

Chinese Multinationals in a New World: Micro-Evidence on Outward FDI

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Abstract

Using a sample of 603 subsidiaries of 125 Chinese MNCs, we explore the regional and industrial pattern of Chinese outward FDI. Our analysis reveals several important facts. First, most of Chinese outward FDI is directed in finance and real estate and services. Second, by far the majority of investment projects are carried out in the home region of Asia-Pacific. Third, outward FDI is highly concentrated geographically and the average investment project is relatively small. Fourth, establishment of subsidiaries is the most preferred way of carrying out FDI. Finally, market seeking and technology seeking motives seem to drive most of FDI strategies. Last but not least, a large number of Chinese investment is conducted mainly in within China revealing a strong multi- domestic character.

Keywords: Outward Foreign Direct Investment, Chinese Multinational Corporations

1. Introduction

Over the last two decades China has made significant progress in attracting and promoting Foreign Direct Investment (FDI). By year 1992, China was one of the largest receivers of inward FDI and was experiencing growing outward FDI (UNCTAD 2005). One of the striking features of Chinese outward FDI is that differently that from the other emerging economies is not limited to the neighboring countries but spans significantly to industrialized countries (Wang, 2002). Reasons related to possession of more advanced technologies and better management practices help explain this pattern (Deng, 2007).

The “gradualist” approach of economic development with little political changes that China followed has resulted in two main types of enterprises: the state owned enterprises (SOEs), owned by the central government, and the township village enterprises (TVEs), owned by village governments and/or private firms. Since SOEs are under tight government control, they are sometimes more favoured (Deng, 2007). Nevertheless, the Chinese government has played an important role in motivating Chinese enterprises in investing abroad by introducing regulations to improve their competitiveness and supporting investments in R&D. The unique “gradualist” approach to development accompanied by a strong government support indeed has promoted high levels of outward FDI.

In this paper we will explore the pattern of Chinese outward FDI using a sample of 603 subsidiaries of 125 Chinese Multinational Corporations (MNCs), especially focusing on the regional and industrial specific effects. Before that we briefly review the implications of the literature on outward FDI in general and Chinese outward FDI in particular. Our analysis shows that Chinese outward FDI displaying strong regional and industrial bias, pointing to industry and location being two important determinants of the pattern of outward FDI.

2. Literature Review

The understanding and study of Chinese multinationals falls in the wider analysis of MNCs coming from developing countries. Early work by Lall (1983) and Wells (1983) aimed at providing the theoretical foundations of the understanding of MNCs that come from countries that are usually recipients of FDI and not dispatchers of physical capital. Since then, a large empirical literature has investigated inward FDI in developing countries with emphasis on Latin American and South East Asia (for recent research on these issues see, for instance, Lauridsen, 2004; Galan and Gonzalez-Benito, 2006; Treviño and Mixon, 2004). Similarly, empirical work exists on outward FDI that concentrates on domestic MNCs coming from mainly South East Asian countries (Kim and Mah, 2006).

The case of China is not an exception and since the early 1990s has attracted the attention of scholars as the host country of foreign MNCs (Buckley et al. 2007; Cassidy and Andreosso-O'Callaghan, 2006; Wei and Liu, 2006; Xing, 2006). However, the overseas activities and thus the emergence of Chinese multinationals and outward FDI is still not a very well explored topic. Among the first attempts to explain the phenomenon of Chinese MNCs is that of Young et al. (1996) who provide some initial empirical evidence on the internationalization process of Chinese multinationals. Their investigation relied on a case study of five state-owned Chinese MNCs involved in manufacturing. Their findings showed that the companies under investigation not only had a strong regional presence in Asia, but also they had a quite strong presence outside Asia and in particular in the North American market. Their choice of entry into new markets included all possible modes ranging from greenfield investment to joint ventures and it was closely related to the type of the host market as well as the motivation to invest abroad. In this

line of argument the authors showed that knowledge and market seeking were among the most important motives for Chinese MNCs.

Earlier work by Li (1993) discussed the nature of Chinese investment in Canada. In particular, he claimed that Chinese investment in Canada in the late 1980s and early 1990s was the outcome of economic reforms in China and the emergence of business like and professional Chinese entrepreneurship.

