Step | -2 Log likelihood | Cox & Snell R Square | Nagelkerke R Square |
| 1 | 113,377a | ,361 | ,494 |
| a. Estimation terminated at iteration number 5 because parameter estimates changed by less than ,001. | | | |

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Variables in the Equation** | | | | | | | |
|  | | B | S.E. | Wald | df | Sig. | Exp(B) |
| Step 1a | Target\_ind\_tech | 1,377 | ,296 | 21,617 | 1 | ,000 | 3,962 |
| Target\_ind\_strat | -,590 | ,505 | 1,362 | 1 | ,243 | ,554 |
| Prev\_exp | -,035 | ,067 | ,268 | 1 | ,604 | ,966 |
| Local\_part | -1,210 | ,484 | 6,252 | 1 | ,012 | ,298 |
| Purpose | ,156 | ,618 | ,064 | 1 | ,801 | 1,169 |
| Constant | -1,847 | ,514 | 12,893 | 1 | ,000 | ,158 |
| a. Variable(s) entered on step 1: Target\_ind\_tech, Target\_ind\_strat, Prev\_exp, Local\_part, Purpose. | | | | | | | |

Figure 3.4. Model-building, steps 3 – 4 variables.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Omnibus Tests of Model Coefficients** | | | | |
|  | | Chi-square | df | Sig. |
| Step 1 | Step | 58,699 | 4 | ,000 |
| Block | 58,699 | 4 | ,000 |
| Model | 58,699 | 4 | ,000 |

|  |  |  |  |
| --- | --- | --- | --- |
| **Model Summary** | | | |
| Step | -2 Log likelihood | Cox & Snell R Square | Nagelkerke R Square |
| 1 | 113,440a | ,361 | ,494 |
| a. Estimation terminated at iteration number 5 because parameter estimates changed by less than ,001. | | | |

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Variables in the Equation** | | | | | | | |
|  | | B | S.E. | Wald | df | Sig. | Exp(B) |
| Step 1a | Target\_ind\_tech | 1,377 | ,295 | 21,777 | 1 | ,000 | 3,964 |
| Target\_ind\_strat | -,599 | ,503 | 1,418 | 1 | ,234 | ,550 |
| Prev\_exp | -,034 | ,068 | ,259 | 1 | ,611 | ,966 |
| Local\_part | -1,206 | ,484 | 6,223 | 1 | ,013 | ,299 |
| Constant | -1,819 | ,500 | 13,260 | 1 | ,000 | ,162 |
| a. Variable(s) entered on step 1: Target\_ind\_tech, Target\_ind\_strat, Prev\_exp, Local\_part. | | | | | | | |

Figure 3.5 Model-building, steps 4 – 3 variables.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Omnibus Tests of Model Coefficients** | | | | |
|  | | Chi-square | df | Sig. |
| Step 1 | Step | 58,435 | 3 | ,000 |
| Block | 58,435 | 3 | ,000 |
| Model | 58,435 | 3 | ,000 |

|  |  |  |  |
| --- | --- | --- | --- |
| **Model Summary** | | | |
| Step | -2 Log likelihood | Cox & Snell R Square | Nagelkerke R Square |
| 1 | 113,704a | ,360 | ,492 |
| a. Estimation terminated at iteration number 5 because parameter estimates changed by less than ,001. | | | |

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Variables in the Equation** | | | | | | | |
|  | | B | S.E. | Wald | df | Sig. | Exp(B) |
| Step 1a | Target\_ind\_tech | 1,341 | ,283 | 22,510 | 1 | ,000 | 3,821 |
| Target\_ind\_strat | -,570 | ,500 | 1,301 | 1 | ,254 | ,565 |
| Local\_part | -1,259 | ,474 | 7,062 | 1 | ,008 | ,284 |
| Constant | -1,842 | ,494 | 13,878 | 1 | ,000 | ,158 |
| a. Variable(s) entered on step 1: Target\_ind\_tech, Target\_ind\_strat, Local\_part. | | | | | | | |

Figure 3.6 Model-building, steps 4 – 2 variables.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Omnibus Tests of Model Coefficients** | | | | |
|  | | Chi-square | df | Sig. |
| Step 1 | Step | 57,027 | 2 | ,000 |
| Block | 57,027 | 2 | ,000 |
| Model | 57,027 | 2 | ,000 |

|  |  |  |  |
| --- | --- | --- | --- |
| **Model Summary** | | | |
| Step | -2 Log likelihood | Cox & Snell R Square | Nagelkerke R Square |
| 1 | 115,112a | ,353 | ,483 |
| a. Estimation terminated at iteration number 5 because parameter estimates changed by less than ,001. | | | |

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Variables in the Equation** | | | | | | | |
|  | | B | S.E. | Wald | df | Sig. | Exp(B) |
| Step 1a | Target\_ind\_tech | 1,134 | ,203 | 31,080 | 1 | ,000 | 3,109 |
| Local\_part | -1,260 | ,471 | 7,140 | 1 | ,008 | ,284 |
| Constant | -1,804 | ,482 | 14,023 | 1 | ,000 | ,165 |
| a. Variable(s) entered on step 1: Target\_ind\_tech, Local\_part. | | | | | | | |

The study is proceeded with more in-depth look at the chosen model. The reported output also identifies b-parameters for the explanatory variables, namely 1,134 for the target industry and -1,26 for the local partners. For those who would like to build the full formula for prediction, constant is also reported - -1,804. The b-parameter in logistic regression can be interpreted as change in the logit of outcome variable resulting from a unit change in the predictor variable. The sign of the b-parameter reflects the direction of the relationship. Wald-statistic also confirms that b coefficient is significantly different from zero, which indicates that both variables are significant predictors of the dependent variable.

Figure 3.7 shows SPSS output, which reports that 78,6% of the cases are correctly classified by the current model: 33 cases of investment in SEZs are identified correctly and 70 cases of investing in other regions of China are identified correctly. As for odds ratio (Exp(b)) and associated confidence interval, the output indicates, that for target industry technological intensity as the predictor increases, the odds of the outcome occurring increases, whereas for local partners, with the increase of predictor, the odds of outcome occurring decreases. The confidence interval for target industry (C.I. more than 1) indicates, that the relationship we observed is true for the whole population. For the local partners the situation is symmetrical (C.I. lower than 1), which means that negative relationship of variable increase and odds of outcome occurring is also true for the whole population.

