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Determinants and Impact of Outward Direct Investment from China: Evidence from a Firm-level Survey in Guangdong Province

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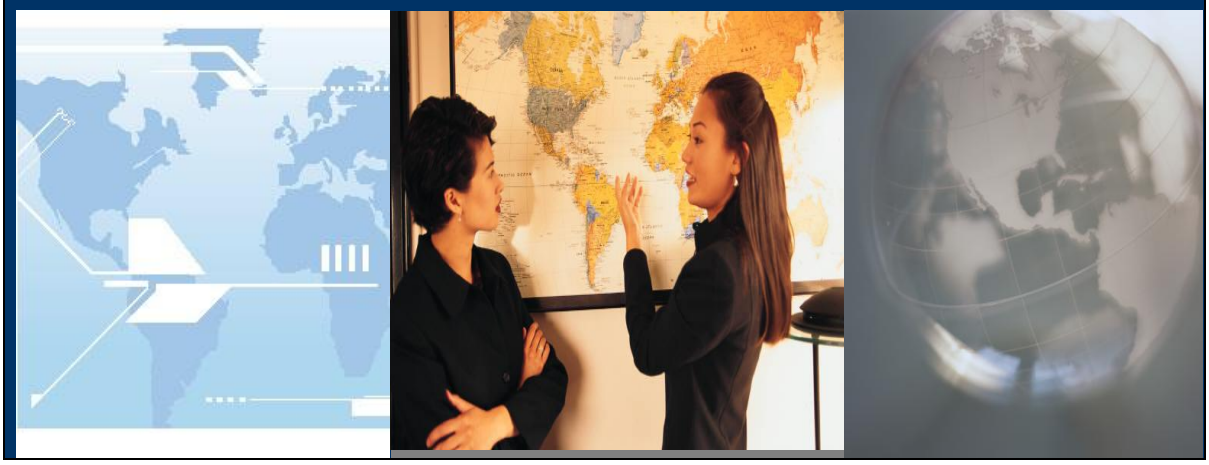

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Table of Contents

1 Introduction

After around 30 years of rapid economic growth, China has become the world's second largest economy, the world's largest exporter and a major driving force for global economic growth (World Bank, 2012). In parallel with its continuous expansion in economic growth, Chinese firms' overseas foreign direct investment (OFDI) has also increased rapidly, a fact which has attracted substantial attention from the academic community, policy makers and practitioners. According to the Investment Development Path theory[1], the growth of Chinese overseas investment is consistent with its economic development. Existing studies have examined the motivation for overseas investment as well as the choice of destinations and mode of entry of large Chinese enterprises when they invest directly in other countries. However, due to strict financial regulation in China and a tightly regulated capital account, some instances of overseas investment, especially overseas investment by non-state-owned enterprises, is not fully reflected in data released by the government. Therefore, macro data cannot fully reflect the current situation of Chinese enterprises with respect to overseas investment, especially in the non-state-owned sector.

This project aims to examine the overseas investment strategies of firms in Guangdong Province, China. We focus on the characteristics of firms which undertake OFDI, the incentives for and the main obstacles of overseas investment, the destination of OFDI from Guangdong, the strategies to conduct OFDI, and the impact of overseas investment on company performance and future development. The survey shows that the characteristics of firms significantly affect the firms' incentive to carry out OFDI and that some of the incentives and strategies to conduct OFDI demonstrated by Chinese firms are not consistent with what is often claimed by the media and existing studies. Evidence from the survey suggests that OFDI by Chinese MNEs is still in its infancy stage. At this stage, the functions of overseas subsidiaries mainly involve marketing and not production. An over-concentration on particular destinations, the lack of talented personnel with sufficient international management skills also overshadow the OFDI of Chinese firms. However, whilst the utilization of local financial and labour resources pool is still limited, Chinese MNEs have considerable engagement with local economies and communities via collaboration and public activities. The findings from this survey will provide important policy and practical implications to Chinese firms and the governments of both China and other countries.

This paper uses results from a firm-level survey conducted in 2010. The implementation of the survey benefited significantly from the assistance of the Guangdong Commission for Foreign Trade & Economic Cooperation as well as the Guangdong Research Institute for International Strategies. Questionnaires were posted to 2,000 firms in Guangdong Province which already had overseas direct investment or were regarded as having the potential to go global. 341 valid responses were received, implying a response rate of 17.1%. Each firm was asked to fill in a questionnaire which covers the nature of their business and asked questions with respect to characteristics such as ownership, management, industry, scale/size, exports, overseas investment experience and performance in the global market over the past three years (meaning here the

[1] See Dunning, J. (1981), "Explaining the international direct investment position of countries: towards a dynamic and development approach", *Weltwirtschaftliches Archiv*, 117, pp. 30-64.
Dunning, J. and Narula, R. (1996), "The investment development path revisited: some emerging issues", in J. Dunning and R. Narula, eds., *Foreign Direct Investment and Governments* (Routledge).

2007-2009 period). We also interviewed senior managers and business owners of 21 firms.

Among these 341 firms, 299 were private-owned and 26 were public-owned (we were unable to identify the ownership of the remaining 16 firms). 328 firms provided information on their registered industry/trade, including 267 manufacturing firms, 23 enterprises involved in wholesale and retail, 9 IT service companies and 29 firms in other industries. 80 of these 328 firms reported that they had had overseas investment experience, accounting for 23 percent of total firms in the sample.

As shown in the following map, Guangdong Province is located on China's South China Sea coast, adjacent to Hong Kong. It accounts for the largest proportion of China's gross economic output. The exports of Guangdong account for more than 25% of China's exports. In addition, the amount of overseas investment of Guangdong is the highest of all provinces in China (Guangdong overseas investment in 2010 accounted for 19.3% of the stock of foreign investment in addition to central government owned enterprises). Hence, it is instructive for the enterprises of other countries to understand the behaviour of overseas investment from Guangdong province.

The remaining sections of this paper will be arranged as follows. In the next section we will examine overseas investment by looking at the characteristics of firms, such as ownership and size. Following that, we will look at the relationship between firms' overseas investment and their business/trade. In Section 4 we will further investigate the incentives of making overseas investments as well as the concerns which restrict firms to invest in other countries. In Section 5 we will examine the destinations and strategies of Guangdong firms' overseas investment. Section 6 evaluates the performance and prospects of Guangdong firms' investments in other countries.

Section 7 concludes this project with a summary of findings and possible practical implications.

2 Guangdong firms' overseas investment: an overview

As Charts 2-1 and 2-2 show, 84% of firms who undertake overseas investment are not state-owned. Among firms not owned by the state, 21% have experience of OFDI. If we divide firms with overseas investment experience according to their specific ownership, as shown in Chart 2-3 and Chart 2-4, we find that non-state controlled limited companies account for the largest proportion of firms with overseas investment experience (around 1/3). This is perhaps due to the fact that we mainly provided the questionnaires to larger enterprises with foreign investment and foreign exports while fewer questionnaires were delivered to SMEs. In fact, according to existing theories, when GDP per capita reaches USD 10,000, the ratio of foreign investment attraction and foreign investment ratio should be 1:1. The per capita GDP of the core economic area of Guangdong - the Pearl River Delta - was almost USD 10,000 in 2009 but the ratio only reached 1:0.05. In the same period, the ratios in South Korea and Taiwan were 1:1.8 and 1:2.09 respectively. It is thus clear that overseas investment from Guangdong is still in its initial state. This phenomenon is often overshadowed by the large number of centrally controlled enterprises involved in overseas investment.

Chart 2-1 Enterprises with overseas investment (by ownership)

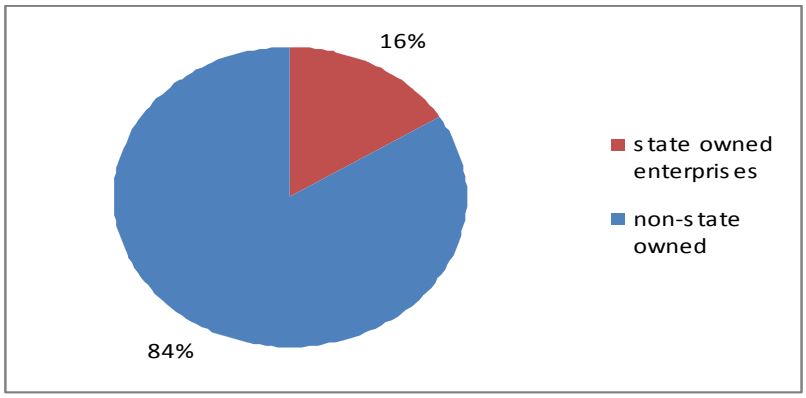


Chart 2-2 Enterprises' overseas investment (within each sector)

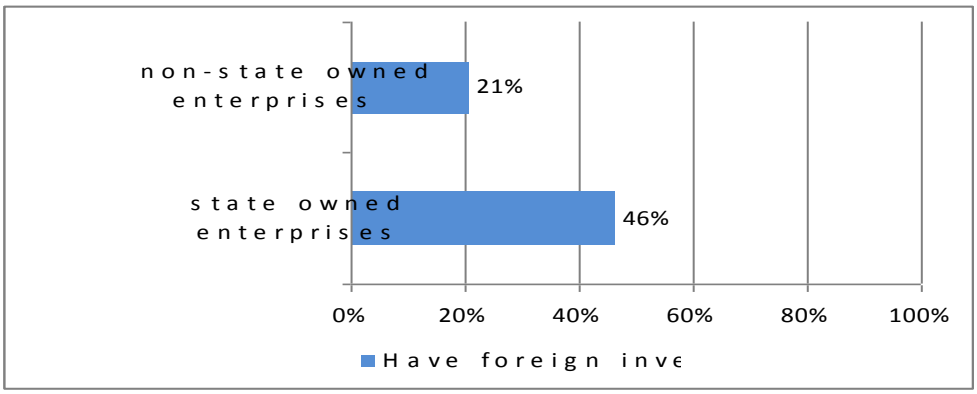


Chart 2-3 Firms with overseas investment (by types)