Later research on Chinese MNCs by Ding (2000) discusses the relationship between internationalization and what he calls *informal privatization*. In his paper he demonstrates how publicly owned Chinese companies invested abroad and how through this process public funds were re-baptized as private creating serious issues of corporate governance. Nevertheless, Ding's study confirms Young et al. (1996) in regards to the geographical diversification as well as the motivation of Chinese MNCs.

Similar are the findings of Frost and Ho (2005) whose main concern though is the impact of the increasing volume of Chinese outward FDI on corporate social and thus the export of possibly poor management and labor practices.

Finally, Hong and Sun (2006) discuss the strategies of Chinese MNCs. In their findings they acknowledge the strong domestic presence of Chinese MNCs through joint ventures with foreign investors. This finding is also confirmed by Liu and Li (2002) in their case study of the Haier Group. Hong and Sun (2006) underline the emerging compel of resource seeking and emphasize the technology seeking nature of Chinese outward FDI which has been the major strategic motivation behind the successful story of the Haier Group (Liu and Li, 2002).

3. Patterns and Rationale of Chinese FDI

In this section we would first explore the trends and patterns of Chinese FDI and then argue on the motivations behind Chinese firms investing abroad. To this end we use a sample of 603 subsidiaries¹ of 125 Chinese firms. The data are obtained from the Summer 2006 edition of Corporate Affiliation Directory. The average number of subsidiaries is about 5 per parent firm. Nevertheless, it would be misleading to conclude that all firms are engaged in FDI to the same degree. The number of subsidiaries per parent firm differs markedly, ranging from 1 to 60. Further, 34% of all subsidiaries belong to only 5 firms, namely China National Chemicals Import & Export Corporation, China Minmetals Corporation, CITIC Group, Gold Peak Industries (Holdings) Limited and Bank of China, while 42% of firms have only one subsidiary.

*** Table 1 and Table 2 approximately here ***

The international business literature identifies, by and large, five different motivations to invest abroad: to gain resources, technology, markets, diversification and strategic assets. These underlying motivations have implications on the distribution of FDI across industries and regions. Table 1 and Table 2, as well as illustration in Figure 1 and Figure 2, show this distribution across fourteen industries defined at 4-digit level and six geographical regions. First, it is clear from Table 1 that most of Chinese FDI is concentrated in financial and real estate (18%) and other services (27%), with trade (15%) being the next popular investment strategy. From the rest of industries FDI seems to go to manufacturing (10%) and electronics (9%) and oil and gas (9%). Turning to Table 2 we see that distribution of investment instead of being globally

¹ At this point we use the generic word subsidiary to include different entry modes in a foreign market. Further on in our analysis we will distinguish among them.

distributed has a strong geographical dimension, with almost 75% of FDI projects going to firms' home region, i.e., Asia-Pacific, with North America being a second distant popular destination with almost 14% and Europe following with about 10%.

*** Table 3 approximately here ***

Combining the industrial and regional distribution of FDI in Table 3 we see that within Asia-Pacific finance and real estate investment account for about 23%, other services for 25%, manufacturing and electronics for 9% and oil and gas for 10%. In comparison the respective share of investment in these industries in North America and Europe are the following: finance and real estate about 5% and 6%, other services for 30% and 37%, manufacturing 11% and 17%, electronics for 8% and 11% and oil and gas about 4% and 6%. Curiously the share of FDI going to these industries as a total of overall FDI in the respective region is larger in Europe than in North America, with the latter dominating Europe in the share of trade investment: 33% versus 17%.

*** Table 4 approximately here ***

In fully determining the importance of Asia-Pacific as a destination region of Chinese FDI one needs to separate the effect of investment within China itself from those in the rest of the region. Table 4 gives the distribution of FDI according to host country. Several points are worth noting. First, there are 34 different countries Chinese firms have invested in. Second, about 39% of investment projects are undertaken within China. Third, even accounting for this

Asia-Pacific remains the most important destination for Chinese FDI with about 36% of total number of investment projects. If, however, Chinese investment in Hong Kong are also classified as mostly domestic than foreign then the importance of Asia-Pacific drops substantially, attracting about 11% of investment projects, making it the second most important region after North America. Fourth, excluding China and Hong Kong, the USA is the most important destination of Chinese investment abroad attracting about 36% of investment projects, followed by Germany (8%), Singapore (7%) and Australia (6%). These data are in line with previous studies that report the value of outward Chinese FDI as opposed to the number of investment projects. For instance, (Deng, 2004) emphasizes that by the end of 2001 Chinese outward FDI is strongly concentrated in a small number of destinations. Further, UNCTAD (2005) reports that, for the period 1997-2002, about 62% of China's FDI outflows went to four top destinations, that is Hong Kong, USA, Canada and Australia. Finally, the data support the conjecture that Chinese firms invest more in higher income and industrial countries due to their superior investment environment, high technology and advanced management methods.

