

MOTIVATION OF CHINESE INVESTMENT IN VIETNAM

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ABSTRACT: China attracted a record of US\$52.7 $\times 10^9$ in foreign direct investment (FDI) in the year 2002, surpassing the United States to become the world's largest FDI recipient. China's success in attracting FDI has received significant attention from academics. Several theoretical approaches have been developed to explain the determinants of FDI in China. However, it seems to be ignored that China has also become a growing provider of significant FDI to the rest of the world. According to United Nations Conference on Trade and Development (UNCTAD)'s 2004 report, as a developing country, replacing Japan, China has made the list of the expected top five home countries worldwide for the first time in terms of geographical coverage (2004- 2005). Vietnam is second largest market and another emerging transition tiger in Southeast Asia. Both China and Vietnam were and are experiencing transitions from centrally planned economy to free market economy. This paper, therefore, attempts to explore the development of Chinese investment in Vietnam, analysing the main motives for, and characteristics of, Chinese Multinational Enterprises' (MNEs) investment in Vietnam.

KEY WORDS: FDI from China; Chinese MNEs; Vietnam; motivation

CLC number: F276.7

Document code: A

Article ID: 1002-0063(2006)01-0041-07

1 INTRODUCTION

In January 2003, the London Based Financial Times reported that China attracted a record of US\$52.7 $\times 10^9$ in foreign direct investment (FDI) in the year 2002, surpassing the United States to become the world's largest FDI recipient. From zero in 1978 to over US\$52 $\times 10^9$ in 2002, the compound rate of growth of FDI in China has been nearly 40% per year. This growth helped China achieve a remarkably high average growth rate of GDP of nearly 10% per annum from 1978 to 2002, which has allowed China to develop into one of the most dynamic economy in the world. This phenomenal development is impressive. China's success in attracting FDI and utilizing it for domestic development since the adoption of the open-door policy in the late 1970s, has received significant attention from academics. Several theoretical approaches have been developed to explain the determinants of FDI in China, such as market power, internalisation, international competitiveness and the production-cycle model (SUN, 1998; WU, 1999; FU, 2000). The motivational factors supporting FDI in China that have been identified include the country's high GDP growth rate, low work force cost, large market size (economic factor) and bamboo network (cultural

factor). Chinese enterprises have benefited from this FDI in terms of technology transfers, improved management practices, and capital investment.

However, it seems to be ignored that China has also become a growing provider of significant FDI to the rest of the world. According to United Nations Conference on Trade and Development (UNCTAD)'s 2004 report, as a developing country, China has made the list of the expected top five home countries worldwide for the first time in terms of geographical coverage (2004-2005), replacing Japan (UNCTAD, 2004). At a global level, China's offshore investment is still small, but significant growth potential clearly exists.

A number of competing and complementary theories have been proposed to explain the motivation of FDI. Among others, these include the neoclassical theory of capital mobility, such as HYMER (1976) ownership advantage, BUCKLEY and CASSON's (1976) internalisation theory, DUNNING's (1977, 1979) eclectic theory, and VERNON's (1966) product life cycle theory. These theories will be applied to Chinese investment in Vietnam. Academics such as WANG (2002), TAYLOR (2002) and CAI (1999) have touched on this issue, but only generally addressed the motivations of Chinese Multinational Enterprises (MNEs) to invest in other

Received date: 2005-05-09

Foundation item: Under the auspices of the University of Melbourne

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countries, particularly in developed countries and regions, such as Australia, Canada, United States and Hong Kong Special Administrative Region of China. Chinese investment in destinations such as Vietnam has not been examined by most academics. Both China and Vietnam were and are experiencing transitions from centrally planned economy to free market economy. This paper, therefore, attempts to explore the development of Chinese investment in Vietnam, analysing the main motives for, and characteristics of, Chinese MNEs investment in Vietnam. Two Chinese MNEs—China Luoyang Floating Glass Corp. (CLFG) and China TCL Holdings Co. Ltd. (TCL) have been selected as case studies for this paper. Information on the Chinese MNEs and their investment in Vietnam was collected during a field trip to China and Vietnam in 2002. Existing problems with these investments and future trends of Chinese outward investment in Vietnam will also be identified at the end of this paper.