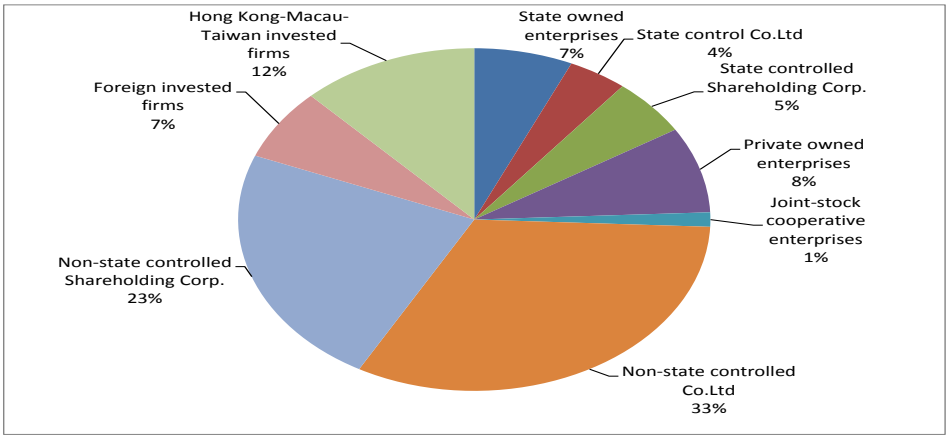
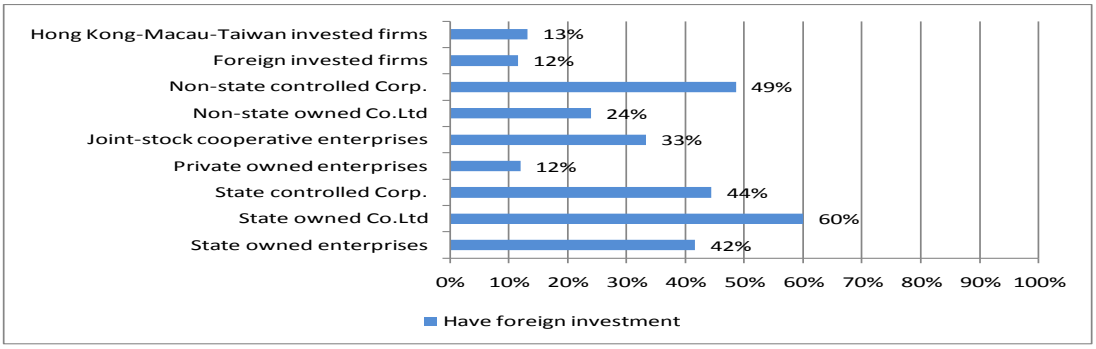


Chart 2-4 Firms with overseas investment (within each type)



Turning to the firms' registered trade/industry, we can see that around three quarters of firms with overseas investment experience are in the manufacturing industry (Chart 2-5). Among these manufacturing firms, firms producing medical products and automobile producers cover the largest proportion (each accounts for around 13%), while producers of textile, clothes and shoes follow in the third place with a proportion of over 11% (Chart 2-6).

Chart 2-5 Firms with overseas investment (by industry)

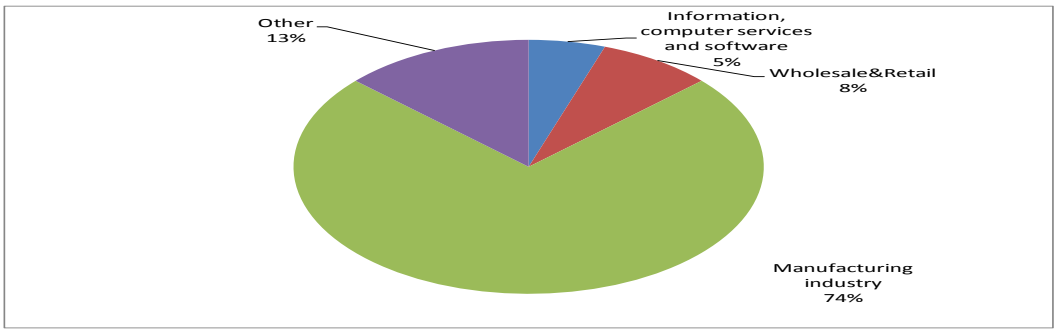
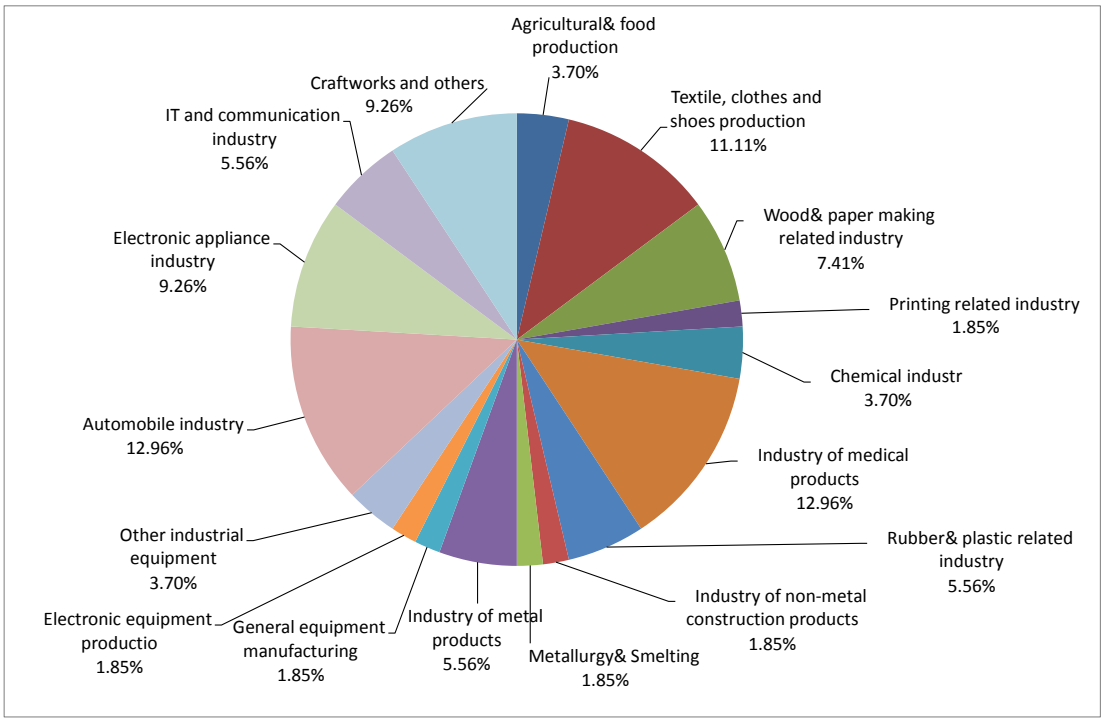


Chart 2-6 Manufacturing firms with overseas investment (further division by NO. of firms)



From Chart 2-7 and Chart 2-8, it can be seen that the scale of a firm is positively linked to its overseas investment decisions: as 63% of extra large firms have foreign investment experience and 44% of large enterprises have invested in other countries but these figures drop to 19% for either medium-sized firms or small-sized firms respectively. Among all firms with overseas investment, 39% of them are medium-sized and 23% of them are large firms.

Chart 2-7 Firms with overseas investment (by firm size)

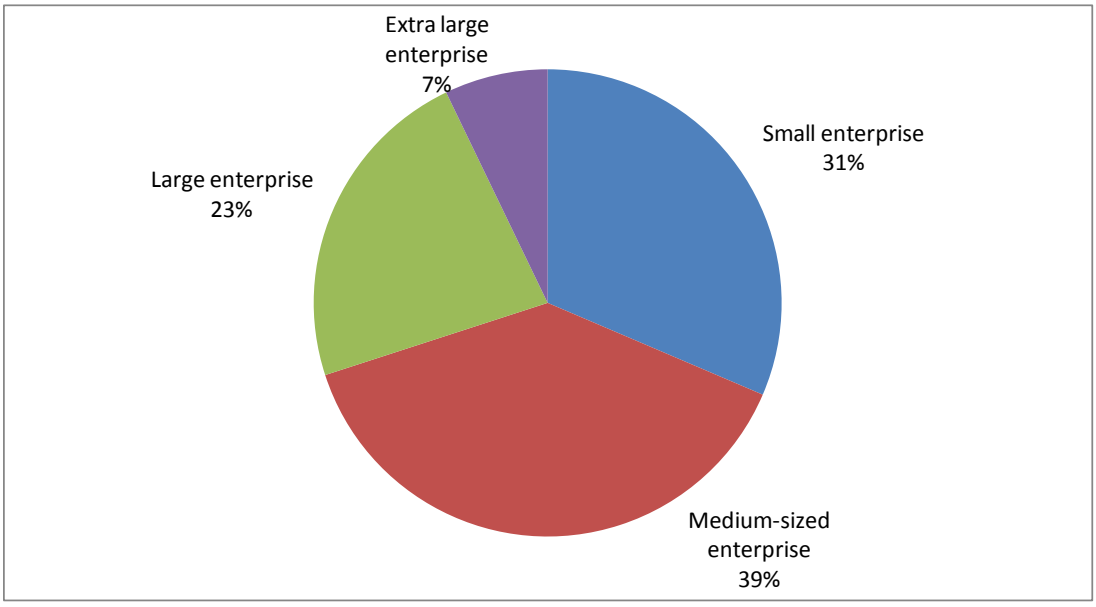
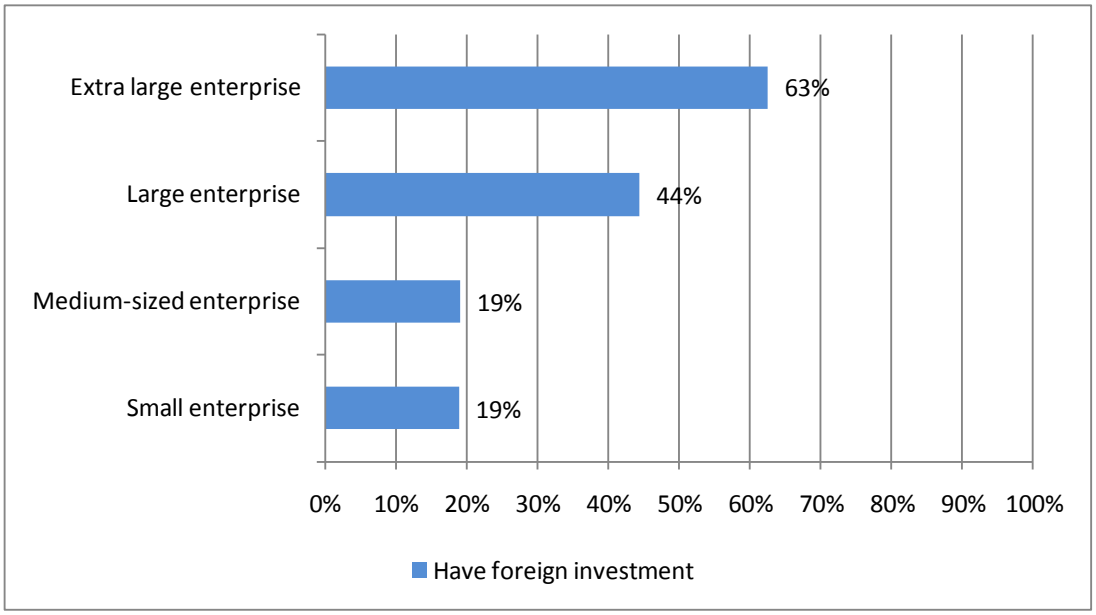


Chart 2-8 Firms with overseas investment (within each scale)



Turning to Chart 2-9 and 2-10, we find firms hiring more than 1,000 employees account for the largest proportion of firms with overseas investment experience (37%). Around half (47%) of firms with more than 1,000 employees have overseas investment experience.

Note: 'extra large enterprise' refers to annual production value of over CNY 5 billion, 'large enterprises' means annual production value is between CNY 500 million and CNY 5 billion, small enterprises are those with annual production value below CNY 50 million, and a medium-sized enterprise has annual production value between CNY 50 million and CNY 500 million.

