THREE ESSAYS ON CROSS-BORDER MERGERS ANG ACQUISITIONS

YUHUILIN CHEN

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Abstract

This thesis mainly focuses on three essays on cross-border M&As. A sample of Chinese outward mergers and acquisitions (M&As) between 1997 and 2011 involving Chinese listed firms as the acquirers is analysed in the first essay to highlight the relationship between political connections, financial constraints, and stock returns. On average, Chinese firms, especially private firms, are more likely to face financial constraints. However, the political connections can release these kinds of financial constraints. Less financially constrained firms have higher stock returns when there is an announcement of outward M&As.

The second essay investigates whether foreign acquisitions can mitigate financial constraints, improve Chinese target firms' research and development (R&D), and productivity, based on a sample of 914 inward M&As deals over the period of 1994-2011. Empirical results show that foreign acquisitions in China are associated with a reduction in target firms' financial constraints, which is pronounced for non-state owned enterprises. I also provide evidence that foreign acquisitions can improve target firms' R&D investment and productivity post acquisition.

The third essay investigates the impact of strategic assets with firm heterogeneity on location-takeover choices by Chinese multinational enterprises by employing a dataset of 978 outward M&A cases over the time period 2000-2014. There is positive correlation between strategic assets and location-takeover choices. Technology is the most important factor in comparison to brands and management practices. Firms with a higher degree of R&D expense are sensitive to host country's strategic assets. Government-involved firms care more about 'hard' technology (e.g. advanced innovation of product, plant, or equipment) than 'soft' technology (e.g. management quality).

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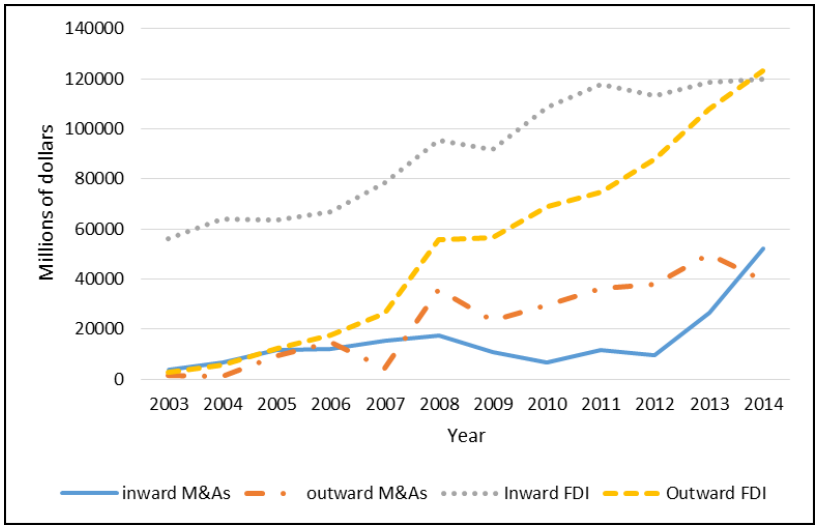
Chapter 1. Introduction

1.1 Research background and motivations

Following the initiation of economic and institutional reforms in 1979, China is widely seen as pivotal in attracting foreign direct investment (FDI) (Buckley et al., 2007a). Having been portrayed as a magnet for FDI since the 1990s, there has been significant growth in outward FDI by Chinese multinational enterprises (Duanmu, 2012). FDI inflows into China increased from 52,659 million US dollars in 1999, to 118,721 million US dollars in 2013, meanwhile, the stock of outward FDI stood at 107,843 million US dollars by 2013, while it was valued at 26,506 million US dollars in 2007 (National Bureau of Statistics of China, 2004-2015). In a similar vein, cross-border mergers and acquisitions (M&As), which are recognised as a popular entry strategy for internationalisation by multinational enterprises, have experienced a dramatic increase in China in the past few decades. Figure 1.1 presents the value of inward FDI, outward FDI, inward M&As, and outward M&As in China during the time period 2003-2014. The values of both inward and outward FDI have rocketed in the past 10 years. In 2014, the value of outward FDI was surpassed by that of inward FDI for the first time. As can be seen, during the past decade, outward M&As, which constitute the dominant share of outward FDI, rose from 1,647 million US dollars in 2003, to 50,148 million US dollars in 2013, and 39,580 in 2014. Although inward M&As occupied a smaller share of inward FDI at the early stage, inward M&As have become an important entry mode of inward FDI in China. The value of inward M&As increased from 3,820 million US dollars in 2003, to 52,415 million US dollars in 2014. They accounted for 6.8% of FDI inflow in China in 2003, up to 43.8% in 2014 (United Nations Conference on Trade and Development, 2015). This suggests that cross-border M&As in China have become more important as a form of entering foreign markets and for FDI

inflows. Understanding the forces and implications of cross-border M&As by Chinese multinational enterprises deserves more scrutiny and discussion.



Sources: National Bureau of Statistics of China (2004-2015), United Nations Conference on Trade and Development (2005), United Nations Conference on Trade and Development (2008), United Nations Conference on Trade and Development (2015)

Figure 1. 1 Value of inward FDI, outward FDI, inward M&As, and outward M&As in China for the years 2003-2014

With the rapid development of Chinese cross-border M&As and their important role in foreign investment, several interesting motivations are combined to explore the topic of cross-border M&As in China. First, considering that the institutional environment in China is different from that in developed countries, the Chinese government is a major shaping force for multinational enterprises' cross-border M&As behaviour (Kang and Jiang, 2012). The government remains in control of the internationalisation of Chinese firms through outward M&As. For example, there are regulations and government agencies involved in the process of international market expansion by Chinese multinational enterprise and, as a result, the process for Chinese companies to invest abroad is convoluted. There are five main government agencies involved in outward investment procedures: the National Development and Reform Commission; the Ministry of Commerce; the State-owned Assets Supervision and Administrative Commission of the State Council; the State Administration of Foreign Exchange;

and the Ministry of Finance (Backaler, 2014). This means that central government officials are in charge of screening, and approval, of Chinese outward M&As (Hong and Sun, 2006). Large state-owned enterprises receive preferential treatment in the government's overseas investment approval system and gain financial support from the state-owned banks (Backaler, 2014). Firms with political connections, like state-owned enterprises, not only enjoy preferential status with government agencies when multinational enterprises adopt cross-border M&As, but also gain benefits from ease of access to financial support and key production facilities and resources. Firms with political connections with banks are more likely to gain access to long-term debt than those firms without political connections (Charumilind et al., 2006). However, the effects of political connections on firms' performance and investment are particularly critical. Government related enterprises suffer more in terms of their investments because government intervention reduces investment efficiency and performance (Fan et al., 2007, Fisman, 2001). Government involvement in firms' internationalisation is critical when firms adopt cross-border M&As because these kinds of firms are more likely to face political sensitiveness and public worries in the host country, which can, in turn, lead to the failure of outward M&As (Zhang et al., 2011). The effects of political connections on financial constraints and cross-border M&As by Chinese firms are under-researched.

Second, there has been a rapid development in Chinese inward M&As in recent years. In the literature, although a number of papers focus on Chinese inward FDI, only a small number consider inward M&As. There are two main categories relating to inward M&As. On the one hand, most papers describe the development of inward M&As in China in general without in-depth analysis of the factors involved and their implications, e.g., Chen and Findlay (2003) and Peng (2006). On the other hand, research tends to evaluate the factors that incentivise cross-border M&A inflow in China and the effects of inward M&As

on the Chinese economy, e.g., Nagano and Yuan (2013), Liu et al. (2015), and Zou and Simpson (2008). The research on the effects of foreign acquisitions on Chinese target firms is still not well-explored. Moreover, recent studies focus on whether foreign acquisitions can release the financial constraints of target firms. For example, empirical tests carried out by Erel et al. (2015) aim to identify whether, or not, foreign acquisitions can mitigate a target firms' financial constraints in European countries. However, currently there is limited evidence about enterprises in emerging countries. The main obstacle to research in this area concerns the data availability of target firms subsequent to their acquisition (ibid). Foreign acquisitions seem an effective way for target firms to access external debt from parent firms and the international market (Wagner et al., 2013). While the foreign acquisitions are more likely to reduce the financial constraints faced by the target firms, intriguing questions are raised about the effects of foreign acquisitions on target firms' R&D and productivity. This represents another under-explored issue.