2 CHINESE FOREIGN DIRECT INVESTMENT IN VIETNAM

Since the normalisation of relations between China and Vietnam in the early 1990s, bilateral economic, trade and political ties have developed rapidly. The volume of

bilateral trade increased from US\$32 $\times 10^6$ in 1991 to US\$1440 $\times 10^6$ in 1997, and by 2000, reached US\$2466 $\times 10^6$, of which China's export was US\$1537 $\times 10^6$ (an increase of 59.5%) and Vietnam's export was US\$929 $\times 10^6$ (an increase of 162.3%). By exploring more investment opportunities in a neighbouring market, these two transitional economies became important trading partners. The two governments have also signed numerous agreements for investment protection since the normalisation of relations.

According to the statistics of Chinese MOFTEC (now called Ministry of Commerce), by June 2002, China had invested in 59 projects in Vietnam, with contract volume totalling US\$93.6 $\times 10^6$ (TEBACFERT, 2003; Ministry of Commerce, 2005) (Fig. 1). Based on Vietnam Ministry of Planning and Investment (MPI) statistics, at the 20th of July, 2005, China had invested in 342 projects in Vietnam with total capital reaching US\$700.31 $\times 10^6$, with this investment ranking 14th among all the countries and regions (MPIV, 2005). The discrepancy between the Chinese and Vietnamese statistics can be accounted for by the large amounts of private capital transactions that cross the boarder into Vietnam. These transactions do not show up in the Chinese official statistics but are accounted for in the Vietnamese figures.

Two Chinese MNEs—China Luoyang Floating Glass

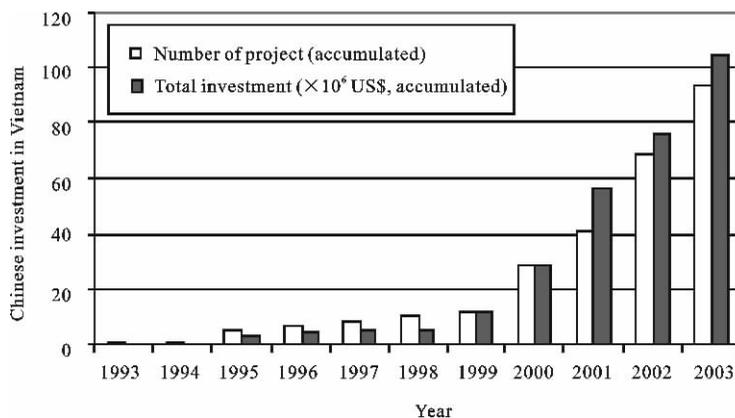


Fig. 1 Chinese investment in Vietnam 1993- 2003
(Source: TEBACFERT, 1994- 2004; Ministry of Commrece, 2005)

Corp. (CLFG) and China TCL Holdings Co. Ltd (TCL) have been selected as case studies for this paper. Both companies are large, state-owned manufacturing enterprises. However, they have very different backgrounds. CLFG is the largest comprehensive glass manufacturer in China and the birthplace of "Luoyang Float Process" known as one of three float processes in the world. Preparations were made for setting up the company in 1956. Today, after more than 40 years of development,

CLFG possesses two affiliated companies, eleven majority-controlled sub-companies (excluding secondary majority-controlled companies), three share-holding sub-companies, and one collectivized sub-company. CLFG has 12 000 employees and total assets of 3.9 $\times 10^9$ yuan (RMB) (1 yuan = US\$0.121) with net assets of 2.5 $\times 10^8$ yuan. China Luoyang Float Glass Group, with China Luoyang Float Glass Group Co. Ltd. appearing as its core, is not only one of 56 large-scale business groups of

China selected for experimentation but is also one of the business groups which are on a special list of the national planning. The Chinese government selected qualified, large state-owned enterprises (SOEs) for reforming experiments during the 1980s. The decision making power was then passed to the managers of these enterprises from the Chinese government. During the early period of transition from a centrally planned economy to a market economy, only a few SOEs had been selected. China Luoyang Glass Co. Ltd.—a majority-controlled sub-company sponsored and created by CLFG, has consecutively listed H and A shares in Hong Kong and Shanghai, raising capitals of 1.2 $\times 10^9$ yuan. This has allowed it to enter into financial markets both at home and abroad and also has opened a new financing channel.