Chart 2-9 Firms with overseas investment (by size of employment)

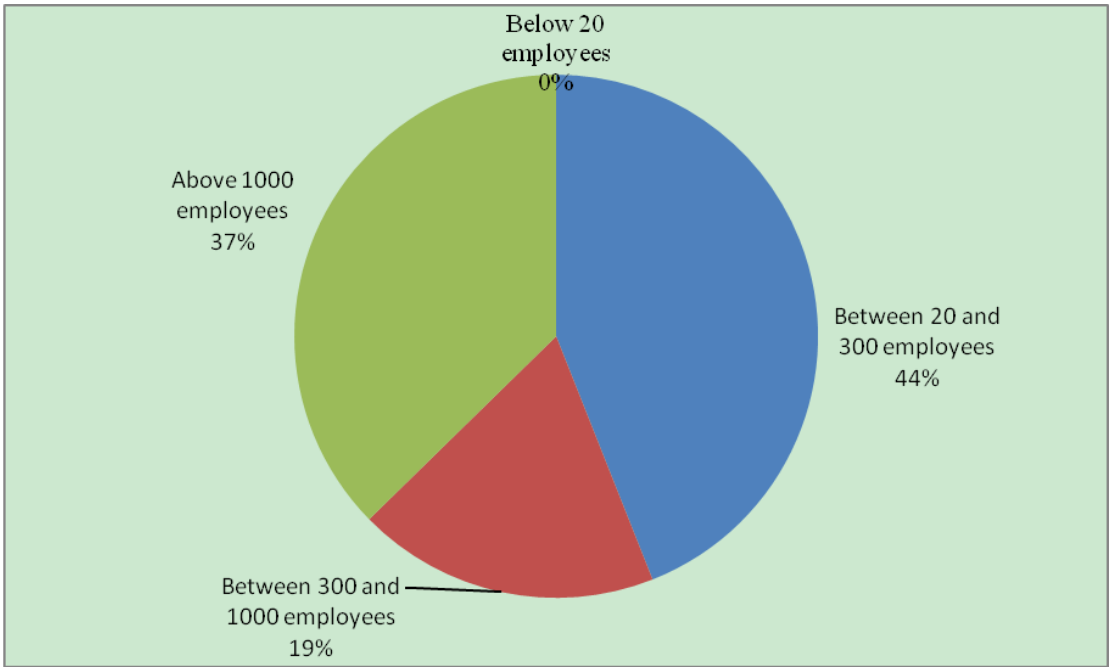
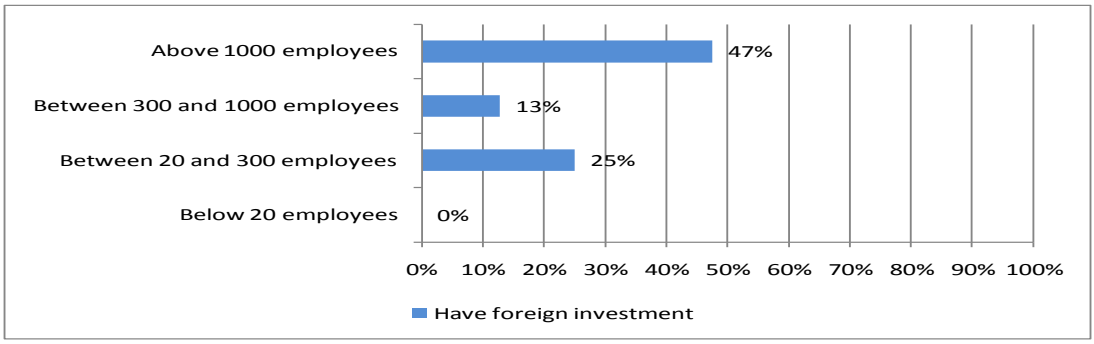


Chart 2-10 Firms with overseas investment (within each size of employment)



Note: The classification of employment size is consistent with the official classification

Besides the size of workforce, we find that the educational and professional level of employees also have impacts on firms' overseas investment. For example, Chart 2-11 reveals that among manufacturing firms which have foreign investment experience, 54% of their managers have benefited from at least one overseas learning or working experience. As another example, as shown by Chart 2-12, among firms with overseas investment, 38% have workforces made up of 10%-30% of employees with college degrees or above. Similarly, as demonstrated in Chart 2-13, over 40% firms with overseas investment have a research team which involves 10%-30% of their employees.

Chart 2-11 Firms with overseas investment (by the overseas experience of managers)

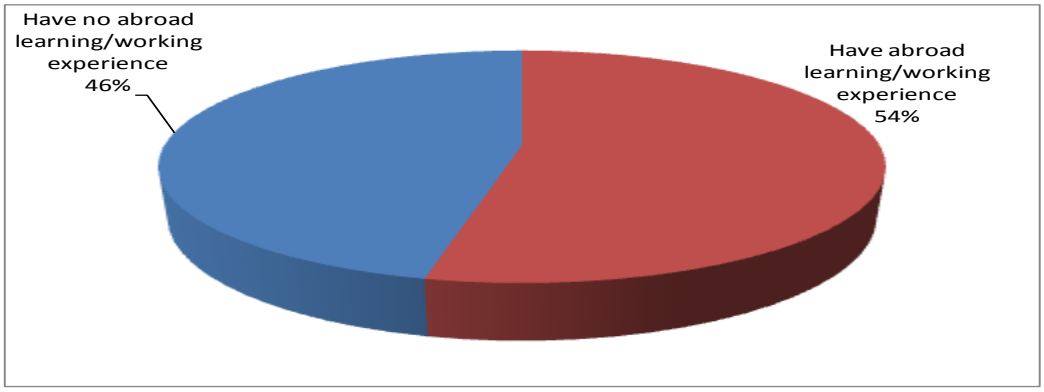


Chart 2-12 Firms with overseas investment (by percentage of college or above degree holders)

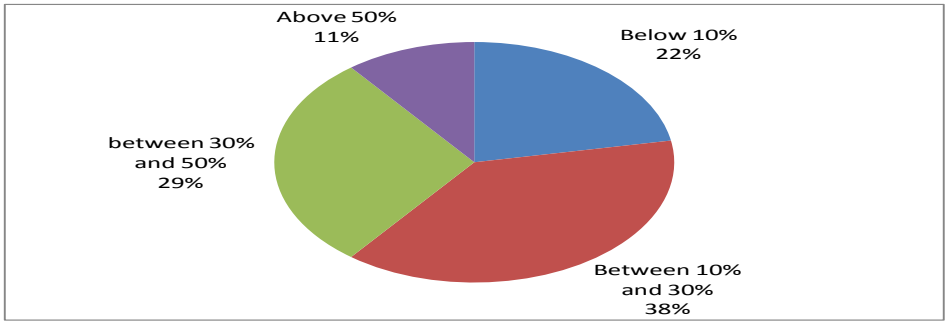
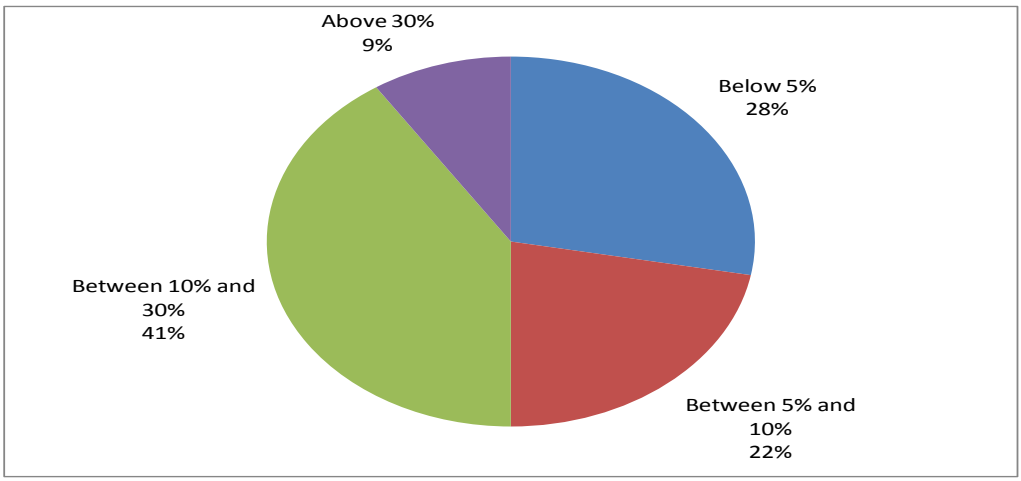


Chart 2-13 Firms with overseas investment (by proportion of research staff)



3 Guangdong firms' overseas investment: an overview of the relationship with the business of firms

It is commonly believed that making new products or adapting technologies is connected in some way with firms' investment strategy. Theoretically, the reason why firms adapt new technologies and produce new products is also the reason to engage in foreign investment or, alternatively, the result of foreign investment. This is also supported by Chart 3-1 and Chart 3-2, which illustrate that the proportion of income from new products/technologies is positively related to the percentage of firms with overseas investment. We find that 64% of firms with overseas investment are firms in which new products/technologies contribute over half of their income. Also we can see that for firms which have over 50% of their revenues generated from new products/technologies, 55% have overseas investments. This figure drops to less than 30% among firms in which new products/technologies contribute less than 10% of their revenues.

Chart 3-1 Firms with overseas investment (by contribution of new products/technologies)

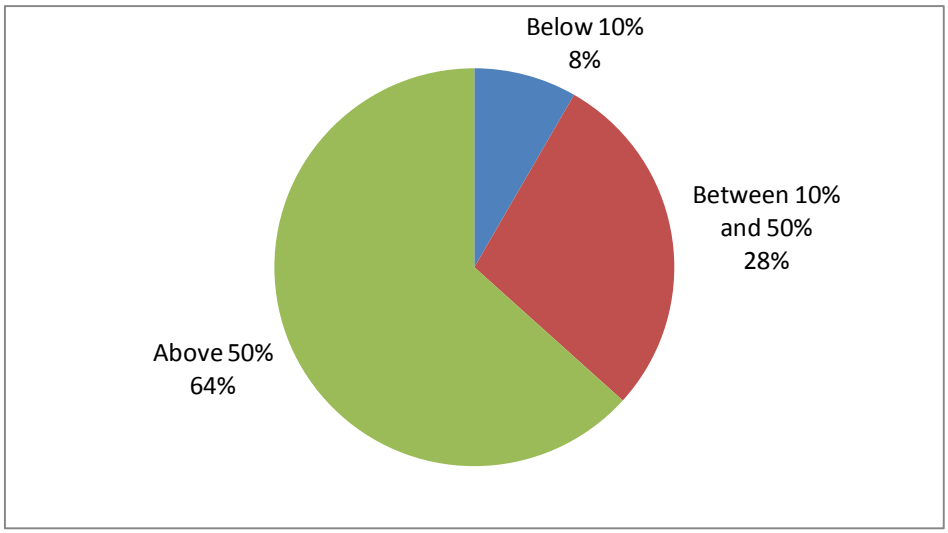
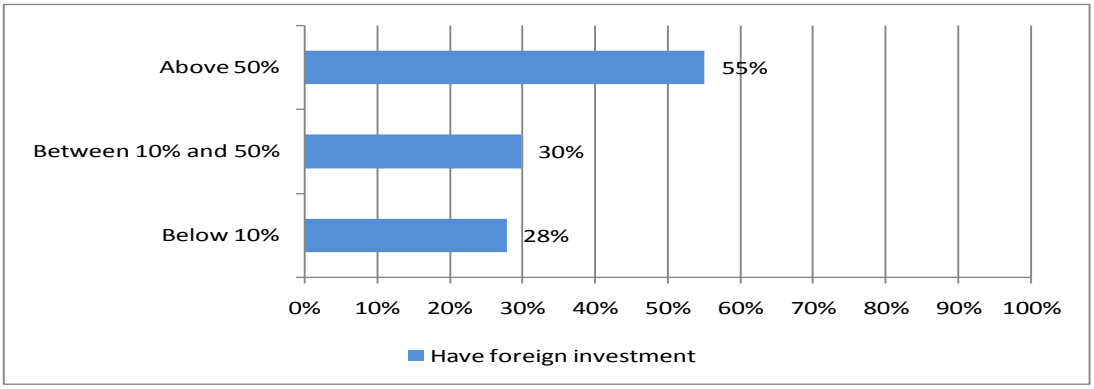


Chart 3-2 Firms with overseas investment (within each level of contribution from new products/technologies)



As shown in Chart 3-3 and Chart 3-4, most firms which have overseas investments generally work in trades other than production of general parts, key intermediate input goods and assembling of finished products. Firms producing key intermediate input goods are more likely to have overseas investments than firms producing general parts (4 percentage points lower) or assembling finished products (11 percentage points lower).

