Drivers of Chinese Outward Foreign Direct Investment and the Location Choice

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Abstract. In recent years, the outward foreign direct investment of Chinese enterprises has increased significantly under the policy support, but comparing with developed countries and the newly industrialized countries such as the United States and Japan, there are still some shortcomings in the location choice. Chinese outward foreign direct investment grows fast, and the investment location is relatively concentrated, diversified investment areas. Expanding market scale, reducing production cost, attaining technology and management skill are the main inside incentives for Chinese enterprises to invest abroad. The host country and home country’s political, economic, social and cultural environment are also important factors in promoting Chinese outward foreign direct investment. Based on this, Chinese enterprises should pay more attention to culture, social environment and geographic conditions when they implement outward foreign direct investment, so that they can catch the investment opportunities and do the proper investment location choice.

1. Introduction

With the development of globalization, the relationship within counties is much tighter than ever before. The variety of foreign direct investment flow is a measure for evaluating the economic power of a country and the competitiveness of an enterprise in a certain period. In order to push outward foreign indirect investment of China and melt with the world economic further, the government has induced policy of “Going Outside” since 2000. Under this background, the outward direct investment of China grew rapidly, even upon the stagnant of world economic. The Report of 2014 Chinese outward foreign direct investment reveals that Chinese outward foreign direct investment has achieved the new record in history at 123.12 billion dollars and ranked the third place in the world for three consecutive years.

Outward foreign direct investment is an important part of the economic and is the key step for economic development. Comparing to other countries, outward foreign direct investment from China started late and still facts the problems of unreasonable location choice and serious competition from developed and emerging countries [1,2]. Limited experiences and low technology lever have troubled Chinese enterprise for a long time [3-5]. Through outward foreign direct investment, Chinese enterprises can learn advanced technology as well as management skill and enforce their own international competitive power. Thus, it’s vital to research what drive Chinese enterprises invest abroad and what affect their location choice. Upon this background, this paper analyses foreign direct investment location status and the trend of Chinese enterprises, after that explores the factors driving invest based on enterprise, home country and host country side. At last, the paper proposes the investment strategies for Chinese outward investment to make a better investment location decision.

2. Chinese Outward Direct Investment Status and Location Choice

Chinese outward direct investment broke the record in 2015 and ranked the second place globally.
2.1 The growth rate and the scale of Chinese outward investment grow significantly

From table 1, we can find that the flow and the stock of Chinese outward foreign direct investment grew significantly in recent years. According to the statistics, the growth rate of Chinese outward direct investment flow arrived at 17% yearly on average from 2010 to 2015. The stock of Chinese outward foreign direct investment grew from 317.2 billion dollars in 2010 to 1097.9 billion dollars in 2015. It’s the first time for China to become the second biggest foreign capital outflow country in 2015. Not only the amount of Chinese outward direct investment but also its growth rates are all significant.

Table 1. The Stock and the Flow of Chinese Outward Direct Investment in 2010-2014.

<table>
<thead>
<tr>
<th>Year</th>
<th>Stock</th>
<th>Flow</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>3172.105</td>
<td>668.1</td>
</tr>
<tr>
<td>2011</td>
<td>4247.806</td>
<td>746.5</td>
</tr>
<tr>
<td>2012</td>
<td>5319.405</td>
<td>878</td>
</tr>
<tr>
<td>2013</td>
<td>6604.784</td>
<td>1078.4</td>
</tr>
<tr>
<td>2014</td>
<td>8826.4</td>
<td>1231.2</td>
</tr>
<tr>
<td>2015</td>
<td>10978.7</td>
<td>1456.7</td>
</tr>
</tbody>
</table>

Data source: 2011-2016 Chinese Statistics Yearbooks

2.2 Chinese outward direct investment spreads throughout the world, but mainly concentrates on Asia

From Fig.1, we can find that the countries that Chinese enterprises invested in are spread throughout the world, but concentrated in Asia. The proportion of investment in Asia has been the largest in the study period, and it even reached percentage of 74.39 in 2015. Latin America always occupied the second largest investment proportion, but it was only 8.66% in 2015.

2.3 The outward direct investment in Asia, Latin America and North America grows rapidly

![Figure 1. 2010-2015 Chinese net foreign direct investment in different continents](image)

From Fig.1, we can conclude that the trend of foreign outward investment from China to Asia, Latin America and North America keeps growing and the grow speed is very high, especially during 2013-2015. Chinese net foreign outward investment in North America grew nearly four times from 2010 to 2015.
2.3 Chinese outward investment diversifies in different industries

Table 2. 2010-2015 the proportion of net foreign direct investment from the top four in different industries in China.