In 1990, CLFG realized a wholesale agent from Guangxi Province had a high demand for glass, typically consisting of ten train carriages per month, with additional special train arrangements for the shipment. After market investigation, CLFG discovered that all the products had been sold to Vietnam. Based on the information gathered from Guangxi Province, CLFG decided to send a delegation to Vietnam for marketing research. The delegation interviewed different ministries officials, customers and local Vietnamese glass distributors, also collected data for the glass consumption in the different parts of Vietnam. The research report showed that market demand in Vietnam for CLFG glass was very high, mainly from the construction industry. There was only one glass factory in Vietnam in 1990, with no foreign companies manufacturing. Thus, there was little competition at that time. The technology used in Vietnam was far behind those used by CLFG. Based on the report, and the organization's strategy, CLFG management decided to invest in Vietnam.

Established in 1981, China TCL Holdings Co. Ltd. (TCL) is a comprehensive, large-scale, state-owned enterprise. It is engaged in business ranging from the R&D, manufacturing and sale of electronics and telecommunication products to that of information products. After a 20-year development, TCL has formed four series of products represented by TCL King Brand colour television in the industries of audio-visual products, telecommunication, information appliance and electrical components. Moreover, the corporate strategy is positioned at hastening the enterprise developments by integrating audio and video products represented by King Brand TV and mobile communication products represented by cell phone. TCL maintains a cutting edge by continuously enhancing its core competitiveness. Over the past 20 years, TCL has undergone a period of substantial devel-

opment and it is also one of the fastest-growing major industry manufacturers, having recorded a compound annual growth rate of more than 50% in the last ten years. Today, all of its four pillar industries lead the market in their respective fields. As a whole, TCL is ranked sixth out of China's 100 most prestigious electronics & IT enterprises. In 2001, TCL's brand equity was valued at 14.4 $\times 10^9$ yuan, its total sales reached 21.1 $\times 10^9$ yuan, and its export earnings came to US\$716 $\times 10^6$ (nearly 40% higher than that in 2000). In 1996, TCL acquired a Hong Kong based company. This company had a subsidiary in southern Vietnam (Dong Nai Province) that manufactured TV's, but due to a variety of reasons, this factory was nearing bankruptcy. After TCL founded an International Department, top management considered taking their first overseas venture into Vietnam. In November 1999, the first TCL colour TV appeared in Vietnam. By the end of 2000, TCL in Vietnam had started making profits. The total sales of colour TV's in 2000 were 20 000 sets, and the total sales of VCD's were a couple of thousand. The total profit in 2000 was US\$130 000. TCL achieved 8% of the colour TV market of Vietnam in 2001 and grew this to 16% (only 1% behind the industry leader) by 2002, while total profit was a half million US dollars in 2001.

3 REASON OF INVESTING IN VIETNAM

There are some common motives for investment in Vietnam between TCL and CLFG. First, both companies were attracted by Vietnam's large domestic market. Both TCL and CLFG simply followed their customers into Vietnam. They both had been exporting large quantity of their products to Vietnam before they decided to invest there. For TCL and CLFG, Vietnam's market size and economic growth were the main motives driving their investment. With a population of nearly 80 $\times 10^6$, Vietnam adopted a free market economy in the late 1980s. In the past 15 years, GDP growth rate has averaged around 7%. CLFG's main customer in Guangxi Province explored Vietnam's glass market in the early 1990s and found the neighbouring region of northern Vietnam had a great potential for construction industry. By following this Guangxi customer, CLFG was able to meet all the key officials in Vietnam. CLFG was easily able to enter Vietnam and establish their distribution network under the official Guan Xi (network in English). CLFG had an agreement with their Guangxi customer that CLFG would set up the new factory in the southern Vietnam and mainly target the southern and central market, while keeping the traditional northern market for their customer. In

1992, CLFG set up its joint venture Vietnam-China Longjiang Glass Ltd. in Bien Hoa of the southern Vietnam. For TCL, its market entry into Vietnam was based on the purchase of a Hong Kong subsidiary that had set up its Vietnamese factories in 1995. Hong Kong's financial location and its Vietnamese factory were the main reason for this acquisition. As the new owner of the Vietnamese factory, TCL simply renewed its contract with the Vietnamese government and entered the Vietnamese market.

