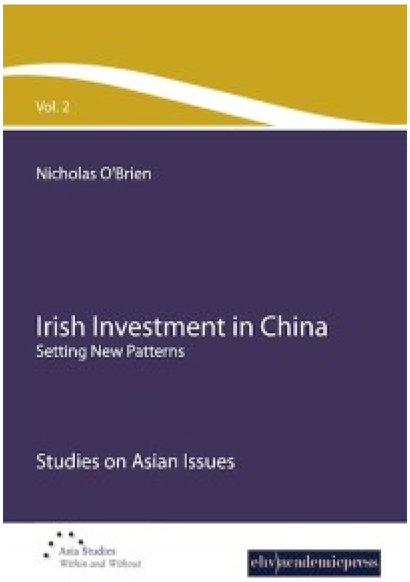
# Chapter 3: The Views of Investors ~ Irish Investment In China. Setting New Patterns




*Introduction*

As indicated above, traditional Irish outward FDI to the US and Europe is disproportionately horizontal in nature and is concentrated in the non-traded sector. (Barry et al, 2003) This chapter explores the views of business executives as to the rationale underlying their investment in China, their experience since investing, the disincentives and barriers to investing in China, and the role which executives see for state support in ameliorating the locational disadvantages which China poses.

By analysing the organisation and scope of activities of Irish MNEs which have invested in China, conclusions can be drawn as to whether Barry et al's model is applicable to Irish FDI into China. The experiences of executives in both the Irish and non-Irish MNEs categories allow us to draw conclusions as to the locational challenges which China may pose. These perceptions and an analysis of the investment climate in the next chapter will permit conclusions to be drawn as to whether the validity of our sub-hypothesis holds, namely that the Chinese investment climate is considerably different from that faced by Irish investors in developed economies, the traditional location for outward FDI.

Should significant locational disadvantages be found to exist, within the meaning of Dunning's eclectic paradigm, our prescriptive research question will examine the potential role which exists for government to assist potential investors.

This chapter sets out the results of the research undertaken for this study. Initially, the profiles of the investing companies (both Irish and non-Irish) will be set out, but in a manner which respects the confidentiality offered to interviewees. This will be followed by a consideration of the investment rationale and the available incentives, which drove the MNE to invest in China. Using this framework, the locational advantage which China offers can be identified.

Locational disadvantages will also be explored by examining the experience of executives since investing. The manner in which MNEs protect their ownership advantage through utilising internalisation advantage will offer guidance to potential Irish investors. Perceptions on the role of the state will be explored, which will assist in the consideration of our prescriptive research question. This will be followed by an evaluation of the views of Irish MNEs which have invested in Eastern Europe. It will be interesting to note if their perceptions as to the challenges facing investors in China will be borne out by the view of both Irish and non-Irish MNEs which have already invested in China.

*Profile of the MNEs included in this Research – Irish MNEs*

There is a significant variation in the size and scope of the Irish MNEs which have invested in China. The average size of the MNE's investment in China was € 168 million. However, this figure is skewed by one large investment greater than €1 billion. When this investment is excluded, the average investment of Irish MNEs was € 6.3 million, which represents a significant commitment on the part of the parent Irish firm. The average number of employees in the Chinese subsidiary of Irish MNEs was 332. Again, this is distorted by the size of one MNE. Excluding this MNE, the average was 49 employees. This is not a large number of employees by Chinese standards. Perhaps this small number can be accounted for by the fact that just under half of the subsidiaries are in the hi-tech sector, where employee productivity tends to be high, and another is in the property sector, but not directly engaged in construction projects. LOCOmonitor (2006) found that the average number of employees in the overseas subsidiaries of Irish MNEs is 147. Taking all Irish investments in China, the number of employees is higher than the global average.

Turning to the parent Irish MNE, globally Irish MNEs which have invested in China had an average annual turnover of € 1.4 billion. Again there are large divergences within this average figure. The average number of employees globally was 4,247. This data gives an indication of the size and diversity of the MNEs which were included in this research.

Having analysed the activities of the Chinese subsidiaries we can say that, of the Irish MNEs which have invested in China, just over 80% are in the traded sector. The proportion between vertical and horizontal FDI is broadly equal. These results have significant implications for this research and indicate that Barry et al's model is not directly applicable for the current wave of Irish investment in China, as it is largely in the traded sector and could not be described as disproportionately horizontal. We shall return to these findings in chapter five, when the nature of Irish FDI into China is explored.

*Non-Irish MNEs*

Among the non-Irish MNEs included in this study, the average investment was € 520 million, compared with the average Irish investment of € 168 million.

The average turnover of the Chinese subsidiary of the non-Irish MNE was € 210 million and the average number of employees in China was 4,047. Globally these MNEs had an average turnover of € 68.6 billion. The average number employed globally is 114,000. While the scale of these MNEs and their Chinese subsidiaries is larger than that of the Irish MNEs and their subsidiaries, the non-Irish MNEs were selected with reference to the Government's Asia Strategy. In addition, the interviewees selected were involved in the initial decision to invest in China and have considerable experience of the investment climate in China.

Analysing the activities of these subsidiaries, it can be said that all of the investments were horizontal in nature and that 75% operate in the traded sector. While the breakdown in the traded/non-traded sector is not very different from that of the Irish MNEs, the FDI of the non-Irish MNE population is totally horizontal. This finding should not be given undue weight as it would be possible to assemble a cohort of MNEs which replicates the Irish MNEs. Based on this research, and accepting the limited size of the population, there would appear to be a stronger level of FDI in the traded sector. This is possibly a reflection of the dominance of manufacturing in the Chinese industrial base. However, this is changing along the eastern seaboard with the service sector increasing in market share. We shall return to this topic later.

An interesting comparison of the ratio of turnover and staffing of the Chinese subsidiary as compared with the global operation shows a divergence between the Irish and non-Irish MNEs. Of the Irish MNEs, the average turnover of the Chinese subsidiary as a percentage of global turnover was 46%. The average employment was 40%. However, in the case of the non-Irish MNEs the turnover of the Chinese subsidiary as a percentage of global turnover was 14%. The corresponding data for employment was 4%. Presumably this is a reflection of the truly international nature of the non-Irish MNEs and conversely, the limited international operations of Irish MNEs, with the Chinese subsidiary playing a significant role in the corporate structure of the Irish MNEs. It also points to the increasing number of medium-sized Irish companies which are investing overseas.

This supports the view of Moosa (2002) who, in discussing the strong rebound which took place in international FDI after the slowdown in 1990-92 associated with the East Asian financial crisis, points to the growing role of smaller firms engaging in outward FDI.

*Structure of the Chinese Subsidiaries – Irish MNEs*

Among the Irish MNEs, just under 20% are in joint venture arrangements and just over 80% are Wholly Foreign Owned Enterprises (WFOEs). The joint venture MNEs decided to enter into this form of arrangement as it was perceived as the easiest manner in which to enter the particular markets in which they are active. In one case the MNE established a relationship with a Chinese partner firm which is in a position to obtain the required licence. (At the time of entry only domestic firms could be licensed. While this restriction has now been lifted, de facto it still proves difficult to obtain such a license.)

Most executives were opposed to the concept of a joint venture structure. They cited the risk of the loss of intellectual property rights (IPR) as a reason for not entering into a joint venture, fearing that their technology would be leaked to competitors. One executive commented that he 'would not be happy to go in with any third party given the hi-tech risk we would face'. The consulting company executive observed that virtually all new investments in China are Wholly Foreign Owned Enterprises with a marked reluctance to enter into Joint Venture arrangements. He sees the lack of accountability within a Joint Venture, particularly on the Chinese side, as one of the main weaknesses of this form of market entry. In addition, he described a Joint Venture as a particularly bad way of protecting intellectual property.

Among the Irish investments all but one were greenfield investments. However, most Irish outward FDI uses M&A activity as an entry strategy (O'Toole, 2007). When this issue was raised during interviews, one executive replied that 'the challenges associated with due diligence is not something we wanted to do'. 'Even in Ireland, before entering into a joint venture you would conduct a lot of research and due diligence investigation on a prospective partner, and in China that's even more important'. (Enterprise Ireland, 2005: 17) Cantwell and Santangelo (2002) argue that merger and acquisition activity is at a considerably lower level in Asia than in other regions. The gain in market power is greater if an investment takes the form of a merger or acquisition as it directly eliminates one potential rival. The threat which a joint venture arrangement poses to the protection of intellectual property rights can be considered as a locational disadvantage which threatens the MNE's ownership advantage. Lieberthal and Lieberthal (2004) argue that joint ventures are particularly difficult in China because of diverging objectives between the two partners. While most MNEs want to reinvest profits to increase market penetration, Chinese firms, which are typically cash-strapped, want to extract profits.

*Non-Irish MNEs*

Almost 90% of the non-Irish MNEs are Wholly Foreign Owned Enterprises (WFOE). One of the executives recalled the experience of joint venture arrangements which the MNE had previously had:

In terms of ownership structure, we started life in China as a joint venture. At one stage we had over ten joint ventures and only two years ago did we manage to bring all their operations into a single WFOE. In a JV (Joint Venture) too much energy is spent meeting the needs of the JV partner rather than concentrating on core business objectives.

A financial services executive pointed out that foreign banks are reluctant to purchase 20% or more of any Chinese financial institution. If the bank does so, the Chinese subsidiary would be subject to prudential supervision by the financial regulator in the bank's home economy.

One of the non-Irish MNEs operates in the education sector. While it does not have a joint venture arrangement, it has a Chinese partner with a minority shareholding. This is not unusual in this sector, as education is tightly regulated by the authorities. We shall return to this issue in chapter five, as education is one of the sectors identified in the Government's Asia Strategy as offering the potential for deepening economic ties with Asia.

A view among the executives interviewed is that control is important when making an investment in China. This supports the view of Moosa (2002), who states that control is a distinguishing feature of FDI as compared with other forms of investment. It can be deduced from the response of interviewees that a joint venture company structure is a locational disadvantage within the meaning of Dunning's eclectic paradigm. A wholly foreign-owned enterprise (WFOE) represents an internalisation advantage. There is the additional risk that a joint venture arrangement may lead to a leakage of intellectual property. Should this occur, the MNE's ownership advantage would be dissipated. Accordingly, when investors are considering the appropriate organisational structure to adopt for their Chinese subsidiaries, they should seek to retain internalisation advantage by utilising a WFOE structure and thereby avoid threats to ownership advantage.

*Rationale for Investing and Incentives*

An examination of why MNEs invest in China is of assistance in identifying the locational advantage which China offers.

*Irish MNEs*

Of the Irish MNEs, over 80% decided to invest in China because of the market potential which is on offer, 10% invested because of the locational advantage which China offers in labour costs, and just under 10% invested for both market opportunity and labour cost considerations, with a slight preference for the latter. It can be said that within Chen and Ku's (2000) categorisation, the vast majority invested for expansionary purposes.

The principal benefit identified by virtually all investors is the market opportunity which China presents. These MNEs see the emerging market in China as the natural progression to their existing activities. They recognise the emergence of the middle class in China, which has increasing amounts of disposable income to spend on consumer products. In addition, they see investing in China as adding value to their global operations. O'Toole (2007: 394) argues that 'most of the FDI from Ireland is motivated by gaining access to overseas markets'. This research corroborates this view and shows that Irish FDI into China conforms to this general pattern.

In some cases MNEs are following companies with which they already have a close business relationship and who have already invested in China. One executive stated: 'Some of the large US multinational companies which we supply were moving their operations to China. This factor made the decision to invest easier as there was a need to follow our market'. This view is corroborated by a non-Irish MNE executive who pointed out that all of their suppliers have established a production facility in China in order to maintain their supply contracts. An interesting observation made by an Irish MNE executive in the hi-tech sector was: 'Not all our international competitors were operating in China. Therefore, we knew we would not face the same level of competition as we do in the USA. In addition, there were no Chinese competitors in the specialised hi-tech area in which our firm specialises'. Another executive argued that in the electronics industry 'you have to be in China, simply because all the suppliers are here. Time-to-market is crucial to gaining contracts. Because all the components are made here, we had no choice. Nowhere else has the capacity'. An executive of a chemical MNE commented that 'the attraction of China is its very large market. While the technology they use is very different to ours, Chinese producers can produce at lower cost. We can't afford to be outside the market. To sell within, we will use our production facility as a bridgehead'.

A packaging executive spoke of a new market emerging for foreign investors within China – 'Chinese companies want to sell products in Europe and the States; to do that, they need European standards. That's where we come in'. Food sector MNEs have decided to focus on the business-to-business sector rather than attempt to penetrate the retail sector which is viewed as:

*…too complex for foreign companies to break into. Maybe we will look at it in ten years time. A strategic decision has been taken to focus on the business-tobusiness market rather than the retail sector. The retail sector is really complex for foreign companies, given the distance from the home economy and the branding challenges which would require a significant outlay on advertising.*

Worthy of note is the additional opportunity which one MNE has identified. It intends servicing its market on the west coast of the USA from China rather than from Europe, which it currently does, as the costs involved are considerably lower.

There was a clear perception that the immediate market potential is along China's eastern seaboard. Establishing an operation in the centre or west of the country was described by one executive as 'challenging, mainly because of the undeveloped logistics system.'

One MNE invested with a dual objective. Firstly, it wished to exploit the market opportunity for its existing products. Secondly, it wanted to use its plant in China to manufacture components for its global supply chain as a means of reducing costs.

Only in the case of one Irish MNE is the relatively low cost of labour the prime motivator. Buckley (1989) argues that location advantage enables MNEs to gain maximum advantage from differential prices of non-tradables in particular locations, particularly labour costs.

The dominant objective of exploiting market opportunity among Irish MNEs is in contrast to the perception that investors are attracted to China because of cheap labour. This finding supports the views of Li and Li (1999), who argue that investors from developed economies are likely to be attracted by market opportunity rather than low-cost labour. These findings are also in line with Van Den Bulcke et al's (2003: 58) analysis of EU investment in China, which is that 'they [EU investments] are relatively more concentrated in capital and technology intensive sectors, have a large investment size and a high localmarket orientation'.

*Non-Irish MNEs*

All of the non-Irish MNEs included in this research invested in China in order to exploit market opportunity. However, two identified low labour costs as a factor contributing to this decision, but stressed that market opportunity was the primary motivation. The consumer products executive stated that 'we decided to invest simply because of the size of the potential consumer market – 1.3 billion consumers'. Another executive expanded on the market opportunity which the MNE had identified: 'China is a natural extension of our geographic business; there was a need to "follow our customers" as we are heavily involved in funding the exploitation and acquisition of natural resources'. The executive of another MNE mentioned that most of the firm's suppliers have now located a manufacturing facility in China, which provides easier access to materials. This point is of interest to potential Irish investors who provide services and goods to other multinationals.

One MNE executive pointed out how important market opportunity is by indicating that labour costs played no role in the firm's decision: 'We decided to invest in China solely because of the potential market. The cost structure of our firm is not typical; materials account for 50-60% of total cost and labour costs are typically in the region of 10%, so cheap labour didn't bring us here'.

Reflecting the dual objectives of another MNE, the respondent stated: 'We invested because we saw the market coming. But also to have a lower cost production base, not only for China, but also in south-east Asia. We can produce heaper in south-east Asia, but we can get good quality production cheaper in China than in Europe'.

The evidence presented above by the majority of interviewees, in the case of both Irish and non-Irish MNEs, points clearly to the locational advantage of the market opportunity which China offers. Building on the ownership and internalisation advantages which these MNEs possess, investors recognise the market opportunities which China offers, and wish to exploit it. Interviewees acknowledged that this market opportunity currently exists only along the eastern seaboard. This represents an important regional variation and modifies the locational advantage which China offers. Accordingly, it can be said that the locational advantage currently exists only in one segment of the Chinese market and not throughout the country.

*Incentives*

The level of incentives offered by the Chinese authorities did not feature prominently as a motivation for investing, among either Irish or non-Irish MNEs. As the majority of those interviewed cited market opportunity as their motivation for investing, this is not surprising. This view supports a finding in Agarwal's (1980) study, which shows that incentives have a limited effect on the level of FDI, as investors base their decision on risk and return considerations.

MNEs in the hi-tech sector spoke of attractive packages which are offered by local government authorities. One executive stated: 'As we are in the hi-tech sector, we were in discussions with the authorities in several locations to negotiate the best possible package'. The interviewee from the consultancy firm suggested that during the set-up stage, local authorities have considerable latitude when negotiating, with large investors who obviously possess the leverage to obtain a more favourable deal. He recommended that companies should establish their operations in a Special Economic Zone in order to gain the most advantageous tax and incentive packages.

Interviewees spoke of the various incentives available from local governments. One executive recalled how the MNE received considerable grant assistance when constructing its headquarters building. As it is a prestigious MNE, local governments competed strongly to attract the FDI to their particular regions. As a result of the generous land-use rights offered, the MNE effectively built its corporate headquarters at little or no cost. This points to a regional variation which investors should take into consideration when making an investment decision. As such, it can represent a locational advantage or disadvantage. We shall explore this further below.