Third, since the 'go global' policy initiated by the Chinese government in 2001, there has been a rapid expansion in Chinese outward investment. Extant research interprets the motivations and determinants of outward M&As by Chinese multinational enterprises, e.g., Buckley et al. (2007b), Wang et al. (2012), and Kang and Jiang (2012). Enterprises from emerging countries lack the strength of international experience, technological skills, and managerial practice which are traditionally held by enterprises in developed countries (Ramamurti and Singh, 2009). In order to negate, or lessen the impact of, these kinds of disadvantages, Chinese multinational enterprises have to improve their technological and commercial capabilities by following strategic asset motivated outward M&As (Deng, 2009). However, a small number of studies investigate the strategic assets and location take-over choices of Chinese multinational enterprises. For example, qualitative research methods have been employed by Rui and Yip (2008), who

claim that Chinese firms gain strategic assets in terms of intellectual property, brands, and technology through outward M&As in order to strengthen their competitive advantage in the global market. Similarly, Cui et al. (2014) empirically examine the factors that drive Chinese firms' strategic asset seeking by foreign investment. They conclude that there are several factors determining the strategic asset seeking outward M&As by Chinese multinational enterprises, such as government structure, financial capability, and foreign competition. However, the issue of strategic assets motivated cross-border M&As by Chinese multinational enterprises is under-researched, and requires analysis with further empirical evidence.

1.2 Research questions

In response to past studies and the extent of the rapid development of cross-border M&As in China, this thesis aims to analyse three aspects of cross-border M&As made by Chinese multinational enterprises. Firstly, I consider the effects of political connections and financial constraints on outward M&As by Chinese multinational enterprises. Since the government still controls the main resources and key inputs in China, firms seek to build political connections to release their financial constraints caused by information asymmetries and corporate governance (Xu et al., 2013). To what extent can political connections release financial constraints faced by Chinese firms involved in outward M&As? The effects of political connections on firms' performance and investment is mixed. Political connections bring benefits of access to bank loans since most of the banks in China are state-owned and controlled by government institutions (Allen et al., 2005, Li et al., 2008). However, government related firms are more likely to face political sensitiveness and public worries in host countries (Zhang et al., 2011). In order to explore this issue, I further investigate the market value response when there is an announcement of outward M&As for both the

politically connected firms and the financially constrained firms, and compare this to the non-politically connected firms and less financially constrained firms.

Secondly, due to imperfect financial market development, Chinese firms, especially private ones, are more likely to face financial constraints compared to those of firms in developed countries (Allen et al., 2005, Chen, 2008). Foreign acquisitions provide an effective solution for financial constraints faced by the enterprises (Wagner et al., 2013). I investigate whether Chinese firms are facing financial constraints, and to what extent foreign acquisitions can mitigate those financial constraints faced by Chinese target firms. Since foreign acquisitions can release financial constraints, whether they can improve target firms' R&D expense and productivity is also investigated. This helps me better understand the explanatory theories on this growing trend of inward M&As in China.

Thirdly, with the rapid development of outward M&As in China, I investigate the relationship between strategic assets and location-takeover choices of Chinese multinational enterprises with firm heterogeneity. Due to a shortage in technological skills, fewer skilled human resources and management practices, multinational enterprises from emerging countries, as latecomers, have less ownership advantages in terms of strategic assets than their international rivals. Therefore, they are incentivised to access advanced technologies, management skills, and brands through outward M&As with foreign countries in order to compete successfully (Anand and Delios, 2002, Jindra et al., 2016, Luo and Tung, 2007). Based on the literature, I explore the knowledge base on the impacts of strategic assets in a host country on attracting Chinese multinational enterprises' location-takeover choices. I further investigate what kinds of strategic assets determine the Chinese outward M&As by constructing composite strategic asset indices and empirically examining their components. Moreover, I also examine the effects of firm heterogeneity on outward M&As to examine whether strategic

asset motivation varies with firm heterogeneity in the terms of firm size, R&D intensity, and government involvement.

1.3 Research contributions

In line with past studies on the examination of the impacts of political connections and financial constraints on firms' investment in China, the first essay of the thesis sets out to investigate the effects of political connections on financial constraints faced by the enterprises and outward M&As in China, which is still under-researched. Liu et al. (2013) empirically test the influence of political connections on Chinese firm's M&As, but they fail to discriminate between domestic and cross-border M&As. The determinants and institutions faced by the firms in cross-border M&As are different to those faced by firms in domestic M&As, as a result the effects of political connections on firms' performance are dynamic in different types of M&As (domestic M&As and cross-border M&As). The first essay of this thesis not only examines the effects of political connections on financial constraints of Chinese listed firms relating to outward M&As over the time period of 1998-2011, but by employing event study methodology, it also analyses the effects of political connections and financial constraints on firms' stock returns when there is an announcement of outward M&As. Moreover, this article is not only in line with previous studies that use investment to cash flow sensitivity as a measure of financial constraints, but also uses another proxy of financial constraints (tangibility), which has been used by Xu et al. (2013) to estimate the Chinese firms' financial constraints. This essay also adds to the growing literature on home country determinants of outward M&As by Chinese multinational enterprises in terms of ownership structure, political connections, and financial constraints. My empirical research shows that Chinese firms' are more likely to face financial constraints caused by information asymmetries and agency costs, but that political connections can

mitigate these kinds of financial constraints. Financially constrained firms have lower stock returns, but, politically connected firms do not present significant influence when there is an announcement of outward M&As.

The second article of this thesis is about the inward M&As in China, where I examine the effects of foreign acquisitions on Chinese target firms' financial constraints, R&D expense, and productivity. While China has experienced rapid development in terms of inward M&As, only a small number of papers work in this area, justified by the fact that the transactions of inward M&As taking place is smaller in value than those of outward M&As in China (Zou and Simpson, 2008). However, considering the important role played by inward M&As in FDI in China, this article contributes to the literature of inward M&As in China by evaluating the effects of foreign acquisitions on firms' financial constraints, R&D, and productivity. Moreover, although recent studies work on whether foreign acquisitions can potentially release target firms' financial constraints and improve investments in the context of developed countries, studies in this research area in developing countries is limited. One possible reason that the degree of financial constraints in target firms remains under-researched is that these predictions and evaluations need financial data of target firms before and after acquisition, and this is restricted by implications of financial constraints and financial policies (Erel et al., 2015). However, target firms in my sample are listed on the Shanghai Stock Exchange Market and the Shenzhen Stock Exchange Market, which provides a rare opportunity to access disclosure of financial data for target firms. So it is possible to observe the financial data of target firms both before and after foreign acquisitions. I have collected a data set of three year's pre-acquisition and three year's post-acquisition information to investigate whether Chinese target firms face financial constraints pre-acquisition, and whether these kinds of financial constraints are released post-acquisition. My empirical results indicate that foreign acquisitions in China are

associated with a reduction of target firms' financial constraints by using investment to cash-flow sensitivity to measure financial constraints. The extent of financial constraint reduction is pronounced for non-SOEs compared to SOEs. Evidence shows that foreign acquisitions can also improve a Chinese target firms' productivity and investment in R&D post-acquisition.

The third essay of this thesis is in line with the research area of motivations of Chinese multinational enterprises' location-takeover in terms of strategic assets, which is still under-researched. This article adds new insights to the current knowledge set and enriches the literature on Chinese multinational enterprises' location-takeover choices in terms of strategic assets with firm heterogeneity. Most past papers use independent measures of strategic assets, such as technology, patents, R&D expense, and the export of high technology (Buckley et al., 2007b, Ramasamy et al., 2012, Zhang and Roelfsema, 2014). Based on the previous literature, I not only empirically investigate the overall map of the effects of strategic assets on location-takeover choices by constructing a series of composite strategic asset indices, but also examine what kind of specific strategic assets in a host country mostly attract Chinese firms' outward M&As. This examination is based on a wide range of dimensions, including technology, brands, and management practices, and uses a conditional logit model. Furthermore, most existing papers in the research area of Chinese strategic asset motivated outward M&As work on macro-economic factors at the country level of analysis (Buckley et al., 2007b, Deng and Yang, 2015). A number of papers work on firm level analysis to understand the effects of firm heterogeneity on location-takeover choices (Wang et al., 2012). In response to such earlier research, I not only consider the determinants of host country macro-economic factors, but also analyse whether the strategic asset motivated outward M&As vary with firm heterogeneity. My empirical results show that host country strategic assets significantly attract Chinese multinational enterprises' location-

takeover choices. Technology is an important matter for Chinese outward M&As in comparison with brands and management practices. Chinese firms care more about the commercial technology that they can convert into commercially viable products and services, rather than other intangible strategic assets (Ramasamy et al., 2012). Firm size does not matter for strategic asset motivated outward M&As, but firm R&D expense and government involvement do. Government involved firms are attracted to host countries with a higher degree of strategic assets to increase their core competencies in the global market, but they care more about 'hard' strategic assets, like the latest innovations and technology, rather than 'soft' ones, like managerial quality.