Chart 3-3 Firms with overseas investment (by production tasks)

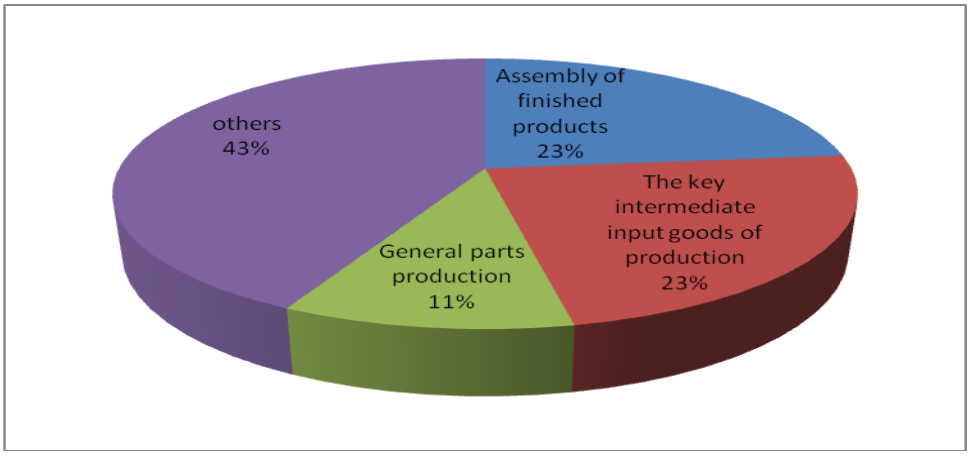
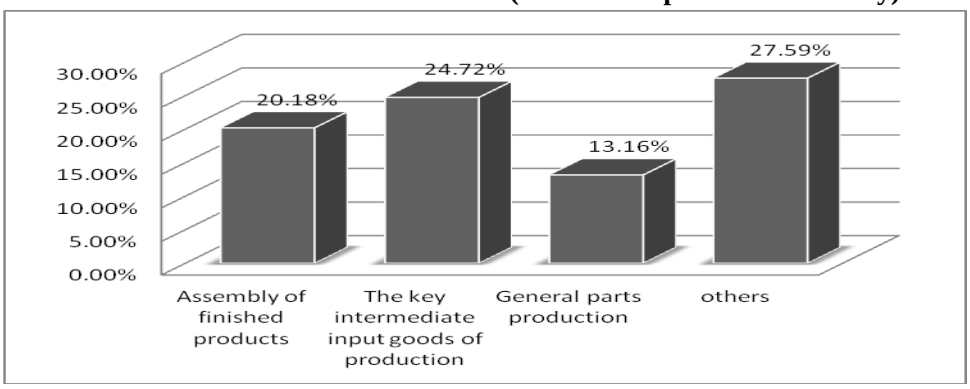


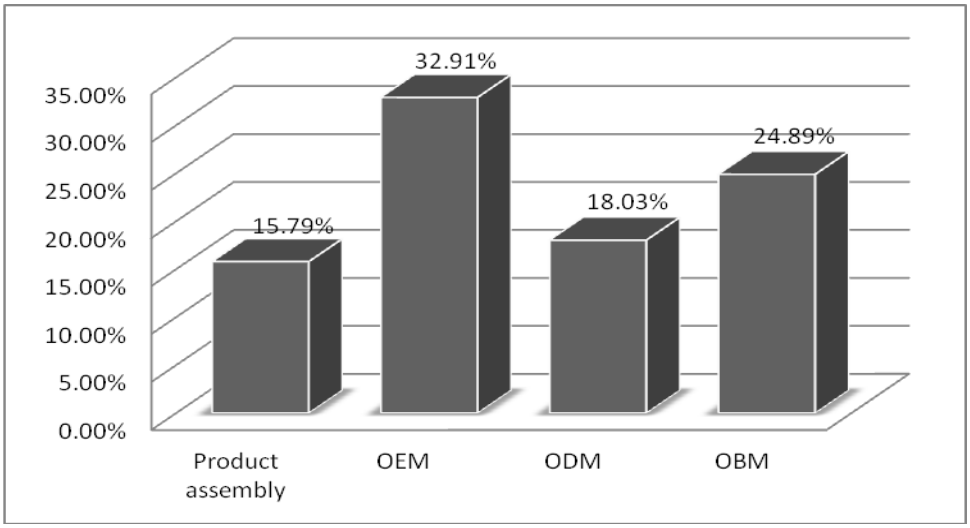
Chart 3-4 Firms with overseas investment (within each production activity)



As illustrated by Chart 3-5, firms working on an original equipment manufacturing (OEM) basis

are much more likely to invest in other countries than firms working on an original design manufacturing (ODM) or original brand manufacturing (OBM) basis or in assembling products. For example, nearly one third of firms working on an OEM basis have overseas investment experience, while only slightly over 18% of firms working on an ODM basis have invested in other countries. OEM is the primary method for firms in Guangdong to integrate into global value chains. This is an interesting phenomenon which needs further research. According to the general theory of internationalisation, firms' foreign investment is a continuous learning process. OEM firms are specialised in processing and production, but they normally do not have strong technological and design capabilities. In contrast, ODM and OBM firms are often believed to have stronger technological capabilities. Therefore, ODM and OBM firms should have a stronger capacity to 'go global' than OEM firms. However, evidence from the survey suggests a different picture. In-depth studies are required to understand this phenomenon.

Chart 3-5 Overseas investment and production modes



4 Investing in Foreign Countries: Incentives and Concerns

In the survey, firms in Guangdong Province provided several reasons for investing in other countries. Firms without overseas investment experience also express the concerns which prevent them from investing in foreign countries. Chart 4-1 and Chart 4-2 demonstrate some key incentives for firms investing in developed and developing countries, respectively. The highest agreement level (76.7%) related to the belief that 'to exploit international market' is an important incentive for investing in developed countries. This figure is followed by 75.6% of firms who believed that 'to acquire advanced technology and management experience' is an important incentive for investing in developed countries. However, firms have different reasons to invest in developing countries. For example, only 43.3% of firms believe that 'to acquire advance technology and management experience' is an important incentive for investing in developing societies. The highest agreement level (72%) related to the view that an important reason to invest in developing countries is to seize the local market while this figure for investing in developed countries is only 61%.

Chart 4-1 Main incentives for investing in developed countries

Chart 4-2 Main incentives of investing in developing countries

It seems that state-owned and non-state owned firms also have different reasons for investing in other countries. For example, as shown in Chart 4-3 and Chart 4-4, no state-owned firms believe that reducing the labour cost is an important factor for investing in developed countries whilst nearly one third of non-state owned firms believe that reducing labour cost is an important reason to invest in developed countries. Similarly, comparing with state-owned firms, a larger proportion of non-state owned firms consider the exploitation of a locally convenient financial system and international payments and the existence of preferential policy towards local production are important factors when deciding to invest in developed countries.

Chart 4-3 Incentives for state owned firms to invest in developed countries

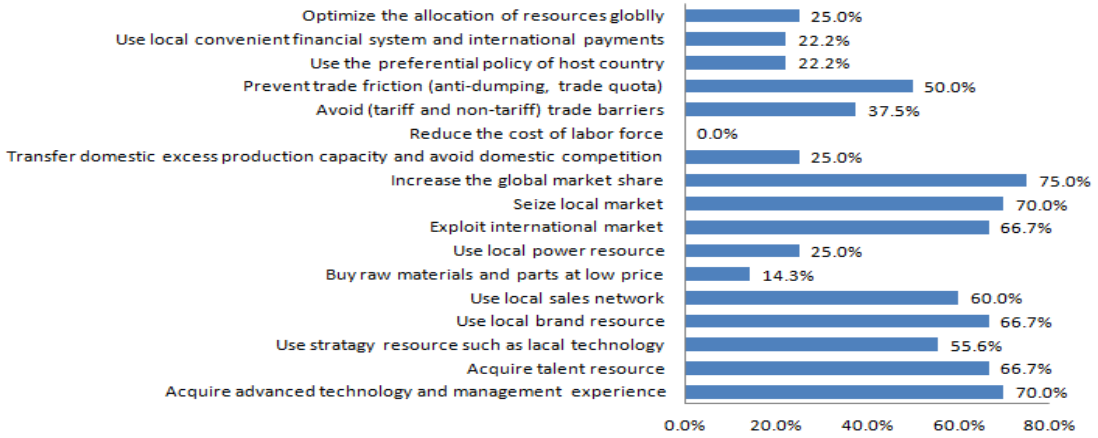
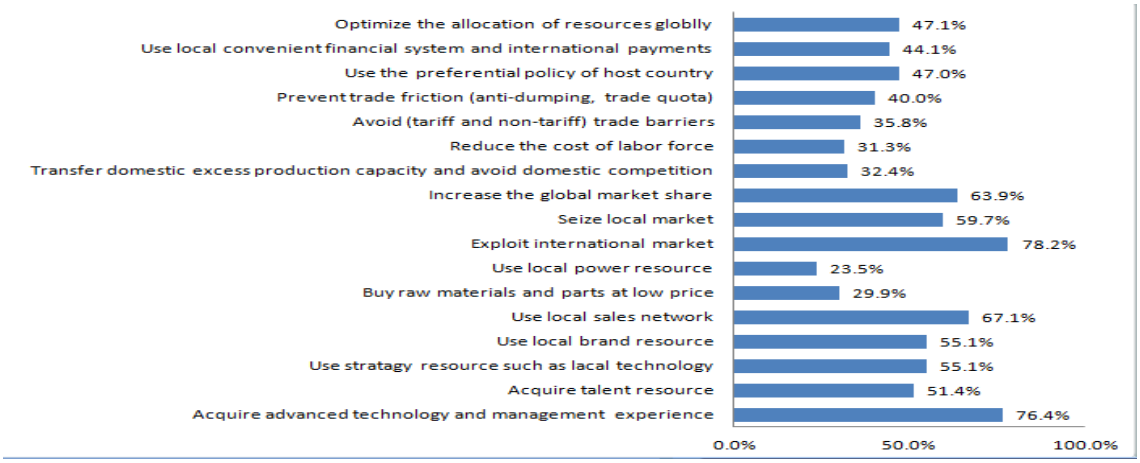


Chart 4-4 Incentives for non-state owned firms to invest in developed countries



As illustrated by Chart 4-5 and Chart 4-6, when investing in developing countries, state-owned and non-state owned firms also have different incentives. A higher percentage of state-owned firms (62.5%) treat 'optimising the allocation of resources globally' as an important reason, while only 46.8% of non-state owned firms consider it to be an important incentive when investing in developing countries. Nearly 90% of state owned firms would like to seize a share of the local market when investing in developing countries while the figure for non-state owned firms is less than 70%.