Let us continue, by analyzing classification plot, depicted in the Figure 3.8. This plot is a histogram of the predicted probabilities that the investment in done in SEZs. As a rule of thumb, the more the cases cluster at each end of the graph, the better the model predicts the outcome variable. In our case we see that the outcomes are not cluttered around 0.5, which is a sign of good explanatory power – the choice is not made like a coin toss 50:50. Also, only few cases are misclassified, which confirms good fit of the model.

Figure 3.7. Classification table and Variables in the equation.

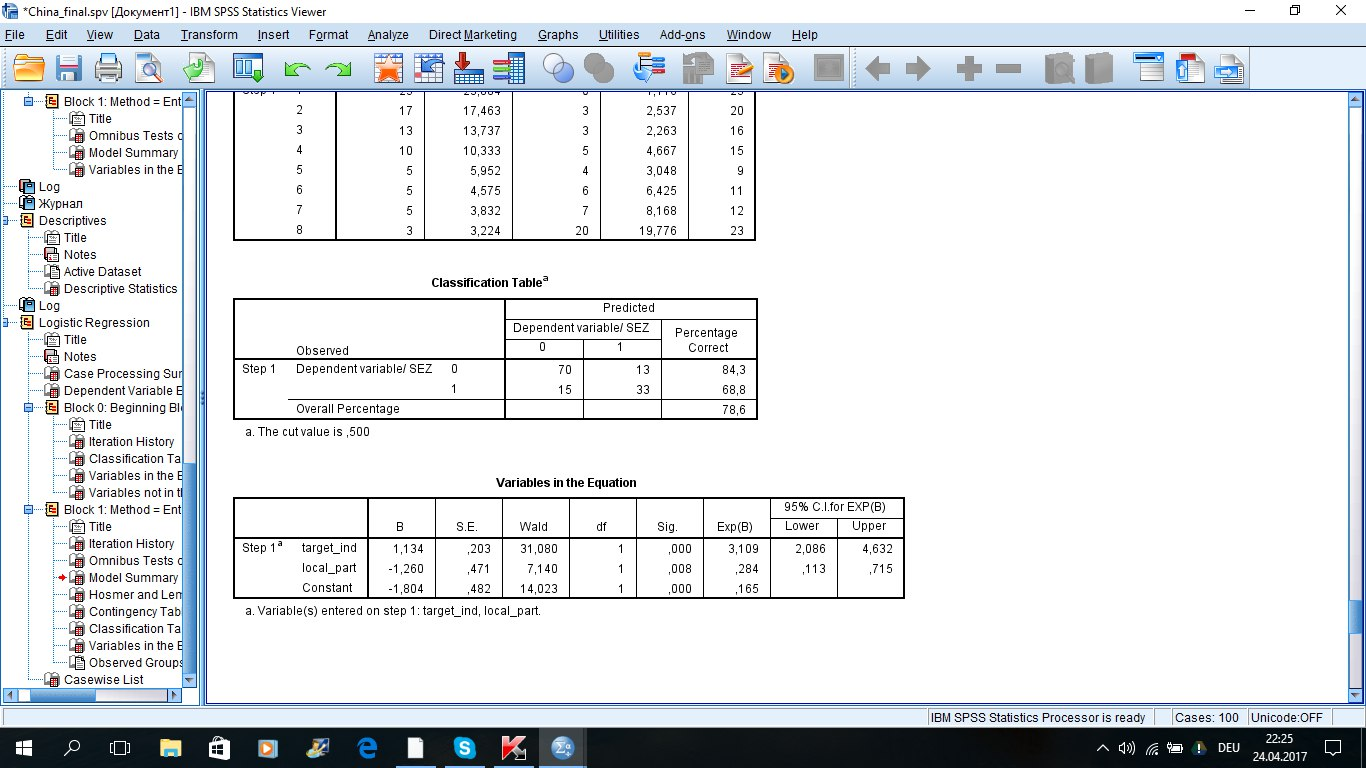
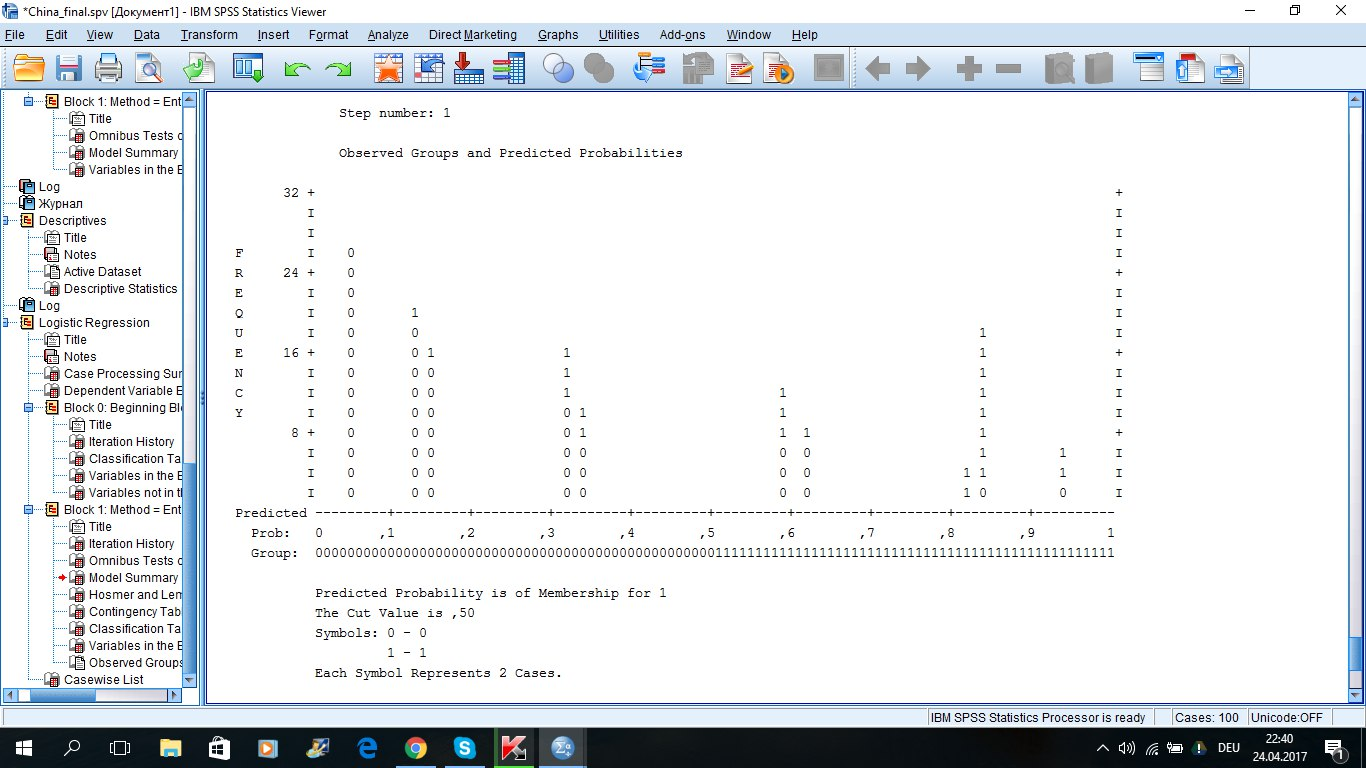
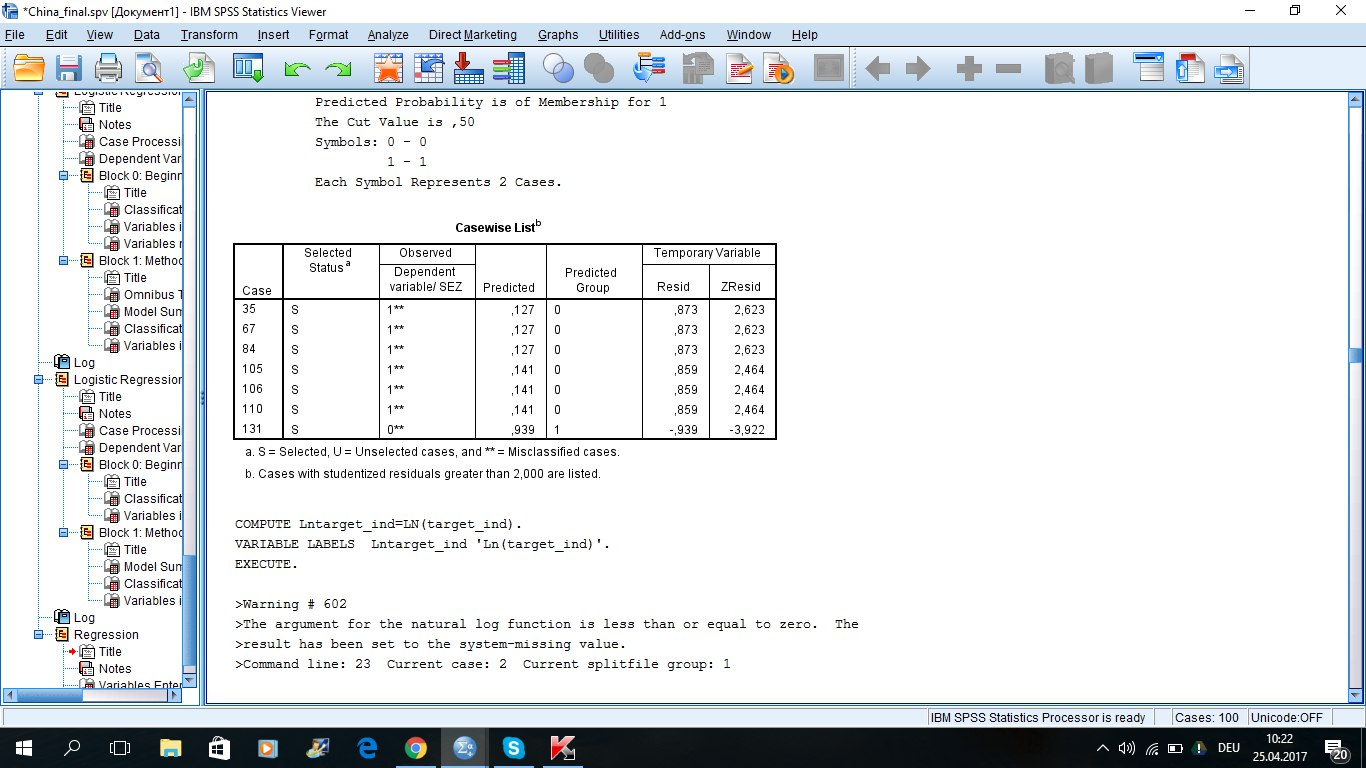