1.4 Thesis outline

The thesis is made up of three essays on cross-border M&As. Chapter 2 introduces the traditional theories and literature on cross-border M&As, which covers the pioneering works in the international expansion of firms, and a discussion of traditional motivations for international investment, entry strategies used by multinational enterprises, a definition of cross-border M&As, and research on Chinese cross-border M&As. Chapter 3 interprets the first essay about the effects of political connections on financial constraints faced by the Chinese firms involved in outward M&As and the performance of stock returns. Chapter 4 presents the second essay about the impacts of foreign acquisitions on target firms relating to inward M&As in China in terms of financial constraints, R&D, and productivity. The final essay is presented in Chapter 5, and examines the effects of strategic assets with firm heterogeneity on attracting Chinese multinational enterprises' location-takeover choices. A conclusion is made in Chapter 6.

Chapter 2. Literature review

2.1 Introduction

This chapter reviews the literature which helps to explain the field of cross-border mergers and acquisitions (M&As). Section 2.2 provides an explanation of the globalization activities of multinational enterprises which covers pioneering works in multinational activities, international theory, Kojima's macroeconomic approach, and Dunning's eclectic paradigm. Section 2.3 provides a discussion of the traditional motivations for international investment including market seeking, resource seeking, efficiency seeking, and strategic asset seeking. Following that, section 2.4 shows the entry strategies used by multinational enterprises to access foreign markets, such as joint ventures, greenfield investment, cross-border mergers and acquisitions; the latter is clearly defined in Section 2.5. Then, sections 2.6 and 2.7 provide an interpretation of the research into Chinese inward and outward M&As based on the literature. Finally, conclusions are drawn in section 2.8.

2.2 General explanation of multinational activities

This section provides an explanation of multinational activities in general based on traditional theories and frameworks. Both Hymer's (1976) and Vernon's (1966) works are pioneering in their analysis of multinational value-added activities. Buckley and Casson (1976) explain internalisation theory by referring to operational internalisation and knowledge internalisation in multinational activities. Kojima's (1982) macroeconomic approach to Japan's FDI, and Dunning's eclectic paradigm about the determinants of foreign investment are also explained.

2.2.1 Pioneering works

Hymer's (1976) and Vernon's (1966) analytical frameworks are pioneering works on the theory of multinational activities. Hymer (1976), as a pioneer of the modern theory of multinational enterprise activities, discovered that there were a growing number of United States (US) firms performing foreign direct investment (FDI) in foreign countries like Canada and Western Europe (Dunning, 2001). FDI is more than simple capital movement, rather it is an international strategy decision made at firm level. Hymer (1976)'s framework allows that FDI relieves the competition and conflicts between firms caused by market imperfections. According to Hymer (1976), firms have certain types of advantages in international operations, which help to eliminate competition and conflict between firms in foreign markets and allow them to exploit their specific advantages from a foreign location.

In contrast to that of Hymer (1976), Vernon's (1966) approach explains the concept of foreign value added activities of US firms in terms of microeconomics, i.e., the product cycle. According to Vernon (1966), a product's development should experience three stages: new product; maturing product; and standardized product. In the first stage, the product is produced for the domestic consumer in the home country and there is no international trade. In the second, or maturing product stage, there is an expansion of the product provided by US firms because of favourable product advantages and innovation. Then, the product begins to be exported to other developed countries who have the most comparable demand patterns and supply capabilities to the US. In the final standardized product stage, product supplying firms minimise the costs of value added activities and increase the cost efficiency because imitators start to enter the market and consumers become more price elastic. At this point, it is more attractive for product suppliers to perform value adding activities in foreign

countries. This product cycle explains the market seeking motivations of firms, but it does not explain other types of foreign direct investment such as the resource-based seeking, efficiency seeking, or strategic asset seeking (Dunning and Lundan, 2008). To sum up, Vernon's (1966) product cycle interprets the dynamic interaction between international trade and international investment.

2.2.2. Internalisation theory

Internalisation theory is conceptualized by Buckley and Casson (1976b) based on the earlier insights of Coase (1937), which is deeply embedded in Hymer's (1976) work and contributes to the explanation of the function of multinational enterprises. Internalisation theory focuses on a way to deal with imperfections in the intermediate product markets (Rugman, 1981), and explains the boundaries of external environment and internal organisations (Rugman and Verbeke, 2008). Operational internalisation and knowledge internalisation are two main forms of internalisation in analysing the boundaries of multinational enterprises. Operational internalisation concerns the flow of intermediate inputs and outputs, while knowledge internalisation is a result of research and development linking products (Buckley and Casson, 2009). However, asymmetric information exists in the marketplace. For example, some producers and service providers are unable to ensure the quality of their final product because the quality of intermediate products, like intellectual property rights, is controlled by others. It is reasonable to internalise the intermediate products by forward integration. Another internalisation is about backward integration to reduce the risk of interrupted supplies or price hikes.

Internalisation theory can be considered as a general theory in so far as it explains the situations in which multinational enterprises internalise intermediate products across national boundaries with the purpose of reducing

transaction costs. However, Buckley (1990) points out that it is more reasonable to describe it as a paradigm rather than a theory because it only explains one dimension of multinational enterprises. Location specific variables should be embedded in internalisation variables when explaining the direction and amount of foreign value-added activities (Casson, 1987).

2.2.3 Kojima's macroeconomic approach

Kojima's (1982) macroeconomic approach extends the neoclassical theory to explain the trade-oriented Japanese FDI. The basic theorem is that FDI should be undertaken when the intermediate products that require resources and capabilities are comparatively disadvantaged in the home country while, at the same time, these intermediate products are potentially comparatively advantaged in the host country (Kojima, 1982). There is a comparison between the trade-oriented Japanese type FDI and the anti-trade oriented American type FDI. The former suggests the comparatively disadvantaged industry in the home country can improve the industrial structure and accelerate the trade of both the investing and receiving countries, while the latter, constructed within oligopolistic, traditional, and price competitive market structures in the home country, leads to an imbalance of payments and damages the long-term operation and trade between the investing and receiving countries (Dunning and Lundan, 2008). In Kojima's macroeconomic approach, FDI, as an effective conduit for trading intermediate products between two countries, contributes to a harmonious development of both the home and host countries.

To some extent, Kojima's macroeconomic approach generally explains the direction of foreign value-added activities. However, it fails to fully explain modern trade (Dunning and Lundan, 2008). Buckley (1991) claims that Kojima's (1982) approach does not actually explain the elements of internalisation theory

and is considered to be seriously flawed, out-dated, and inapplicable because the assumptions are unduly narrow and its approach ignores the competitive process and the role of services and national culture on outward FDI. However, Kojima (1992) identified the importance of the internalisation of intermediate products and determined the optimized combination of internalisation and externalisation on multinational enterprises' business to increase the economic efficiency and achieve an optimal scale of production.

2.2.4 The eclectic paradigm

In recent decades the eclectic paradigm has been the dominant analytical conceptual framework used to test the determinants of the foreign activities of enterprises. The eclectic paradigm draws on a macroeconomic theory of international trade in interaction with a microeconomic theory of firm behaviours, which attempts to integrate various explanations of the level and structure of the cross-border value-adding activities of enterprises (Dunning and Lundan, 2008). If a firm has the motivation to enter into a foreign market, it must have specific advantages to achieve a lower cost. There are three sets of interdependent variables explained by the eclectic paradigm to interpret 'what are' the foreign value adding activities of enterprises.