*** Table 5 and Table 6 approximately here ***

Analyzing the scale of investment would have required data on investment spending. In their absence we use sales data as a proxy for the size of an investment projects. For the purposes of this analysis we have classified subsidiaries into five groups according to sales revenue they generate² as follows: those generating up to 100 million dollars in sales, those generating between 100 and 500 million dollars, those generating between 500 million and 1 billion dollars,

² We do not possess data on the exact level of sales. Rather we have data on the interval where sales fall. In constructing the intervals have balanced the need to keep their number manageable and not to pool together firms of substantially different size.

those generating between 1 and 1,5 billion dollars and those generating more than 1,5 billion dollars. The distribution of firms across these five groups is given in Table 5. Due to missing sales data there are only 447 observations. Most of investment projects are of a relatively small size, with 41% of projects generating sales of up to 100 million dollars and another 41% generating sales of up to 500 million dollars. This result is again in line with those of Deng (2004) who finds that the average size of an investment in most countries is pretty small. The pattern does not seem to alter when looking at size distribution across regions represented in Table 6. In all major regions, i.e., Asia-Pacific, North America and Europe, dominant investment projects are small. Of note is the fact that big projects, those generating more than 1,5 billion in sales, are predominantly carried out in Asia-Pacific and, except for one investment located in Singapore, are all located in China or Hong Kong.

*** Table 7 approximately here ***

We have used the term subsidiary to refer to all firms in our sample. Yet, the term might be a misnomer as the establishment of subsidiaries might not be the most preferred form of investment by Chinese firms. This requires a review of modes of entry in foreign markets, reported in Table 7 and illustrated in Figure 3. The table reveals that in our sample subsidiaries are indeed the most preferred investment mode as they constitute 78% of all investment projects. Joint ventures are the second most important mode with 8% of investment projects, with the rest of entry modes accounting for the remaining 14%. Even accounting for the large number of subsidiaries within China, the share of subsidiaries in overall investment projects is still

dominant. This finding contradicts that of Deng (2004) who finds that by the end of 2001 joint ventures with local firms were the most preferred form of investment for Chinese firms.

*** Table 8 approximately here ***

A final issue related to entry mode is the degree of involvement of parent firms in terms of equity shares. Information of the degree of ownership from the parent firm could be extracted for 250 of the sample firms (about 42% of the sample) and in Table 8 we report the distribution of firms by equity shares and entry modes. In light of the previous finding on the preference of subsidiary establishment it is not surprising to find that wholly owned subsidiaries constitute the bulk of the sample, with 67%. Only in three subsidiaries the parent firm had less than 50% equity involvement. Overall, only in 3,2% of cases the equity involvement is less than 50%. The average equity share over the whole sample is 93%, with the lowest value being 20%. This finding coincides with that of previous studies, which have found parent involvement in terms of average equity shares to be high and increasing over time. For instance, MOFTEC (1997) reports that this share was 46% in 1995 and increased to 48,5% in 1997.

As already mentioned the industrial distribution of investment projects could be used to understand parent firm's motivation for investing. Often however firms invest having multiple motivations. Alternatively, motivations change subject to evolution of firms, their strategies and the environment they operate over time. The results of Table 1 though could, at least, be indicative of the investment motivations of the firms in our sample. One common rationale of establishing subsidiaries abroad is to acquire stable supply of resources for use in own production operations. Given that China is a country with relatively low per capita availability of

resources, it could be conjectured that resource-seeking motives would constitute an integral part of firms' investment strategies. This implies one would expect to observe a large number of investment projects in natural resource industries such as agriculture, fishing and mining and oil and gas. Overall, only 10% of investment projects in our sample belong to these industries suggesting that, although present, this motive is not the one driving the pattern of outward investment. This is especially true as 60% of these investments are carried out within China and only 40% abroad.