Chart 4-5 Incentives for state-owned firms to invest in developing countries

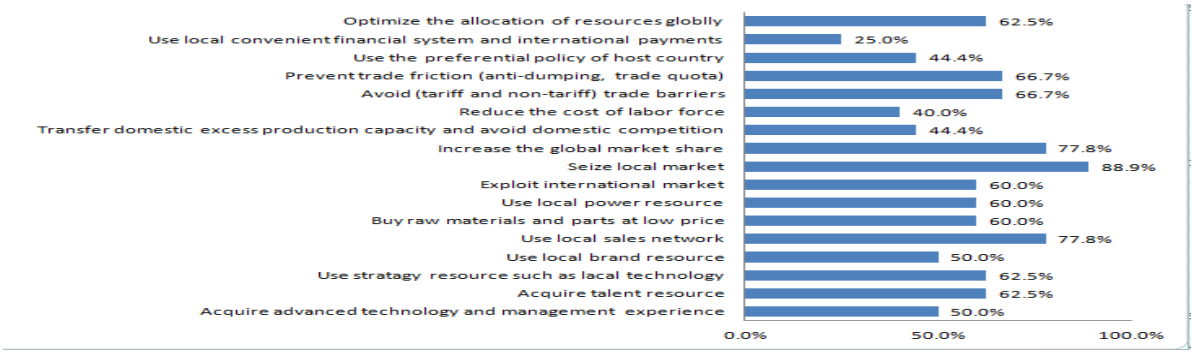


Chart 4-6 Incentives for non-state owned firms to invest in developing countries

However, we note that besides the incentives for investing in other countries, firms also explained their reasons for not investing in other countries. For example, as demonstrated by Chart 4-7, around 65% of firms worried that their small sizes may not be able to support any overseas investment. According to Chart 4-8, 63% of firms reported that they believe that unfamiliarity with the global market is an important or very important reason for not undertaking overseas investment. Similarly, as shown in Chart 4-9, 57% of firms stated that their products are mainly for the domestic market and hence they do not have overseas investment experience.

Chart 4-7 Reasons for not investing overseas: Small firm size

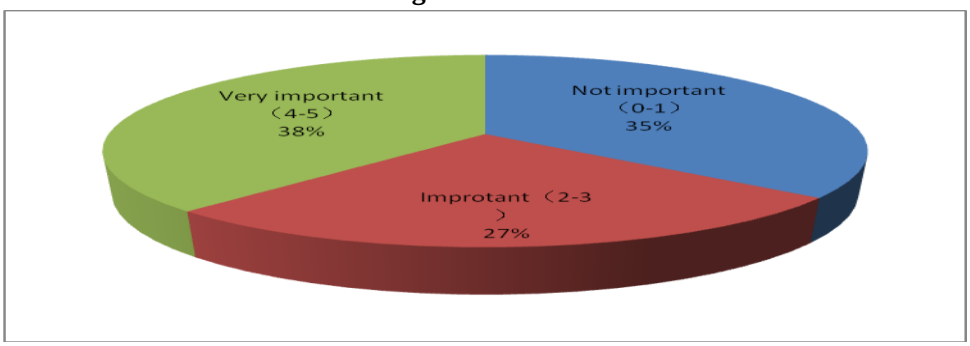


Chart 4-8 Reasons for not investing in other countries: unfamilarity with the global market

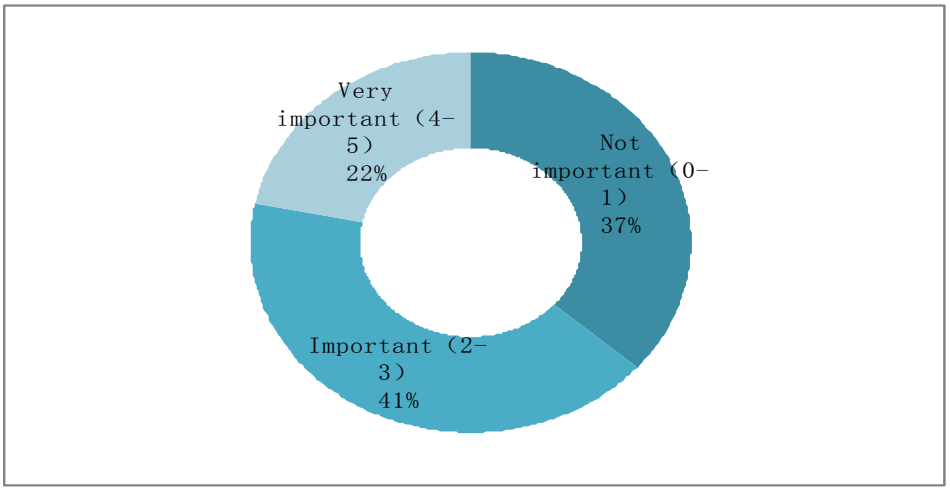
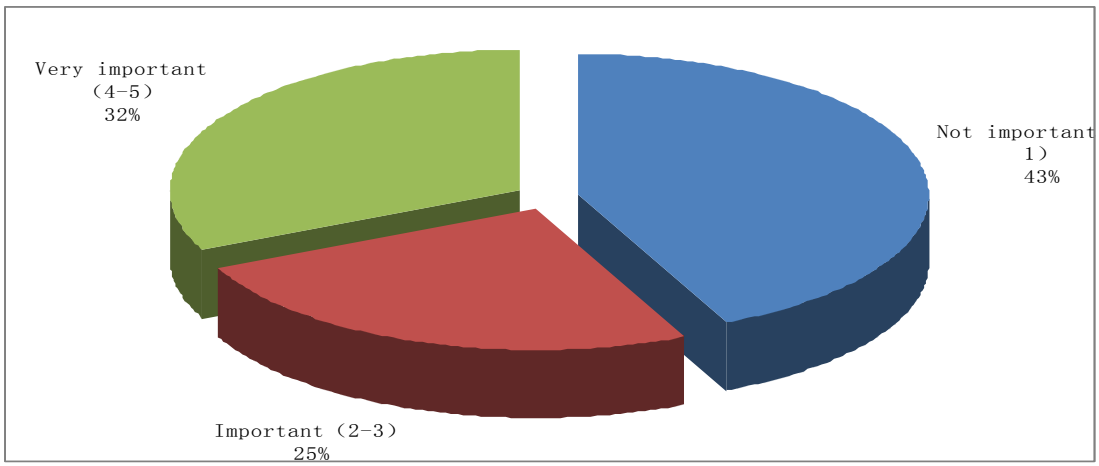


Chart 4-9 Reasons for no overseas investment experience: Domestic-oriented production



There are also other concerns about investing in foreign countries. For example, over 74% of firms believe that it could be highly risky to invest in a foreign country and therefore they have not had overseas investment experience in the past three years. 73% of firms were concerned about a possible decline in competitivity if they invest in other countries. These are demonstrated by Chart 4-10 and Chart 4-11 respectively. Human capital becomes another reason why firms restricted their overseas investment. Chart 4-12 suggests that 77% of firms stated that they have not undertaken overseas investment due to a lack of talented employees with sufficient multinational management skills.