Figure 3.8. Classification plot.



Now, residuals have to be analyzed to account for outliers and any particular influential cases. We start by analyzing cases, in which the model misclassifies cases (see output in the Figure 3.9). This list gives us an understanding that few cases can significantly alter the overall model and may potentially be outliers of the sample, as their studentized residuals are greater than 2. These cases need special attention in the discussion section and also ask for more focused analysis of residuals.

Figure 3.9. Case summary.



Descriptive statistics of the different residual outputs (Cook’s distance, leverage, standardized residuals and DFBeta values) are presented in Figure 3.10. Cook’s distance variable is less than 1, indicating no influential cases, having an effect on the model. Leverage values lie between 0 and 1 and are close to calculated expected value of 0,023 ((k+1)/N- k-number of predictors, N-sample size). Normalized residuals present a problem, as we notice cases with an absolute value of more than 3, which is a potential outlier. DFBeta absolute values are all less than 1, indicating no problem with the statistic.

In order to be able to generalize the findings of the logistic regression, we have to make sure, that the underlying assumptions have been met. Therefore, linearity of logit and lack of multicollinearity among the predictor variables are to be tested. We proceed with reporting logistic regression for the independent variables and the interaction between the predictor and the log of itself (Hosmer & Lemeshow, 1989). In the Figure 3.11 the result of the linearity test is depicted. As local partners is a binary variable, it and its the interaction with its log is not included as predictor variables in the table reported. We observe, that the two variables mentioned are not significant as predictor, which means that the linearity assumption holds true.