The second common motive is adapting to local tastes and needs from customers. When CLFG entered the Vietnamese market in 1992, the construction industry in Vietnam was booming. In terms of technology and market economic experience in the glass industry, Vietnam was behind China. As the main glass company in China, CLFG was technologically advanced in its manufacturing capabilities. Due to the different market needs and the boom of the construction industry in Vietnam, CLFG had to manufacture different products to cater for local tastes and needs. For example, in Vietnam's construction industry in the early 1990s, there was a high demand for coloured glasses such as blue and "Tea" brown. While CLFG had the manufacturing capability to produce these products, the market demand for coloured glass in China had reduced significantly as these products were in the decline stage of the product lifecycle in the Chinese construction industry. Thus, CLFG shifted these machines and technology as a capital investment to their joint venture in Vietnam. TCL also offered local TV products for the Vietnamese market. At this time, Vietnam still experienced shortages of electricity and did not have a broadcasting network or satellite technology to cover some remote mountainous and rural parts of the country. Due to the different needs and tastes of local Vietnamese customers, TCL produced a "powerful receiver" coloured TV in Vietnam. In these regions, TCL's TV provided much clearer reception than other brands. This is the main reason why TCL achieved a high market share within a couple of years after entering the Vietnamese market. During an interview with CLFG and TCL, both companies mentioned that a lack of knowledge of the local language and business customs of Vietnam was also another reason why they wanted to set up Vietnamese subsidiaries.

Reducing transaction costs was another motivation for TCL and CLFG in setting up their Vietnamese subsidiaries. Vietnam had high tariffs for imported TVs, and a local quota system that blocked TCL targeting the market directly. The Vietnamese government was under pressure from existing TV industry investors in protect-

ing existing TV manufacturers in Vietnam. The government put high tariffs on imported TV sets overseas and used a quota system to protect the existing investors. The cost of import tariffs and the import quota significantly increased the transaction costs for TCL in Vietnam. As a result, TCL entered Vietnamese domestic market to avoid this cost. CLFG was an early bird in the Vietnamese market. The company did not face a tariff or quota system for importing glass for Vietnam's construction industry. However, after the Border War and due to the political relationship between China and Vietnam, transportation costs between China and Vietnam were very high in the early 1990s. By setting up a new production line in the local market, CLFG could save huge transportation costs and effectively target the Vietnamese market.

Another set of common motivations relates to government policies: both China and Vietnam were and are experiencing transition. Both the Vietnamese and Chinese governments tried to attract more FDI to their countries. However, China was more successful in doing this and encouraging its own large MNEs to invest overseas market. After China joined the WTO and set up a free trade agreement with the Association of Southeast Asian Nations (ASEAN), the Chinese government believed "going outside" for Chinese MNEs was the best option for development. The governments in China and Vietnam played an important role in attracting, encouraging and providing FDI between the two countries. After nearly 30 years of economic reform in China, the Chinese government decentralised a lot of authority to the management of state-owned enterprises (SOEs). As a result, some of these enterprises were privatized, while some became public listed companies. However, the Chinese government still had a strong influence on the decision-making of the Chinese MNEs through policies. The "going outside" policy is a good example of this influence. The Chinese government realized that overseas activity of their MNEs could increase their international competitiveness and improve their performance in their home economy. Regardless of whether the individual enterprises were ready to go outside or not, most choose to go outside after the policy was implemented. This phenomenon could also be called the MNEs with Chinese Socialist Characteristics Market Economy. Both CLFG and TCL experienced strong push factors to "going outside". During an interview with both MNEs, they mentioned they had strong encouragement from the central and local government to invest in Vietnam. During the policy making process, the Chinese government not only took economic factors into account, but also factored

political reasons into consideration. Encouraging Chinese MNEs to invest in Vietnam is a clear example of the government taking economic and political factors into account when forming policy.