Chart 4-10 Reasons of not investing in foreign countries: high risk

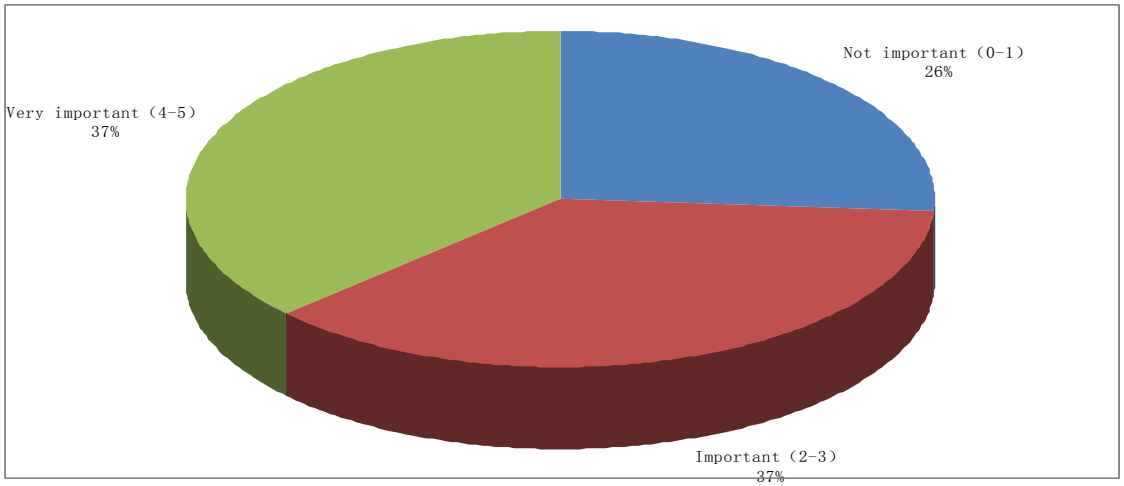


Chart 4-11 Reasons of not investing overseas: possible decline in competitivity

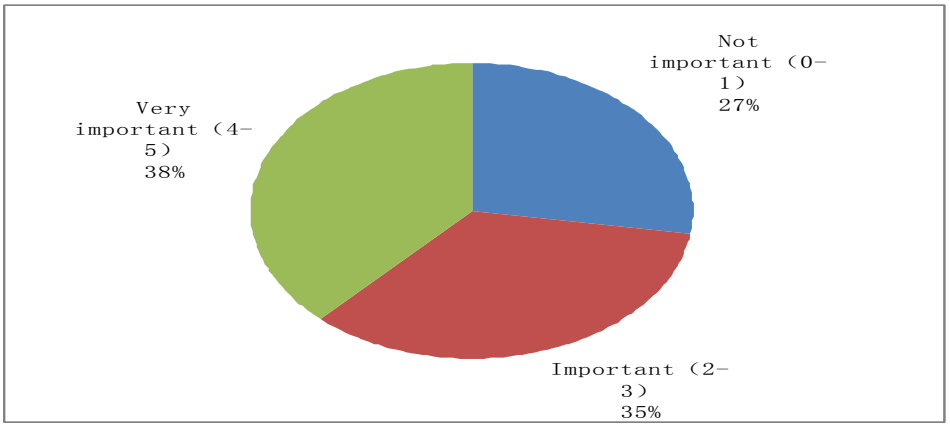
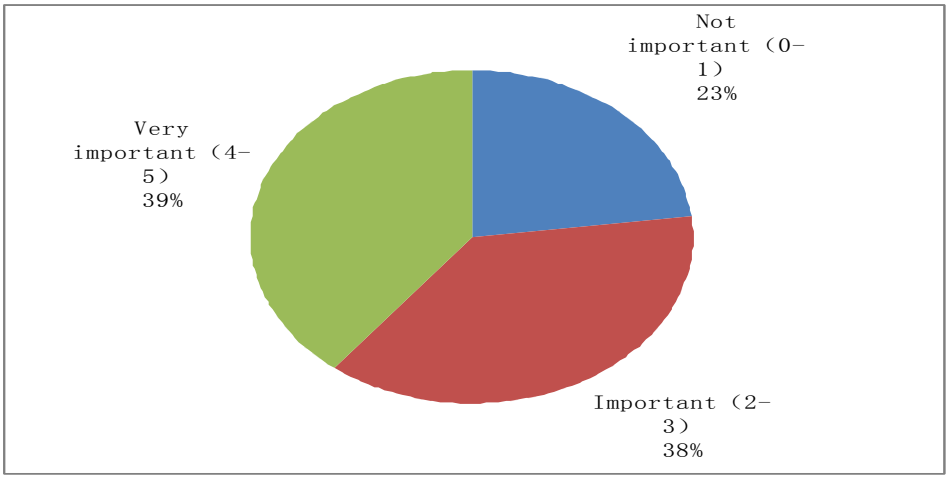


Chart 4-12 Reasons of not investing overseas: lack of international management skills



5 Destinations, Strategies, Types, and Production Reasons for Overseas investment

Based on Chart 5-1, firms in Guangdong Province invest in diverse destinations within foreign countries. Among firms who provided information on the destinations of their overseas investment, 45% of firms have invested in Hong Kong, followed by 20% in the USA. Nevertheless, according to Chart 5-2, for many firms (31%), the USA is still the largest foreign market.

Chart 5-1 Destinations of investing in other countries

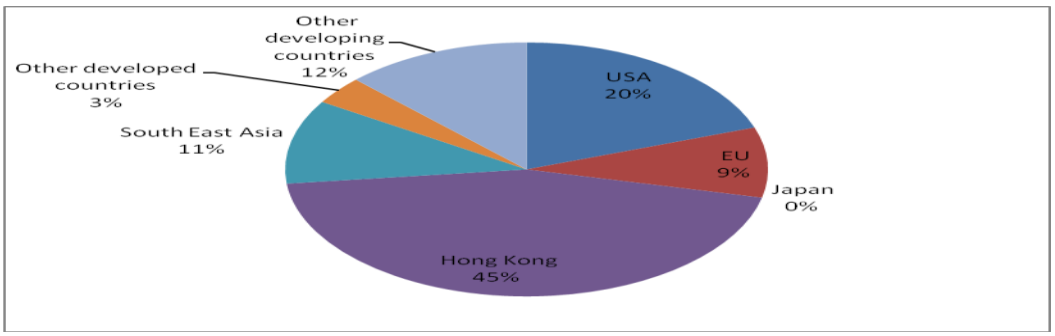
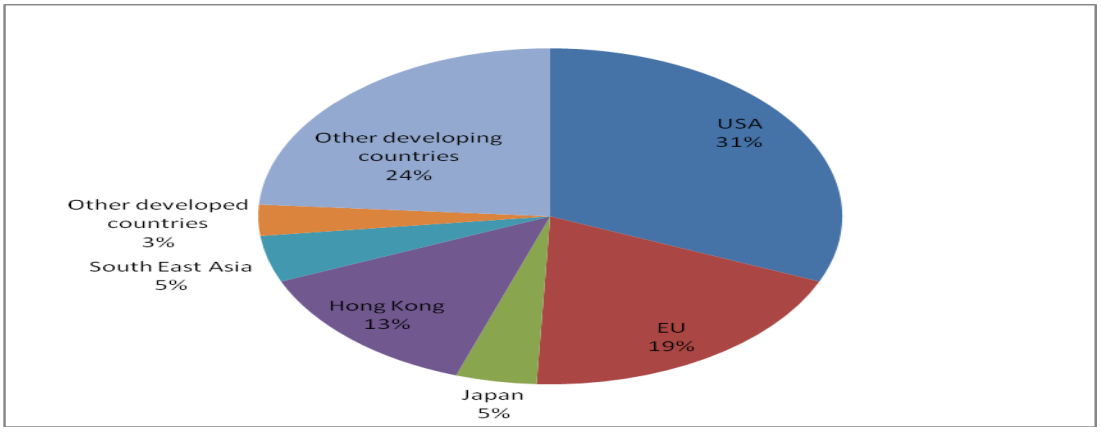


Chart 5-2 The country that firms invest in as the largest foreign market



Firms from Guangdong Province also have a variety of strategies and production reasons for undertaking investment overseas. Based on Chart 5-3, more than half of them choose a strategy of building up new wholly-owned enterprises when deciding to invest in foreign countries while only 12% of them choose the strategy of cross-border M&A. Chart 5-4 shows that the majority of firms (over 2/3) believe that their reason to engage in overseas investment is to make sales. Chart 5-5 finds that 72% of firms reported that their overseas investment projects are wholly-owned. It is possible that the production reasons and types of overseas investment are related to the broader strategies of firms to invest in other countries.

Chart 5-3 Strategies for firms to invest in foreign countries

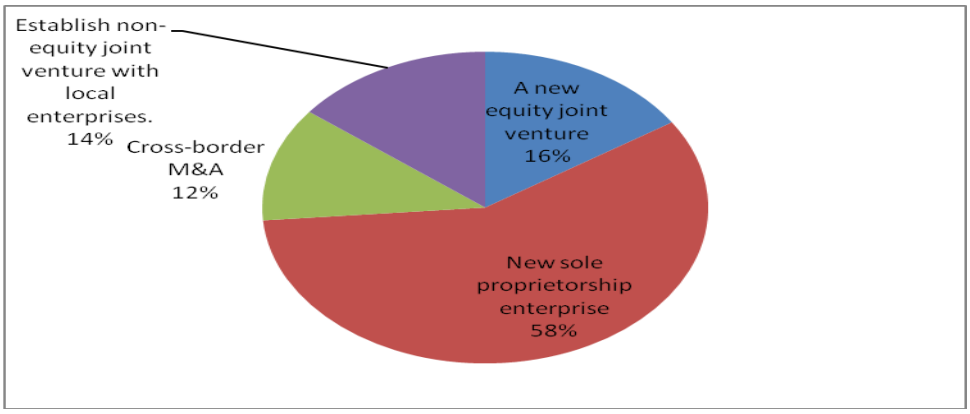


Chart 5-4 Production functions of overseas investment

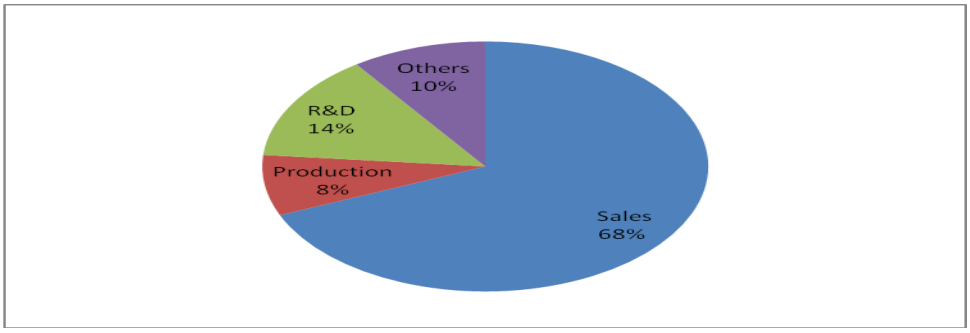
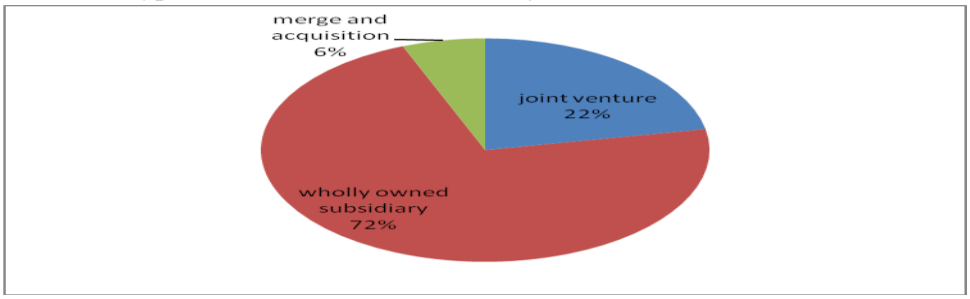


Chart 5-5 Types of Overseas investment Projects



6 Performance of Guangdong Firms' Overseas investment

According to the data collected in the survey, from 2007 to 2009, the 341 firms invested USD 603.38 million outside mainland China. This included USD 175.53 million in 2007, USD 213.31 million in 2008 and USD 214.55 million in 2009. The amount increased rapidly between 2007 and 2008 by over 21.5%, while the rate of increase dropped to 0.84% between 2008 and 2009. This is perhaps related to fluctuations in international trade due to the global financial crisis which reached its climax in 2008. Looking at firms individually, the largest amount of overseas investment was USD 759.5 million and the smallest amount of overseas investment was USD 8,580. On average each firm invested USD 4.74 million in foreign countries.

The survey also echoes the existing belief that firms in Guangdong Province have a long and diverse history of investing outside mainland China. Among the 341 firms which participated in the survey, the longest experience of overseas investment lasted over 23 years (from April 1987) and is the average experience of overseas investment was 4 years and 3 months. The surveyed firms operate 257 branches or centres in other Asian countries, North America, Europe as well as many other developed and developing regions. These 257 branches hire 4,971 employees including 2,319 Chinese nationals and they have a total asset base of around USD 436.03 million.

Although in absolute terms, Guangdong firms have invested large sums in foreign countries and their overseas investments have a long history, the survey does not suggest that Guangdong firms have sufficient contacts and co-operation with the host countries. As shown in Chart 6-1 and Chart 6-2, only 55% of firms have connections with the host countries. Amongst these, 40% of connections are established via clients, 18% of contacts are built-up through suppliers and only about 8% of connections are linked to governmental organizations.