The clear view of interviewees is that taxation played a role only in the choice of location within China and not in the decision to invest itself. One executive stated: 'while the tax arrangements are good, this is not why we invested. They help the bottom line, but even without them we would be here. The moves to increase corporation tax for foreign entities will not force us to change our strategy'.**[i]**

As discussed above, the literature on the effect of taxation on FDI offers diverging

opinions. The result of this research confirms the view held by Moosa (2002) that it is the overall environment of a particular country which attracts inward FDI and the expected return on capital invested. In the case of MNEs which invest in China for market opportunity purposes, we can say that the relationship between taxation policies and FDI is not particularly strong for this category of investors.
While the following sections will explore locational disadvantages, it should be borne in mind that China continues to offer strong and very positive locational advantages.
This almost goes without saying, given the strong levels of inward FDI which China continues to enjoy. The purpose of exploring locational disadvantages is firstly to assess their impact and secondly to explore whether or not it is appropriate for state intervention to ameliorate such locational disadvantages.

The first section, entitled 'Experience Since Investing' will explore the responses of executives to the questions relating to experience of the set-up stage, regulatory issues and transfer of technology. The responses identified in these areas can be considered to be minor locational disadvantages and offer an indication of the business environment facing investors. These challenges are not unique to China and could be experienced in other investment locations, in both developed and developing economies. As such, they can be considered to be in the realm of general locational disadvantages which investors face when establishing a subsidiary abroad. As set out above, the reality is that foreign companies will incur some additional costs in comparison with indigenous companies. These extra costs range from a culturally unfamiliar environment to legal and political uncertainties.
In the section entitled 'Disincentives and Barriers to investing in China', particular disadvantages and barriers to investment will be discussed.

*Experience Since Investing – Irish MNEs*
Executives of Irish MNEs spoke of the importance and challenge of obtaining appropriate business licenses. The executive of one hi-tech MNE commented that 'Not only do we need a business licence, we need a licence for each product we manufacture and an import licence as well'. This points to a complex regulatory regime. It also indicates the unfamiliarity of Irish MNEs with the requirement of obtaining business licences, which is not a practice in Ireland.
Some specific issues were highlighted. The service sector MNE pointed to the difficulty of operating in a restricted sector. While this sector has recently been

opened up to international investors, in line with China's WTO commitments, the executive is reluctant to apply for a licence, as the one foreign firm which has done so has experienced enhanced regulatory surveillance in the conduct of its business.
One executive offered an example of the level of bureaucracy which Irish MNEs would not be accustomed to – 'If there is a discrepancy between the amount of raw materials bought by the company versus the amount of goods estimated to be made from that amount, the customs will halt the shipment until the discrepancy is cleared up'. While the purpose of this approach is to prevent the loss of fiscal revenue, it presents a challenge which MNEs operating in the West would be unaccustomed to.
One of the food sector executives complained of a lack of national treatment:
*'Food ingredient importation is particularly restrictive with Chinese companies not subject to the same level of rigour and inspection. This is a form of non-tariff barrier and one which merits government intervention'*.

A consistent challenge identified by executives is the difficulty of locating and recruiting suitably qualified staff. 'One of the main obstacles experienced by our firm is the ability to attract management who are competent and can integrate into the firm's culture'. Lack of managerial expertise was also identified as an on-going difficulty. This view is corroborated by the OECD (2000).
Another executive was of the opinion that the *'biggest difficulty during our set-up phase was identifying and employing a suitable country manager. We only located someone through the help of Enterprise Ireland'. An executive in a firm for which delivery times are critical stated that the firm 'couldn't afford to lose staff, so at an early stage I decided to pay 15% above the going rate'*.

*Non-Irish MNEs*
Executives of non-Irish MNEs were less pre-occupied with the business licence issue than were Irish investors. Most executives were of the opinion that if the paperwork was in order, the licences could be obtained in a relatively straight-forward manner. One executive stated that when he worked in Germany, licences could take longer to obtain. This difference between the perceptions of Irish and non-Irish investors may be accounted for by the fact that industry may be more regulated in continental Europe than in Ireland, with permits and licences required to a greater degree.

In the banking sector, inhibiting factors which are currently restricting the development of banks were identified in initial interviews. An executive complained of the obligation to deposit RMB500 million (approximately euro 50 million) for capital adequacy purposes for each branch that is opened. This condition does not apply to Chinese banks and, as such, can be seen as a non-tariff barrier. He stated that he is keenly awaiting 1 December 2006, when China is obliged under its WTO commitments to grant national treatment to foreign banks. The banking executive was re-interviewed in 2007. Since then, China had made provision for foreign banks to incorporate in China. (In April 2007 four foreign banks were granted national incorporation by the Chinese regulatory authorities). By incorporating they will move closer to obtaining national treatment and the capital adequacy requirement per branch will be removed. He was of the view that, while not yet perfect, China has made significant strides in opening up its banking sector.

A telecoms executive referred to the high level of state control in the telecommunications industry. The fixed line and mobile network is state-owned and there is scope for investors in the telecoms equipment sector only. An education company executive pointed out that this sector is highly regulated for political reasons. Foreign investors at the third level must have a Chinese institutional partner. 'There is scope for investors in the international schools sector, which is booming. But even there you need the local government as a partner if you want to have a trouble-free existence'. These issues are of relevance to this research as the Government's Asia Strategy highlighted these sectors as promising a deeper engagement with China. It is important that these locational challenges should be appreciated by potential investors.

Technology transfer is an important consideration for the Chinese authorities. One executive recounted his experience of the investment negotiations:
*'The Chinese side insisted that we use the latest available technology. This resulted in an USD900million investment. If we had been allowed use lower specification technology, which would have produced much the same output, our investment costs would have been halved'*. He suggested that the transfer of technology is very important to the Chinese side in granting approval for investments. This poses a dilemma for potential investors given some of the views expressed on the lack of protection for intellectual property rights. Investors will need to take steps to adequately protect key technology to avoid the proliferation of one's technology into what one executive described as '*communal property*'.

The issue of recruiting and retaining qualified staff featured as a challenge, in the experience of executives of Irish MNEs. One executive stated that his firm currently employs 1,000 staff and expects this number to grow to 5,000 in five year's time, although he added 'if we can find suitable people'. Another who had experienced difficulty with recruiting and retaining qualified experienced staff suggested that the most likely staff member to leave is the number two in each department, as s/he sees little opportunity for advancement. This opinion is corroborated by the view of another executive, who stated that staff retention has not been a major problem as there have been plenty of promotion opportunities. He argued that the availability of opportunities for advancement is more important than pay in relation to staff retention.

Borensztein et al's (1995) model of endogenous growth, which uses technological progress as the main determinant of long-term economic growth, argues that more advanced technology requires the presence and development of a sufficient level of human capital in the host economy. If this condition is not satisfied, then the absorptive capacity of the developing host economy will be limited. This complementarity between FDI and human capital is evident in the response of virtually all interviewees, where they raise the challenge of recruiting and retaining suitable staff. This limitation may restrict the level of inward FDI in certain industries in future years. It remains to be seen if this limitation is of such magnitude that it could offset the locational advantages which China offers. What can be said at this point is that the executives are keenly aware of human resource limitations. One executive pointed out that these limitations may restrict their expansion plans. To date, however, they have not inhibited FDI growth.

The general experience of investors in the set-up and early stages could be described as time-consuming, bureaucratic, but not particularly challenging. The environment could be seen as no more challenging than investing in any other developing economy. Issues highlighted tended to be of a sectoral specific nature. At this point, drawing on the results of this research, disincentives and barriers to investment will be explored with a view to identifying the particular locational disadvantages which China poses for investors.

*Disincentives to Investing in China*

The major disincentives and barriers identified were described in response to the questions relating to cultural challenges and perceptions on the role of contract law. The main challenges can be broken down into three distinct areas, viz guanxi, intellectual property rights, and contract law.

*Guanxi – Irish MNEs*

Executives of Irish MNEs spoke of the importance of networking in the conduct of business affairs. In addition, the need to build relationships with relevant officials was also identified. Executives saw the need to interact and develop stronger relationships with officials as time-consuming and a 'cost' which one would not have to incur in Ireland. One executive spoke of initially being quite nervous in dealing with the local authorities at a more intense level than in Ireland – 'It took quite a while to come to terms with officialdom; they wanted us and were very accommodating. But agreements can be altered by government officials, so we know that we need to have a strong relationship with them'. This statement hints at the historical divergence between China and the West in terms of the power of local officials, as identified by Jones (1994). As set out in chapter two, laws were traditionally open to interpretation and local officials exerted considerable power. While this has changed in recent times, local officials still exert influence, given the role which the state plays in the economy. Therefore, Irish executives see the need to cultivate strong relations with officials as an important component of China's business culture. This indicates a cultural difference between China and Western economies. As it represents a drain on the resources of investing MNEs, it is a locational disadvantage.

In addition, regional divergences were identified regarding the pervasiveness of guanxi. By and large, executives in the eastern seaboard region recognise the importance of developing strong relationships with business and official contacts, but did not stress the importance of guanxi as traditionally understood. They tended to see relationships in this region as slightly above the normal scope of business. One executive observed: *'Guanxi is important outside the main economic centres. However, in cities such as Shanghai, doing business is somewhat similar to many other developed economies. Relationship building is important, the same as in any country, except you need to work with officials more'.*

The consultancy company executive suggested that:

Since the opening-up policy was introduced, a change in business culture has occurred. Guanxi was important 15 years ago, but is no longer as strong an influence in the major industrial cities on the east coast. This is not to say that business relationships and contacts are any less important than in any other economy. Doing business in eastern China is normalising, but the Government still has a large measure of control over the economy.

The executive of the service MNE stated that 'Guanxi is very important in southern China, because the government controls industry'. Therefore, if Irish MNEs invest outside the eastern seaboard they are likely to encounter a higher level of locational disadvantage.

*Non-Irish MNEs*

Executives of non-Irish MNEs also spoke of the need to develop strong relationships with officials because of the level of bureaucracy which one has to contend with. One executive commented that 'Access is an issue, so I have to devote time to working the local officials. This means that I can solve problems quicker'. Another executive spoke of the regional variation identified by Irish MNEs. This MNE has re-located its manufacturing facilities from Shanghai to a province in the centre of the country. He stated that 'In terms of guanxi, we seek to build a strong relationship with the local mayor or party secretary, preferably the latter. We use this channel to negotiate difficult issues which we can't resolve at official level'.**[ii]**

This view corroborates the observations of Irish executives that there are regional variations in the practice of guanxi in China. Along the eastern seaboard, executives spoke of investing time in developing relations with key officials. However, away from this region, executives spoke of traditional guanxi and the need to develop strong relationships with officials. China would appear to have developed an intricate and pervasive network which investors must take cognisance of. (Luo, 1998)

An interesting observation on Chinese culture was made by the banking executive. He suggested that a positive dimension of Chinese culture which assists banks is the emphasis on guanxi. In his view, banks should be relationship and not transaction driven. Accordingly, he sees a synergy between Chinese and foreign banking cultures. This is of relevance to potential Irish investors as financial services are one of the eight sectors highlighted for deeper engagement with Asia in the Government's Asia Strategy.

*Intellectual Property Rights – Irish MNEs*

The lack of respect for intellectual property rights was raised by over half the Irish MNEs as an issue of concern. An executive of a chemical MNE recounted that the technology which they introduced into China has now proliferated throughout their Chinese competitors. ‘Technology is seen as fair game, it is seen as communal property’. The executive of this particular MNE is firmly opposed to introducing its newest technology into China.

The protection of intellectual property was also identified as a key consideration for the food sector. One of these firms is currently planning how to best protect its intellectual property and is looking at importing a key ingredient from abroad to mix with the ingredients manufactured in China. This reflects the view of Lieberthal and Lieberthal (2004) who suggest that critical technologies should be kept outside the Chinese manufacturing process as a means of compartmentalising production and thereby reducing the risk of IPR theft. Another executive pointed out that obtaining trademarks ‘takes longer in China, takes at least 12 months to be reviewed, searched and granted, so this leaves plenty of time for the copying of products’. The executive of an MNE which has a joint venture arrangement spoke of the importance which the parent firm places on protection of intellectual property. ‘We had to pick our partner very carefully and make sure that there is an incentive for them not to leak the intellectual property’.

IPR was not a concern for the Irish MNE which operates in a specialised textiles sector, presumably because the firm is operating in a niche market. One of the IT executives suggested that IPR is seen as posing the same challenges in China as it does in other overseas investments. He stated that he had a clear impression that the Chinese authorities wanted to be seen to be respecting intellectual property rights.

*Non-Irish MNEs*

The protection of intellectual property rights was also identified as a key concern by over half of the non-Irish MNEs. Counterfeiting was identified as a serious problem for the consumer products MNE. While the products are not of particularly high value, it is nevertheless profitable for counterfeiters to sell low-value substitute produce under the firm’s brand name. Generally, the firm resorts to legal procedures only if the local administration cannot resolve the issue. However, the legal avenue has not always proved successful in the past, particularly if the violation occurred in a province outside the MNE’s manufacturing base. This view was corroborated by a healthcare executive who referred to the challenge of avoiding counterfeiting, ‘which we put a lot of resources into’.

Overall a picture was painted of a less than complete lack of respect for intellectual property rights. Both the European Union Chamber of Commerce in China (2005) and the American Chamber of Commerce Shanghai (2005) highlight the lack of enforcement of China's intellectual property rights laws. The European Union Chamber (2005: 71) expresses its concern that the enforcement on a national level of the IPR laws in China seems to be performed on the basis of specific high profile campaigns rather than on a permanent basis and is not evenly spread across all regions in China… it is a well known fact that counterfeit products are still found in significant quantities, in open or closed retail markets and that authorities being aware of this fact do not show any initiative to stop such sales.

The most visible expression of such counterfeiting is luxury items available in the markets. The EU Commissioner for Customs and Taxation**[iii]** expressed concern that the areas with the highest potential for counterfeit and which have substantial health considerations are pharmaceuticals, car parts and aircraft spare parts.

The literature suggests that FDI is a better route to protect one's intellectual property than licensing production to a third party. (Baranson, 1970; McManus, 1972; and Baumann, 1975) Internalisation also avoids the difficulty of what Buckley (1987) terms the 'buyer uncertainty problem' whereby the licensee obtains a transfer of intellectual property, as discussed above.

These considerations are particularly pertinent in the case of China. The threat to a MNE's intellectual property in China may represent a significant locational disadvantage. (This issue was also cited as a reason not to enter into a joint venture structure.)

Intellectual property is an ownership advantage. Therefore, FDI in China can also pose a threat to an MNE's ownership advantage. This research indicates that if an MNE is investing in China it should exploit its internalisation advantage and retain the production function internally. In addition, it must be constantly vigilant of the need to protect the MNE's intellectual property. This is particularly pertinent where hi-technology industries are involved as, should the MNE's intellectual property be lost, the MNE is effectively left with little ownership advantage.

*Contract Law – Irish MNEs*

Almost two-thirds of executives identified significant difficulties with the implementation of contract law in China. A view emerged of MNEs trying to cover all eventualities in a contract in the knowledge that, should difficulties emerge,

there was little legal redress available. An executive stated:
‘We try to cover everything in the contract but it is a very immature system and very difficult to enforce any breach. It cannot be relied upon, so managing any business relationship smoothly becomes much more important in order to avoid having to try to enforce a contract through court’. Another executive suggested that the ‘quality of contracts in China is very good, probably better than Europe – because we put everything into it. It is written and signed, but how much value is that at the end of the day?’ It was suggested by another executive that ‘courts do not have a sophisticated approach to contracts because this is a trust based society’.
One executive, who had previously had a bad experience with the non-honouring of a contract by a Chinese firm, saw no merit in contracts because ‘They will find ways to walk away… There are no safety nets like you would use in the West. There is no tradition… The courts don’t have the stature to move things along’. In his previous dispute, the firm could not find a competent court which would accept jurisdiction for the case. This occurred ten years ago but gives an indication even today of the lack of a tradition of Rule of Law. An executive with a large manufacturing facility stated that he has ‘no contract with any supplier. The day I put pen to paper, I don’t trust them’. Such an opinion supports the view of Jones (1994), who suggests that the Rule of Relationships is more important than the Rule of Law in China. Overall, a view emerged of executives seeking to negotiate detailed contracts in an effort to cover as many eventualities as possible. However, there was also a recognition that in the event of a dispute, pursuing a legal route was not likely to be the most productive means of addressing it.

*Non-Irish MNEs*
The views of the previous category are mirrored by executives of non-Irish MNEs. One executive spoke of the detailed negotiations which the MNE’s inhouse lawyer engages in when negotiating contracts. The contracts which the MNE uses in China are much more detailed than in their home economy. They clearly define conditions of delivery, service, etc, which would not require definition in the West. An executive of a pharmaceutical MNE recounted the level of detail which the MNE inserts into contracts but the value of contracts is relatively low compared to Germany or the US. Going to court is worthless. We have had clear cases but the other side declared bankruptcy, opened up another company and the court facilitated it. Contracts are only one small part of an overall

relationship. [It’s] just an addendum which reminds people of their rights.