Figure 3.10. Descriptive residual statistics.

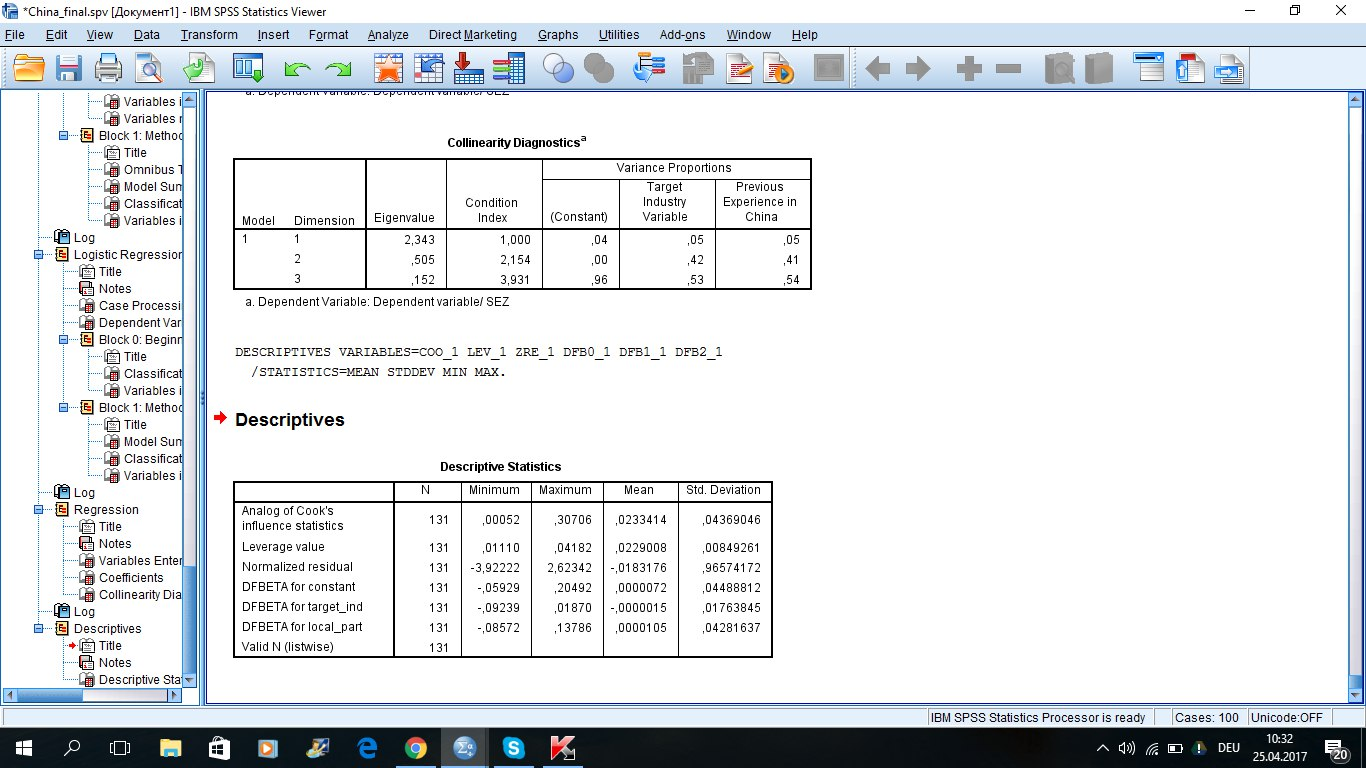
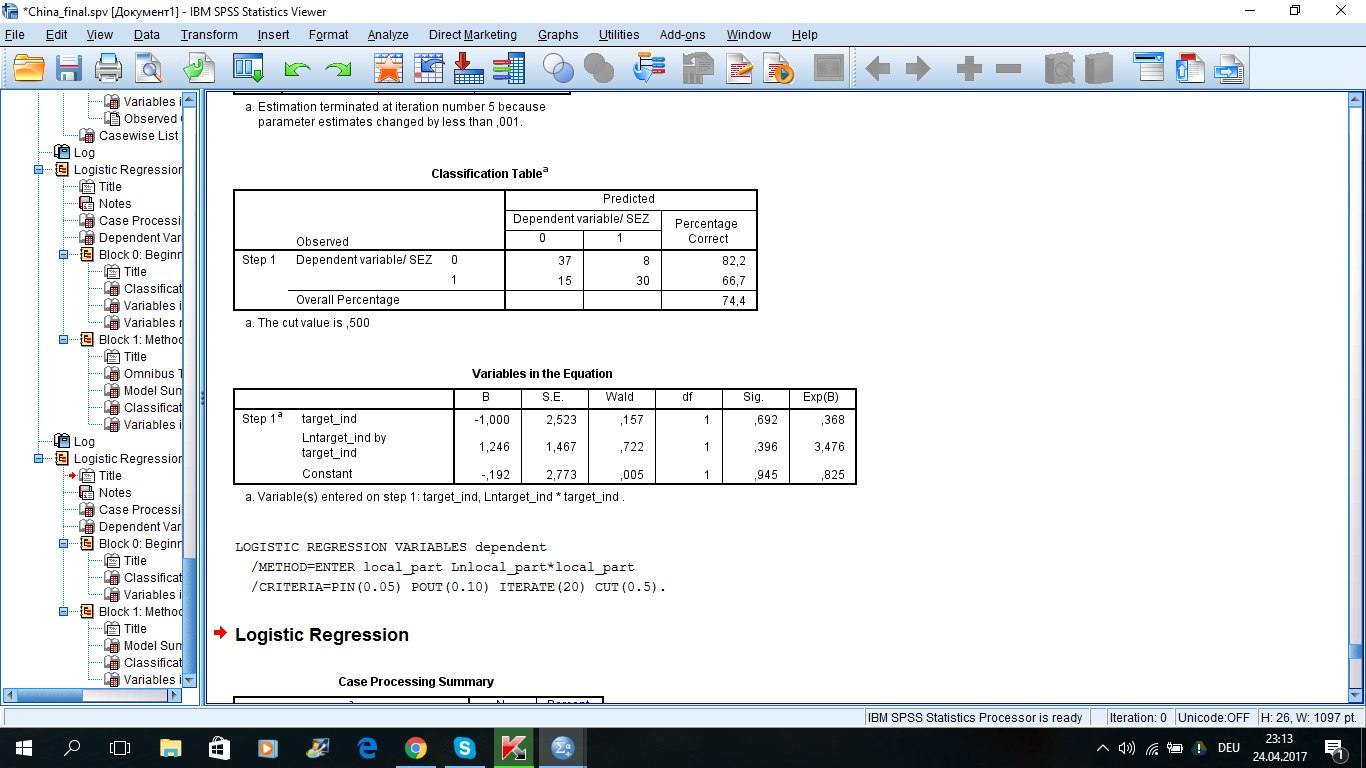
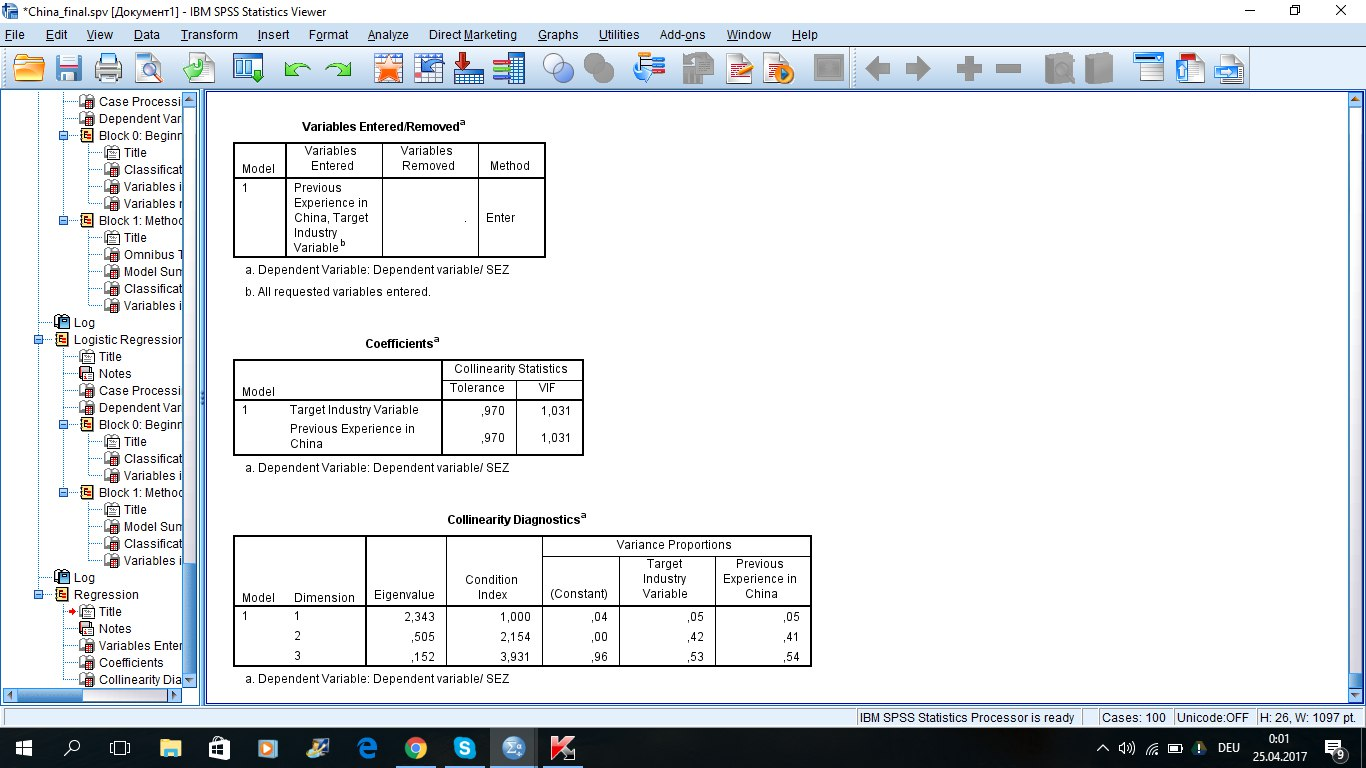