First of all, whether a firm has a capability to supply or enter into a foreign market depends to what extent it possesses, or is able to acquire, a unique and sustainable asset which is not available to another country's competitors. Such kinds of asset refer to a firm's specific and competitive ownership (O) advantage. The specific ownership advantage could be various types of items including tangible assets like natural resources, human resources, and capital, and intangible assets like technical skills, information and management practices (Dunning and Lundan, 2008). The greater the level of ownership advantages, the

more the multinational enterprises are likely to participate in foreign value-adding activities, rather than trade, license, or portfolio investment (Dunning, 2000).

There are three main kinds of specific ownership (O) advantages: assets based ownership advantages (Oa); transaction based ownership advantages (Ot); and institutional based ownership advantages (Oi) (Dunning and Lundan, 2008). Asset based ownership advantages refer to firms' privileged ownership or competitive capabilities on production management, innovations, knowledge and accumulated experience in reducing inter-firm transaction costs in the market. Transaction based ownership advantages (Ot) refers to the advantage of common governance in terms of the firms' ability to organise their assets with other complementary assets across national boundaries to capture the transactional benefits (Dunning, 1988). The institutional assets advantage refers to firms' formal and informal institutions and capability on governing corporate operation and foreign value-added activities, including corporate norms and culture, leadership and diversified management practice.

The second condition of the eclectic paradigm refers to the total control of the internal assets, or internalisation (I) advantages. Given the ownership advantages of a firm, they prefer to use these to achieve their best interests, rather than licensing or aligning with another company across national boundaries (Dunning, 1988). There are three main reasons for the internalisation of products caused by market failure: risk and uncertainty in the foreign market; an imperfect market situation when exploiting large-scale economies; and higher transaction costs of particular goods or services. Dunning and Lundan (2008) list what motivates enterprises to acquire internalisation advantages including: avoiding negotiation costs and moral hazards; avoiding quotas and tariffs; controlling the quality of products and sale of input; and capturing economies of the use of complementary

assets. The greater the incentives for reducing the transactional costs of enterprises, the more the enterprises are likely to internalise their own specific ownership advantages, rather than licensing and contracting with other companies in the foreign market.

Considering ownership specific and internalisation advantages are necessary for the foreign value-added activities, the third strand of the eclectic paradigm refers to 'where' the production should be sited, known as location (L) advantages. Enterprises must work in their best interests to achieve a good combination of ownership specific advantages and internalisation advantages. Transferable intermediate products in the home country should, at least, be integrated with the immobile capabilities or resources in the host country (Dunning, 1988). For example, enterprises prefer to produce their goods or services close to their downstream customers in order to save transportation costs and provide an efficient service. Dunning and Lundan (2008) identify several location specific factors that may influence enterprises conducting foreign value-added activities. Concerning various aspects, such as input, quality of products, international transport and communication costs, artificial barriers to trade, and cross-country ideological differences the more immobile capabilities or resources enterprises combine the more likely they are to exploit their ownership specific advantages by engaging in foreign value-added activities.

It is widely suggested that the eclectic paradigm generally provides a basic explanation of international production referring to the main types of foreign value-added activities by multinational enterprises (Bucklety et al., 2007a). The eclectic paradigm not only offers a general framework for the explanation of international production, but it also relates to the main issues or factors that multinational enterprises may face. However, it is confirmed that there is no perfect approach to the analysis of the international profile of foreign value-

added activities by enterprises. For example, Dunning (1988) points out that the eclectic paradigm ignores transactional market failure when explaining international production because there are various types of market failure among different countries, and different types of economic activities. It does not offer specific hypotheses on the specific effects of OLI variables on particular types of foreign direct investment (Dunning, 2000).

2.3 Motivations for international investment

Given the above general explanation of multinational enterprises, the question arises as to what drives multinational enterprises to participate in international business. This section will analyse the main motivations and strategies for foreign investment separately for the sake of clarity. The traditional economic approach presented by Dunning and Lundan (2008) is generally the most appropriate way to explain the determinants of FDI as seen in much of the recent literature. There are four main types of motivation for foreign investment: market seeking; resource seeking; efficiency seeking; and strategic asset seeking. Table 2.1 summarises these four motives. However, as found in previous studies, the motives for foreign investment by enterprises interact with each other, and are therefore mixed, complementary, and evolutionary.

2.3.1 Market seeking

One motivation for foreign direct investment is market seeking, which refers to multinational enterprises' desire to increase, or to exploit, the existing market shares of finished products by entering into new overseas markets (United Nations Conference on Trade and Development, 1998). These kind of investing enterprises generally have exporting experience to the host countries, but have found that exporting products is no longer the best route to sales because of

political barriers imposed by local governments or changes of market size in host countries (Dunning and Lundan, 2008). As a result, enterprises enter foreign markets by investing rather than exporting. Another phenomenon that contributes to foreign market seeking by multinational enterprises is that there are specific production services (e.g., water supplies and telecommunications) which need to be contemporaneously supplied with production distribution. The growth of market size is positively associated with foreign capital inflow (Buckley et al., 2007b). For Chinese companies, they are logically market oriented toward foreign investment, motivated by export oriented governmental policies since China's reform and opening-up policy. A well-known Chinese example is that of the Haier Group. Its initial motivation for international expansion by adapting to local customer needs and tastes is to obtain world-wide brand recognition (Child and Rodrigues, 2005).

Dunning and Lundan (2008) clarify four main reasons for international market seeking by multinational enterprises. Firstly, enterprises invest in overseas markets because they have to follow the foreign strategies imposed by their suppliers or customers in order to retain their business. This kind of market seeking investment is more common in the service sector. For example, accounting, auditing, and advertising companies have to offer contemporaneous service to their clients in order to maintain their competitive position in the world (Dunning et al., 1990). Secondly, enterprises need to invest abroad in order to become familiar with the local culture, and the legal and customer specific needs when they sell finished goods or intermediate products in the foreign markets. The third reason for market oriented foreign investment concerns production and transaction costs. Enterprises save costs and gain more benefits if they build facilities near their main supplier and their customers. Such benefits occur in the reduction of manufacturing and transaction costs which helps achieve economies

of scale in their output. The final possible explanation for market-oriented foreign investment is that the multinational enterprises consider investment in foreign markets as a global business strategy which will help them to retain their competitive advantages and to offer a presence in the leading markets.

2.3.2 Resource seeking

Resource seeking is an important motivation for cross-border investments because multinational enterprises invest in overseas markets with the purpose of acquiring and securing particular and specific resources which are scarce in the home country. Resource seeking investment usually takes place when a host country has an abundance of natural resources but does not have the capability to extract or sell them to the rest of the world (United Nations Conference on Trade and Development, 1998). Apart from the presence of a specific natural resource in the host country, foreign investors need to create an infrastructure, or specific facilities, in order to exploit and obtain the raw materials, which often occur in the primary sector. For example, a number of Chinese stated-owned enterprises invest in Sub-Sahara Africa's natural resources and infrastructure in order to extract raw materials (Kaplinsky and Morris, 2009). Yao et al.'s (2010) case study on Chinalco's investment in Rio Tinto is a case in point as it analyses the resource seeking strategy of Chinese outward FDI. Although Chinalco does not have competitive advantage to maximise profits in the international market, it enjoys the support of the Chinese government, thereby remaining motivated to invest in Rio Tinto. This is because Rio Tinto has a stable reserve of mining and the Chinese government is motivated to use Chinalco as a vehicle to obtain the raw materials at a reasonable cost.

There are three main types of resource-oriented FDI (Dunning and Lundan, 2008). First of all, natural resource seeking is a typical determinant of foreign

value-added activities. Enterprises producing primary products, or manufacturing enterprises from developed and developing countries, look for the scarce raw and natural resources like minerals, fuels, and agricultural products at minimised costs around the world. Secondly, in addition to natural resource seeking, resource motivated FDI also refers to lower labour costs. Manufacturing and services companies from countries with relatively higher labour costs are motivated to acquire unskilled or semi-skilled labour at cheaper prices. The third type of resource seeking is related to the higher quality of human resources. Multinational enterprises seek technologically skilled experts in high-tech industries to achieve effective collaborative alliances.