*Views of Lawyers*

In order to explore further the role of contract law and the general legal framework, interviews were conducted with two lawyers on the specific issues of the legal environment and the role of contracts in the conduct of business in China. The first lawyer is a partner in the largest indigenous Chinese law firm and works exclusively with foreign investing MNEs. The second lawyer is a partner in a large international consultancy firm and specialises in M&A activity by foreign investors.

The first lawyer suggested that one could consider contract law in China as being akin to a test of strength: ‘If one side is in a position of strength, they will seek to include ridiculous conditions in contracts’. He suggests that this occurs when executives do not have a deep and trusting relationship. The second lawyer described contracts involving foreign MNEs as containing ‘much too much detail. Between two Chinese companies it is very simple. He sees the reason for this as the under-developed nature of law in China. ‘In Europe, there is a developed contract law – the law can interpret intentions. But China is a highly regulated society so lawyers advise that agreements must be specific. Therefore, lots of detail’. Later he added that ‘contracts are linked to relationships. Before, the government owned the whole economy, so one’s word was enough. Now, with so much inward investment, things have changed considerably.’

Should a decision be taken to commence court proceedings, the first lawyer suggested that it is much easier to take a case against a publicly listed firm in the province in which the MNE is located than against a private firm in another province. Again, a regional disparity in governance is evident. However, he cautions that litigation is not a happy event. While obtaining a judgement may not be a problem, enforcing it is not easy. Enforcement is just too difficult. Foreigners think they are the only ones who can’t get judgements enforced, but it happens to everyone.

If an MNE is proposing using M&A as an entry vehicle, the second lawyer cautions that normally a deal is worked out based on financial information.

*Due diligence normally indicates little divergence. Here, I believe that figures have traditionally not been used to measure performance. In a communist atmosphere, figures don’t matter – just meet production quotas and pay tax. There is no profit motivation. Financial statements are completely different to the*

*West. With the emergence of a private sector, accounts are still wrong. Tax is high, so the accounts are wrong. I suppose the financial statement is not complete, rather than not correct.*

Regarding the general conduct of commercial law, the first lawyer identified a trend among foreign investors of seeking to insert a clause that made legal agreements and contracts subject to the legal jurisdiction of the home country. *'…[B]ut if there is no mutual co-operation agreement, which a lot of countries don't have with China, then such clauses don't make sense. It is completely up to the courts in China whether to implement a foreign judgement'*. The second lawyer pointed out that much M&A activity is made subject to Hong Kong law. However, he cautioned that unless the Chinese partner has assets in Hong Kong, the merit of this approach is questionable.

Pointing to a general absence of the Rule of Law in favour of the Rule of Relationships, the first lawyer suggested that should a significant issue arise, the easiest and most effective method of dealing with it is to approach the provincial government. The local or county government will support the Chinese firm, but governments at provincial level want to attract more inward FDI so they are likely to support the foreign MNE 'or at least be neutral'. He recalled several cases which were settled in a satisfactory manner through this channel. However, he would propose this route only when there are significant issue to be resolved and not in the case of a problem with a sales contract.

A regional variation in the administration of law was identified by the second lawyer. 'Judgements in the east of the country tend to be fair, particularly in Shanghai and Beijing. In other areas, there is a tendency to protect local companies. The application of the concept of separation of powers is questionable'. He expressed the opinion that this has occurred because the focus of the authorities has been on economic development. *'Developing a legal environment doesn't have the same priority. The legal system wasn't well developed under the Communist system. What people say is that it takes too long to get to court. The government doesn't see developing capacity as a problem to be addressed'*. He also identified the lack of the award of damages as an issue which sometimes surprises foreign MNEs when they are considering litigation. '*Opportunity cost is not compensated. You have to prove how much you lost'*.

A picture was presented of contract law having little real impact on the conduct of business. Paradoxically, lawyers seek to cover a greater level of contingencies than in the West when negotiating contracts, but there is a recognition by executives that turning to the courts to impose the conditions which a contract contains is likely to be a costly and often fruitless exercise. Allied to this is the emphasis which executives place on the importance of building and sustaining good relationships. This corroborates the view that the Rule of Relationships supersedes the Rule of Law in China (Jones, 1994). We shall discuss this further in the following chapter.

*Role of the State*

All Irish and non-Irish executives, except one, saw no role for the home country government in providing financial support to investing MNEs. They were of the clear view that it was inappropriate for home governments to subsidise investment overseas and that investment should be undertaken based on clear economic rationale only. Only one executive had received support from his home government. He recounted his difficulty in obtaining start-up capital: *'It took us over a year to raise the capital for the initial investment. The catalyst for obtaining the funds was when Enterprise Ireland agreed to invest'.* When this point was raised with the Enterprise Ireland executive, it was pointed out that the agency made this investment on the basis that the head office and core functions would be located in Ireland. This can be seen as recognition of the importance and added-value which head office operations add to the Irish economy. We will return to this issue in chapter five.

All executives envisaged a role for home government 'soft' supports to varying degrees. There was a distinction between large and small MNEs, rather than Irish and non-Irish MNEs. The largest MNEs saw a role for state support in lobbying the Chinese authorities on issues such as national treatment (this was a particular issue in interviews with those from the banking and food sectors) and protection for intellectual property rights. The importance of double taxation treaties as a facilitator for investment was also recognised. The smaller MNEs agreed on the need for lobbying and bilateral taxation agreements but also envisaged a role for additional soft supports. The executive of one Irish MNE recounted how he decided to invest in China following the firm's participation in a government-led trade mission to China, when he visited the firm's Chinese customers for the first time. Based on these discussions, he identified China as a potential major market.

The role played by diplomatic missions and state agencies was recognised by respondents in this category. Because of the continuing high level of state involvement in the economy, executives expressed their appreciation of the role which diplomatic missions and state agencies play in terms of making introductions, their presence at events etc. One executive recounted the assistance offered by the home country's trade and investment agency in resolving an issue with the Chinese authorities. He pointed to the opaque nature of government in China and stated that once his own government became involved, the Chinese side responded.

Several executives of Irish MNEs spoke of the need for an increased level of provision of information by state agencies, particularly in view of the opaqueness of Chinese administration. Also identified was the lack of assigned responsibility to any state body for the provision of assistance or guidance for outward investors. The role played by Enterprise Ireland was acknowledged, but it was pointed out that trade missions do not facilitate investors, nor are potential 'match-making' or feasibility studies offered to investors by Enterprise Ireland, as their core focus is on the promotion of trade.

The importance of trade missions was highlighted by one executive who commented that the MNE's customers 'are very impressed when we can produce a minister for a signing ceremony. They read this as, us having strong government contacts. But this is so much easier in a small country of only four million, compared to China'.

Overall, there was strong support for 'soft' assistance from the state. The divergence in views between large and small MNEs can presumably be accounted for by the fact that large MNEs enjoy considerable access to local authorities and have sufficient strength to resolve issues by themselves.

*Investors in Eastern Europe*

The industrial sectors in which the Irish MNEs operate are financial services, pharmaceuticals, manufacturing, IT and electronics. Three of these areas, financial, IT and electronics, are suggested in the Irish Government's Asia Strategy as areas for strengthening links with China. Hence, the views of executives in these industries are of particular relevance.

Just over half of the MNEs invested in Eastern Europe for market potential opportunities, with the remainder deciding to do so because their customers were investing there. Both of these phenomena were also evident in the case of investors in China, but the focus identified by interviewees in Chineseinvested MNEs was primarily on exploiting market opportunity.

In response to the question as to why they invested in Eastern Europe rather than

China, the general response was that China didn't fit in with the firm's business plan at the time of the investment. Asked if they now considered that they should invest in China, all were non-committal. One executive suggested that 'things can be controlled easier close to home. We know the environment'. Another said 'We were facing competition from other European countries and central Europe matched up. We looked at China two years ago. We have no interest in a greenfield site. We are not big enough and don't have management depth'. An executive of a pharmaceutical MNE stated that 'We don't follow low wage economies. In the hi-tech pharmaceutical industry there are a different set of entry principles. In other industries there are low entry barriers, but not in ours'.

The perceptions of the regulatory and cultural environments centered on the lack of respect for intellectual property rights and contract law. An IT executive spoke of his concern about the lack of IPR protection and was not convinced that he could protect his patents through the legal system. A pharmaceutical executive recalled that intellectual property accounts for 80% of the value of the MNE and stated in strong terms that intellectual property is the lifeblood of the MNE so it must be protected (the firm has an in-house team of lawyers for this purpose).
The electronics executive spoke of there being 'no enforceable rights' when the question of contract law was raised. All executives spoke in similar terms, saying that they had no expectation that their intellectual property could be protected by contract law or by the legal system in the event of a dispute. The consensus was that the legal system is not sufficiently mature to enforce their rights. It should be borne in mind that these views are perceptions from a distance, as these firms have no engagement with the Chinese economy.
A financial services executive referred to a strong level of state control in the banking sector in China. When the fact was raised that other international banks have shown an interest in acquiring holdings in the 'big four' Chinese banks, he replied that the maximum shareholding they are being permitted to acquire is 20% at a very expensive price. The Irish financial institution would have an interest in the provision of corporate banking only, if it were to ever consider investing. His perception is that the retail market 'is sown up by state banks'.

The executives interviewed did not express particularly strong views on the cultural dimension of investing in China, which is understandable given their lack of engagement with China. Issues such as cultural difference and corruption were mentioned, but not as insurmountable barriers to investment. The principal barriers identified were regulatory/legal. All interviewees saw a role for diplomatic missions, government-led trade missions and the support of state agencies in assisting entry into the Chinese market. Similar to the views of investors in China, there was support for ‘soft’ assistance only. The views of executives in this category are not based on direct experience of investing in China. The perceptions offered on IPR protection and contract law corroborate those of executives whose MNEs have already invested in China. Generally, there was little recognition of the potential market opportunity which China offers. However, executives from the same five industries, which have already invested in China and which are included in this research, pointed to the locational advantage which China offers in this respect. It can be assumed that the Irish MNEs which have invested in Eastern Europe possess ownership and internalisation advantages. The size of these MNEs is not dissimilar to that of the Irish MNEs which have already invested in China. Therefore, what factors are inhibiting their willingness to exploit the locational advantage which China offers? The main reason cited is the lack of legal protection for intellectual property, should they invest in China. Accepting that the population included in this category of the research is small, it can be argued that there is an acknowledgement among sections of Irish industry that investing in China exposes a firm to the risk of IPR violation.

*Conclusion*

There was a clear consensus among both Irish and non-Irish investors in China that the locational advantage which China offers, as understood by Dunning, is market opportunity and this is the principal criterion underlying investment decisions. Of particular interest to our consideration of Barry et al’s model is the fact that just over 80% of Irish MNEs are in the traded sector. This research indicates that the current wave of Irish FDI into China differs from the model of Irish outward FDI identified by Barry et al (2003) in the case of the UK and US, and that the hypothesis advanced in this research holds, namely that Irish FDI into China does not conform to Barry et al’s model in the case of China. Irish FDI into China was found to be largely in the traded sector and could not be described as disproportionately horizontal.

While just under 20% of Irish MNEs have joint venture structures, the clear preference of investors not to enter into joint venture arrangements with Chinese partners is apparent. Instead they wish to establish Wholly Foreign Owned Enterprises (WFOEs), where they can retain full control of operations. The preference toward the establishment of WFOEs reflects 'the decreasing dependence of MNEs on the Chinese government for marketing support, the diminishing reliance on Chinese partners because of the acquired experience and more entrenched position by the foreign investors and especially the relaxation of the foreign ownership regulations'. (Van Den Bulcke et al, 2003:68) It also reflects the manner in which MNEs wish to exploit the internalisation advantage which they possess. The preference in favour of WFOEs is also important as a means of protecting the MNE's ownership advantage, in the form of intellectual property rights. The risk to IPR and the absence of enforceable contract law were identified as the most significant disincentives to investing in China. These views were supported by Irish investors in Eastern Europe. These disincentives represent a challenge to the ownership advantage of MNEs.

The executives interviewed paint a picture of companies which are taking a long-term strategic approach to investing in China, rather than having a focus on short-term profits. They see their investment as adding value to their global operations, in particular the locational advantage which China offers in market opportunity. However, the challenges associated with investing in China should be borne in mind. At this point, we shall turn our attention to specific consideration of such challenges before presenting views on the nature of and prospects for Irish inward FDI into China.

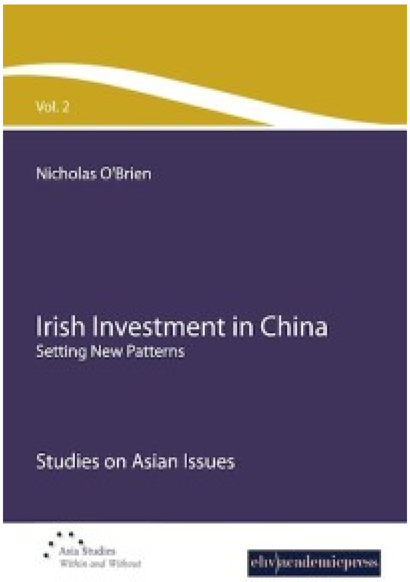
NOTES

**[i]** The reference to increasing tax refers to a move to harmonise tax rates for foreign and Chinese firms, which is required under WTO rules.

**[ii]** In the Chinese political system, a Mayor is the public face of local government and manages affairs on a day-to-day basis. However, a Party Secretary de facto out-ranks a Mayor and is responsible for the determination of key policy issues.

**[iii]** Commissioner László Kovács addressing Consuls General in Shanghai, May 2006

# Chapter 4: A Land Of Opportunity And Challenge ~ Irish Investment In China. Setting New Patterns




*Introduction*

Li and Li (1999: 11) contend that 'for potential foreign investors, a omprehensive understanding of the investment environment in China – including its unique history, culture, political system, socio-economic regime, legal system, infrastructure, and consumer behaviour is essential for the establishment of successful ventures in China'.

This paper will draw together the data generated by this research and identify the locational advantages and disadvantages which China holds for Irish investors. Initially the locational advantage which China offers will be considered as a means of appreciating the opportunity which China offers Irish investors.

This will be followed by a consideration of the locational disadvantages which China poses in the areas identified in the literature and through this research, namely the regulatory, cultural and legal frameworks. The literature review identified the legal framework as challenging, so issues raised in this research, namely contract law and intellectual property rights, will be considered.

Finally the effects of regionalism will be discussed with both locational advantages and disadvantages identified. At the conclusion of this paper we will be in a position to answer the question posed in the sub-hypothesis as to whether or not the business environment in China is different from that experienced by Irish investors in other markets. If this is the case, this analysis will also assist in providing an answer to our prescriptive research question as to the desirability of state involvement in the facilitation of Irish FDI into China.

*Locational Advantages which China offers*

The literature review points to the considerable advances which China has made in attracting inward FDI since the opening-up policy was introduced in 1979. MNEs continue to recognise the locational advantage which China offers and are seeking to exploit their ownership and internalisation advantages by investing in China.

*China's overall record since reforms began in 1979 is dazzling, and its performance is in many ways improving. Annual real GDP has grown about 9% a year, on average, since 1978 – an aggregate increase of some 700%. Foreign trade growth has averaged nearly 15% over the same period, or more than 2,700% in aggregate. Foreign direct investment has flooded into the country, especially throughout the past decade… The country has developed a powerful combination – a disciplined low-cost labor force; a large cadre of technical personnel; tax and other incentives to attract investment; and infrastructure sufficient to support efficient manufacturing operations and exports. (Lieberthal and Lieberthal, 2004: 3-4)*

Associated with this rapid economic growth is an ever-increasing domestic consumer market. 'Host countries with larger market size, faster economic growth and higher degree of economic development will provide more and better opportunities for industries to exploit their ownership advantages and therefore, will attract more market-oriented FDI'. (OECD, 2000: 11) 'Survey evidence suggests that the main motives for Irish companies investing abroad are to enter new foreign markets and acquire new technologies rather than to lower the cost base'. (Forfás, 2001: 4) This view is supported by this research, with the vast majority of executives clearly identifying the locational advantage which China offers as market opportunity. This research among both Irish and non-Irish MNEs also supports the views of Li and Li (1999), who argue that MNEs from developed economies which invest in China will be attracted by the large and growing consumer market and the significant potential for future development rather than the relatively cheap labour pool which China also offers. We can say therefore that the size and growth of the Chinese economy has been identified by Irish investors as offering a significant locational advantage, within the meaning of Dunning's eclectic paradigm model.