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Mining and Quarrying</td>
<td>8.3</td>
<td>19.35</td>
<td>15.43</td>
<td>23</td>
<td>13.44</td>
<td>7.72</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>6.78</td>
<td>9.43</td>
<td>9.87</td>
<td>6.67</td>
<td>7.78</td>
<td>13.72</td>
</tr>
<tr>
<td>Financial service</td>
<td>12.54</td>
<td>8.13</td>
<td>11.47</td>
<td>14.01</td>
<td>12.93</td>
<td>16.64</td>
</tr>
<tr>
<td>Leasing and business service</td>
<td>44.01</td>
<td>34.29</td>
<td>30.46</td>
<td>25.09</td>
<td>29.91</td>
<td>24.89</td>
</tr>
</tbody>
</table>

Data source: Calculate by 2011-2016 Chinese Statistics Yearbook

According to statistics, Chinese outward foreign direct investment involved first, second and third industries, 18 different specific industries. From table 2, we can find that Chinese enterprises invest mainly in mining and quarrying, manufacturing, financial and business service industry. These four industries occupied over half proportion of the total investment during 2010 to 2015. Mining and quarrying industry is with the character of capital and energy intensive. Manufacturing industry has the feature of labor intensive. At the same time the investment growth rate of manufacturing industry rank the first place within all industries during study period. Financial service is with characters of high technology and high value-add. Although the investment percentage of leasing and business industry with the feature of capital intensive is declining during research period, it is still occupy the largest investment percentage within all industries. In a word, Chinese outward foreign direct investment industries structure is still mainly focus on capital incentive industry, but it has a diversified trend. So, it means that Chinese outward investment industry structure tends to be optimized.

3. The Drivers of Chinese Outward Foreign Direct Investment

Chinese outward foreign direct investment grow rapidly, the areas which are invested mainly focus on Asia. While North America and Latin America have great investment potential, for investment growth rate there is accelerating. The industries invested are mainly in capital intensive industries. This kind of investment pattern is affected by inside and outside reasons. Inside reasons are the cause from investors which will affect their investment conditions like their technology, capital reserve and management skill. The outside reasons are mainly affected by outside factors, like the factors from home country or host countries.

3.1 The need for enterprises development drives outward foreign direct investment

Enterprise is the main entity for outward foreign investment. The objective of enterprises is to maximize their profit. Foreign outward direct investment helps them to achieve that goal.

3.1.1 To reduce manufacturing cost by optimizing scarce resource allocation

The basic reason for foreign direct investment is to maximize the profit, the key to realize the cost is to reduce the cost of production. From foreign direct investment, enterprises can get the sustainable supply of raw material like labor and land, which are cheaper to sustainable supply, and reduce transportation cost once they want to sell in the production site. As well as they can avoid the lost from exchange rate fluctuation and avoid the trade barriers from host country. All these reasons contribute to drive outward foreign direct investment. Also these reasons can explain why Chinese outward foreign direct investment concentrates on the area of Asia. That's because the majority countries in Asia are developing countries with great opportunities and low investment costs. Labor cost in China increased gradually these years. According to statistics, the average wage in China was 56339 Yuan in 2014 that was 7.1% higher than last year. The wage still keeps going up in the future. Thus, considering the cost factors, manufacturing has become a main industry in Chinese enterprises to invest in and Asia has become the first choice for Chinese enterprises to go
The reasons for rapidly investment growth rate in Latin America and Africa are that they have little market restriction and low production and sale cost.

### 3.1.2 To occupy the market share

With the development of economy and the improvement of residents’ consumption ability, the demands for commodities are increased. So the competition in China is very serious, Chinese companies have to turn to oversea market. On the other side, once a company has a certain market proportion in home country, it has to invest abroad to produce and sale in order to maintain customers there. For instance, TCL entered Vietnam market in 1999. Nowadays he has become the one of the top three TV suppliers in Vietnam market.

### 3.1.3 To acquire brand advantage, technology and management skill

The developed countries have brand and technology advantage especially in product design and management experience. Through green field investment, merger or acquisition, Chinese companies can acquire these resources. For instance, Geely acquired the North Europe famous band Volvo to get the advantage technology and management skill. So that he built XC90 based on the original scalable platform which worth 11 billion dollars.

Besides this, the reasons for Chinese enterprises to invest abroad may include setting a good image, getting the latest economic information or individual preference. Beside these, the basic motive for enterprises investing abroad is reducing the cost and maximizing profit.

### 3.2 The outside factors drive enterprises to invest abroad

The outside factors push enterprises to invest aboard include home country factors and host country factors.

#### 3.2.1 Home country factors

(1) New policies incentives

Home country’s policy would have direct impact on the decision of direct investment from enterprises. In the new period, upon the “One Belt One Road” strategy, the countries along the Silk Road have become the main objective of Chinese enterprise to invest in. According to the Business Department statistics, Chinese enterprises have invested in 48 countries along the “one belt on road”, the amount of investment accumulated 10.7 billion dollars, the grow rate achieved at 48.2% yearly. The implementation of the new policy can not only give Chinese enterprises the direction of investment, but also in various forms to encourage foreign direct investment.