Since the Doi Moi policy was implemented in the late 1980s, the Vietnamese government had tried repeatedly to attract FDI into the country. Vietnam not only saw the benefits of FDI in their "friend and comrade" China, in terms of domestic economic development and improvements in the people's living standards, but experienced these benefits partially in the FDI they had attracted. The law for FDI had been amended four times since it was introduced in 1988. Fundamentally, the law protected the right for FDI in Vietnam. Meanwhile, the Vietnamese government made favourable policies for attracting FDI and competing with neighbouring countries such as Malaysia, Thailand and other ASEAN countries. CLFG was the first Chinese FDI project in Vietnam. The Vietnamese government provided a lot of encouragement for this project, as it was a symbolic project of the normalisation of the two countries diplomatic relationship. Due to the intense competition within Vietnam, different provinces had their own regulations and policies to attract FDI. Provinces such as Dong Nai set up a different industry zone and export processing zone for FDI, built infrastructure for the investment and reduced the bureaucracy from government. Evidence of the success of this policy is provided by the fact that both the Chinese MNEs located their FDI projects in Dong Nai Province. TCL also had similar experiences in investing in Vietnam. In 1998, it was the hardest period for Vietnamese economy. The Asian Financial Crisis had a devastating impact on the local economy. FDI had declined from the pervious years and the government was very concerned about the economy. Several new policies were implemented to attract more investment into Vietnam. TCL benefited from these policies, said Dr. Yi Chun-yu.

Similar cultural backgrounds, political systems and the bamboo network between China and Vietnam are another set of advantages accounting for why Chinese MNEs selected Vietnam as a FDI destination. China and Vietnam both were centrally planned economies before. Both were and are in a transition from a planned economy to a market economy. Furthermore, both countries shared similar Confucian philosophies and cultural values. China was the first to adopt an open door policy in the late 1970s. About 10 years later, Vietnam adopted a similar policy and opened up. In the period of economic transition, the Chinese MNEs gained experience at meeting the market demands of consumers, and in doing so,

improved their marketing skills, technology and management systems. These propriety assets provided ownership advantages for Chinese MNEs when investing in Vietnam. In interviews with both companies, it was pointed out that this advantage made Vietnam a prior investment destination in Southeast Asia. They mentioned that they could easily understand the workings of the Vietnamese government system, local consumer behaviour, and did not experience difficulty in executing their marketing strategies. Dr. Yi from TCL mentioned that in the past 10- 15 years the market knowledge they had gained from the Chinese market could write a textbook for the Vietnamese market.

Does the size of a company really matter for Chinese MNEs? Most Chinese MNEs believe in the globalized economic environment: "the larger, the better". In the globalising economy, greater company size can be a crucial parameter, particularly in an economy like China. Chinese MNEs believe that size itself can provide a sustainable competitive advantage for a company. It also has this protective function from its competitors. Both TCL and CLFG mentioned that large sized MNEs in different geographic locations can also collect and adopt new information and innovation for the company. CLFG and TCL are the largest companies in China. CLFG was one of the top 500 trial-reformed SOEs in China in the 1980s. TCL was the most rapid growing SOE. Even though it was only founded in the 1980s, the achievement of TCL is remarkable. Now TCL is among the top 500 enterprises in China. Both companies have the strategic objective of sustaining and advancing their international competitiveness. To promote and implement this strategic objective, they select particular economies with the most promising investment potential. "The larger, the better" philosophy is another motivation driving Chinese MNEs to invest in Vietnam.

Beyond those similarities, there are a couple of different motivations between TCL and CLFG. Different company backgrounds, management styles and products have resulted in different FDI motivations. The intensive market competition in China pushed TCL to escape from its home market. The Chinese home appliances industry has been growing really fast. From the 1980s to the 1990s, different Chinese brands and companies have emerged in China to intensify competition in this market. Companies operating in this market have used different marketing skills and strategies to target customers. Profit margins were low. This situation is similar with that of many developed countries and Newly Industrialized Economies (NIEs) that have experienced various stages of market competition in their economic development. By

increasing exports of these products overseas, benefits were offset by growing trade barriers and tariffs in many countries, particularly in developing countries such as Vietnam. TCL believed that if the company wanted to achieve rapid growth again, it should find a new growing market. The high market competition from its home market pushed TCL to take the step into the international marketplace. Vietnam represents the start for TCL's international strategy.