While China has a population of 1.3 billion, the literature indicates that the consumer market is primarily along the eastern seaboard and numbers in the region of 300-350 million. This research supports this finding. This is equivalent to the population of the European Union before the ten central and eastern states joined in 2004. A market of this size in one country, greater than the domestic market of the US, represents a considerable locational advantage. While China's eastern seaboard does not obviously have the purchasing power to be found in developed economies, the consumer market is segmented and growing rapidly. China’s upper middle class is not dissimilar to the size of Germany’s population, with GDP continuing to grow at close to double digit levels. In this environment of continuing high economic growth and increasing consumer spending power, foreign MNEs see the attractiveness of investing in China. Lieberthal and Lieberthal (2004: 4) give an indication of the magnitude of the locational advantage available to investors in China.

*Four to six million new cell phone subscribers are signing up every month. Computer use is spreading more rapidly than in any other country. The automotive market is surging, making China the one place in the coming decade where carmakers can compete for a pie that is growing rather than fight over one that is not. In the early 1990s, almost all retail outlets in China were small shops and wet markets. Now, at least in major cities, hypermarkets are common… Long-term trends in China, moreover, promise continued growth.*

The findings of this research support an attitudinal study undertaken among foreign investors in China by Du Pont (2000). In a survey of 100 investors in China, each firm with an investment in excess of USD1 million**[i]**,Du Pont (2000) found market potential to be the prime motivator driving FDI.

Importance of Factor

| Category | Very | Fairly | Little | Irrelevant | Total |
|---|---|---|---|---|---|
| 1. Market Potential | 53.0 | 18.5 | 9.5 | 19.0 | 100 |
| 2. Low Labour Cost | 18.0 | 25.3 | 15.6 | 41.1 | 100 |
| 3. Rich Resources | 14.0 | 32.5 | 17.4 | 46.1 | 100 |
| 4. Investment Climate: | | | | | |
| - government policies | | | | | |
| - investment incentives | | | | | |
| - import substitution | | | | | |
| - political stability | 6.5 | 34.6 | 18.6 | 40.3 | 100 |
| 5. Others: | | | | | |
| - transportation cost | | | | | |
| - follow the competitor | | | | | |
| - technology transfer | | | | | |
| - weak industry | 20.8 | 32.3 | 20.4 | 26.5 | 100 |

*Source: Du Pont (2000: 186)*

Table 1: Determinants of FGI into China

Some interesting data emerges from Du Pont’s study. There is a clear identification among investors of the market potential which China offers. Over half of those surveyed (the highest result for any category) identify market potential as 'very important'. This is clearly corroborated by our research findings. Slightly over half see little or no importance in low labour costs. Again, Du Pont's study is supported by this research. Rich resources emerged as relatively important in Du Pont's study but this is not surprising given that the car and cement industries were included. In Du Pont's research, over half see government policies and incentives as of little or no importance. This would seem to indicate that those surveyed are broadly content with the political environment and level of incentives available.

A second reason why MNEs from developed economies are investing, and identified by this research, is that as more MNEs invest, MNEs which have supply contracts with the initial investor must also invest in China in order to protect their supply contracts. This was identified by both Irish and non-Irish MNEs. This phenomenon appears to be particularly prevalent in the electronics industry and is likely to increase in importance in China for two reasons. Firstly, large electronics manufacturers want to gain an increasing share of the domestic Chinese market**.[ii]**Secondly, as more and more firms locate, a critical mass is created, which means that other MNEs in this sector have little
choice but to follow. This reason was cited by an Irish MNE which operates in the electronics sector.

China also offers other locational advantages. The OECD (2004) has identified the considerable resources which China has committed to the development of its physical, financial and technological infrastructure, which has resulted in a higher standard than that in many of China's east and south-east Asian competitors. In addition, since China acceded to the WTO it has sought to display an openness to international trade and access to its markets. This is exemplified by the reduction in 'the average level of applied import tariffs from more than 50% in 1982 to just under 10% in 2005. Compared to many developing countries, China's average import tariff is relatively low'. (Bergsten et al, 2006: 81) While the removal of barriers to trade can remove one of the incentives to invest, countries which are more open to trade tend to receive higher levels of inward FDI. (Lipsey, 2000)

Some commentators cite the relatively low cost and productivity of labour as a key locational advantage which China offers. (Although, as indicated earlier, there are significant regional variations in this regard. If an investor wishes to avail of low labour costs, then the centre and western parts of the country are more appropriate then the eastern seaboard.) As a reason for investing, this is not particularly relevant for Irish investors, with only 10% of Irish MNEs citing this locational advantage as a key determinant. Low labour costs are an important consideration for investments from some countries, but not those from Ireland.

The executives who participated in this research referred to the level of incentives available. However, these incentives did not feature prominently in the decision to invest. What was evident was the need for MNEs to locate in a Special Economic Zone to benefit from preferential tax treatment. Also, investing MNEs should be cognisant of the significant inter-regional competition to attract inward FDI. In particular, MNEs in hi-tech industries are likely to receive offers of attractive incentives. Generous land-use permits are one of the most important fiscal incentives available to local authorities. All land is owned by the State and land-use permits grant a 50-year lease in the case of an enterprise or a 70-year lease in the case of a private dwelling. The Detailed Implementation Act of the Equity Joint Venture Law provides that provincial level governments have the power to determine the scale of rent for land-use fees.

Foreign investments are entitled to tax exemptions and reductions e.g. there are tax exemptions for profits for the first two years; 50% reduction for the next three years; and an additional ten years of 15-30% tax reduction for those located in economically deprived areas. The average tax rate for foreign investments is typically of the order of 15%, while indigenous enterprises face a rate of 33%. However, in order to comply with its WTO obligations on non-discrimination, in March 2007 the National People’s Congress announced that corporation tax for all entities, both foreign and domestic, will be amended to 25% for new investments. However, tax breaks will still be permitted in Special Economic Zones. This movement in rates appears to have done little to dampen inward investment. Presumably this is because the economy’s large-scale inward FDI, coupled with the country’s substantial trade balance, has created excess liquidity in the economy.

As the focus of Irish investment into China is the exploitation of market opportunity, changes in the tax code are unlikely to significantly affect the levels of Irish inward FDI. This research found that executives did not place particular emphasis on taxation policies in their decision to invest. This supports the relevant literature, which found that taxation is part of a package of measures which investors find attractive (Moosa, 2002; Agarwal, 1980) and shows that incentives are considered as part of the risk and return considerations. If changes in tax codes are to affect inward FDI, it is likely to be in those industries where low-cost labour rates are the motivating factor behind the FDI. In the case of China, this type of FDI originates mainly in east and south-east Asia.

Overall, Irish MNEs which have invested in China to date conform to Li and Li's (1999) categorisation of investment by MNEs from developed economies. They also conform to the general trend in Irish outward FDI, which focuses on market opportunity. (O'Toole, 2007) While accepting the limited nature of this study, it is interesting to note that no significant motivational variations between Irish and non-Irish MNEs included in this research have been found, a fact which lends weight to the view that Irish investment in China appears to conform with investment patterns from other developed economies.

*Locational Disadvantages which China Poses*

*The Regulatory Framework*

Luo (2000) contends that the peculiarity of China's economic system generates uncertainties for international firms that operate there. The OECD (2005) calls for significant reforms in public and corporate governance, observing that laws and regulations are sometimes applied in an unsystematic manner and can be skewed by special interests.

It is important to be aware of the developing nature of the Chinese economy and the relatively recent creation of the framework governing FDI. China has put in place a legal and regulatory infrastructure in a relatively short space of time, with institution building starting only in 1979. The Law on Joint Ventures Using Chinese and Foreign Investment, which is also known as the Equity Joint Venture Law, was promulgated in July 1979. This legislation is brief and contains only 15 articles. Since it was sketchy and its wording was vague, it left latitude for divergent interpretations and a lack of legal certainty. Many important operational issues, such as market access, taxation, foreign exchange and land use, were not dealt with or were defined in ambiguous terms. This allowed provincial governments to interpret the law and laid the foundation for the strong inter-provincial competition to attract inward FDI which still exists today. In addition, the name of the Equity Joint Venture Law spells out the investment model permitted in the early stages i.e. only joint ventures between a foreign investor and a Chinese partner.

Between 1984 and 1990 the three most important elements of the enlarged legal framework were the Provisions for the Encouragement of Foreign Investment, the Law on Wholly Foreign-owned Enterprises (the WFOE Law) and the Law on Cooperative Joint Ventures (the CJV Law). The permitted movement from Joint Venture companies to Wholly Foreign Owned Enterprises (WFOE) is significant. Executives included in this research indicated a strong preference for a WFOE structure rather than a joint venture arrangement. These findings are supported by the views of Shenkar (1990) and Teagarden and Von Glinow (1990), both of whom express a high level of performance difficulties in joint venture arrangements. In this study there was a perception that the Joint Venture arrangement existed to serve the requirements of the Chinese partner first and the foreign investor second.

Depending on the size and location of the FDI project, the foreign investor must approach the relevant authorisation agency. China has a three-tiered structure for approval of FDI projects: the central government, provincial governments, and county governments, depending on the size of the financial investment. The State Council (the central government level) has the authority to approve projects above USD 100 million. The State Planning Commission and Ministry of Foreign Trade and Economic Cooperation (MOFTEC) have the authority to decide on FDI projects between USD 30 million and USD 100 million. Provincial governments have the authority to approve projects up to and including USD 30 million; local government (the county level) has the authority to decide on projects below USD 10 million. The OECD (2003: 19) has called for a 'raising of [the] FDI project value limit above which approval has to be submitted to central government departments at national level and increasing the approval powers of local governments accordingly'.

In the evaluation procedure, relevant government agencies have the duty to examine whether the capital subscribed to the project has been assured; whether the proposed project does not require additional allocation of raw materials by the State; and whether the project does not adversely affect the national balance of fuel, power, transportation and export quotas (Implementing Regulations on the EJVL, art 8(1) and (2)). FDI projects are required to promote and benefit the development of China's economy (Implementing Regulations on the EJVL, art 3 and WFOEL, art 3). These requirements indicate the added-value dimension which the Chinese Government requires of foreign investments i.e. that they should bring in advanced technology and equipment or generate foreign currency. It is important for Irish investors to be aware of such regulations as foreign investors are required to set out how they comply with these requirements.

Executives of non-Irish MNEs found the business licence process to be bureaucratic but manageable. Irish investors found the process more challenging, which is understandable given the lack of such requirements in Ireland. Interviewees referred to particular sectoral licensing issues. It can be expected that China will continue to liberalise the investment regime as it continues to meet its WTO obligations. Unless there are issues relating to national security, or the continuity of supply, or there is a natural monopoly, it is difficult to justify sectoral restrictions on FDI. A role exists for state involvement in lobbying for the removal of such restrictions because 'government restrictions on who can do business in which sectors were specifically designed to protect domestic producers from international competition'. (Breslin, 2005: 739)

A regulatory restriction is in place on the availability of capital, but it has to be acknowledged that this is constantly evolving. Local banking systems and equity markets are underdeveloped in China and venture capital is particularly limited. (Khanna, 2005) Foreign currency restrictions were also an issue raised during this research. While China has made moves to liberalise its currency, it is not a freely convertible currency. Investors can repatriate profits but only with the consent of the State Administration for Foreign Exchange. This consent is granted provided one's tax affairs are in order, but delays can be experienced.

Investors should also be aware of particular requirements relating to the transfer of technology. Given the predominantly hi-tech nature of Irish industry,such requirements are of relevance. Borensztein et al (1995) developed a crosscountry regression framework for testing the effect of FDI on economic growth by drawing on investment flow data from industrialised economies to sixty-nine developing economies over a twenty-year period. Their results show that FDI is an important vehicle for the transfer of technology from developed to developing countries. The effects of the conclusion reached by Borensztein et al are evident in the Chinese Government's focus on seeking a transfer of technology when investors are negotiating inward FDI. A potential spin-off of this is an upgrading of local industry. In addition to the transfer of technology, there is an expectation that the transfer will lead to an increase in social capital skills. The effect of this policy was made clear by the executive of the automotive MNE, which had in effect to double its anticipated level of investment by installing the most up-to-date technology in its manufacturing plant. The requirement to affect a transfer of technology can have adverse implications for an MNE's ownership advantage if sufficient precautions are not taken to protect intellectual property rights. (See below for a discussion of this issue.)

In summary, the regulatory regime can be described as complex but by no means impossible to deal with and, as such, cannot be described as a significant locational disadvantage. However, as will be argued below, the regulatory requirements regarding the transfer of technology combined with the lack of protection for intellectual property rights represents a potential threat to an MNE's ownership advantage.

*China's Culture*

Culture can be a form of location-specific disadvantage within the context of Dunning's eclectic paradigm and has the potential to dissipate other location specific advantages. While China is in rapid economic transition, it still has a strong cultural heritage. 'Although the history of China has been marked by periodic upheavals, its majority of Han people have experienced the longest span of homogenous cultural development of any society in the world… Since the Chinese culture and social structure are very different from the western world, it is essential for potential investors in China to develop a comprehensive understanding of these differences'. (Li and Li, 1999: 130)

With China's 5,000 years of civilization history, Chinese culture, tradition, and its value system have a significant impact on the operations of all Chinese businesses, as well as on joint ventures. (Yin and Stoianoff, 2004) Li et al (2001) argue that foreign investors can encounter problems not only of an institutional nature but also informal constraints such as culture and ideology. In this regard Yin and Stoianoff (2004) contend that an understanding of Chinese social and cultural background is necessary for foreign investors because it can help them to handle the differences in Chinese society. The core of Chinese culture is directly related to Confucianism**[iii]**and the key traits of Chinese culture emphasise relationships, face saving, and reliance on the group. Although formal laws and regulations have always existed in traditional Chinese society, they could be amended to favour people in different situations. In order to obtain such a favourable amendment, Chinese culture has formed a special institutionalised system of personal relationships called guanxi. Traditionally, guanxi was used as an alternative path to formal bureaucratic processes and procedures. Guanxi operates both within and outside the official economy and involves the cultivation of personal networks of mutual dependence and trust. (Yang, 1986; Smart, 1993)

China's cultural uniqueness and the role of guanxi were exploited in the early phase of the reform process, when much of the FDI came from countries or regions that have large overseas Chinese populations, notably Hong Kong, Macao, Taiwan, and Singapore. This wave of FDI was focused on the Pearl River Delta (the hinterland surrounding Hong Kong) and Xiamen. A strategic decision was taken to exploit this relationship.

'[T]he predominance of Hong Kong investment in China may be largely due to use of guanxi and the dramatic reduction in costs that it facilitates (Smart and Smart, 1991)'. (Jones, 1994: 201) Overseas Chinese from Hong Kong and Macao have a similar dialect and culture similar to those to be found in the Guangdong Province. Jones (1994) points to a general cultural preference for relational rather than formal legal and impersonal ties, which is shared by both mainland and overseas Chinese, and which has practical economic effects.

*[T]he Chinese economy is still characterised by undeveloped market structures, poorly specified property rights and a weak production market. In this situation, the guanxi network often substitutes for government instituted, formal channels of resource allocation and dispersal. (Luo, 1998: 173)*

Davies et al (1995) point to the importance of business networks, arguing that they enhance comparative advantage by providing access to the resources of other network members and are particularly important in respect of market entry. This research found that the executives of MNEs recognise a particular cultural environment in China and its distinct attributes. Even in the advanced Yangtze River Delta region, the executives spoke of a quasi-normal cultural milieu but also spoke of the need to develop strong relationships with relevant government officials. It was recognised that the level of relationship required in China extends beyond that normally encountered in the West. Executives spoke of the need to develop stronger guanxi links the further one goes from the eastern seaboard region, which represents a regional variation in the conduct of business affairs. Overall, the view presented was one where stronger relationships are required than Western business people are traditionally accustomed to. This research also corroborates the view of Macauley (1963) that relationships are central to business transactions. His views on the importance of honouring one's commitments and the perceptions of the individuals within one's industry are particularly relevant given the importance of not 'losing face' in Chinese culture.

An observation made by several interviewees was that one of the most important barriers to the development of guanxi by foreign businesspeople is the Chinese language. This view is supported by Bjorkman and Kock (1995), who point out that, while western businesspeople take part in discussions with their Chinese counterparts, it is impossible to develop a personal relationship as they do not speak the language. While some foreign business people speak Mandarin, they tend to be in the minority.

Guthrie (1998) argues that perspectives on guanxi vary directly with a firm's position in the industrial hierarchy: the higher a firm is in the hierarchy, the less likely the firm is to view guanxi practice as important; the lower a firm's hierarchical position, the more likely it is to view guanxi practice as important to its success. The reason for this is that firms in the higher levels of the industrial hierarchy already have privileged access to those with whom they have to deal, which they derive from their economic strength e.g. they have easier access to resources, and already have a strong relationship with the relevant government economic agency. Firms with a lower hierarchical position cannot enjoy similar privileges. This view is supported by this research. Those from particularly large MNEs did not place particular emphasis on guanxi or building strong relationships. This is to be expected as, given the economic importance of the MNEs concerned, they presumably enjoy easy access to senior officials. When the author asked further questions about this, one executive replied that 'We have a very smooth relationship with the local government'. It can be deduced that executives associated with large-scale foreign investments are likely to enjoy high-level access to local authorities and are somehow granted guanxi by virtue of the scale of the investment.