(2) The limitation of resource pushes foreign direct investment

<table>
<thead>
<tr>
<th>Year</th>
<th>Energy Consumption</th>
<th>Energy Production</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>3606.48</td>
<td>2860.92</td>
</tr>
<tr>
<td>2011</td>
<td>3870.43</td>
<td>3121.25</td>
</tr>
<tr>
<td>2012</td>
<td>4021.38</td>
<td>3401.78</td>
</tr>
<tr>
<td>2013</td>
<td>4169.13</td>
<td>3587.84</td>
</tr>
<tr>
<td>2014</td>
<td>4258.06</td>
<td>3618.66</td>
</tr>
<tr>
<td>2015</td>
<td>4300</td>
<td>3620</td>
</tr>
</tbody>
</table>

Data source: 2016 Chinese Statistics Yearbook

There is a great gap between energy production and consumption in China. From 2010 to 2015, the demand for energy has been increasing, while energy production couldn’t keep up with the growth of energy consumption. Thus, outward direct investment is a way to solve such a conflict. On one side, through outward direct investment, we can solve the problem of resources shortage and unstable energy supply. On the other side, through outward direct investment, we can reduce the environmental damage caused by energy exploitation and realize environment sustainable development. In this situation, the limitation of resources is a key factor to drive enterprises to invest mining and quarrying industry aboard.
3.2.2 Host countries factors drive outward direct investment

(1) Social factor
Social environment would have direct impact on foreign direct investment. Enterprises would avoid investing in the areas where political change is frequent, with frequent strikes and terrorism. It is reported that in 2011 since the outbreak of the political crisis in Syria, Chinese and Indian joint venture lost $70 million in two month. Chinese investment suffered heavy losses from Islamic state armed robbery upon the investment of oil fields in Syria 2013. The social environment of the investing country will have the direct influence on the investment enterprises. Therefore, enterprises in the choice of investment location should carefully exam the political environment and invest in the areas with stable and safe social environment.

(2) Culture factor
Multinational corporations usually invest in countries with similar culture. Because by this way, cultural conflicts and avoid additional costs can be reduced. The adaptability to the social and economic environment of investment areas will be strengthened. Data shows that Chinese companies invested most in Hong Kong, Singapore and Indonesia in 2013. This is because culture difference is small between China and these three areas, which would help improve the convenience of Chinese investment there. This is also one of the important reasons why Chinese companies choose to invest the most in Asia. That’s because the similarity of culture.

(3) Economic Factor
Economic factor will reflect the economic variation of the areas where the business entities invest in, such as gross domestic product, national income lever and so on. The change of economic factors will have positive or negative effects on the location choice of Chinese enterprises. Most Chinese companies choose to invest in Asia may be because the cost of long-distance transport will be saved and it’s easier for them to adapt to the host country environment.

Latin America and Africa with rich endowment, little economic barriers, low production costs, higher purchasing power and large potential market become the important targets for Chinese enterprises to invest in. The major countries in North America are developed countries with the latest information, advanced technology and management experience, where Chinese outward foreign direct investment increase rapidly. The explanation above indicates the reasons why Chinese investments in North America and Latin America grow rapidly.

4. Chinese Outward Foreign Direct Investment Location Choice Countermeasures

Although Chinese foreign direct investment has increased significantly, its location is not yet reasonable. Chinese enterprises are lack of investment experience and their location choice is relative concentration of certain areas, which needs to be optimized. In order to help Chinese multinational companies reduce investment risk and choice the right place to invest, the suggestions are proposed as follows:

4.1 Recommendations from Chinese government perspective

The government should further implement the “Going Out” and “One Belt and One Road” strategies to lead Chinese foreign direct investment in a planned, purposeful and creative way. The government should pay more attention to the protection of intellectual property rights, basic construction of the information system and ensure economic information transparence. Besides, the government should emphasize the construction of legal system, improve the efficiency of relevant departments, standardize and simplify the approval system. The government should also enhance international and inter regional economic cooperation to make sure the interests of Chinese overseas enterprises are guaranteed. At the same time, Chinese government are supposed to strengthen propaganda and formulate relevant financial and tax policies to encourage enterprises invest abroad bravely.

4.2 Recommendations from corporate perspective

Enterprises should carefully choice the investment location based on their overall condition and
future strategies. When they analyse the possibility of investment location, they should pay more attention to the host countries’ political environment, economic environment, cultural environment and social environment, especially relevant policies like laws and regulations.

Different projects are motivated by different investment motivation. The market-oriented enterprises should estimate overall demand of target market, trade barriers and the degree of market competition. Cost oriented enterprises should take into account host country’s natural resources endowment, labor cost, land costs, the fluctuation of exchange rate and transportation costs. The enterprises which are information oriented should consider the informatization of host country and his ability to obtain international economic information.

Enterprises should also focus on the training international business personnel, actively participate in economic business, pay close attention to the preferential policies of various regions and make the proper policy of location selection.

Reference