Figure 3.11. Linearity test.



As for multicollinearity of the independent assumptions, Figure 3.11 reports results on this test. The tolerance values are 0,97 for both independent variables and VIF equals 1,031, which does not indicate any problem with the multicollinearity. Collinearity diagnostics table does not raise any suspicion towards multicollinearity issues, even though first eigenvalue is fairly larger than the other two, which indicates that regression parameter estimates can be greatly affected by small changes in the predictors or outcome. Condition index, on the other hand, do not show much differences between the eigenvalues, thus not supporting the previous indication. Finally, variance proportion values are not concentrated over particular eigenvalues, rejecting possibility for multicollinearity.

Figure 3.11. Multicollinearity test.



### 3.3 Results

Coming to interpretation of the results, we can conclude that model fits the data and explains well relationship between the predictor and outcome variables. The findings are also generalizable to the whole population. Two predictor variables are proven to have an influence on dependent variable, namely target’s industry technological intensity and knowledge of local partners. The first has a positive relationship with the outcome variable, whereas the second one has a negative direction of the relationship as has been predicted. Therefore hypotheses 1 and 4 have been accepted by the empirical analysis. Other predictor variables that were suggested by the theory were not proven to have an impact on the outcome variable, therefore we reject hypotheses 2, 3, 5 and 6.

It is also worth mentioning that the explanatory power of the model was questioned by analysis of residuals, which has to receive special attention in the discussion. Concerning the most influential cases that were detected, we can conclude that the investing companies are not always basing their decision on the availability of local partners and their target industry. There are exceptions, which are not fully addressed by the model, but still have to be included, as they represent the real business practice.

### 3.4.1 Discussion of the findings

As can be seen from the previous section the results of empirical analysis confirm the existence of significant relationship between target’s industry technology-intensity and investment location in China; and knowledge of local partners and investment location in China. Hypotheses concerning strategic importance of the target’s industry, previous experience in EEs, purpose of the deal and commitment to the market have not been proven by the analysis. Now each factor will be discussed separately by explaining the findings and comparing them to previous research.