A further motive often cited for outward FDI is technology seeking one. That is, firms from emerging countries invest in developed countries to acquire technology, which they can then transfer back to their home country to increase competitive advantage, upgrade their domestic manufacturing and develop new products at home. Chinese firms are found to exploit this motive especially in their investment in the USA and Hong Kong. This would imply that one would expect to find Chinese investment in developed countries to be concentrated in industries characterized by the use of advanced technology and know-how such as electronics, chemicals and pharmaceuticals, instruments, automobiles and manufacturing. In our sample 25% of firm observations fall into these industries suggesting that technology seeking motives are important drivers of firm strategies.

The FDI literature refers to market seeking and risk diversification as reasons underlying FDI strategies. The former is driven by the limits of domestic demand and/or barriers to foreign market entry in the form of either price or quantity restrictions. This would imply that investments in industries such as textile and apparel, footwear, food products, paper products, trade, simple manufacturing production would fall into this group. Depending on the nature of manufacturing investment in our sample this group could constitute in between 20-30% of all

investment projects. Another driver of market seeking strategies is to service large Chinese communities in various countries, especially in Asia-Pacific and North America. This would imply investments in finance and real estate and service industries to be driven by market seeking objectives, making these objectives the most important in firm strategies. The second motive, often adopted with the encouragement of the state, is driven by the desire to become a multinational through international diversification. It is mainly firms that held monopoly over China's foreign trade in the past that have followed this route towards becoming a multinational. Examples of such firms in our sample are China National Chemicals Import & Export Corporation, China Petrochemical Corporation and Bank of China.

A final motive cited as a driver of FDI strategies is strategic asset seeking. Dunning (1998) emphasizes this motive to be geared less towards exploiting ownership specific advantages and more towards protecting and augmenting that advantage. Such strategies would require firms to invest abroad as part of a global production and marketing strategy. This will allow firms to accumulate knowledge and skills, which could be eventually turned into strengths. Whether this is the case or not would require a more in-depth investigation of investment strategies than simply looking at the industrial distribution. Overall though we expect this motive to be present in Chinese firm strategies in light of Chinese government encouragement, through its 1999 "Go Global" strategy, to firms to invest abroad in order to increase their international presence and sharpen their competitive edge.

4. Conclusions

Using a sample of 603 subsidiaries of 125 Chinese MNCs, we have explored the regional and industrial pattern of Chinese outward FDI. There are some important facts that emerge from our analysis. First, most of Chinese outward FDI is directed in non-productive industries, with finance and real estate and services being the most attractive ones. Second, by far the majority of investment projects are carried out in the home region of Asia-Pacific. Third, outward FDI is highly concentrated geographically and the average investment project is relatively small. Fourth, establishment of subsidiaries is the most preferred way of FDI. Finally, market seeking and technology seeking motives seem to drive most of FDI strategies. Last but not least, a large number of Chinese investments are conducted mainly in within China revealing a strong multi-domestic character.

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Appendix

Table 1. Industrial Distribution of Investment by Chinese Firms

| Industry | Number of Firms |
|------------------------------------|-----------------|
| Agriculture, Forestry and Mining | 2 |
| Oil and Gas | 55 |
| Construction | 2 |
| Food Production | 14 |
| Textile and Apparel | 5 |
| Paper Products | 17 |
| Chemicals and Pharmaceuticals | 19 |
| Manufacturing | 62 |
| Electronics | 55 |
| Automobile and Transport Equipment | 7 |
| Instruments | 5 |
| Services | 162 |
| Trade | 89 |
| Finance and Real Estate | 109 |

Table 2. Regional Distribution of Investment by Chinese Firms

| Region | Number of Firms |
|----------------|-----------------|
| Africa | 2 |
| Asia - Pacific | 451 |
| Europe | 63 |
| Middle East | 1 |
| North America | 83 |
| South America | 3 |
| Total | 603 |

Table 3. Industrial and Regional Distribution of Investment by Chinese Firms

| Industry | Regions | | | | | |
|------------------------------------|----------------|-------------|---------------|--------------------|----------------------|----------------------|
| | Africa | Asia | Europe | Middle East | North America | South America |
| Agriculture, Forestry and Mining | 0 | 2 | 0 | 0 | 0 | 0 |
| Oil and Gas | 1 | 46 | 4 | 1 | 3 | 0 |
| Construction | 0 | 2 | 0 | 0 | 0 | 0 |
| Food Production | 0 | 14 | 0 | 0 | 0 | 0 |
| Textile and Apparel | 0 | 1 | 1 | 0 | 3 | 0 |
| Paper Products | 0 | 13 | 1 | 0 | 3 | 0 |
| Chemicals and Pharmaceuticals | 0 | 19 | 0 | 0 | 0 | 0 |
| Manufacturing | 0 | 41 | 11 | 0 | 9 | 1 |
| Electronics | 0 | 41 | 7 | 0 | 7 | 0 |
| Automobile and Transport Equipment | 0 | 6 | 0 | 0 | 1 | 0 |
| Instruments | 0 | 2 | 2 | 0 | 1 | 0 |
| Services | 0 | 114 | 23 | 0 | 25 | 0 |
| Trade | 1 | 48 | 11 | 0 | 27 | 2 |
| Finance and Real Estate | 0 | 102 | 3 | 0 | 4 | 0 |