2.3.3 Efficiency seeking

In addition to the above-mentioned market seeking and resource seeking strategies, there are other motives for foreign investment by multinational enterprises, such as efficiency seeking. Efficiency seeking reflects a rational restructure of multinational enterprises' existing investments in order to improve efficiency of production and maximise profits on global economic activities (Dunning and Lundan, 2008). Efficiency-oriented foreign investments gain the benefits of economies of scale and scope and risk diversification which come from various sources, such as the arbitrage opportunities in different countries, different prices across exchange rates, different factor endowments, and different economic policies. Efficiency seeking investment often occurs in countries with lower operational costs, in particular lower labour costs. Based on this point of argument, Chinese multinational enterprises do not have strong motivations for efficiency seeking in cross-border investment because the labour cost in China is comparatively low (Buckley et al., 2007b). However, another kind of efficiency-seeking is being used by Chinese multinational enterprises, e.g., Chinese companies enjoy special treatment, like duty-free prices, if they invest

in African countries (Gugler and Boie, 2008).

Generally, there are two main kinds of efficiency seeking in multinational enterprises. Firstly, it is designed to obtain benefits from the differentiation of production costs and availability of factor endowments in different countries (Dunning and Lundan, 2008). For example, the developed countries are more likely to attract capital and technologically intensive foreign investments, while the developing countries are more attractive to the labour intensive and primary industry investors. The second type of efficiency seeking refers to the similarity of economic structure rather than factor endowments. This kind of efficiency seeker enjoys the economies of scale and scope, government supported national and international policies, and incentivised market structures.

2.3.4 Strategic asset seeking

In comparison to the above three categories of FDI motivations, the strategic asset-seeking motive refers to physical assets and human competences rather than specific resources, operation costs, or market size, and those which cannot be captured by the other three determinants. Multinational enterprises engage in foreign value-added activities with the purpose of acquiring specific strategic assets of foreign companies, to sustain and strengthen their long-term ownership advantages and global competitiveness in home and third-country markets (Dunning and Lundan, 2008). For multinational enterprises in emerging markets, strategic asset seeking has been an important interpretation of their foreign strategies. For example, the Chinese company Geely acquired Swedish car manufacturer Volvo in 2010, which is considered a strategic asset acquisition (Bismarck and Zheng, 2016). The primary motivation for this acquisition was not to seek new markets or to access resources in Europe or for efficiency enhancement. Rather, the main incentives for the Geely acquisition were to gain

the international brand of Volvo and to reduce the technological gap between it and its competitors in order to improve its advantages and thwart those competitors. (Meyer, 2015). As a result, Geely successfully entered Europe and the number of cars exported around the world dramatically increased in the following years.

There are several reasons have been involved in strategic asset seeking FDI with the aim of protecting or improving enterprises' long-term competitive position (Dunning and Lundan, 2008). A company has to improve its strategic objectives to compete with its more powerful rivals. Another condition is that a company has to obtain particular technologies or brands in the market by acquiring a group of suppliers. A company engages in strategic asset seeking because it has to supply diversified or complementary products to its customers to meet the market needs. Finally, a company acquires a firm in a foreign country with the purpose of gaining preferable treatment from the host government which is denied to the firm's exporting competitors, acquiring specific contracts for example.

Table 2. 1 Brief summary of main motivations for firm investment

Motivations	Description	Typical categories
Market seeking	To increase or to exploit existing market share.	1) Retain suppliers or customers. 2) Meet specific local customer needs. 3) Save production and transaction costs. 4) Meet global business strategies.
Resource seeking	To acquire and secure specific resources that are scarce in the home country	1) Seek primary resources. 2) Seek unskilled or semi-skilled labour. 3) Seek high quality, skilled human resources.
Efficiency seeking	To improve efficiency by a rational restructure of existing investments	1) Obtain benefits from different costs and availability of factor endowments. 2) Achieve economies of scale and scope.
Strategic asset seeking	To acquire specific assets and human competences	1) Improve strategic objectives. 2) Obtain particular technologies or brands. 3) Supply diversified or complementary products 4) Gain preferable treatment from host government

Sources: Adapted from Dunning and Lundan (2008).

2.4 Entry strategies of multinational enterprises into foreign markets

Based on the various motivations of multinational enterprises' foreign value added activities, a decision on which is the best entry strategy in international business has been one of the biggest challenges faced by multinational enterprises. It is commonly believed that the choice of entry model is based on trade-offs between risks and returns (Agarwal and Ramaswami, 1992). Resource availability and the need for control are concerns of multinational enterprises' entry strategies in international business. Generally, there are several typical strategies for companies accessing foreign markets, such as non-equity based modes (e.g. exporting, licensing) and equity based modes (e.g. joint ventures, greenfield investment, cross-border mergers and acquisitions), which are

discussed in the following section.

Firstly, it is necessary to mention that a firm can enter into a foreign market by exporting through agents; this is recognised as the most traditional and well-established entry mode. Exportation means that a firm produces goods in one country and sells the resulting products in another country. An exporting strategy ensures the operation remains in the home country allowing operational control and low risk (Agarwal and Ramaswami, 1992). However, there are disadvantages in exportation, e.g.: the cost of marketing may be increased because of higher transportation costs over a large distance between two countries; a firm has a greater possibility of facing institutional barriers such as import tariffs, import quotas, and export licences; a higher dependency on importers in foreign markets may lead to non-effective product distribution (Teng, 2004).

Secondly, licensing means that a company in the home country provides limited rights or resources like patents, trademarks, and technologies to a licensee in a specific country for a specific time period. There is no need for substantial investment for licensing in the foreign country, which means that the risk of licensing is relatively low. A company enjoys the benefits of avoiding political risks and regulation barriers by licensing (Cavusgil et al., 2014). However, the lower risk of licensing implies lower profits because a licensor has less control over the licensee (Agarwal and Ramaswami, 1992). Moreover, there are contingent risks in licensing, e.g., a licensee may imitate the specific technology and the work of a licensor's foreign competitor when the agreement expires (Cavusgil et al., 2014).

Thirdly, compared with non-equity based entry strategies, joint ventures, as one type of equity based mode, combine the valuable resources and capabilities of

different companies in different regions to accomplish an international business task. Each party to a joint venture is responsible for the returns and risks in the business operation. There can be cross-cultural conflicts, economic differences, and political barriers for enterprises doing business in foreign markets. However, multinational enterprises can gain adequate local knowledge and unique market information in foreign markets from their partners in the host country (Teng, 2004). A firm involved in a joint venture does not have tight control over subsidiaries and also faces the risk of giving the control of key skills or technologies to its partners (Hill, 2011). Additionally, joint ventures may lead to conflict and create battles between shareholders over managerial or operational strategies.

Fourthly, unlike joint ventures, greenfield investment, as one form of FDI, has no need for local partners. A parent company starts a wholly owned subsidiary in a foreign country by setting up completely new facilities. The first advantage of greenfield investment is that it reduces the risk of a loss of control over a company's competitive advantages. Not only does the company retain tight control over the business strategies of its overseas subsidiaries through greenfield investment, but also the efficiency of a company is improved by the achievement of economic scale and economic scope effects (Hill, 2011). However, greenfield investment is recognised as the most costly entry mode for firms into foreign markets. Compared with other methods of entry, higher capital costs and risks are taken by multinational firms in greenfield investment. The process of investment is slow and a company may face cultural conflicts and entry barriers in foreign countries (Teng, 2004).

Finally, leaving aside the construction of a new subsidiary from the ground up, cross-border mergers and acquisitions have become a primary entry strategy into overseas target markets. There are several reasons for firms to choose cross-

border acquisition instead of greenfield investment. Firstly, the acquisition mode is an instant market entry method with the purpose of gaining valuable resources or higher-level technologies from the targeted overseas firms (Teng, 2004). Secondly, a proven track record by local firms assists the multinational enterprises to enter international markets more smoothly (ibid).

Since greenfield investment and cross-border mergers and acquisitions are two methods which will be considered when contemplating FDI, the question is raised as to why multinational enterprises prefer to acquire existing foreign companies rather than set up new subsidiaries from the ground up? Hill (2011) details the advantages and disadvantages of greenfield ventures and acquisitions in international business. Greenfield investment allows tight control on the subsidiary company, which means that a company can build a new subsidiary in the way it wants and organise the company culture and operating routines of the new subsidiary in the foreign market. It is easier to transfer the competencies, skills, and knowledge from the parent company to a subsidiary. In contrast with greenfield investment, cross-border acquisitions are quicker to execute and less risky. A firm gains a set of assets through cross-border acquisitions, such as operation and customer service systems, and brands for example , which produce known profits, while greenfield investment suffers the uncertainty of revenue and profit streams in business because it has to build a new facility.