Guanxi also poses certain risks to a firm. Employees' personal networks may become liabilities when they return favours from guanxi contacts, whether within the firm or at competing firms. (Van Honacker, 2004) To obviate this threat, MNEs should seek to bring transparency to relationships and prevent conflicts of interest from developing. Guanxi can also be disrupted by staff mobility. When a staff member leaves an MNE the nature of relationships with third parties may change because the former employee had constructed relationships with customers and suppliers. Given the difficulty associated with the retention of staff, as identified by this research, this is a dimension which foreign investors should be aware of and see as a potential locational disadvantage. Van Honacker (2004) proposes a team-based selling approach to avoid customer contacts being concentrated on a single individual, but such an approach may not always be practical.

This research points to a strong cultural milieu in China, which a foreign investor must be cognisant of. The importance of building strong relationships was acknowledged by interviewees, in particular the need to build relationships with relevant officials. While this can also be of importance to business people in the West, it is probably fair to say that it is only of particular importance in regulated industries. The need to develop such relations in China is a cultural divergence from the business situation in the West and one which needs to be taken into consideration by investors. Those who have invested away from the developed eastern seaboard spoke of the need to develop traditional guanxi relationships. As argued above, China’s cultural environment can become a locational disadvantage within the context of Dunning’s model if due account is not taken of the cultural variations which exist. Accordingly, China’s cultural environment can be seen as presenting unique challenges which Irish investors would be unaccustomed to and which they should take into consideration.

Given the large-scale level of foreign investment and the introduction of Western business practices, the question has to be asked as to whether the unique Chinese culture and guanxi will persist. Arias (1998) argues that the economic and structural conditions that make guanxi relevant for conducting business in China are changing. While this research identified a regional variation in the intensity of guanxi, it was found that, executives continue to place an emphasis on the development of relationships even in economically developed regions. A study by McGrath et al (1992) found little breakdown of traditional Chinese cultural values in Taiwan, despite fifty years of exposure to western business practices. McGregor (2007) points to a resurgence in Confucianism, with the implicit approval of the Chinese authorities. He argues that this revival fits comfortably into the Communist party’s effort to reframe its single-party rule as part of a long-standing tradition of benevolent government. The influence of China’s culture is likely to remain an important component of doing business in China for the foreseeable future. Failure to take account of cultural norms is likely to lead to an increase in transaction costs in terms of the time spent in negotiating unnecessary obstacles.

Jones (1994) poses the question of whether or not the persistence of guanxi means that Chinese society is resistant to the globalisation of the Rule of Law. 'This may indeed be the case, but we should also note that globalisation has singularly failed to eliminate cultural networks (such as "old boy" connections) from Western capitalism' (Jones, 1994: 204). Accordingly, it is to the issue of the Rule of Law that we shall now turn our attention.

*Contract Law*

Macauley (1963) identifies the relative unimportance generally attached to contracts in the business world as emanating from an understanding on both sides of an agreement as to the nature and quality of a seller's performance and the value of the relationship underlying the transaction. This research has identified an apparent paradox among Irish and non-Irish investors alike as to their views on the use of contracts in China. On the one hand they seek to negotiate contracts with a greater level of detail than they would do in the West, with provisions on obligations and penalties set out in a forthright manner, and on the other they recognize the general non-enforceability of contracts. One executive, though, spoke of his opposition to agreeing contracts with suppliers. His reluctance accords with the view of Graham and Lam (2003), who state that trust and harmony are more important to conducting business in China than having a legal contract.

Why is there an apparent paradox in the views of executives? Perhaps it emerges from the underdeveloped nature of law in China, as identified by one of the lawyers. He suggested that in developed economies the law can interpret intentions, whereas there is no developed body of case law in China. Therefore, foreign MNEs may be attempting to create comprehensive contracts so that, should a dispute emerge, they can point to the clear and unambiguous detail of the contract. However, there are two difficulties with this approach. Firstly, as identified by executives, the likelihood of obtaining a satisfactory outcome in the courts is not great. Secondly, as identified by one of the lawyers and several executives, contracts are ultimately linked to relationships. This research supports the view of Macauley (1963) that the ultimate non-legal tie is the maintenance of a successful relationship. However, this research is at odds with his assertion that business people are reluctant to engage in negotiating contracts. The research tends to support the view of Jones (1994) that a distinctive form of capitalism has developed in China, dominated by the Rule of Relationships rather than the Rule of Law.

This research provides evidence to support Jones' (1994) view that China may be the 'fifth little dragon' in Asia, which demonstrates that the persistence of guanxi is not contradictory to the logic of capitalism. It also supports her observation that guanxi and relationships provide an alternative mechanism to the Rule of Law in China. This is not to state that China is a legal wasteland. Rather, this research shows that a 'full legal order' is absent and investors must place considerable emphasis on building strong relations with officials and business contacts.

This research also identifies the difficulty of enforcing contracts, which emanates from the lack of a tradition of resorting to court proceedings to oblige a party to fulfill contractual obligations. And it identifies the importance which executives place on approaching the executive branch of government in seeking to resolve disputes. One lawyer spoke on several occasions of using this route and expressed a preference for liaising with government at a provincial rather than at a local level. This approach flies in the face of the concept of the separation of powers, but Deng Xiaoping, the architect of the opening-up policy, never envisaged such a separation of powers. Perhaps, then, one should not be surprised that there is no strong tradition of the Rule of Law in China.

'In the final analysis trust and harmony are more important to Chinese businesspeople than any piece of paper. Until recently, Chinese property rights and contract law were virtually non-existent – and are still inadequate by western standards. So it's no wonder that Chinese businesspeople rely more on good faith than on tightly drafted deals'. (Graham and Lam, 2004:45) It is unlikely that the current legal framework will alter significantly in the short term, but that the situation will continue to improve incrementally.

Within the context of Dunning's eclectic paradigm, the absence of the Rule of Law represents a locational disadvantage for Irish investors. Irish MNEs, in common with other firms in the West, do not place considerable emphasis on the negotiation of contracts when conducting business in the West. (Macauley, 1963) However, this research has identified that they do negotiate detailed contracts when conducting business in China. This represents a cost to the MNEs in terms of legal fees. A picture emerges of the need to build a strong network of relations and in the event of a legal dispute, adequate redress is more likely to be obtained in this manner than through legal channels.

*Intellectual Property Rights*

In 1979 virtually no legal protection was offered to intellectual property rights. Since then, legislation on trademarks was enacted in 1982, on patents in 1984, and on copyright in 1990. 'China's intellectual property rights protection, although strong in theory, are in fact almost impossible to enforce in much of the country'. (Lieberthal and Lieberthal, 2004:15) This research found that executives express concern at the lack of respect for IPR. These findings are supported by IBEC (2006: 3), which found that 'the lack of intellectual property protection continues to be viewed as a significant barrier to trade in China and also, to a lesser extent, in some other Asian markets such as India and South Korea'.

Within the context of Dunning's eclectic paradigm, the lack of respect for IPR raises issues in respect of all three advantages. The absence of legal protection is a locational disadvantage which China poses for investors. Peerenboom (2002) points to evidence that suggests that the lack of the Rule of Law and clear property rights have already taken a toll and will become an impediment to future investment and growth. 'Anecdotal evidence confirms that some companies were scared away or chose to minimise their investment or to deliver second-grade technology rather than the most up-to-date technology'. (Peerenboom, 2002: 474) This view was evident in the case of the food sector MNEs. A chemical sector MNE executive was opposed to the introduction of the firm's latest technology into China, given the previous experience which the MNE had suffered.

This IPR issue also creates a risk for the ownership advantages which MNEs possess. Intangible assets, including technology or patents, are of central importance for MNEs. (Markusen, 1985) Due to the lack of the strict enforcement of patent and trademark laws in China, the transfer of advanced technology is a concern for MNEs. Du Pont (2000) identifies reluctance on the part of MNEs to transfer technology due to the 'copycat phenomenon'. Such a view is corroborated by the findings of this research.

Internalisation advantage refers to the manner in which the MNE organizes its activities in third-country markets. A legal system that protects intellectual property rights can create confidence in the use of independent subcontractors;

while in the absence of protection, the MNE will tend to internalise production. Buckley and Casson's (1976) internalisation theory contends that the protection of ownership advantage is a reason to retain production within the firm. Multinationality, therefore, can be a response to weaknesses in a legal system. This view is evident in the reluctance of executives to enter into joint venture arrangements because of the potential leakage of intellectual property to a competitor. While the use of a joint venture arrangement or M&A can hasten entry into a third country market, the findings of this research indicate that the use of either mechanism poses challenges in the case of China.

While executives from Irish MNEs which have invested in Eastern Europe have little direct experience of investing in China, the threat to the MNE's intellectual property was cited as giving rise to a general reluctance to invest in China. One executive spoke of little hope of redress should such violation occur. He asserted that intellectual property is the core ownership advantage which the MNE possesses. Should this be compromised, it could have significant adverse implications for the MNE. The MNE was therefore unwilling to invest in China despite the market opportunity which China represents.

Another executive stated that the MNE would approach the executive arm of government should IPR violations occur. This reinforces the notion of the importance of guanxi and the under-developed nature of the legal system. In summary, it can be deduced from this research and the relevant literature that the lack of respect for intellectual property rights and the associated challenge of obtaining suitable redress through the legal system pose a potential locational disadvantage for investors.

In a professional capacity, the author has attended briefings in Shanghai's High Court on the judicial efforts taken to protect the intellectual property rights of MNEs. Despite the efforts of the authorities, the evidence from senior executives is that counterfeiting continues. It is probably fair to say that it is becoming more controlled in the larger population centres, but such manufacturing would appear to continue, particularly in Guandong Province. It is in the long-term interest of the Chinese authorities to address this issue.
'Addressing IPR issues more effectively will enable China to attract more long-term investment, especially in high-tech areas where technology transfer is more likely to occur in an environment in which IPRs are well protected. It will also encourage domestic creativity'. (OECD, 2003: 28)

*Corruption and the Giving of Gifts*

It is fair to say that corruption exists, to varying degrees, in all economies, both developed and developing. There is little information available on the level or scale of corruption in China. Had corruption been a major pre-occupation, it is fair to say that it would have been reflected in the interviews particularly with the non-Irish MNEs, because US companies (some of the non-Irish MNEs included in this research fall into this category) are subject to the Foreign Corrupt Practices Act, 1977 (FCPA). The FCPA could be described as a reflection of the basic principles of Western business ethics, which seek to separate business dealings from the government officials with jurisdiction over those dealings. Breaches of the FCPA can have serious consequences for MNEs with American headquarters, even when the corruption takes place in a foreign subsidiary.

One should not confuse corruption with the necessity to offer a gift on meeting a new client for the first time. Gift giving is an important dimension of Chinese culture and it is expected that gifts will be offered. The etiquette of gift exchange distinguishes it from bribery and corruption. (Smart, 1993) 'In bribery, the two parties enter into an impersonal relationship, linked by mutual materialistic utility. Such manipulative exchanges are geared up to shortterm immediate gain. Guanxi, on the other hand, is geared towards the cultivation of long-term mutual trust and the strengthening of relationships'. (Jones, 1994: 205) Jones (1994) points out that if foreign investors do not appreciate the role of guanxi, they will offer gifts as bribes. 'On the other hand, long-term relationships of trust can help investors resolve problems faster, cutting through red tape and assisting with long and complicated negotiating procedures'. (Jones, 1994: 205)

Looking to future legal developments, Economy (2004: 98) argues that middle-class Chinese will want effective legal institutions to protect their newfound assets. She suggests that the new focus on home-ownership will assist in the development of the Rule of Law. Recognising the absence of a Weberian concept of law in China, Peerenboom (2002) develops a theoretical framework which argues that China is in transition from 'Rule by Law' to the 'Rule of Law'. However, the version of the 'Rule of Law' which China will develop will most likely not be a liberal democratic version of the Rule of Law as it is found in Western economies. He proposes that one needs to bear in mind the differences in political and economic institutions and in cultural practices and values. He suggests that it is possible that China may develop an alternative to the Rule of Law concept as understood in the West and instead what may emerge is a form of the 'Rule of Law with Chinese characteristics'.

However, even the creation of a culture of the 'Rule of Law with Chinese characteristics' cannot be achieved in a short period of time. The OECD (2003: 16) suggests that China 'is striving to develop an impartial and effective court system, but, for institutional and manpower reasons, this work will take years, rather than months, to achieve'.

*Regionalism – Advantages and Disadvantages for FDI*

Even within China there are regional locational advantages and disadvantages to be considered within the context of Dunning's eclectic paradigm. While an observer might consider China to be a homogenous unitary state, the de facto situation is that provincial governments have considerable devolved powers. Defence and foreign policy are the preserve of central government, but most other matters fall within the competence of local legislators. Mo (1997) contends that, in the area of FDI, local regulations often seek to fill the vacuum left by national legislation or supplement national laws in areas where they are silent. Eng (2005: 5) argues that 'China's rapidly changing environment makes it difficult for the central government to maintain regulatory uniformity across the land. Therefore, local rules could be at odds with those promulgated by the central government in, for instance, bank lending, consumer rights, factory operations and environmental protection'.

In transiting from a command economy to 'socialism with Chinese characteristics', there was a decentralisation of decision-making power. This evolution not only increased enthusiasm for for eign investment at the local level, but also led to understandable competition between competing provinces and municipalities. 'The fastest way for a leader at the local level to rise to a higher position is to oversee successful economic growth in the locality… this has produced a lot of de facto flexibility and initiatives at all levels, even in an authoritarian system with a socialist planning heritage'. (Lieberthal and Lieberthal, 2004: 15) It is important, therefore, to take cognisance of local regulations when considering the locational advantages which each province or municipality can offer. Indeed, incentives also vary at sub-municipal level. It is worth recalling a previously-used example on this point. One of the executives interviewed described his experience of negotiating with officials at district level in Shanghai when considering a location for a corporate headquarters. Given the prestigious nature of the MNE, local officials were keen to win agreement on locating the headquarters in their particular district (the local authority level). The result of these negotiations was that the firm effectively built their headquarters at little or no cost, when the additional fiscal incentives on offer were taken into consideration.

Investment has not been spread uniformly across China, with significant regional imbalances in FDI trends. Zhang (2002) points out that in the period 1983 to 2002 the eastern region of China received almost 88% of the overall FDI in China, the central region 9%, and the western region only 3%.**[iv]**In addition, the center of China's FDI absorption has moved from the Pearl River Delta to the Yangtze River Delta. Du Pont (2000) identifies three distinct investment areas in the country: the four special economic zones favoured in the experimental period, the fourteen Open Coastal Cities, the three Open Economic Zones established in the Gradual Development Period, and the inland provinces, which he describes as requiring attention in terms of their economy and infrastructure. It is not surprising that investment is skewed in favour of the eastern seaboard. The reformers targeted China's coastal areas in the early phases of the opening-up policy as the appropriate destination for inward FDI. Indeed, in the early phase FDI was permitted only in specially designated zones in this region. Regional variations are also evident in consumer purchasing power and income levels. 'The average income in poorest Gansu or Guizhou is only less than 1/8 of that in the richest Shanghai or Guangzhou, and the gap is getting larger'. (Wang, 2006: 47) The east coast is where the highest income levels are to be found. Household size in the cities is 3.1, whereas it is 5.6 in rural areas, pointing to higher levels of disposable income in urban areas.

Investors from Ireland are more likely to select a location in the coastal region as this is where market opportunities are to be found. Another reason why Irish MNEs would be likely to focus on the eastern seaboard is the sectoral composition of the investment, with the emphasis likely to be on hi-tech, service or complex manufacturing sectors. These are predominately to be found in this region. In addition, if the investing firm is supplying another MNE which has invested in China, this MNE is also likely to be located in the coastal region. This view is supported by the National Council for US-China Trade (1990), which found that production bases for labour-intensive industries are shifting from coastal to inland regions.

This research found that the executives of Irish MNEs have identified regional locational disadvantages which one should be aware of. The executives spoke of the need to develop stronger guanxi links, the further one travels from the eastern seaboard region. Referring back to our earlier discussion on the legal system, Clarke (1995) points to considerable difficulties in having court judgments enforced in civil and economic cases. He points to the problem which 'local protectionism' poses, whereby local governments want to protect local enterprises. This problem was cited by one executive, who referred to particular problems when seeking to take legal action outside the province where its manufacturing facilities are located.

Although the Chinese Government has called for an increase of FDI in the central and western regions of the country, the flow of FDI to these areas still lags far behind that directed towards the coastal region. (Luo, 1998) While there have been high profile investments, Breslin (2005: 750) contends that the 'much vaunted "look West" strategy aimed at encouraging more investment into non-coastal areas has largely failed to pull in significant new investors'.