An export-orientation is one of the motivations for China Luoyang Floating Glass. CLFG set up its Vietnam subsidiary to secure and internalize their Vietnamese market. All the raw material for the subsidiary had to be imported from their head office in China. Regardless of whether the Vietnam subsidiary was profitable or not, the head office did still have to export the raw material to Vietnam. If the subsidiary was profitable, the revenue was considered a bonus. If not profitable, the head office would still make a profit from the manufacturing machines that had already sold to the Vietnam joint venture.

4 CONCLUSIONS

Seeking the Vietnamese domestic market, push and pull forces exerted by home and host government policies, similar political, cultural and economic systems, and the globalization of companies are the common motives behind the Chinese MNEs investment in Vietnam. However, there are some different motivations between the two companies. For TCL, an intensely competitive home market and low profit margins pushed them out to seek other markets globally. Meanwhile, the going global strategy also made TCL regard Vietnam as a manufacturing base from which it could target the whole ASEAN market. Exporting more products to the Vietnamese market was one of the motivations for CLFG to set up its Vietnam subsidiary.

According to DUNNING's (1977, 1979) eclectic paradigm ownership advantage, internalisation advantage and location advantage are determinants of FDI. The two cases demonstrate that technology is not the only ownership advantages which CLFG and TCL had for their investment. The other intangible assets such as distribution knowledge, marketing skill, and their understanding of transitional economies are all ownership advantages for their investment. After 30 years of operating in a transitional economy in China, a lot of Chinese MNEs had rich experiences in knowing how to handle the transitional market, how to deal with customers during this period, how to set up distribution systems, and

how to cope with intensive market competition. All of these intangible assets are comparative advantages for Chinese MNEs to invest in a similar, but lagged, economy such as Vietnam. Like Dr. YI from TCL said, the knowledge TCL gained from operating in the intensely competitive market of China in the 1990s could write a textbook for the Vietnamese market. Vietnam is located in one of the most rapidly growing regions in the world. It has similar political and economic systems and a similar cultural background with China. All of these factors attracted CLFG, TCL and other Chinese MNEs to invest in Vietnam. Both CLFG and TCL had ownership advantages. Therefore, it was more profitable for CLFG and TCL to internalize their advantages by extending their own activities, rather than externalizing them by signing international contracts with independent companies.

The eclectic paradigm of DUNNING partially explained the motivation of Chinese MNEs investing in Vietnam. Some unique characteristics of Chinese MNEs in Vietnam seem missing. The role of the Chinese government and Chinese national policies seem to be ignored in this explanation. In fact, this factor is one of the most important motivations for Chinese MNEs to invest in Vietnam. National strategies and policies definitely had and have a strong influence on the corporate strategies of Chinese MNEs. BUCKLEY (1998) pointed out government policies play an important part in fostering and hindering the preferred business strategies of firms.

Going world for Chinese MNEs is the outcome of China's "going outside" policy and open-door policy initiated after 1978. During the transition from a planned economy to a market economy, Chinese enterprises reformed their management, innovated their technology and gained remarkable experience competing in an intensive marketplace. All of these factors became strengths of Chinese MNEs when engaging in investment activities overseas, particularly in other similar developing countries such as Vietnam. After China joined the WTO and signed the free trade agreement with ASEAN, the globalization of Chinese MNEs in the region and worldwide has sped up. However, there are still limitations for the globalization of Chinese MNEs. The Chinese government has not established any legal infrastructure to protect the overseas investment of Chinese MNEs. There is also a lack of financial support and insurance services. The application procedure in China is still fairly complicated. Furthermore, Chinese MNEs themselves also have internal management problems, such as financial management problems of their overseas investment, human resources management problems etc. Chinese MNEs are still in the early stage of the globalization-

process. From the experiences of other developed countries, Chinese MNEs should set up their overseas investment and management mechanisms, improve the quality of management by selecting qualified management teams, and provide training in areas such as human resources, marketing and foreign languages.

ACKNOWLEDGMENT

The author would like to thank Dr. Mark Wang and Mr. Trent Hennessey for their useful comments on each draft of this paper.

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