Table 3.3. Summary of the hypotheses checks.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| ***H*** | ***Description*** | ***Direct of influence*** | | ***Results*** |
| *H1* | *Companies acquiring targets in technology-intensive industries are more likely to invest in SEZs than overall China regions.* | *+* | | *Accepted* |
| *H2* | *Companies acquiring targets in strategically important industries are more likely to invest in SEZs than overall China regions.* | *+* | | *Rejected* |
| *H3* | *The more experience in EEs the firm possesses, the more likely will the firm invest in overall China than SEZs.* | *-* | | *Rejected* |
| *H4* | *The firms with knowledge of local partners are more likely to invest in overall China than SEZs.* | *-* | | *Accepted* |
| *H5* | *The firms following asset-exploitation purposes are more likely to invest in other regions on China than in SEZs.* | *+* | *Rejected* | |
| *H6* | *The more committed to the country the company is, the more likely it invests to overall China than in SEZs.* | *\_* | *Rejected* | |

To start with, technological intensity of target company industry has a positive relationship with locating FDI in SEZs. The first and most obvious reason is that high-tech companies in China are simply concentrated in the SEZs, therefore if an international firm wishes to acquirer a target in this sector, it has no other choice but to invest in SEZs. This is partially true, as SEZs are usually focused on technology-intensive and capital-intensive industries (Wong, 1987). However, there are important industry hubs out of SEZs, therefore international investors assess both fit of the target company and conditions offered by the investment location – host country CSAs, which will be further discussed.

As has been mentioned in hypotheses development section, better PRP system of SEZs can be another reason for companies in technologically intensive industries to locate FDI in these areas. According to previous research, PRP issues are extremely important for technological companies entering markets with turbulent environment, such as China: technological companies are likely to encounter knowledge leakage and thus shorten their time horizon of capitalizing on their core technologies (Allred & Park, 2007; Falvey, Foster, & Greenaway, 2006). The problem can not be overcome even with full ownership of the target company in China, as transactions with external stakeholders such as competitors, consumers and suppliers are necessary (Zhu & Qian, 2015). Thus, investing in SEZs presents fewer PRP risks to the acquirer companies and becomes an important factor in choosing the investment location.

Another reason for the phenomena is access to skilled labor force in SEZs, an extremely important issue for technological firms or those acquiring an entity in high-technology industry. Companies operating inside the zones can enter into enforceable labor contracts with specific term limits, dismiss unqualified or underperforming employees, and adjust wage and compensation rates to reflect the market situation (ProLogis, 2008). These factors are critical to attracting the right educated talent, which is in shortage in other regions of China.

Finally, positive spill-over effects of SEZs, as an FDI agglomeration, is a possible reason for technological companies to invest in those areas. Previous research has established that for knowledge-seeking OFDI agglomeration economies mean R&D concentrations and knowledge spillovers, which are of considerable importance in foreign locations as an input into the joint learning process of foreign subsidiaries, their suppliers, customers or partners (Jindra, Hassan, Cantner, 2016). Therefore, if tech companies’ investments are of knowledge-seeking nature, they value the spill-over effects of SEZ, as a cluster of related companies.

Coming to the next accepted hypothesis, if the companies know local partners, they are less likely to invest in SEZs. This could be explained through companies’ desire to get an access to the vast consumer market, despite difficult institutional environment in China. Under this context, they are able to realize their FSA, by engaging in cooperation with local counterparts, who offer access to local markets, distribution channels, personnel, knowledge of local regulations, and government relation (Lu & Ma, 2008). Existing literature confirms that foreign investors benefit from information about local partners’ intentions, resource endowments, prior collaboration experience, and past behavior (Meschi, Wassmer, 2013).

It should also be noted that investments in SEZs can be executed without local partners’ help, as seen from the analysis. One reason for that is easier institutional environment of SEZs, that is closer in nature to developed markets. Moreover, local partners’ opportunism is a great risk for the companies investing in China, and previous literature has outlined this as a reason to investment in better-known locations of OFDI agglomerations (Lien & Filatotchev, 2015).

Moving to the rejected hypotheses, the model has not shown relationship between strategic importance of the industry and the investment location. It should be mentioned that many of the strategically important industries overlap with technologically intensive ones, and those have been proved significant by the model. Evidently, the industries, which are strategically sensitive, but not technologically intensive, for example, building and construction and automotive retailing fall out of the model. Therefore, we argue, that only specific industries among the state controlled ones are granted specific host country CSAs, as illustrated earlier for chemical industry.

As for previous experience in EEs, it was not proven to have relationship with investment location. Previous literature states that experience accrued in an EE will tend to bring some knowledge that may benefit group members entering into other emerging economies (Carlsson, Nordegren, & Sjo¨holm, 2005; Kostova and Zaheer, 1999). Therefore, it has been suggested that companies with more experience in EEs will use the knowledge of doing business in a turbulent environment, by opting for other regions in China. However, the results indicate that the relationship has not been proven. The potential reason could be the fact, that for emerging market companies such a competitive advantage comes from the home-market experience (Cuervo-Cazurra and Genc, 2008) and additional experience in other EEs does not add extra understanding of the environment.

Moving on to project-level attributes, the purpose of the deal does not explain location choice in China. As it has been mentioned in the variable measurement section, purpose of the FDI is a strictly strategic decision that is not likely to be revealed to the general public. We assume, that self-reported data found in the database is not trustworthy and over-simplified; therefore, the results are not necessarily valid. Moreover, the descriptive results contradict EMNE-specific research, which indicate that EMNEs internationalize to overcome the lack of FSA, by acquiring the resources, namely undertaking asset-seeking strategies (Kedia, Gaffney, & Clampit, 2012; Peng, Wang, & Jiang, 2008; Ramamurti, 2009). This disparity is left open for further research.

Finally, commitment to the market was not proved to have an impact on the location decision in China. Previous literature revealed that equity stake in a subsidiary owned by the parent company is positively associated with FDI location decisions in less-explored and risky areas and FDI value signals the commitment to the target country (Lien & Filatotchev, 2015). However, this study has not proven any relationship between those factors and investment location in China. The possible explanation could be importance of different factors, namely, host country CSAs or FSAs, for companies from different industries. Making larger commitments for one group may mean, as hypothesized, opportunity to deploy FSAs and learn local market; for the other group – quite the opposite – availability of CSAs matter and enforce their FSAs. Thus, for the whole sample there is no relationship identified.