The choice between greenfield investment and acquisitions is dynamic depending on the circumstances confronting the firm. For example, if there is no incumbent firm to be acquired, the firm has no choice but to build a new subsidiary in the foreign market. A firm prefers greenfield investment if it is not easy to transfer significant knowledge, like skills and organisational culture, from the parent company to the subsidiary (Hill, 2011). However, cross-border acquisitions are able to quickly establish a presence in the foreign market in order

to pre-empt a company's competitors.

2.5 Definition of cross-border mergers and acquisitions (M&As)

A firm can undertake FDI in a host country either by greenfield investment or by merging and acquiring an existing firm (United Nations Conference on Trade and Development, 2000). However, the occurrence of cross-border M&As, i.e., those which take place between two firms whose headquarters are located in different home countries, in emerging markets has increased rapidly in recent years (Shimizu et al., 2004). Cross-border M&As have become the most dramatic implementation instrument for firms' international strategy and for creating value for shareholders. Cross-border M&As can be classified as horizontal, vertical, or conglomerate (Buckley and Ghauri, 2002). In horizontal M&As, the acquiring firm and the target firm are in the same industry; in vertical M&As two companies in value chain linkages are involved. In conglomerate M&As, the business of the acquirer and the target firm are different and unrelated.

A cross-border merger occurs when 'the assets and operations of two firms belonging to two different economies are combined to establish a new legal entity", while for a cross-border acquisition, "the control of assets and operations is transferred from a local to a foreign company, with the former becoming an affiliate of the latter" (Chen and Findlay, 2003, p.23). A foreign company can absorb one or more local companies, or merge with an existing company to establish a single, new company through cross-border merger (Ghauri and Buckley, 2003). For cross-border acquisitions, the target firm remains legally in existence following the international transaction. There are two types of cross-border acquisitions. One is asset acquisition whereby the foreign company buys part, or all, of the assets of the target firm(s). The other is share acquisition whereby the acquiring firm buys shares from individuals or from the target's

parent company in order to control the management of the target firm (Chen and Findlay, 2003). In fact, Ghauri and Buckley (2003) claim that in fact, the number of mergers in cross-border M&As is almost vanishingly small. For practical purposes, the number of "real" mergers is so small and insignificant that cross-border M&As basically mean cross-border acquisitions (United Nations Conference on Trade and Development, 2000).

2.6 Research on Chinese outward mergers and acquisitions

More than half of outward FDI takes place through cross-border M&As (United Nations Conference on Trade and Development, 2015). Existing research on Chinese cross-border M&As predominantly investigates the motivations for such activity, including market seeking, strategic asset seeking and natural resource seeking, initially discussed by (Dunning, 1988). The motivations for Chinese outward M&As are similar but with several distinct features (Deng, 2004). For example, state-owned enterprises' outward M&As in China are mainly controlled by the government. These firms, with the support of government, go abroad to access natural resources, for geopolitical positioning, and for the strengthening of their national competiveness. However, for the non-state owned enterprises, they conduct cross-border M&As with the purpose of entering into foreign markets, accessing foreign sophisticated technology and internationally recognised brands, as well as for the local distribution networks (Schüller and Turner, 2005). Based on the literature, I review the main motivations for Chinese multinationals' outward M&As.

Firstly, one traditional motivation said to be behind outward M&A activities by Chinese multinationals, is market seeking and international expansion (Buckley et al., 2007b). Chinese firms go abroad with the purpose of market-seeking based on several considerations. First, they have a comparative advantage due to

relatively low cost labour and labour-intensive products in the domestic market. However, they commonly face a range of tariff and non-tariff barriers in foreign countries when they export their domestic products (Buckley et al., 2008). In order to overcome these kind of obstacles, Chinese firms have to acquire foreign companies in the host country by which they can access quota rights. Secondly, domestic Chinese firms have no choice but to look abroad in response to limited market growth in their home country. Following Chinese accession to the World Trade Organisation (WTO) in 2001, a growing number of foreign companies have entered China with an inevitable increase in the competitiveness of domestic manufacturing and service markets (Taylor, 2002). In response, Chinese multinationals use international strategies to expand their product market and diversify their business activities in foreign countries. Thirdly, Chinese multinationals' outward M&As motivated by market-seeking are based on the consideration of deepening regional economic integrations. For example, they may invest in Mexico with the purpose of enjoying the benefits of preferential treatment of Mexican imports given by the USA (Buckley et al., 2008). This shows that Chinese multinationals locate cross-border M&As in a specific country for the prospect of improved access to the target country's neighbouring markets.

Empirical research carried out by Buckley et al. (2007b), statistically proves that there is a positive correlation between Chinese outward FDI and the host country's market size measured by the host country's GDP. One unit increase in the host country's GDP is associated with a 0.35% increase in Chinese outward FDI. The market size of the host country represents opportunities for Chinese multinationals to gain efficient use of competitive advantages and achieve economies of scale and scope via cross-border M&As. Similarly, Child and Rodrigues (2005) use case studies to interpret the patterns and motives for

international M&As by prominent market seeking firms in China. Based on a late-comer perspective, Chinese firms go abroad to catch up with the global giants through international strategies. Institutional support from the government encourages leading Chinese firms to globalise.

Secondly, natural resource seeking is another motivation among many Chinese multinationals' to engage in outward M&As. Chinese firms have to secure location-bound natural resources and energy from foreign countries through outward M&As to meet the high domestic demand which is due to enormous consumption (Hui and Qi, 2010). For example, Chinese enterprises, especially state-owned ones, recently invested in Zambia for copper, in Peru for iron ore, and in Western and Central Asian countries for oil exploration and extraction (Buckley et al., 2008). These kinds of enterprises have close relationships with the Chinese government and enjoy its financial assistance which better allows them access to certain parts of developing countries.

Kaplinsky and Morris (2009) investigate Chinese outward investment in Sub-Sahara Africa's resource and infrastructure sectors by Chinese state-owned enterprises. These kinds of investments made by large scale state-owned enterprises are closely bundled with aid and trade. Chinese investors seek natural resources like oil-gas and minerals in Sub-Sahara Africa. The main purpose of investing in the infrastructure sector is to provide transport routes for exporting natural resources. Yao et al. (2010) interprets a case study on Chinalco and Rio Tinto aimed to interpret the resource seeking outward FDI by Chinese multinationals. Although Chinalco failed in its strategic investment in Rio Tinto, it allows for closer scrutiny and discussion on resource seeking which is motivated by outward investment by emerging countries. Empirical examination by Ramasamy et al. (2012), which measured the host country's exports of ores and minerals, shows that Chinese investors are attracted to countries with large

supplies of natural resources. The research investigated the largest 200 Chinese firms listed on the Shanghai and Shenzhen Stock Exchanges during the period 2006 to 2008. Chinese firms have to seek natural resources from other countries because of the continuing demand for natural resources in the domestic market.

Thirdly, strategic asset seeking is becoming an important motivation for Chinese outward M&As. Hennart (2012) argues that OLI framework in Dunning (1988) does not sufficiently explain the characteristics of multinationals in emerging markets. Multinationals in emerging markets do not have firm-specific advantages in a host country or, mostly, they do not exploit their specific competitive advantages efficiently. Rather, they have to enter foreign markets to acquire the intangible resources and innovation-based knowledge they lack. China, as a developing country, has experienced a growing number of foreign investors entering their market, which is a stimulus to cross-border M&As. In order to enhance competitive advantages both at home and abroad and to build its global strategy, Chinese multinationals have to engage in international acquisitions, particularly in developed countries, to access superior marketing expertise, sophisticated technology, and managerial know-how (Rabbiosi et al., 2012). Strategic asset seeking international acquisition seems an effective and fast way to gain strategic assets in foreign countries.