Chart 6-1 Cooperation with host countries

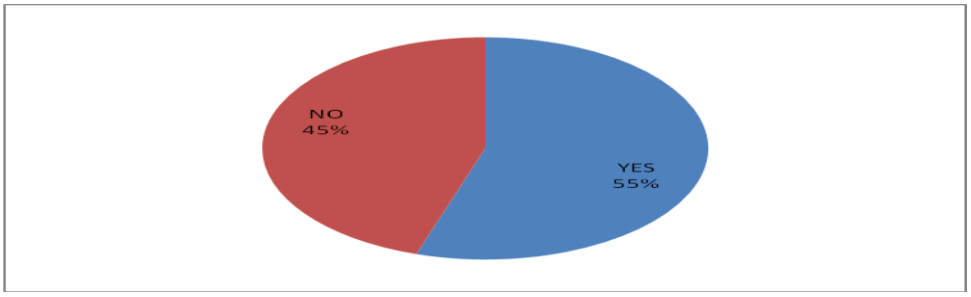
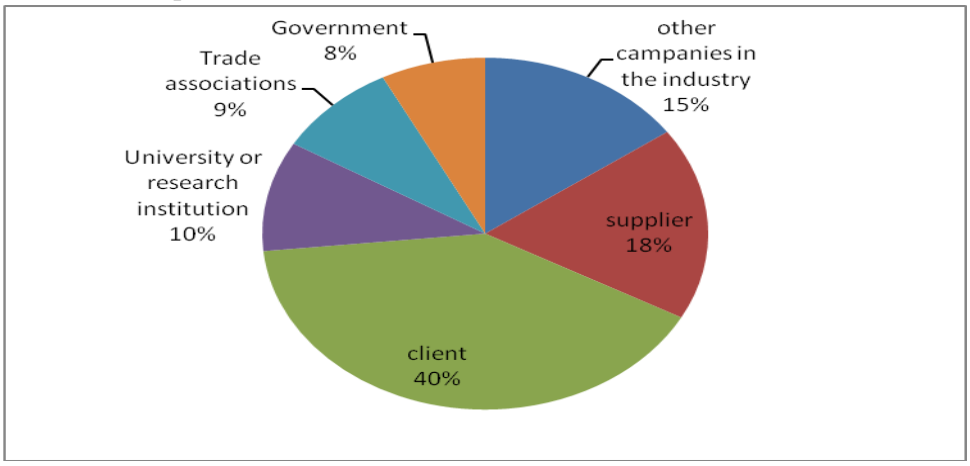
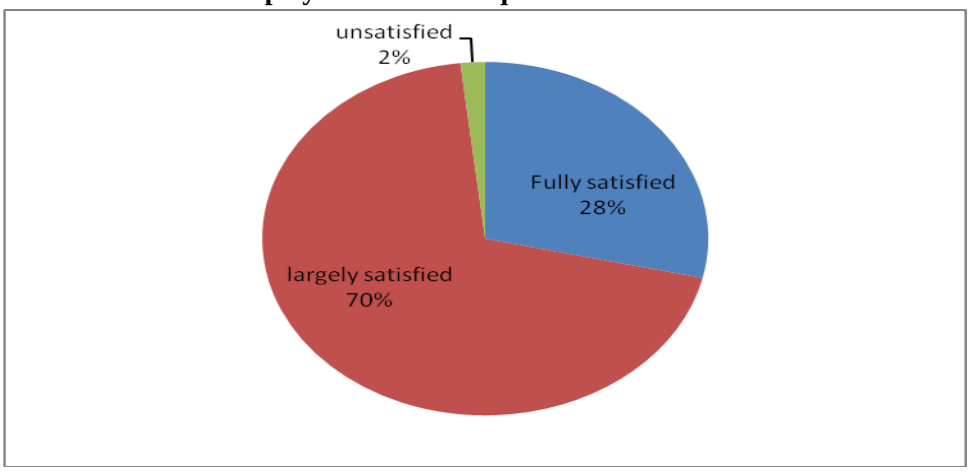


Chart 6-2 Cooperation Channels with host countries



The survey suggests that firms with overseas investments generally use local human resources. Among firms who answered this question (shown in Chart 6-3), 70% of them believe that local employees' performance is largely satisfactory. 28% state that local employees provide a good standard of service which fully satisfies production needs.

Chart 6-3 Do local employees meet the requirements of their duties?



Only 2% of firms complain that local employees cannot meet the requirements of their duties. Where this is the case, 75% of firms provide the necessary training to local staff, with near half of these firms providing training of one month or longer. These can be seen in Charts 6-4 and 6-5.

Chart 6-4 If local employees do not meet requirements, do firms provide training?

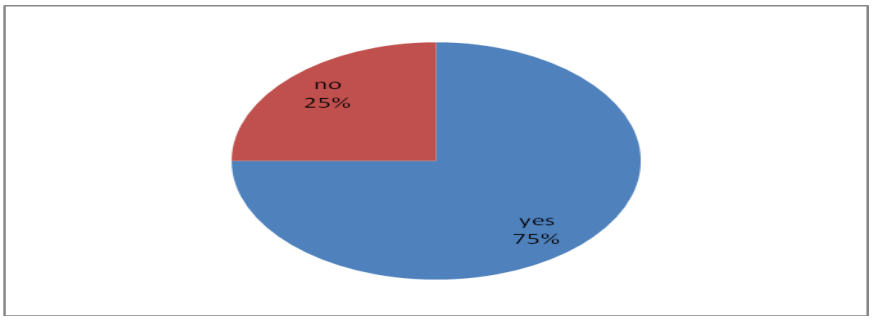
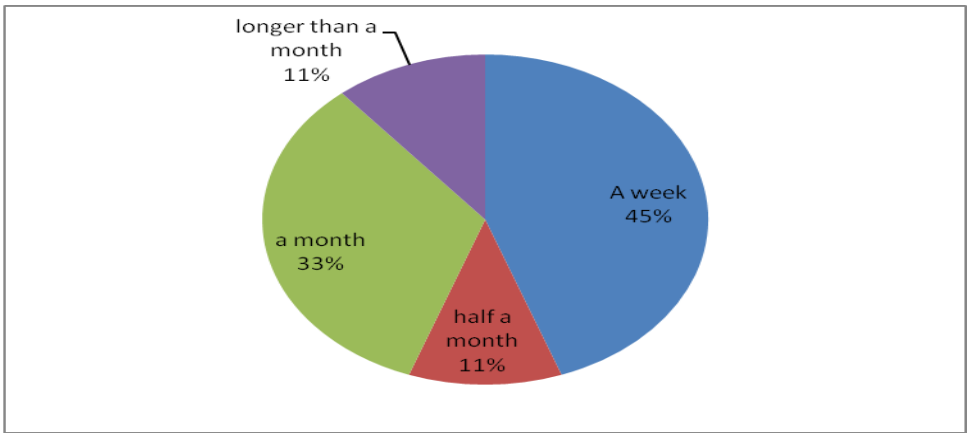


Chart 6-5 Length of training if required



In comparison with firms which do not have overseas investment experience, firms with overseas investment have significantly better performance in a series of respects. For example, as shown in Chart 6-6 and Chart 6-7, 13% of firms with overseas investment have set up R&D centres outside China. This suggests that firms with overseas investment are more likely to exploit R&D resources available in foreign countries.

Chart 6-6 Percentage of firms (with overseas investment) with an overseas R&D centre

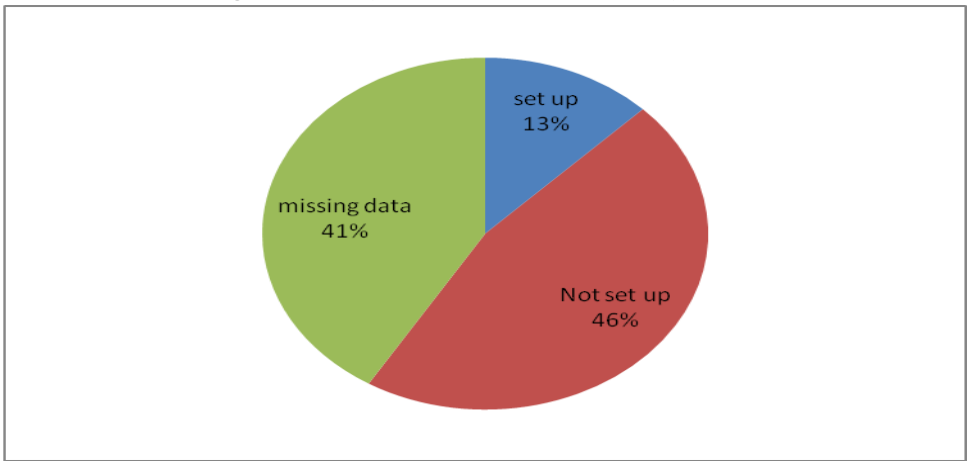


Chart 6-7 Percentage of firms (without overseas investment) with an overseas R&D centre

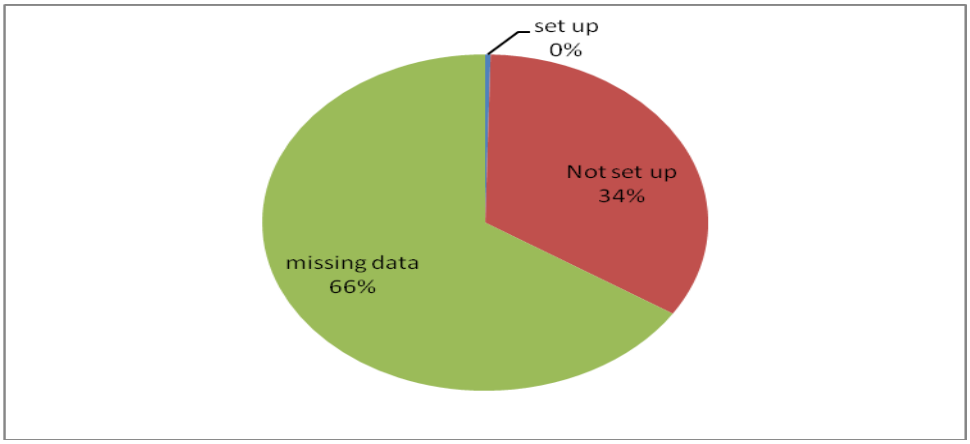
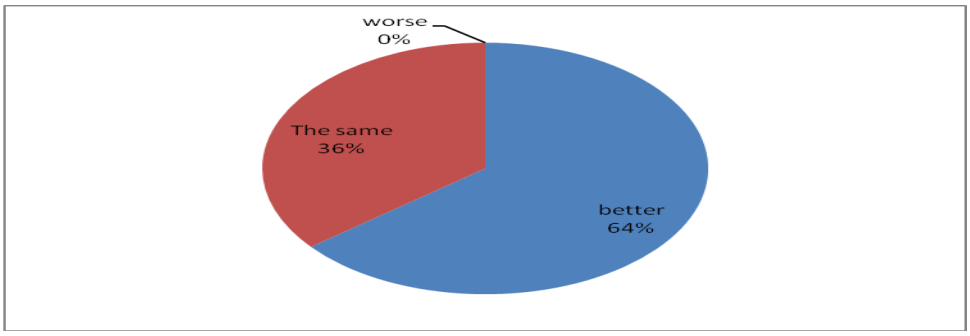


Chart 6-8 suggests that 64% of firms believe innovation obtained at overseas R&D centres is of a higher standard than that obtained domestically, while the remaining 36% believe that innovation undertaken in their overseas R&D centres is of same standard as that undertaken at their centres in China.