### 3.4.2 Theoretical contribution

Overall, this study contributes to the ongoing research in emerging-to-emerging countries investments in a number of ways. First, it presents a trade-off that EMNEs face when making a choice to invest in and out of SEZs. The study introduces 3-level model to assess factors influencing FDI location, namely, host country CSAs, company FSAs and project-level attributes, which addresses a complex decision undertaken by EMNEs. Hence, this research deepens the knowledge about the variety of host country CSAs and deployment of FSAs within one EM (Rugman et al. 2011).

Second, it coordinates FDI agglomeration studies in EM (Filatotchev, Strange, Piesse, and Lien, 2007) with research on FDI in China, by finding clusters’ attributes in widely discussed SEZs. Agglomeration-economy is linked with FDI in China to enrich understanding of SEZ phenomena; and based on additional advantages of agglomeration provides extra explanatory factors for the location decision.

Third, it offers an example of how this trade-off is realized in the real world under the context of Chinese SEZs. The results highlight that technological intensity is an important factor in viewing CSA-FSA trade-off under these exact premises. Thus, a discussion on the differences in company behavior patterns in the same trade-off situation, but under different EM context is initiated as well as on the underlying foundations for these behavior patterns.

### 3.4.3 Managerial implications

The findings indicate a number of managerial implications for both decision makers in companies and Chinese officials. First, emerging market companies investing in China should realize advantages and disadvantages of SEZs, as they are not the best location choice for any business. SEZs suit investments in high-technology sector in China due to better PRP, availability of skilled labor force and positive spill-overs effects in the areas. However, SEZs are less favorable and sometimes even limiting for non-manufacturing businesses, as they are usually located faraway from end consumer and prohibit direct communication with customers and stakeholders.

Second, SEZs present an institutional environment, which is closer in nature to developed markets, thus are easier to grasp without the help of local firms. Practitioners can omit finding a local partner for smooth investment experience when investing in SEZs. Another reason for not considering collaboration with local partners is a spread issue of partners’ opportunism, especially in high-technology industries.

Finally, Chinese government can use the results of the study to underline most valuable to investors attributes of SEZ to attract even more investment in the areas. As has been found, industry specialization plays the major role in choosing a location for investment. Thus, benefits particularly for the industry in question should be emphasized in the promotional materials. It would also be convenient for foreign investors to have one-window approach to finding a location for investment. For example, an investor could be given a list of all SEZs in China, corresponding his desired industry, with stated advantages and risks.

### 3.4.4 Limitations and directions for further research

There are several limitations associated with this study, which, in turn, can be translated into directions for further research. First of all, the study considers only M&A projects, disregarding greenfield investment. Although the influencing factors may be the same due to similar underlying logic of companies, making a decision, it is worth testing the same factors on greenfield projects sample. Covering this research gap is suggested as direction for further research.

Second, some variables measurements are based on assumption rather than precise information, which makes data less trustworthy. It can be suggested to take different proxies for previous experience in EEs, availability of local partners and purpose of the deal variables to be able to draw more reliable conclusions. Also home country CSAs factors and specific location factors are out of scope of this study, yet, would be insightful to test. Both home-country attributes and information about the provinces, where the companies invest may impact the investment location choice, as suggested by FSA theory.

On a larger scale, further research can address other EM context, where FDI agglomeration or SEZs are present. Therefore, behavior patterns can be either proven or different approaches can be found. Host market can actually have a moderating effect of the relationships between the factors and investment location, which would underline differences of doing business in those EM countries.

## Summary of Chapter 3.

In this chapter we outline how we conduct the empirical analysis, provide results and then discuss the findings. Based on the descriptive statistics we make several inferences about the data: there are more projects out of SEZs, than into them; foreign companies tend to invest in medium technologically intensive industries, and less strategic industries in China; companies in the sample have extensive experience of operating in emerging market countires; companies are divided 50:50 to those who employ local partners or operate wihout them; EMNEs in the sample are overwelmingly using asset-exploitation strategy; and companies’ commitment to the market differs greatly among the sample.

With the help of the logistic regression we build the most parsimonious and well-explainig model, which includes two predictor variables – target industry and local partners. We conclude, therefore, that the respective hypotheses are accepted and target industry and local partners influence the emerging companies’ decision to invest in and out of SEZs. The other four hypothses have been rejected, as these variables have not shown a significant impact on the outcome variable.

After getting the results and checking the hypotheses, we discuss and explain the received findings. The more technologically intensive the industry of the target company in China is, the more likely the company will invest in SEZs due to four major reasons explaining this phenomena: agglomeration of Chinese high-tech companies in SEZs, availability of skilled labor force, positive spill-over effects of SEZs and better PRP at place in SEZs. If a company is cooperating with a local partner, it is more likely to invests in other regions of China. This could be explained through companies’ desire to get an access to the vast consumer market, despite difficult institutional environment in China. Their FSAs can be realized in the more difficult institutional environment of other regions in China.

Moving to the unproven hypotheses, strategic importance has not shown impact on FDI location due to lack of host country CSAs provided by the government to some of the strategically important industries. The relationship between previous experience in EEs and investment location was not proven. The potential reason could be the fact, that for emerging market companies such a competitive advantage comes from the home-market experience (Cuervo-Cazurra and Genc, 2008) and additional experience in other EEs do not add extra understanding of the environment.

Purpose of the deal also has no impact on the location decision in China, as the data is highly sensitive and is not expected to be reported sincerely by management. Commitment to the market was not proved to have an impact on the location decision in China. The possible explanation could be differentiating motivations for commitment of companies from different industries. For some FSAs play vital part, and they, as expected would invest in other regions of China; whereas for the other commitment is associated with secure host country CSAs, better provided by SEZs.

Overall, this study contributes to the ongoing research in emerging-to-emerging countries investments in a number of ways. First, it presents a trade-off that EMNEs face when making a choice to invest in and out of SEZs and introduces 3-level model to assess FDI location factors. Second, it coordinates FDI agglomeration studies with research on FDI in China, by finding clusters’ attributes in widely discussed SEZs Finally, the study initiates a discussion on different behavior patterns of companies facing the same trade-off under different EM contexts.