Several papers have investigated Chinese multinationals' strategic asset motivated cross-border M&As. Deng (2009) built on institutional theory to explain why Chinese firms tend to acquire strategic assets in international expansion based on a case study of three leading Chinese firms (TCL, BOE, and Lenovo). China's unique institutional environment determines the Chinese firms' strategic asset motivated international acquisitions. The Chinese government encourages outward M&As by multinationals, especially when their purpose is to enhance innovative capability. Due to institutional constraints, such as lack of

legal protection for patents and less developed markets at home, Chinese multinationals engage in cross-border M&As in order to avoid, or alleviate, this condition. Similarly, Rui and Yip (2008) present a strategic intent perspective to examine foreign acquisitions by Chinese multinationals based on three companies (Nanjing Automobile Group, Lenovo Group and Huawei Technologies). They determined that the explicit intention of Chinese multinationals is to seek strategic assets through foreign acquisitions in order to compensate for their competitive disadvantages in global markets. Chinese firms in the domestic market lack advanced product technology, internationally recognised brands, and international managerial experience. In response to this, they have to quickly acquire a set of assets and capabilities to confront their foreign competitors. Apart from the importance of tangible assets, intangible assets, like entrepreneurial and managerial skills, are also important for Chinese multinationals to learn through cross-border M&As.

In addition to those papers working on motivations for Chinese outward M&As, some papers focus on the performance of these M&As. For example, Li et al. (2016) investigate whether Chinese overseas acquisitions create value for the acquirers' shareholders based on an event study method. A sample of 367 overseas acquisitions made by Chinese listed firms between 2000 and 2011 were analysed for the effects of cultural distance and acquirer's market valuation on Chinese firms' stock returns. Their empirical results show that on average cultural distance is negatively correlated with the extent of the acquirers' value creation. However, for the larger firms, who have more experience of foreign acquisition and have therefore had more learning opportunities, their stock returns are shown to be less affected by cultural distance. Learning and absorptive capabilities of Chinese firms help to overcome the cultural distance between acquirers and the targeted foreign firms. Du and Boateng (2015)

empirical test of the effects of state ownership and institutional effects on value creation through cross-border M&As by Chinese multinationals employed a sample of 468 Chinese firms listed from 1998 to 2011. Their results show that Chinese acquirers' cumulative abnormal return is increased within a range of 0.4771% and 1.5210% following any announcement of outward M&As made by Chinese listed firms. They also empirically prove the important roles of state ownership and institutions in value creation of Chinese multinationals through cross-border M&As.

2.7 Research on Chinese inward mergers and acquisitions

In 2014 China was the largest FDI recipient in the world (United Nations Conference on Trade and Development, 2015). However, the value of inward M&As accounts for just 22% of China's overall inward FDI, which is much smaller than the value of outward M&As as they account for nearly half of China's overall outward FDI (KPMG, 2015). A number of papers investigate inward FDI effects on Chinese firms' development. For example, Buckley et al. (2007a) analyse the spillover effects of inward FDI in China by using the data of a cross-section of branches of Chinese industry in 1995. They indicate a curvilinear relationship between Chinese FDI and spillover effects, which means that past a certain level of penetration the productivity spillover effects start to reduce. Buckley et al. (2002) also investigate the relationship between inward FDI, regional differences and economic growth by employing a panel data analysis of 29 provinces between 1989 and 1999. They demonstrate that the provinces in China with higher level economic growth are more attractive to FDI inflows. Meanwhile, provinces with higher level of competitive market enjoy the realised benefits of FDI. In order to maximise the benefits of FDI, the local government has to accelerate market reform.

However, a small number of papers work on Chinese inward M&As based primarily on the fact that the value of inward M&As taking place in China tend to be much smaller than outward M&As (Zou and Simpson, 2008). However, inward M&As have been an important entry model for foreign investment in China because it is a faster method to establish a presence in a foreign market. The existing literature on Chinese inward M&As can be divided into two categories. The first category concerns a description of Chinese inward M&As, i.e., it gives a general description and explanation of the development of Chinese inward M&As. For instance, Peng (2006) gives a detailed description, and some idiosyncrasies, of the rapid growth of inward M&As in China. He claims that state-owned enterprises have inefficiencies which are not attractive to foreign investors because of their ineffective performance and different managerial identity with Western employees. Chen and Findlay (2003) provide a general review of cross-border M&As in the Asia-Pacific Economic Cooperation (APEC) developing countries, including China. Several factors combine to contribute to the rapid growth of cross-border M&As since the late 1990s, such as the liberalisation of trade and investment between the APEC developing countries, the deregulation of the service sector, the privatisation of state-owned enterprises, and the reform of cross-border M&As of APEC countries. Woodard and Wang (2004) review international acquisitions in China during the period 2000-2004. Before 2004, Chinese inward M&As were lower than other regions in Asia, such as Japan, South Korea, and Hong Kong; 70% to 80% of inward foreign acquisition deals' information were publicly disclosed; and the private and publicly listed Chinese firms began to make outward M&As. However, while these kinds of studies provide a general interpretation of the development of inward M&As, they fail to provide an in-depth analysis.

The second type of research on inward M&As attempts to quantitatively analyse

the determinants of foreign acquisitions in China and the effects of foreign acquisitions on both multinationals and local firms. Zhang and He (2014) empirically investigated the effects of institutional and economic nationalism on cross-border acquisition success in China by using a sample of 7375 cross-border acquisition deals which occurred between 1985 and 2010. Economic nationalism, as a key factor of an institution, determines a country's development and sovereignty, which is a dynamic concept. Economic nationalism could be protectionism and liberalism. This empirical study shows that economic nationalism turns into protectionism and the cross-border acquisitions are less likely to be completed when the target firms are essential industries or state-owned enterprises. However, when the international acquirers are expected to bring high technology or capital to target firms, these kinds of acquisitions are considered as safe and helpful and have a higher probability of success.

Nagano and Yuan (2013) empirically examine the determinants and consequences of inward M&As in two emerging countries, India and China, where there are relatively high ratios of government ownership. They use a data set of inward M&A deals between 1998 and 2006 from Bloomberg which includes both listed and unlisted firms in China and India. Their results show that domestic firms with higher cash-reserve ratios and growth opportunities are more likely to be acquired by foreign investors. Meanwhile, they evaluate the cumulative abnormal returns of target firms when there is an announcement of inward M&As by event study methodology. The target firms have higher shareholder value after the inward M&As than those firms acquired by domestic enterprises, which means that the firms with higher ratios of government involvement in emerging countries have higher investment returns in cross-border M&As than those firms' returns in domestic M&As.

Holtbrügge and Baron (2013) analyse the market entry strategies and inward

M&As success in the BRIC countries (Brazil, Russia, India, and China). They used an online survey and a sample of 564 inward M&A deals in the BRIC countries to interpret how, and when, to enter the emerging markets. Market success is the dependent variable in this empirical study. Results show that market entry strategies significantly correlate with the success of foreign acquisitions in the BRIC countries. Foreign firms prefer to locate and produce products in Brazil and China, while they prefer to export products to Russia and India. For China, the wholly owned subsidiaries acquired by foreign investors have a higher level of efficiency than joint ventures. Similarly, Norris Jr (2011) compares and evaluates three entry models of foreign investment in China including joint venture, acquisition of an existing Chinese company, and greenfield investment. He delivers the benefits and pitfalls of each approach. For cross-border M&As there is no need to establish new distribution and supply chain networks as the existing brands, products, and sales of the domestic firms are gained.

Cooke (2006) studies the determinants, barriers, trends, and patterns of foreign acquisitions of state-owned enterprises in China and their implications for human resource management and experience of work for employees. Cooke (ibid) not only interviews three senior managers from three state-owned enterprises experienced in foreign acquisitions in the last three years in southern China, but also interviews four local government officials who work in the area of cross-border M&As. Compared with cross-border M&As in Western countries, inward M&As in China face lower levels of competition and this allows organisations more time to integrate following acquisition. Several factors drive foreign acquisitions of Chinese state-owned enterprises: privatisation; the desire to acquire knowledge, advanced technology and management skills from foreigners; and the need to be profitable. The lack of

asset-evaluation systems leads entrepreneurs to use cross-border M&As as a business strategy to improve their own interests rather than that of the shareholders or for the development of the firm. It is necessary for the targeted Chinese firms to acquire managerial skills to meet the needs of negotiation during the acquisition and for post-acquisition integration.