Chart 6-8 Comparing the standard of innovation in overseas and domestic R&D centres



Nevertheless we note that in our data only 11 firms with overseas investment experience have established R&D centres in countries other than China. Amongst these, 7 established only one overseas R&D centre, 3 set up two overseas R&D centres, and 1 established 7 R&D centres. At least 44 researchers work in these R&D centres (only 7 of the 11 firms provided information on the number of researchers in their oversea R&D centres). In addition, firms without overseas investment are less likely to participate in financing and public/social responsibility activities in foreign countries, as illustrated in Charts 6-9 and 6-10.

Chart 6-9 Participation in financing and public/social responsibility activities in foreign countries (firms with overseas investment)

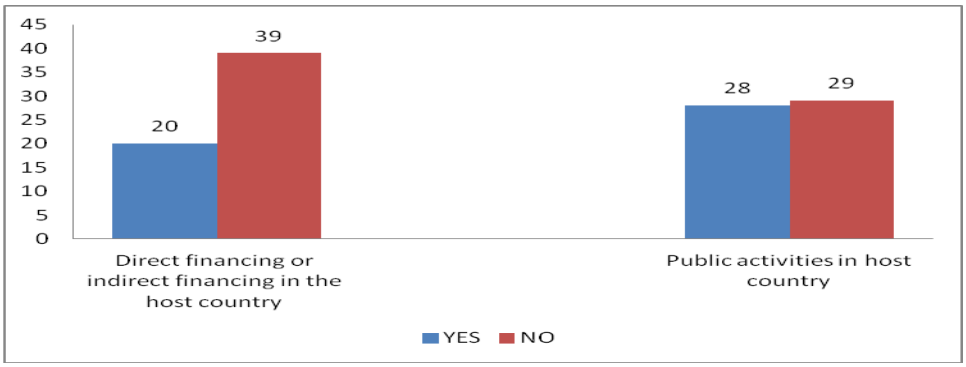
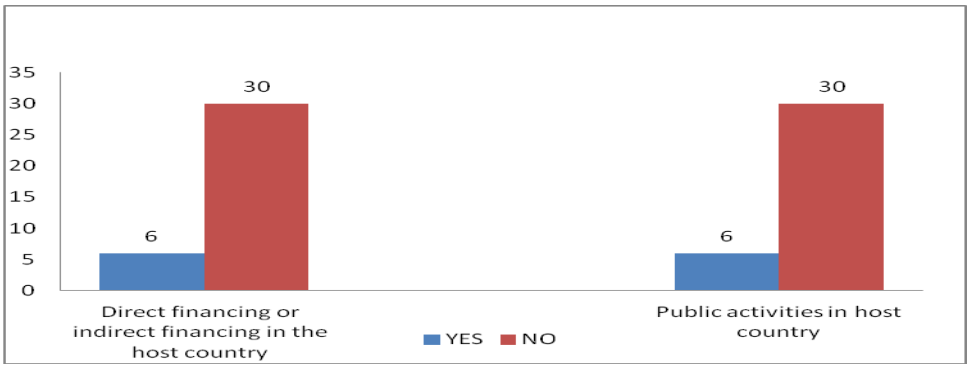


Chart 6-10 Participation in financing and public/social responsibility activities in foreign countries (firms without overseas investment)



According to feedback from firms who have participated in our survey (shown in Chart 6-11), around 56% of firms believe their overseas investment is 'successful' and 'gain more than it loses'. Almost no firms consider their investment outside China to be 'unsuccessful' or to have 'lost more than is gained'. Similarly, from Chart 6-12, we can see that 59% of firms who already have overseas investments plan to expand their investments in foreign countries, 36% plan to maintain their overseas investments at the current level and only 5% plan to reduce their investment outside mainland China. This survey suggests a promising future for Guangdong firms' overseas investment.

Chart 6-11 Firms' self-evaluation of overseas investment

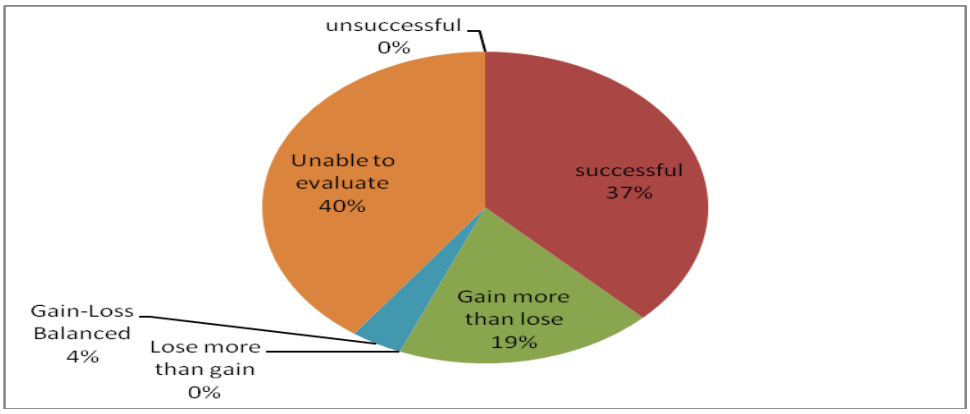
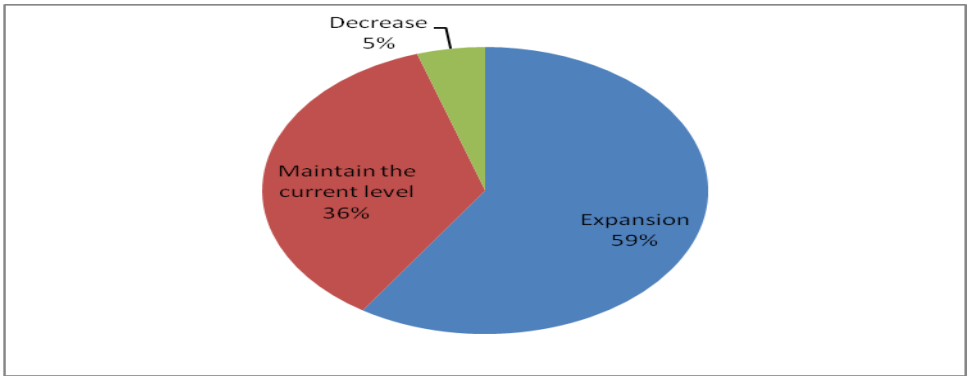


Chart 6-12 Future plans of Guangdong firms' overseas investment (firms with overseas investment only)



7 Conclusions and Discussion

This report summarises the evidence from our survey on Guangdong firms' overseas investment. It attempts to shed some light on the firms' characteristics, their overseas investment destinations, the strategies, methods and channels of investing in other countries, the incentives and concerns when making overseas investment decisions or plans, and the performance of their overseas investment. Some comparisons between firms with and without overseas investment experience have also been made.

Guangdong firms have undertaken large amounts of investment overseas, which covers a variety of industries and regions. Comparing firms which have not invested in foreign countries, those with overseas investment experience have more advantages in innovation. Also, firms with a larger scale and sufficient human capital are more likely to go-global. Non-state owned firms, firms in the manufacturing industry, and OEM firms have stronger incentives to invest in other countries.

Chinese firms' overseas investments are not largely driven by resource-seeking as assumed by certain politicians and researchers. Instead, they tend to give market expansion the highest priority. On the one hand, this may be suitable for the development of Chinese firms' overseas investment at this stage when the largest share of international markets are still occupied by firms from other countries.

On the other hand, to maintain sustainable development, Chinese firms with overseas investments may consider using local resources to a greater extent, especially human resources, in future after they have successfully developed a holding in the global market. The Chinese government, instead of merely encouraging the firms to start and expand investment in other countries, should give more guidance to firms on how to effectively exploit local resources and engage with the local community to achieve sustainable development after firms have invested in other countries.

In addition, state and non-state owned firms have different incentives to undertake investment overseas. State-owned sectors are less sensitive to the costs of accessing local resources (e.g., labour) and pay less attention to local preferential policies. Instead, taking up local or international market shares becomes an important concern when they decide to invest in other countries. This to a certain extent reflects the nature of state-ownership, as market expansion is more likely to be a top priority for the leaders of state-owned firms while the costs and benefits are less important for decision makers. The efficiency of Chinese state-owned firms' OFDI may merit further attention from policy makers in future. In contrast, non-state owned firms demonstrate more practical strategies and more attention with respect to cost-benefit considerations.

A lack of talented staff with sufficient international management skills is a important factor that restricts Chinese firms overseas investment. Since limited international management skills and knowledge of global market are important barriers to investing in other countries, both the government and firms should pay more attention to improve international management skills and

knowledge of global market. The government should introduce more preferential policies to attract talented staff with strong international management skills to work in China or for Chinese firms. For example, the government may consider loosening the barrier of nationality to work for Chinese firms in order to attract more people with strong international management skills. The government may also consider offering intensive training courses about the international market and global competition rules, e.g., the WTO regulations. At the firm level, it may be quite helpful if firms can allocate more of the budget towards human resource development and information collection. For example, firms may consider recruiting more senior staff from overseas elite institutions, as the percentage of senior staff with overseas study or work experience is directly and positively associated with their OFDI decisions.

Chinese firms' overseas investment is mainly concentrated upon Hong Kong and South East Asia. This indicates that geographical proximity is an important factor in the location decision of Chinese MNEs. The USA also attracts large sums of investment from Guangdong firms. Market expansion is ranked as the most significant reason for Guangdong firms to invest in the USA, while acquisition of advanced technological and managerial knowledge is the main considration for investing in Europe. In contrast, Guangdong firms' investment in other developing countries is relatively limited. A further comparison between Guangdong's OFDI and OFDI from other Chinese provinces or even other countries could generate more reflections and practical implications in this area.

The survey shows the main strategy of Chinese firms' overseas investments is different from the general practice of FDI in the world, which is usually conducted by cross-border M&A. More than half of firms in the survey choose a strategy of setting up their own wholly-owned enterprises when deciding to invest in foreign countries and only 12% choose a strategy of cross-border M&A. This may suggest to a certain extent that cooperation and competition between Guangdong's OFDI firms and local collaborators are still limited. Perhaps it will be interesting in future to undertake further investigation regarding the more general situation of OFDI worldwide.

A large proportion of firms indicated a positive self-evaluation regarding the outcome of overseas investment. A substantial proportion of Chinese MNEs have established collaborations with various local partners and have participated in local public activities. The majority are optimistic about the future of their international investment with 59% indicating that they plan to expand and 36% indicating that they plan to maintain their current level of overseas investment.

However, the performance impact of Guangdong firms' overseas investment still needs further analysis. For example, Guangdong firms put limited emphasis on establishing R&D centres to exploit local R&D resources when they invest in foreign countries. Local human resources may have not been properly used due to limitations in the training of local employees and this can be demonstrated to a degree by the relatively high proportion of Chinese nationals (nearly 50%) who staff overseas branches/centres. Understanding how to enhance Chinese firms' participation and involvement in host countries is an important task for both firms and the government.

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