Based on the findings, a set of managerial implications has been developed. First, emerging market companies investing in China should realize advantages and disadvantages of SEZs, as they are not the best location choice for any business. SEZs suit investments in high-technology sector in China, whereas are less favorable and sometimes limiting for non-manufacturing businesses. Second, SEZs present an institutional environment, which is closer in nature to developed markets, thus are easier to grasp without the help of local firms. This cost of doing business in China can be omitted when investing in SEZs. Finally, Chinese government can use the results to underline most valuable to investors attributes of SEZ to attract even more investment in the areas, namely, industry specialization and benefits particularly for the industry in question.

However, there is clearly scope for future research: testing the same hypotheses for greenfield investments in China to figure out, whether this investment type implies different reasoning in defining investment location as opposed to M&A; coming up with home country factors and location-specific factors to understand the whole range of determinants for the investment location decision in China; including other developing countries to the analysis to understand whether the behavior patterns stay the same or differ under different contexts.

## Conclusion

This master thesis was devoted to studying investment location decision in China and which factors affect companies’ choice when investing in and out of SEZs. The research goal of the paper was to determine which factors influence the decision of the emerging countries’ companies to invest in SEZs or in other regions in China. The goal has been accomplished and all research objectives stated have been achieved.

As the first step of the study, theoretical background on Rugman’s FSA theory was investigated and typical FSAs and FSDs of EMNEs investing in emerging markets were highlighted. Also existing literature on FDI in China and SEZs, in particular, was reviewed, which helped to develop hypotheses to be tested. As the second part of the study, an empirical analysis was conducted in order to determine which factors have impact on the companies’ decision concerning investment location in China.

It has been found that target companies’ technological intensity of the industry and access to local partners have an impact on emerging companies’ decision to invest in and out of SEZs. The more technologically intensive the industry of the target company in China is, the more likely the company will invest in SEZs. There are four major reasons explaining this phenomena: agglomeration of Chinese high-tech companies in SEZs, availability of skilled labor force, positive spill-over effects of SEZs and better PRP at place in SEZs. If a company knows a local partner, it is more likely to invest in other regions of China. This could be explained through companies’ desire to get an access to the vast consumer market, despite difficult institutional environment in China. Their FSAs can be realized in the more difficult institutional environment of other regions in China.

Overall, this study contributes to the ongoing research in emerging-to-emerging countries investments in a number of ways. First, it presents a trade-off that EMNEs face when making a choice to invest in and out of SEZs and introduces 3-level model to assess FDI location factors. Second, it coordinates FDI agglomeration studies with research on FDI in China, by finding clusters’ attributes in widely discussed SEZs Finally, the study initiates a discussion on different behavior patterns of companies facing the same trade-off under different EM contexts.

However, there is clearly scope for future research: testing the same hypotheses for greenfield investments in China to figure out, whether this investment type implies different reasoning in defining investment location as opposed to M&A; coming up with home country factors and location-specific factors to understand the whole range of determinants for the investment location decision in China; including other developing countries to the analysis to understand whether the behavior patterns stay the same or differ under different contexts.

Based on the findings, a set of managerial implications has been developed. First, emerging market companies investing in China should realize advantages and disadvantages of SEZs, as they are not the best location choice for any business. SEZs suit investments in high-technology sector in China, whereas are less favorable and sometimes limiting for non-manufacturing businesses. Second, SEZs present an institutional environment, which is closer in nature to developed markets, thus are easier to grasp without the help of local firms. This cost of doing business in China can be omitted when investing in SEZs. Finally, Chinese government can use the results to underline most valuable to investors attributes of SEZ to attract even more investment in the areas, namely, industry specialization and benefits particularly for the industry in question.

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## Appendix 1. Industry categorization by technological intensity, OECD (2011).

**High-Technology Industries :**

* + - Electronics
    - Pharmaceuticals

**Medium –High-Technology Industries:**

* + Automobiles & Components
  + Chemicals
  + Internet Software
  + Machinery
  + Petrochemicals
  + Semiconductors
  + Software
  + Wireless
  + Telecommunications Services

**Medium –Low-Technology Industries:**

* + Alternative Energy Sources
  + Building/Construction
  + Construction Materials
  + Containers & Packaging
  + Metals & Mining
  + Oil & Gas
  + Other Industrials
  + Power

**Low-Technology Industries:**

* Agriculture & Livestock
* Food and Beverage
* Home Furnishings
* Household & Personal Products
* Other Consumer Products
* Textiles & Apparel
* Publishing

**Non-manufacturing Industries:**

* Advertising & Marketing
* Asset Management
* Automotive Retailing
* Banks
* Broadcasting
* Credit Institutions
* Discount and Department Store Retailing
* Food & Beverage Retailing
* Healthcare Providers
* Hotels and Lodging
* Insurance
* IT Consulting & Services
* Other Financials
* Professional Services
* Transportation & Infrastructure
* Water and Waste Management
* Computers & Electronics Retailing
* Other Real Estate
* Supranational

## Appendix 2. Industry categorization by strategic importance, CCP.

## 

**‘Strategic” Industries:**

* + Petrochemicals
  + Telecommunications Services
  + Alternative Energy Sources
  + Oil & Gas
  + Power
  + Transportation & Infrastructure

**‘Pillar’ Industries:**

* + Electronics
  + Pharmaceuticals
  + Automobiles & Components
  + Chemicals
  + Internet Software
  + Machinery
  + Semiconductors
  + Software
  + Wireless
  + Building/Construction
  + Metals & Mining
  + Automotive Retailing

**Non-targeted Industries:**

* Construction Materials
* Containers & Packaging
* Other Industrials
* Agriculture & Livestock
* Food and Beverage
* Home Furnishings
* Household & Personal Products
* Other Consumer Products
* Textiles & Apparel
* Publishing
* Advertising & Marketing
* Asset Management
* Banks
* Broadcasting
* Credit Institutions
* Discount and Department Store Retailing
* Food & Beverage Retailing
* Healthcare Providers
* Hotels and Lodging
* Insurance
* IT Consulting & Services
* Other Financials
* Professional Services
* Water and Waste Management
* Computers & Electronics Retailing
* Other Real Estate
* Supranational