Table 4. Geographical Distribution of Investment by Chinese Firms

| Host Country | Number of Firms |
|---------------------|------------------------|
| Australia | 11 |
| Austria | 1 |
| Belgium | 1 |
| Brazil | 3 |
| Canada | 8 |
| China | 234 |
| China (Hong Kong) | 155 |
| China (Macau) | 3 |
| Cyprus | 1 |
| Denmark | 1 |
| Finland | 1 |
| France | 3 |
| Germany | 18 |
| India | 1 |
| Indonesia | 2 |
| Italy | 4 |
| Japan | 8 |
| Korea (South) | 3 |
| Malaysia | 5 |
| Netherlands | 5 |
| New Zealand | 2 |
| Norway | 2 |
| Philippines | 1 |
| Russia | 1 |
| Singapore | 15 |
| South Africa | 2 |
| Spain | 2 |
| Sweden | 5 |
| Switzerland | 2 |
| Taiwan | 9 |
| Thailand | 1 |
| USA | 76 |
| UAE | 1 |
| United Kingdom | 16 |
| Total | 603 |

Table 5. Size Distribution of Investment by Chinese Firms

| Sales | Number of Firms |
|---------------------------------|------------------------|
| Up to 100 million dollars | 186 |
| 100 - 500 million dollars | 183 |
| 500 million - 1 billion dollars | 33 |
| 1 – 1,5 billion dollars | 5 |
| More than 1,5 billion dollars | 40 |
| Total | 447 |

Table 6. Size and Regional Distribution of Investment by Chinese Firms

| Sales | Regions | | | | | |
|---------------------------------|----------------|---------------------|---------------|--------------------|----------------------|----------------------|
| | Africa | Asia-Pacific | Europe | Middle East | North America | South America |
| Up to 100 million dollars | 1 | 105 | 40 | 1 | 38 | 1 |
| 100 - 500 million dollars | 0 | 150 | 8 | 0 | 25 | 0 |
| 500 million - 1 billion dollars | 0 | 30 | 0 | 0 | 3 | 0 |
| 1 – 1,5 billion dollars | 0 | 4 | 1 | 0 | 0 | 0 |
| More than 1,5 billion dollars | 0 | 33 | 1 | 0 | 6 | 0 |
| Total | 0 | 322 | 50 | 1 | 72 | 1 |

Table 7. Distribution of Firms by Entry Mode

| Type | Number of Firms |
|---------------|------------------------|
| Affiliate | 9 |
| Branch | 18 |
| Group Insurer | 34 |
| Joint Venture | 53 |
| Subsidiary | 475 |
| Unit | 3 |
| Other | 11 |
| Total | 603 |

Table 8. Distribution of Firms by Equity Shares and Entry Mode

| Firm Type | Ownership Share (in percentage) | | |
|------------------|--|----------------|------------|
| | Less than 50 | 50 - 99 | 100 |
| Affiliate | 1 | 1 | 0 |
| Branch | 0 | 0 | 10 |
| Group Insurer | 0 | 4 | 16 |
| Joint Venture | 3 | 4 | 7 |
| Subsidiary | 3 | 24 | 169 |
| Unit | 0 | 1 | 1 |
| Other | 1 | 0 | 5 |
| Total | 8 | 34 | 208 |

