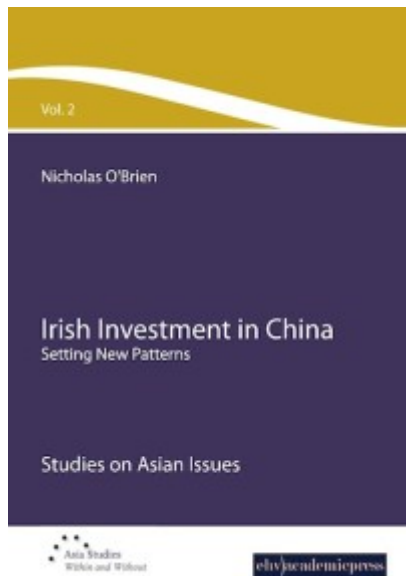


# Chapter 6: Conclusions & Bibliography ~ Irish Investment In China. Setting New Patterns



## *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 is 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 of 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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