Therefore, in considering an investment in China, Irish MNEs should take cognisance of the regional variations and seek to exploit regional locational advantages. If the object of the investment is to exploit market opportunity, then the eastern coastal region is where the highest disposable income is to be found. Also, when negotiating incentives, one should be aware of the differing levels of incentives available. This, of course, will be related to the nature of the investing MNE, with a premium placed on hi-tech MNEs.

*Conclusion*

It is generally agreed that increased knowledge of a foreign country reduces both the cost and the uncertainty of operating there. (Buckley and Casson, 1985) Irish investors need to be aware of potential challenges and include them in their business planning. Some are capable of rectification while others are more difficult to ameliorate. It is important that investors recognize that they are not conducting business in a developed economy and include contingencies to overcome obstacles.

This research has identified the principal locational advantage which China offers for Irish investors as being market opportunity. The overall experience of Irish MNEs could be described as very positive. While they recognise the existence of locational disadvantages they are keen to exploit the market opportunity which

China offers.

Several locational disadvantages were identified, the most significant being the lack of protection for intellectual property rights. This is of importance for Irish MNEs given the general hi-tech nature of Irish industry. Failure to protect ownership advantages through the utilisation of appropriate internalisation advantages could place the ownership advantage of an Irish MNE at risk.

We can conclude that our sub-hypothesis holds and that the business environment in China is different from that experienced by Irish investors in traditional destinations for Irish outward FDI, particularly in the legal domain. Therefore, it can be argued that market imperfections exist, which distort the operation of the market, with a role existing for the state in removing such obstacles.

NOTES

**[i]** The firms surveyed were in four industries: agricultute, food-processing, car manufacture, and paper and cement.

**[ii]** Announcing a US2.5 billion investment in Dalian, north-east China, on 27 March 2007, Chief Executive Ortelli of Intel cited the increasing market opportunity which China represents as a key consideration underlying the multinational's investment.

**[iii]** The teachings of Confucius (551-479 BC) have moulded Chinese civilisation. His teachings were the officially recognised imperial ideology for over 2,000 years, from 136 BC to 1905 AD.

**[iv]** The Eastern region of China includes Beijing, Tianjin, Shanghai, and the provinces of Hebei, Liaoning, Jiangsu, Zhejiang, Fujian, Shandong, Guandong, Guangxi and Hainan. The Central region of China includes the provinces of Shanxi, Inner Mongolia Autonomous Region, Jilin, Heilongjiang, Anhui, Jiangxi, Henan, Hubei and Hunan. The Western region of China includes Chongqing and the provinces of Sichuan, Guizhou, Yunnan, Tibet Autonomous region, Shanxi, Gansu, Qinghai, Ningxia and Xinjiang Uygur Autonomous Region. Hong Kong, Macao and Taiwan are not included.

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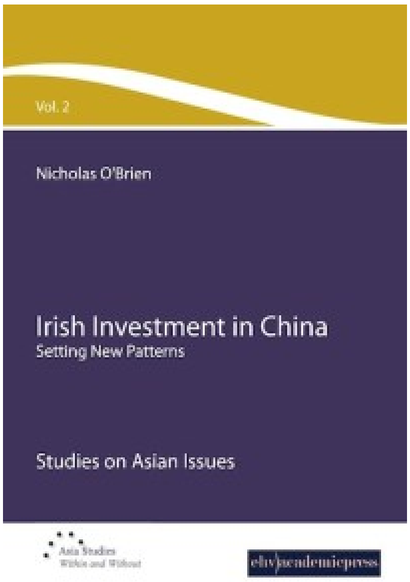
# Chapter 5: Irish FDI In China ~ Evidence, Potential And Policy ~ Irish Investment In China. Setting New Patterns




*Introduction*
Having set out the locational advantages and disadvantages which China possesses, this chapter will explore the non-applicability of Irish FDI in China to Barry et al's (2003) model for developed economies, and will attempt to explain why there is such a divergence. It can be argued that there is a view which equates outward FDI with the re-location of jobs abroad. In order to address this perception, the effects of outward FDI on the home economy will be explored. Acknowledging that our sub-hypothesis holds and that the investment climate in China is different from that faced by Irish investors in developed economies, we will explore our prescriptive research question, namely the role which exists for government in supporting potential investors who wish to enter the Chinese market.

*Barry's Model*
Barry et al's (2003) model states that Irish outward FDI is disproportionately horizontal in nature and oriented towards non-traded sectors. This model is based on an analysis of Irish FDI in the traditional destinations for Irish FDI, namely the US and UK, both of which are developed economies. This research analysed Irish FDI in China, a developing economy. While accepting the limited nature of this research, it was found that 82% of FDI is in the traded sector and only 18% in the non-traded sector. It can be said, therefore, that this finding is at variance with the model for developed economies, as set out by Barry et al (2003). Secondly, in relation to the  horizontal or vertical nature of Irish FDI in China, this research

identified 55% as being of a horizontal nature and 45% as being vertical. Barry et al's model states that Irish traditional FDI in developed economies is "disproportionately horizontal in nature'. 55% could not be described as 'disproportionately horizontal'. Accordingly, this finding also deviates from Barry et al's model. Accepting the difficulty of measuring the true level of horizontal versus vertical FDI, as highlighted in the literature review, the figure of 55% is below the level of 70% which Moosa (2002) contends may be the general order of horizontal FDI. This points to the level of horizontal Irish FDI in China being somewhat lower than the norm and not as strong as would have been anticipated had it been in accordance with Barry et al's model.

We can say that this research indicates that the current wave of Irish FDI in China is predominately in the traded sector and marginally horizontal in nature.

Accepting that the sample size for this research is limited, it is nevertheless an accurate reflection of current investment patterns by Irish MNEs in China.

**Table 5: A comparison of Irish investment in the US and China by sectoral composition (in percentage terms)**

| Sector | Irish Investment in China(rounded) | Irish Investment in the US |
|---|---|---|
| Food, drink and agribusiness | 20 | 17.5 |
| Print, paper and publishing | 10 | 16.2 |
| IT, telecoms and electronics | 20 | 4.0 |
| Chemical and pharmaceuticals | 10 | 9.5 |
| Other manufacturing | 20 | 5.8 |
| Construction, property | 10 | 22.2 |
| Financial services | 0 | 22.5 |
| Services (consulting, retail etc) | 10 | 2.3 |
| Total | 100.0 | 100.0 |

Table 5: A comparison of Irish investment in the US and China by sectoral composition (in percentage terms)

*Irish FDI in China and Barry's Model*

It is also interesting to examine whether the limited Irish investment in China diverges or conforms to the sectoral composition identified by Barry et al (2003) for developed economies. Using the categorisation of Irish investment in the US put forward by Barry et al (*see table 3 in previous chapter*), the following comparisons can be made (*Table 5*):

The percentage for food, print and chemicals is not greatly different between both categories. IT, telecoms and electronics are considerably more important in the case of China. Significant deviations can be identified in 'other manufacturing', financial services and construction to a lesser degree. Notably, the Irish financial service sector is absent from China. Again acknowledging the small sample size of this research, current Irish investment trends into China show a divergence from patterns identified for investment in the US.

Why then does Irish FDI deviate from Barry et al's model and also diverge in sectoral composition from that identified in traditional destinations for Irish outward FDI? There may be several possible explanations.

Recalling that firms invest abroad because they possess ownership and internalisation advantages, Barry et al (2003) suggest that R&D and superior product differentiation through advertising are generally found to be the most important firm-specific assets associated with multinationality; but Irish MNEs do not appear to follow the standard pattern associated with multinationality. Instead, they propose that the predominant proprietary assets which Irish firms possess are in the fields of management and expertise, mainly in non-traded sectors. However, this research found that the composition of Irish MNEs investing in China is largely in the traded sector. It is possible, therefore, that because the expertise of Irish MNEs largely lies in the non-traded sector, this is inhibiting current levels of FDI in China, given the largely manufacturing and traded nature of the Chinese economy at this point in time.
Secondly, the structure of the Irish economy can be broadly defined as highvalue output with little high-volume low-value manufacturing. (This results from the relatively high cost structure of the economy, as compared with developing economies). While Barry et al point out that the Investment Development Path hypothesis is silent on the distinction between vertical and horizontal FDI, they claim that as production costs rise there is an incentive for domestic firms to engage in vertical FDI, moving labour-intensive components to countries with a locational advantage in low-cost labour. This opportunity was identified by a very limited number of Irish MNEs. While China's low wage cost environment may facilitate some Irish investment, market opportunity remains the primary investment objective.

Barry et al point to a large increase in outward investment by Irish firms in the US in hi-tech sectors such as information technology and the pharmaceutical industries. There has been limited investment by the Irish information technology industry in China and none by the pharmaceutical industry. IPR is a substantial component of ownership advantage in both of these industries. This research identified the risk to intellectual property rights (IPR) which investing in China may pose. This view was reflected not only among Irish MNEs which have invested in China, but also among executives of Irish MNEs which have invested in Eastern Europe. The threat to IPR was identified by the latter category as the most significant reason not to invest in China. The absence of predictable contract law was also cited. This was also evidenced by Irish investors in China in the food and chemical industries in China. Therefore, the information technology and the pharmaceutical industries may not be willing to commit to China until they are assured that their primary ownership advantage, namely IPR, will be adequately protected.

A factor possibly underlying the high level of investment in traded sectors may be the rapid emergence of China's consumer base. In the case of China, the development of a critical mass of high-spending consumers has occurred in a relatively short period of time. It is possible that indigenous firms have not developed adequately to respond to the demands of consumers. However, with the focus in Irish industry on the service sector, Irish firms may not be well placed to take advantage of current consumer trends in China. A fifth possible explanation is that China's service sector is in the early stages of development, whereas this represents a strong component of Irish industry. Therefore an explanation for the divergence in Irish investment in China from that identified by Barry et al for developed economies could be that it is the Irish manufacturing sector which is predominately investing in China, as against in developed economies.

The reasons advanced for the divergence between the results of this research and that of Barry et al (2003) point to the under-developed service sector, the lack of respect for legal norms, and the large manufacturing component in the Chinese economy. Du Pont (2000) has identified the emergence of the service and construction sectors. This may present additional locational advantages for Irish investors. By analysing industries in which Irish MNEs possess ownership and internalisation advantages it would be possible to identify which sectors may be keen to exploit China's locational advantage in the coming years.

Table 6: Asia Strategy - Targeted Sectors

| Economic Sectors | Targeted Asian Priority Countries |
|---|---|
| SERVICES EXPORTS | |
| Information Technologies | Japan, Korea, China, Singapore, Malaysia, Thailand Vietnam, India, Australia/NZ |
| Telecoms Applications | Japan, Korea, China, Singapore, India, Australia/NZ |
| Financial Software and Services | Singapore, India, Australia, New Zealand, China |
| eLearning | China, India Australia/NZ |
| Education Services | China, Korea, China, India, Malaysia, Singapore, Australia/NZ |
| Construction Services | Japan, Korea, China, India |
| Consultancy Services | China, India |
| Others – for example, Aviation, Security, Biometrics | Japan, Korea, China, Singapore, Malaysia, Thailand, Vietnam, India, Australia/NZ |
| GOODS EXPORTS | |
| Healthcare Devices and Pharmaceuticals | China, Japan, India |
| Biotechnology | Japan |
| Agricultural Machinery and Veterinary Pharmaceuticals | Australia/NZ, Korea, |
| Electronics and Industrial Goods | Japan, China, India |
| Consumer Products | Japan. Australia/NZ |
| Nanotechnology | Japan |
| Food, Drink and Seafood | Japan, China, Hong Kong and other Asian markets |

Note: Although Australia/NZ are not included in the Asia Strategy, they are included in the above chart.

Table 6: Asia Strategy – Targeted Sectors
Note: Although Australia/NZ are not included in the Asia Strategy, they are included in the above chart. Source: Government of Ireland (2005)

*The Potential for Irish Investment*

The Government of Ireland's (2005) Asia Strategy provides assistance is seeking to identify which sectors of the Irish economy are likely to possess the ownership and internalisation advantages required to exploit China's locational advantages and overcome potential locational disadvantages. While the focus of the Asia Strategy is trade, it can be argued that these sectors are also likely to succeed in the investment domain, given the strong relationship between trade and investment. *Table 6* sets out the Government's recommendation as to which sectors of the economy should intensify their efforts in particular Asian economies.

The major sectors highlighted for the Chinese market in the goods sectors are healthcare devices, electronics, and food, drink and seafood. In the services sector, the categories are information technology, telecoms, financial software, education, and construction. Of these, Irish MNEs have already invested in the electronics, food, information technology and construction categories. In the case of the four remaining sectors, non-Irish MNEs were included in this research so as to capture the experience and perceptions of executives from all eight industrial sectors which are suggested as target sectors for developing economic links with China. The following section will consider issues of note raised by the executives from these industries and potential areas for investment will be highlighted. However, an in-depth analysis of the sectoral opportunities for investors lies outside the scope of this research.

Within the goods sector, the need to strengthen IPR protection was identified as a locational challenge by the executives from the electronics and food sectors. The food MNEs which have invested in China have decided to participate in the business-to-business sector and not the retail sector. They identified this as a stronger means of protecting intellectual property and also recognised the high cost of entry barriers to the retail market in terms of advertising costs. One food sector executive also spoke of the MNE’s plan to service the market in the west coast of the US from its Chinese plant rather than from Europe, which is what it does at present. This locational advantage for European investors was not highlighted in the literature on European investment in China. A food sector executive also spoke of the lack of national treatment. The electronics executive identified the critical mass of electronic MNEs in China as a key consideration in deciding to invest.
Barry et al (2003) point to the increase in the number of Irish IT MNEs investing abroad since 2000. This research identified a divergence of views between the executives of the Irish and the non-Irish IT MNEs, with the former citing IPR risk as being at the same level as in other markets, whereas the latter spoke of the significant risk which IPR violation poses. An executive of an Irish IT MNE which has invested in Eastern Europe cited the potential risk to IPR as a reason for not investing in China. McDonnell (1992) argues that if a sufficient return accrues to the parent firm to compensate for this risk, then the location of R&D overseas is deemed worthwhile. It would appear that if a firm is manufacturing retail software in China, there is a potential risk of IPR violation. This risk is reduced when the MNE operates in the business-to-business sector exclusively.

There is currently no Irish investment in the telecoms sector in China. There is a high level of state control in the telecommunications industry. ‘As the reform of state-owned telecoms continue, the market is not creating opportunity for foreign actors as understood under China’s WTO commitments’. (European Union Chamber of Commerce in China, 2005: 223) The fixed line and mobile network is state owned and there is scope for investors in the telecoms equipment sector only. No particular locational disadvantages were identified in this sub-sector.

The financial sector was identified as one of strong regulation, but also one of opportunity. China's growth over the past 25 years has been achieved within the context of a closed banking system. This worked by channeling individual savings into state-owned banks which were used to fund state-owned enterprises. With the opening up of the banking sector in 2006 in response to WTO obligations opportunities will increase for foreign banks to offer loans to profitable private and state-owned enterprises. This presents an opportunity for niche market lending. It also offers significant financial service opportunities as the state-owned 'big four' banks will be obliged to restructure and modernise. The banking executive identified a skills deficiency in Chinese banks. This represents a locational challenge for foreign investors who wish to establish banking operations in China, but a market opportunity for providers of specialised financial services.

The education sector in China is closely regulated, as identified by an executive from this sector. If Irish investors wish to enter this sector, it would seem that the optimal route is to co-invest with a Chinese minority shareholder. Because of the risks which joint ventures pose to ownership advantage, as identified in this research, this structure is best avoided. It is also important that education providers appreciate the changing structure of the Chinese market. 'China graduated a million technicians and engineers in 2001. That figure leapt to 2 million in 2003 and will go still higher. And the quality of engineering training has improved to the extent that fewer Chinese are now going to the United States for engineering degrees because they can obtain excellent education more cheaply at home'. (Lieberthal and Lieberthal, 2004: 4-5) This trend points to fewer Chinese students being willing to make the investment associated with studying abroad. If this trend continues, education providers from developed economies need to re-focus their efforts and seek to create strategic partnerships with Chinese colleges and, in addition, to consider the direct provision of education services in China, rather than seeking to attract Chinese students to study abroad exclusively. An option which several Irish third-level institutions have successfully established is one whereby students study in both the Chinese and Irish institutions e.g three years study in China and one in Ireland.

As identified by Barry et al (2003), the construction sector is one of the most active in Irish outward FDI. Xianming (2004) gives an indication of the size of this

sector in China. 200 million metric tons of cement are produced every year in Western Europe. In China the figure is 1,000 million metric tons. Irish construction multinationals have already displayed their ownership and internalisation advantages and have an overseas presence. China would seem to be the appropriate next stage of investment, given the nature of the expanding industry in China and the locational advantage which this confers.
In addition to these sectors, some Irish firms may wish to examine the opportunities for moving low-value manufacturing to China and strengthening their head-office operations at home. This could have the outcome of placing the firm on a stronger financial footing in the medium term. The reality is that it is becoming increasingly difficult for Irish companies to profitably manufacture lowvalue products in Ireland, given the relatively high cost base as compared with Asia. If a firm wishes to protect its ownership advantage, it may have to evaluate its internalisation advantage and examine the option of creating a manufacturing subsidiary in China whilst retaining the higher-paid jobs in the home economy e.g. finance, design etc. This practice is sometimes portrayed as the relocation of jobs, but the reality is that it is difficult to continue such manufacturing in developed economies. In the medium term, the result is the retention of higher paid and more skilled jobs in the home economy.