Figure 2. Regional Distribution of Chinese Outward FDI

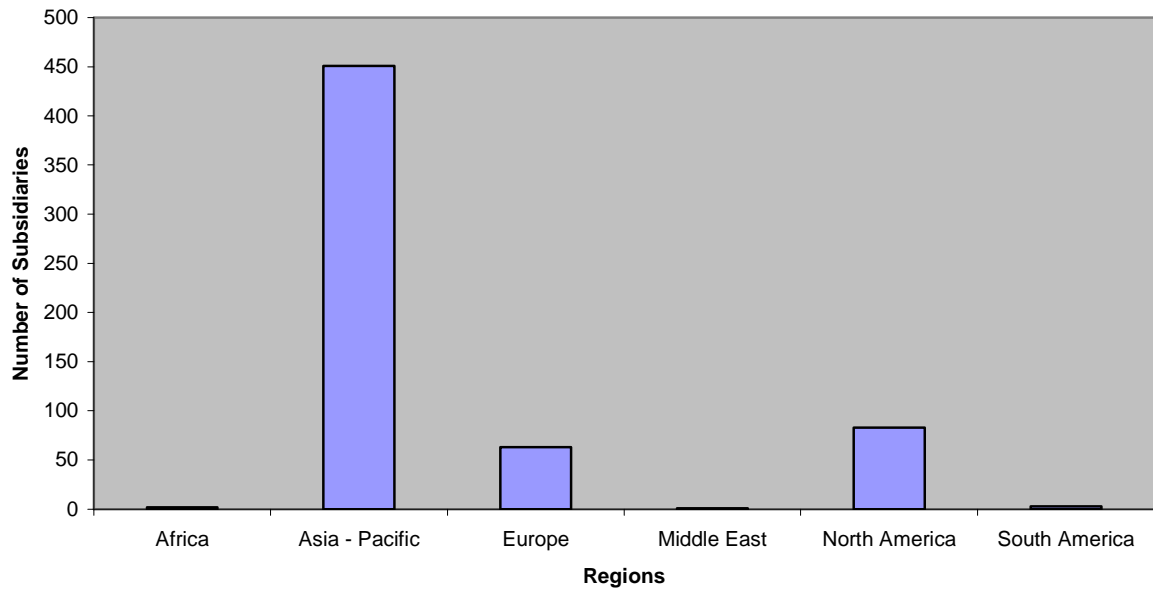


Figure 1. Industrial Distribution of Chinese Subsidiaries

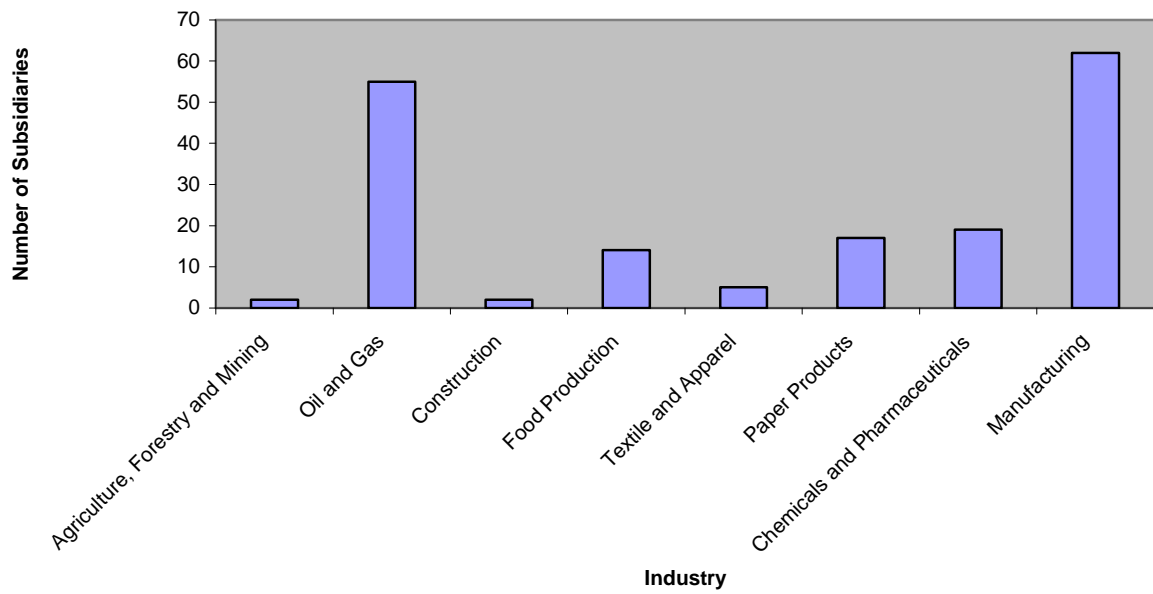


Figure 3. Distribution of Modes of Entry in Foreign Markets