*Home Country Effect*

'People take national pride when their MNEs do well in Fortunes' ranking of the largest firms in the world, but they worry when they see their companies closing domestic plants and opening up new ones in cheap-labour countries. Feelings are mixed because the issue is intricate'. (Navaretti and Venables,2004: 217) Responding to this argument, O' Toole (2007: 397) argues that 'the small number of studies that examine the productivity effects of offshoring production at an aggregate economy wide level suggest that it has a positive impact in the long run, particularly for small countries like Ireland'. In the same vein, Forfás (2001) argues that outward FDI should not be seen as an indication of economic decline, but a restructuring into higher value-added activities that will form the basis of long-term growth in competitiveness, exports and employment.

While by no means conclusive, overseas studies suggest that outward direct investment has been broadly beneficial for the 'home' economies concerned, boosting domestic exports, employment and wages, and providing a catalyst for restructuring of the domestic economy into higher value-added activities… Where key drivers in the business environment, such as taxation, infrastructure and the availability of skilled workers are supportive of high value-added activities being located in the domestic economy, then outward direct investment acts as a positive force in economic development, leading to the creation of high-skilled, highly paid employment. (Forfás 2001: Foreword)

Outward FDI is seen as having effects primarily in the areas of employment, taxation, and technology transfer. There is still considerable debate among economists about the employment effects of FDI in both the host and the home economies. In particular, the effect of outward FDI on employment levels at home is a controversial issue. (Moosa, 2002) Critics argue that outward FDI diminishes employment levels at home as the output of foreign subsidiaries becomes a substitute for output from the parent firm in the home economy. However, proponents of outward FDI contend that FDI creates jobs in the domestic economy because domestic firms export more when they have foreign subsidiaries.

Blomstrom et al (1988) analysed the employment data of Swedish MNEs, which showed that MNEs with subsidiaries abroad have higher levels of employment in head office operations when compared with firms which have not invested abroad. Head and Ries (2001) conducted research on 932 Japanese manufacturing firms over a 25-year period. They confirmed a complementarity between FDI and employment. The relationship, however, varies across firms. They found substitution when firms are not vertically integrated and assembly facilities in foreign countries are not supplied by intermediates produced at home.

Forfás (2001) clearly does not subscribe to the notion that outward FDI is a relocation of Irish jobs that will damage Irish industry.

*Despite fears that outward direct investment by Irish companies may lead to a 'hollowing out' of industry and loss of exports, studies of countries with long experiences of high levels of outward direct investment all indicate that outward direct investment and exports are broadly complementary. According to one OECD study of member countries, each $1 of outward direct investment was associated with $2 of additional exports and a trade surplus of $ 1.70.* (Forfás, 2001: 4-5)

Forfás also points to the international evidence which suggests that outward FDI has broadly positive effects on employment and wage levels in the domestic economy. Research commissioned by Forfás shows that ‘overseas investment by Irish companies has created demand for high-skilled employment at their respective head offices in Ireland e.g. for accountants, managers and marketing specialists’. (Forfás, 2001: 5)

In support of this view, the executive of an Irish MNE specifically argued that the company’s investment in China has added value to global operations and not threatened jobs at the Irish parent firm. Indeed, it was argued that having an R&D facility in China has helped the firm acquire new clients in China and grow global operations. The literature on the effect of outward FDI on employment in the home economy is far from conclusive. There appears to be some evidence that vertical FDI may complement domestic activities, whereas horizontal FDI may have a substitution effect. ‘These results contrast with the general belief that investments in cheap-labour countries weaken home activities, whereas those in other advanced economies enhance the national presence in foreign markets.
The reason is probably that vertical investment reduces production costs for the MNE as a whole, therefore raising output and employment of complementary activities at home or at least preventing them from declining’. (Navaretti and Venables, 2004: 44) This research established that Irish FDI in China does not follow the general trend identified by Barry et al and is not predominately horizontal. If vertical FDI is complementary to employment in a home economy, then Irish FDI in China may have less of an impact on employment in Ireland than outward FDI to other locations where horizontal FDI dominates.
Even if commentators hold differing views on this issue, there is a public perception that outward FDI involves the relocation of jobs to a third country. Perhaps this is an issue which needs to be addressed by commentators. While it may not be the most popular issue to address, the Irish economy is in a state of transition, having recently become a net exporter of FDI. From an economic governance perspective, it is important that issues surrounding this development are explored and policies enunciated.

Outward FDI also has an effect on taxation. Feldstein (1994) considers the effect of outward FDI in both the host and the home economies on taxes and tax credits. He argues that in the event of outward FDI the national income of the home economy will be affected, depending on the magnitude of the loss of tax revenue to the host economy and the use of foreign debt. He analyses these two factors, assuming most national savings remain in the home economy. He points out that the payment of tax to the host government by a subsidiary of the investing firm represents a loss of revenue by the home government. If investing firms receive tax credits for these payments, as they would do if a double taxation treaty exists, the firm will be indifferent to where the tax is paid. The firm will remain indifferent until the after-tax rate of return on the foreign investment is equal to the after-tax return on domestic investment. Another pertinent issue is whether or not outward FDI has an impact on technology up-grading and investment in R&D in the home economy.

Technology transfer to the host economy can take place through the adoption of foreign technology and the acquisition of human capital. FDI by MNEs is considered to be a major channel for the transfer of technology to developing economies. (Moosa, 2002) However, multinational enterprises will invest in technological research or the adaptation of their technology or in up-skilling local labour only to the extent that such investment holds a clear prospect of profit. The gains which accrue to the host economy are largely incidental, arising from the fact that it is in the multinational's interest for such transfers to take place (McDonnell, 1992). Moosa (2002) argues that the benefits of technology's accruing to the investing firm and the host economy are substantial.

From the perspective of the home economy as a whole, rather than the individual firm, there is an interest in retaining the key technological components at home. What may be of value to the home economy is exporting slightly obsolete technology to the host economy, which can be used to increase market penetration.**[i]** In order to maximise long-term growth, technologically advanced countries need to protect high-value technology. However, the individual firm is a profit-maximiser and will be indifferent as to where it locates its intellectual property as long as the ownership advantage can be adequately protected.

While there will be understandable adverse comment on individual factory closures in developed economies when manufacturing facilities are relocated to lower-cost economies, the evidence would appear to indicate more positive than negative effects. 'Foreign investments are more likely to strengthen than to deplete home activities… Comparing firms investing abroad and national firms just operating in the home country, we find that investing abroad enhances the productivity path of investing firms'. (Navaretti and Venables, 2004: 239)

Acknowledging that research on home country effects is limited, the material available indicates that it is in the long-term interests of the home economy for its firms to invest abroad because of the potential for market expansion or the production of goods at a lower cost. In the case of Ireland, a detailed econometric model would be required to accurately predict the likely outcome. One of the problems identified by Moosa (2002) is the lack of data to adequately assess the impact of outward investment on employment.

*Irish Public Policy*

The sub-hypothesis under study has been found to be valid, as this research has indicated that the business environment in China is relatively different from that experienced by Irish investors in traditional destinations for Irish outward FDI. Given this challenging environment and the presence of imperfect market conditions, the question arises as to the role which exists for state intervention in ameliorating these market imperfections.

There is no enunciated government policy on outward FDI. While there are understandable emotive connotations associated with outward FDI, in today’s globalised economy national governments evaluate their economic strategies and policies on an on-going basis. With Ireland now a net exporter of FDI, perhaps it is opportune for a policy debate on this economic governance issue.

Ireland is an extremely open economy and subject to external economic pressures. The degree of transnationality of host countries, as measured by UNCTAD’s Transnationality Index,**[ii]** shows that the most transnationalised economy in 2003 was Hong Kong, which was followed by Ireland in second place. (UNCTAD, 2006) In addition, Forfás and Enterprise Ireland (2004) point out that companies supported by Enterprise Ireland supported over 23,000 workers in overseas operations in 2003. This figure is equal to 17.5% of total employment in these companies. Given the positive effects of outward FDI, particularly in strengthening high-value wage employment at the head office, such developments have policy implications and require consideration.

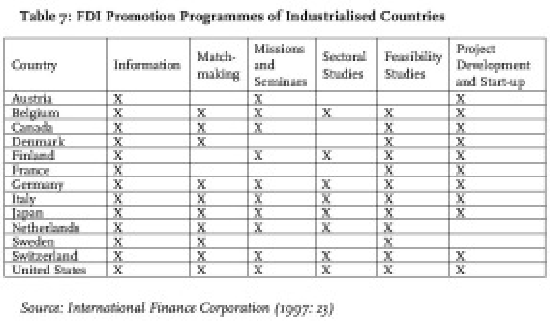


Table 7: FDI Promotion Programmes of Industrialised Countries

| Country | Information | Match-making | Missions and Seminars | Sectoral Studies | Feasibility Studies | Project Development and Start-up |
|---|---|---|---|---|---|---|
| Austria | X | | X | | | X |
| Belgium | X | X | X | X | X | X |
| Canada | X | X | X | | X | X |
| Denmark | X | X | | | X | X |
| Finland | X | | X | X | X | X |
| France | X | | | | X | X |
| Germany | X | X | X | X | X | X |
| Italy | X | X | X | X | X | X |
| Japan | X | X | X | X | X | X |
| Netherlands | X | X | X | X | X | |
| Sweden | X | X | | | X | |
| Switzerland | X | X | X | X | X | X |
| United States | X | X | X | X | X | X |

*Source: International Finance Corporation (1997: 23)*

Table 7: FDI Promotion Programmes
of Industrialised Countries

Source: International Finance Corporation (1997: 23)

Indeed, governments in a number of other developed economies accept that market imperfections exist in the case of outward FDI, and operate investment promotion programmes to help national firms that wish to invest abroad. These programmes are generally focused on the provision of information on the target country, sponsoring missions of potential investors, matching potential investors to projects, and giving financial support for feasibility studies. Small- and medium-sized enterprises are normally targeted on the assumption that they lack the resources to seek out investment opportunities. The International Finance Corporation (1997: 23) argues that 'the use of public funds is justified by a market imperfection, in this case the cost and difficulty of securing information about investments in developing countries'. *Table 7* sets out the range of services available to potential outward investors in 13 developed economies.

In an interview with a senior executive of Enterprise Ireland it was confirmed that assistance may be provided to outward investors if it could be shown that outward FDI would not adversely affect employment in the Irish firm's operation and would add value to the Irish firm. Assistance in gathering information would be offered on this basis. Also, it would be possible to include such companies in trade missions, but not to provide a specific investment focus. Perhaps consideration could be given to formalising such arrangements. Understandably, government agencies must operate within very careful parameters and not be seen to assist any company relocating and shedding jobs in the home economy, but they do work with companies who need to outsource certain activities which will make the company's overall position more secure and help make it more competitive at home.

Currently no individual state agency has responsibility for outward FDI in the manner in which Enterprise Ireland is charged with promoting Irish trade and the Industrial Development Agency is responsible for attracting inward FDI in Ireland. Understandably, facilitating Irish outward FDI is a sensitive issue but, as argued above, such FDI should be developed if Ireland is to further develop its economy.
This research identified market imperfections in the Chinese economy, which investors must deal with. Economic theory makes provision for state intervention

when market imperfections exist. (Mulreany, 1999) Drawing on the findings of this research, potential areas of state support could be explored with a view to ameliorating the impact of China's market imperfections. Barry et al (2003) suggest that Irish MNEs do not exhibit the normal proprietary assets associated with the horizontal multinationalisation of the firms. They point to the difficulties facing firms in late-developing regions in surmounting FDI entry barriers. This strengthens the case for government intervention in facilitating investors and seeking to reduce the impact of imperfect market conditions.

Perhaps the first objective of any government intervention must be based on an informed and constructive debate on the impact of outward FDI on the Irish economy. As argued above, this is an important dimension of economic governance, given Ireland's status as a net outward investor of FDI. Responding to concerns that outward FDI is the relocation of Irish jobs to a third country, arguments proposed by commentators such as Navaretti and Venables (2004) to the effect that outward FDI actually strengthens economic activity in the home economy could be drawn on. The case of the US could be cited. It is the source of most outward FDI, yet it is the largest global economy. Arguments could be advanced that the goal of assisting Irish firms to invest overseas would be to protect the higher value, more skilled employment, with a focus on maintaining head office, R&D and core functions in Ireland.

Consideration might also be given to the expansion of the Government's Asia Strategy to incorporate the facilitation of outward FDI. IBEC (2006: 63) argues that 'Asia clearly shows potential for increasing outward foreign direct investment by a number of Irish companies'. The focus of an expanded Asia Strategy could be on providing information and assistance to medium-sized firms that wish to invest overseas, sponsoring missions of potential investors, matching potential investors to projects, and giving financial support for feasibility studies All forms of international activity are management intensive, foreign investment particularly so. Information gathering, a crucial part of the feedback process, is particularly time intensive. IBEC (2006) found that China scored the highest of the twelve Asian countries included in its research on a lack of market intelligence. The comment by one executive of a firm which has invested in Eastern Europe but not in China, that the management team did not feel competent to deal with the challenges associated with investing in China, points to the desirability of some form of government assistance. In addition, 'small firms face a high degree of risk in going international, it is likely that the proportion of resources committed to a single foreign direct investment will be greater in a small firm than a large one'. (Buckley, 1997: 35) Consideration could be given to putting in place a range of services for investors, similar to those identified in table 8 above, with a view to providing market intelligence and support for those Irish firms which wish to invest in China.

All Irish and non-Irish participants bar one saw no role for the home country government in providing financial support to investing MNEs. They were of the clear view that it was inappropriate for home governments to subside investment overseas and that investment should be undertaken based on clear economic rationale. However, all executives envisaged a role for home government 'soft' supports to varying degrees.

Utilising the analytical framework of state supports employed by the IFC, as set out in table 8 above, the executives of Irish MNEs interviewed within the framework of this research identified the need for a greater provision of information by state agencies. In addition, the lack of assigned responsibility to any state body for the provision of assistance for outward investors was identified. The lack of a specific focus on outward investment in 'trade missions' was raised, as were the lack of potential 'match-making' and funding for feasibility studies. With a very slight re-focussing, the introduction of these services would assist Irish MNEs in their endeavours to invest abroad.

Specific issues of note were also identified by this research. The most significant locational challenge identified by executives is the potential threat to intellectual property, which investing in China poses. Government has a role to play in lobbying for greater protection for this ownership advantage. It is probably fair to say that most lobbying on this issue is undertaken by the European Commission on behalf of EU member states, and by the European Chamber of Commerce. Perhaps a role exists for concerted lobbying by individual EU governments in addition to the role played by the European Commission. There is a temptation to leave issues such as this to the European Commission, as trade is a competence of the European Commission. However, concerted action is likely to lead to stronger results. Lobbying at governmental level is also required when national treatment is denied to foreign investors.

Managing government relations is an important dimension of investing in China which Irish investors would be unfamiliar with. While China is a transition economy, it maintains many of the hallmarks of a centrally-planned economy. Government tends to intervene in the economy to a greater degree than in western economies. (Robins, 1996) Osland (1994) argues that, when operating in an economy with an element of arbitrariness in decision-making, maintaining good relationships with officials is critical to long-term success. Robins (1996) points to the close involvement which the Chinese authorities maintain in the economy and their willingness to intervene and manage markets.

All executives acknowledged and were deeply appreciative of the role played by diplomatic missions and state agencies in assisting entry into the Chinese market and in facilitating contact with relevant Chinese officials. The location of diplomatic missions should be reviewed periodically to assess if additional locations are required to reflect emerging Irish investment location patterns in China. The findings of this research are supported by IBEC (2006: 63), which found that 'over half of the companies surveyed found the support offered by Diplomatic and State Agency offices important or critical'. It was also found that these supports were perceived as relatively more important to companies doing business in Asia than elsewhere.

The policy of providing limited venture capital merits further consideration. An Irish MNE specialised textile manufacturer found it difficult to raise capital. It was only after the state agency responsible for the promotion of trade decided to invest that it proved possible to raise the required capital. The State may be required to take on such a role on a case-by-case basis. Enterprise Ireland commonly takes a shareholding in start-up companies in Ireland. There may be a need to extend this practice and actively take a shareholding in firms which wish to invest abroad, but only in cases where this would result in the maintenance and strengthening of the Irish base of operation. Such an investment should be undertaken only in firms which can exhibit that they possess ownership and internalisation advantages.

Governments also have a role to play in providing the legal infrastructure to facilitate FDI. At the end of 2006 there were 2,944 double taxation treaties globally (International Bureau of Fiscal Documentation), pointing to the importance which governments attach to this issue. Jun (1989) identifies three channels through which tax policies affect the decisions taken by MNEs. First, the tax treatment of income generated abroad has a direct effect on the net return on FDI. Second, the tax treatment of domestic income affects the profitability of domestic investment. Finally, tax policies affect the relative cost of capital employed in FDI. By using an inter-temporal optimisation model, Jun shows that an increase in the domestic corporate rate of tax leads to an increase in the outflow of FDI.

What is important is the existence of a double taxation treaty with the country in which they are investing. Ireland has 41 double taxation treaties, including one signed with China on 19 April 2000. (Department of Finance, 2006)
However, Ireland does not have a Bilateral Investment Treaty (BIT) with China. In fact, Ireland has only one BIT, which was concluded with the Czech Republic in 1996. In comparison, 19 of the EU's 25 member states have BITs with China. In fact, of the EU15 (member states prior to the May 2004 enlargement), all of the other 14 have BITs with China. (UNCTAD, 2007) Ireland's policy relating to Bilateral Investment Treaties was discussed with a senior official in the Department of Enterprise, Trade and Employment. He set out the Government's general policy that multilateralism is the preferred framework for issues of this nature, given our membership of the EU. He stated that there are many EU trade and competition regulations which impinge on investment treaties and which have to be taken into account. When third countries suggest a bilateral investment treaty (BIT), the Department declares its preference that the country should negotiate a comprehensive agreement with the EU, which will have legal effect in Ireland.
The Chinese authorities attach considerable significance to the signing of international agreements as a visible expression of friendship between two nations. The author has witnessed this penchant for signing Memoranda of Understanding during trade missions. While there are very valid reasons why Ireland does not negotiate BITs, perhaps consideration could be given to evaluating the potential merits of such a treaty with China, given its status as the prime location for inward FDI.
The challenge facing the Irish Government is to manage the impact of the increasing levels of outward FDI in order to ensure that core technology remains in Ireland and that higher value employment is created, while at the same time strengthening Irish companies to enable them to compete in the global economy. The Government can assist by providing information and expertise to companies which wish to invest in China's challenging market. This should not be seen as advocating the movement of large tranches of the Irish industrial base to China. Rather it is a recognition of the market opportunities which China offers to Irish

indigenous companies which possess the required ownership and internalisation advantages, as a means of further strengthening the Irish industrial base.

*Conclusion*

As indicated above, Irish FDI in China does not conform to Barry et al's (2003) model that Irish outward FDI is disproportionately horizontal and largely in the non-traded sector. Irish FDI in China is predominately in the traded sector and marginally horizontal. While it is difficult to precisely identify trends, it is clear that there has been no significant change in this pattern since 2007 and there is unlikely to be a shift in the near future. In the medium term there is the possibility that the nature of Irish FDI will alter as the service sector develops in China. The extent to which Irish MNEs can exploit this development depends on the level of ownership and the internalisation advantages which firms in these sectors possess.

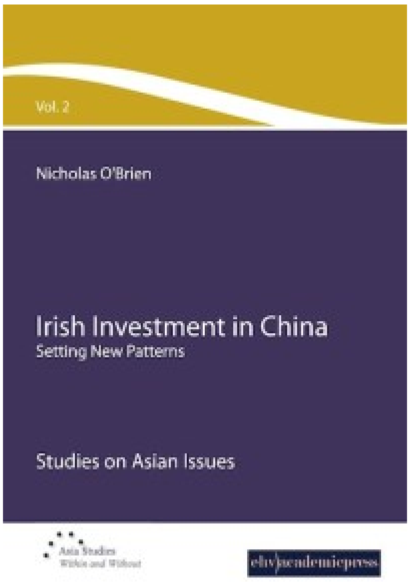
Based on the locational disadvantages which China poses, the market imperfections which exist, and the potential to expose the ownership advantages of Irish MNEs to risk, a role exists for state intervention. There is merit in the government's engaging in a policy debate on the nature and impact of Irish outward FDI, particularly in view of Ireland's recently-acquired status as a net exporter of FDI. Given China's pre-eminent ranking as the largest recipient of inward FDI, the effect of outward Irish FDI to China, as well as FDI to traditional FDI destinations, merits further consideration.

NOTES>

**[i]** An example of this is the relocation from Europe and the US of moulds for the production of obsolete car models for sale in the Chinese market. Given the substantial cost involved in producing moulds, this represents a saving to car manufacturers.

**[ii]** This is measured by an average of four shares: FDI inflows as a percentage of gross fixed capital formation for the past three years; FDI inward stocks as a percentage of GDP in 2003; value added by foreign affiliates as a percentage of GDP in 2003; and employment of foreign affiliates as a percentage of total employment in 2003. (UNCTAD, 2006: 11)

# Chapter 6: Conclusions & Bibliography ~ Irish Investment In China. Setting New Patterns




*Introduction*
Based on research undertaken on Irish outward FDI into the US and UK, both of which are developed economies, Barry et al conclude that Irish FDI is disproportionately horizontal and oriented towards non-internationally traded sectors. As China is now the largest global recipient of inward FDI, and is a developing economy, research was undertaken among all Irish MNEs which have invested in China to ascertain if current Irish FDI into China conforms to the model identified in the case of Irish FDI into the US and UK.  Accepting that the level of Irish FDI in China is at a relatively low level, the value in considering this hypothesis is that Irish FDI in China will presumably increase, given China's pre-eminent role in inward FDI.
While there are several investment theories, Dunning's eclectic paradigm was chosen as the optimal framework within which to conduct this research, as it facilitates simultaneous analysis of the advantages enjoyed by both the MNE and the host economy.
Desk-based research and semi-structured interviews were conducted to explore the nature of Irish FDI in China. The decision to use semi-structured interviews to obtain data on the perceptions of executives can be considered appropriate, as the executives provided rich data on the rationale underlying the investment decision and the locational advantages and disadvantages which China poses.
Executives of non-Irish MNEs which have invested in China were interviewed in addition. The inclusion of non-Irish MNEs provided an opportunity to corroborate the views of executives of Irish MNEs and provided a broader pool of expertise from which to gather perceptions on the locational advantages and disadvantages which China poses for investors. Executives from Irish MNEs which have invested in Eastern Europe were interviewed separately to gain an understanding of why

the level of Irish FDI into China is relatively low.

*Main Findings*

Barry et al (2003) analysed the nature of Irish outward FDI and observed an increasing level of Irish outward FDI. The main destination for this FDI is developed economies, particularly the US and the UK. It is suggested that Barry et al made a significant contribution to the research into Irish outward FDI by their identification of Irish outward FDI as being disproportionately horizontal and oriented towards non-internationally traded sectors. This research builds on their model and extends the knowledge of Irish outward FDI by examining the nature and scope of Irish FDI into China, a developing economy. The value in studying FDI in China lies primarily in its status as the principal recipient of inward FDI globally. Since the introduction of the 'opening-up' policy in 1979, economic reforms in China have created an increasingly favourable climate for inward FDI. However, considerable challenges still remain with inadequate legal protection and challenges to intellectual property rights.

*But Beijing's desire to expand the service and private sectors, combined with its willingness to allow foreign firms to compete nearly across the board, means that the China market is now becoming a real opportunity just as the purchasing power of Chinese consumers is beginning to increase. And China is likely to remain the world's fastest growing major economy for the coming decade and beyond …Understanding how to do well in China and with Chinese resources will become a critical component in a global competitive strategy. (Lieberthal and Lieberthal, 2004: 11)*

In order to deepen our understanding of the nature of Irish FDI and specifically the nature of Irish FDI in the largest global recipient of inward FDI, this research has examined the hypothesis that the nature of Irish outward FDI, as identified by Barry et al, varies in the case of China. This research has contributed to our understanding of Ireland's investment development path by introducing a study of Irish outward FDI in a developing economy for the first time.

The research was undertaken among all Irish MNEs that have invested in China. The aim was to identify initial trends and patterns, while relating this to the existing, albeit scant, literature on Irish outward FDI. While accepting that this is a small sample size, the results of this research indicate that Irish FDI in China is predominately in the traded sector (82%) and is marginally horizontal (55%) as opposed to vertical (45%) in nature. This represents a deviation from Barry et al's earlier findings in the case of Irish FDI in developed economies, namely the US and UK. It can be said, therefore, that current Irish FDI into China is chiefly in the traded sector and marginally horizontal, and that Barry et al's model does not apply to the current wave of Irish FDI in China. In addition, the sectoral composition of FDI in China varies from that in the US, as identified by Barry et al. IT, electronics and telecoms have a higher proportion of investment in China than in the US. However, FDI in financial services and construction is at a lower level in China.

The question has to be asked why Irish FDI in China deviates from that in the traditional destinations for Irish FDI. This research found that perhaps the most significant locational disadvantage which China poses is the challenge to the preservation of intellectual property rights. Barry et al point to the strong growth in outward FDI in Irish IT and pharmaceutical industries. However, the potential risk of IPR violation may be restricting FDI in China in these sectors.

This view is supported by research undertaken among executives of Irish MNEs which have invested in Eastern Europe. Another possible explanation for the relatively low levels of Irish FDI in China is the relatively under-developed nature of the service sector in China, which is particularly strong in the Irish economy. Given the large manufacturing base of the Chinese economy, it is possible that investors in Irish manufacturing sectors are in the first wave of Irish FDI in China. They may be followed by MNEs from the service sector, as this sector gathers pace in China.

Structural changes are occurring in the Chinese economy, with a reduction in manufacturing and increases in construction, utilities and the service sector. The shift in the composition of industry should be of benefit to potential Irish investors, given the largely non-traded element of Irish outward FDI in developed economies. It can be speculated that as the importance of the nontraded sector increases in China, more Irish MNEs may invest. This could alter the composition of Irish FDI in China, increase the non-traded component, and move Irish FDI in China closer to Barry et al's model.

In order to deepen our knowledge of Irish investment into China, this research also examined a sub-hypothesis and, on this basis, advanced some prescriptions regarding the role of public policy. It is hypothesised that the business environment in China is different from that experienced by Irish investors in more traditional destinations for Irish outward FDI. On the basis of this, an additional argument was made that consideration should be given to ameliorating these market distortions through public policy.

Before summarising the findings of this research in relation to locational disadvantages, it is important to identify the locational advantages which China offers investors. The principal locational advantage identified by investors is market opportunity. There is recognition of the existence of a growing and affluent middle class, which will drive consumer spending. Of the Irish MNEs which have invested in China, over 80% described market opportunity as the rationale underlying their investment in China. The focus of Irish MNEs on market opportunity confirms that Ireland conforms to the categorisation of investors in China as proposed by Li and Li (1999), who found that MNEs from developed economies will focus on market opportunity in China, whereas MNEs from developing economies will be attracted by the low-wage environment. The investors also identified the importance of investing in China if an Irish firm is supplying another MNE which decides to invest in China, as a means of preserving existing supply contracts. Irish MNEs did not identify the incentives available from the Chinese authorities as particularly pertinent to their decision to invest. While the literature on incentives is inconclusive, the views of Irish MNEs support Devereux and Griffith (1998), who argue that incentives do not influence the decision to invest abroad, but once the decision has been taken, they play a role in the choice of location.

Research among the executives of MNEs which have invested in China identified locational disadvantages which China may pose. The principal locational challenges are in the areas of the protection of intellectual property rights (IPR) and the enforceability of contract law. The threat to IPR is significant for MNEs in the high-tech sector. One executive pointed out that IPR is the core asset of the MNE and, should this ownership advantage be compromised, a threat to the operation of the MNE would be posed. Regarding contract law, an apparent contradiction among executives was identified. While the executives pointed to the difficulty in legally enforcing contracts, they also spoke of negotiating detailed contracts which sought to cover all eventualities. This apparent contradiction results from the executives seeking to set out responsibilities in some detail so as to use this level of detail to negotiate solutions, should difficulties emerge. Lawyers were interviewed as part of this research to seek their views on this issue. They pointed to the historical context within which the Rule of Law issue must be seen. The focus of the Chinese Government since the reform process commenced in 1979 has clearly been on the creation of an environment conducive to economic growth and they have been spectacularly successful in this regard. Allied to this is the strong cultural heritage which China exhibits, particularly in the area of guanxi. One of the effects of the pervasiveness of Chinese culture is that the Rule of Relationships rather than the Rule of Law dominates. (Jones, 1994) Jones suggests that this occurrence supports the view that China is replicating what has happened in the other four Dragon Economies in Asia, where the Weberian concept of the Rule of Law has not developed.

While executives seek to negotiate detailed contracts, there is also the realisation that relationships and not legal documents are the fundamental basis upon which business in conducted. This finding supports Macauley's (1963) seminal work on the nature of contract law. Indeed, in this respect conducting business in China is not dissimilar to conducting business in any other country.

A common thread that emerges from the research is the strongly regional nature of China. Provincial and municipal governments have considerable powers and offer competing incentives to attract inward FDI. However, the principal regional variation is in purchasing power parities. The developed eastern seaboard has the highest levels of disposable income, making this the most attractive location for investors seeking to exploit market opportunity. The potential consumer market is not one in five of the world's population but approximately 350 million people located in the cities along China's eastern seaboard, who have been the main beneficiaries of the opening-up policy.

Lieberthal and Lieberthal (2004) identify management shortcomings as a constraint on the competitiveness of indigenous Chinese companies. They see the problem as embedded in the economic system because of the dominance of state-owned enterprises in the major manufacturing and service industries, which dominance has resulted in greater emphasis being placed on political skills than on modern management techniques. This presents an opportunity for Irish investors. Irish MNEs which have the ability to invest overseas will have developed ownership advantages within the context of Dunning's eclectic paradigm. These ownership advantages often involve management skills.

In addition, if economic growth in Ireland is to be sustained, one of the contributory factors will be proactive outward FDI focused on developing economies such as China. '[R]ises in future economic welfare will depend primarily on increases in productivity. FDI can enhance the productivity of the Irish economy, by allowing Irish firms to focus on areas where they have a comparative advantage, by creating new market opportunities for a firm's existing products and by promoting the creation on new dynamic firms'. (O'Toole, 2007: 397)

There is an understandable hesitancy to engage in a debate on outward FDI as it can be presented in an emotive manner as the relocation of Irish jobs to low-cost locations overseas. While the literature on the effects of outward FDI on employment is not conclusive, the evidence points towards vertical FDI's being complementary to employment in the home economy. There is an argument that society should engage in a broad discussion on Irish outward FDI. Given the increasing levels of outward FDI, with Ireland now a net exporter of FDI, this issue is likely to require attention in the coming years. In order to have an informed debate, there is a need for the creation of a broader statistical database on FDI.

Consideration might be given to an extension of the current high range of services provided to exporting MNEs to those Irish MNEs which wish to invest in third country markets. Consideration might also be given to the negotiation of a Bilateral Investment Agreement with China. It would also be necessary to continue to lobby the Chinese authorities in the areas of protection of IPR and national treatment.

The insights gained from this study are a contribution not only to the academic debate on Irish FDI in China but will hopefully stimulate the study of Irish FDI in the other important developing economy, namely India. This would allow a comparative dimension to be explored and facilitate the development of a model for Irish FDI in developing economies.

*Conclusion*

This research identified a divergence in Irish investment patterns in China from that in the traditional destinations for Irish outward FDI. The nature of FDI in China is different, with most of it being in the traded sector. Challenges associated with investing in China were also identified, with China's legal environment posing locational challenges. Failure to take due account of such challenges, through the appropriate exploitation of the MNE's internalisation advantage, could pose a threat to ownership advantages.

It is easy to set out here the challenges that investors face, as these have been highlighted during the performance of the research. However, what cannot be over-emphasised is the enormous potential which China offers. Those MNEs which moved into China early are now reaping the benefits. China is simply too large a market and too important a market for MNEs to ignore, if they wish to develop an international footprint. If Irish MNEs would engage in China more deeply and in a more sustained manner, their efforts would be sure to contribute to the strengthening of the Irish economy.

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# Worldbank ~ Violence In The City : Understanding And Supporting Community Responses To Urban Violence

This study aims to understand how urban residents cope with violence, or the threat of it, in their everyday lives, to inform the design of policies and programs for violence prevention. The study is the first global study on urban violence undertaken by the World Bank and covers three regions. It emerged from the growing demand within the Bank and client governments for a more comprehensive understanding of the social dimensions of urban violence. The study is not an exhaustive review of the topic, but rather is an exploration of the social drivers of violence, and its impact on social relations. The report consists of six chapters. In chapter one, the topic of urban violence is introduced as a pressing development issue. Chapter two discusses the complex relationship between cities and violence. In chapter three, the report reviews the literature to develop an analytical framework for understanding community capacities for violence prevention. Chapter four reviews interventions to prevent violence in terms of their impact on these key community capacities. The empirical findings from the five case studies are presented in chapter five, followed by strategic policy orientations in chapter six.

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