2.8 Conclusion

In conclusion, this chapter reviews previous studies on cross-border M&As. Hymer's (1976) and Vernon's (1966) analytical frameworks are pioneering works on the theory of multinational activities. Internalisation theory is conceptualized by Buckley and Casson (1976) and has deeply embedded Hymer's (1976) work to explain a way to deal with imperfections in intermediate product markets. Kojima (1982) gives the neoclassical theory of FDI in Japan. Based on these traditional theories and frameworks, Dunning's (1998) eclectic paradigm has been the dominant analytical conceptual framework used to test the determinants of the foreign activities of enterprises. A firm is motivated to invest in a foreign market because it has its own specific advantages (ownership (O), internalisation (I), and location (L)) in that foreign market to achieve a lower operation cost. The eclectic paradigm generally provides a basic explanation of international production. There are four main determinants of cross-border M&As: market seeking, resource seeking, efficiency seeking, and strategic asset seeking. For market seeking foreign investment, firms enter a foreign market in order to exploit the market or avoid barriers to exportation. When resource seeking, the firms enter a foreign market for the purpose of accessing key natural resources which are scarce in home country. In order to improve the efficiency of production and maximise profits, firms have to enter foreign markets to seek efficiency in order to achieve economies of scale and scope. Strategic asset seeking FDIs are mainly driven by firms from emerging markets. They have to

enter foreign markets to gain the latest technology and management skills to complement their disadvantages in the global market. Joint ventures, greenfield investment, and cross-border mergers and acquisitions are the three main models for multinational enterprises entry to foreign markets. Cross-border acquisitions are a fast way to establish a presence in the foreign market in order to pre-empt a company's competitors. A number of studies have investigated Chinese outward M&As, focusing especially on the motivations for cross-border M&As. However, only a small number of papers investigate inward M&As in China which therefore require further research.

Chapter 3. Political connections, financial constraints, and China's outward mergers and acquisitions

3.1. Introduction

China's role as an investor country has been strengthened in recent years. Its non-financial outward direct investments reached a total of $US 90.2 billion by the end of 2013, and a large majority of those investments are cross-border mergers and acquisitions (M&As). Although many papers have discussed various perspectives of China's outward direct investments (Buckley et al., 2007b, Morck et al., 2008, Wang et al., 2012), understanding of this process remains limited. For example, up to now, investing abroad for Chinese investors has been tightly controlled by national and provincial governments and Chinese companies need formal approval from government, either administratively or financially, to conduct cross-border investments. Given the fact that the Chinese government still controls most resources, and that state owned enterprises (SOEs) enjoy preferential status in obtaining financial support and other key production and investment inputs (Li et al., 2008), whether or not political connections and financial constraints affect China's corporate investment abroad remains one of the most interesting and controversial issues for economists to discuss.

The definitions and measurements of political connections and financial constraints have drawn much academic attention. In the literature, a firm is politically connected if at least one of its top officers, or a large shareholder, is, or has been, a government official, or has personal connections, or shares social networks with government officials (Faccio et al., 2006, Xu et al., 2013). A firm is financially constrained when the gap between the cost of internal funds and external funds is increased (Kaplan and Zingales, 1997). Financial constraints

can also be classified as internal and external; a firm with internal financial constraints faces obstacles to the availability of cash flow, while the cost of raising external funds by a firm with external financial constraints is too high to allow investment (Guariglia, 2008).

A handful of papers look into the effects of financial constraints on corporate investment. Fazzari et al. (1988) show there is significant influence of cash flow on investment decisions. Whited (1992) points out the negative effect of the imperfect debt market in the US on firms' investments throughout the obstacle of raising external finance, and the very high cost of external financing significantly precludes a firm making an investment. Allayannis and Mozumdar (2004), Cleary et al. (2007), and Carpenter and Guariglia (2008) point out the negative effects of internal financial constraints on investments. Guariglia (2008) and Almeida and Campello (2010) confirm that there is a complementary effect between internal and external finance. The demand for external finance will increase when there is a decrease in the availability of internal finance. The firms with a higher degree of external financial constraints, and a lower degree of internal funds, display greater sensitivity of investment to cash flow.

There is a well recorded relationship between political connections and financial constraints. A politically connected firm is more likely to obtain subsidies and preferential treatment from the government, and to benefit from better access to resources such as bank loans, and is thus able to release those financial constraints. For instance, Charumilind et al. (2006) examine whether business connections predict preferential access to long-term bank credit based on 270 non-financial companies listed on the Thai Stock exchange in 1996. They find that firms with connections to banks and politicians have greater access to long-term debt than firms without such ties, and politically connected firms need less collateral, obtain more long-term loans, and use fewer short-term loans than

those without connections. Claessens et al. (2008) investigate the role of campaign contributions on political connections and preferential access to finance in Brazil and find that contributing firms substantially increase their bank financing relative to a control group after each Brazilian national election. This indicates that access to bank finance is an important channel through which political connections operate. Houston et al. (2014) analyse whether or not the political connections of listed firms in the US affect the cost, and terms, of loan contracts and find that the cost of bank loans is significantly lower for companies that have board members with political ties.

In transition economies, where the state still intervenes in the allocation of capital, such as occurs in China, there is wide evidence that political connections can help firms to gain access to external finance for investments, and to mitigate the problems of financial constraints (Faccio et al., 2006, Li et al., 2008, Xu et al., 2013), and thus can affect corporate investment behaviour. Goldman et al. (2009), Fisman (2001), and Faccio and Parsley (2009) claim that political connections release the financing restrictions on firms and help them to gain comparative advantages, including access to key resources, such as bank loans granted at favourable terms, favourable tax treatment, a higher IPO offer price, and government sponsored bailouts (Wu et al., 2012). All these enhance firm performance and value, and the politically connected firms usually have higher market values than non-politically connected firms.

In addition to the above positive view about the effects of political connections on financial constraints and firm value, some studies state that political connections and assistance from government increases the probability of a firms' survival in hard times, such as economic depression and financial crises (Faccio et al., 2006, Johnson and Mitton, 2003, Khwaja and Mian, 2005). Faccio et al. (2006) analyse the likelihood of government bailouts of 450 politically

connected firms from 35 countries during 1997–2002, and their evidence suggests that at least in some countries, political connections influence the allocation of capital through the mechanism of financial assistance when connected companies confront economic distress.

In contrast, the other view argues that political connectedness has a negative effect on firm value and investment performance, and firms with political connections have weaker investment efficiency than non-connected firms (Chen et al., 2009, Faccio et al., 2006, Fan et al., 2007, Fisman, 2001, Yuan, 2011), or even worse, have not mitigated the financial constraints at all (Lin and Bo, 2012). Fisman (2001) estimates the value of political connections by employing a total sample of 79 firms from 1995-1997. The evidence implies that political-connected firms will suffer more, relative to less political-connected firms, and present worse performance. Based on a sample of 42 countries, Faccio et al. (2006) finds that politically connected firms under-perform, compared to their non-connected peers, on an ex ante basis, even though political ties provide a number of benefits. Fan et al. (2007) investigate a sample of 790 new partially privatised firms in China and indicate that firms with politically connected CEOs under-perform those without politically connected CEOs; based on three-year post-IPO stock returns they also have poorer three-year post-IPO earnings growth, sales growth, and change in returns on sales. Chen et al. (2009) find that political connections actually damage investment efficiency for Chinese SOEs. Lin and Bo (2012) further argue that political connections, represented by state-ownership, do not necessarily help in reducing the firm's financial constraints on investment after examining how state-ownership affects financial constraints on the investments of Chinese-listed firms during 1999–2008.

My paper builds on two existing lines of research. First, it aligns with various papers examining the effects of financial constraints and political connections

on Chinese firms' investments, such as Chen (2008), Chow et al. (2010), Xu et al. (2013), Li et al. (2008) and Wu et al. (2012). Second, it works on the investment behaviour and market valuation of Chinese firms' cross-border mergers and acquisitions in other countries, which complements the studies on China's recent surge of outward investments, such as Buckley et al. (2007b), Morck et al. (2008), and Wang et al. (2012).

In the context of China, the resource-based value of political connectedness is likely to be influenced by government ownership as resources are controlled by the government (Wu et al., 2012). SOEs have direct ties with the government, and thus have preferential status in obtaining bank loans and other key resources (Brandt and Li, 2003). In China, as a typical developing country, the government controls most board seats and there is inefficient government regulation along with serious government intervention (Claessens and Fan, 2002). The government prefers to be involved in the M&A transactions for several reasons. For example, it encourages some kinds of firms to join in a large merger for the purpose of preventing a monopoly or the creation of "national champions" (Brockman et al., 2013). Chinese outward M&As are typical business activities in which governments are motivated to intervene.

Furthermore, combined with a growing number of firms joining cross-border M&As in China, it is meaningful to investigate the effects of political connections on outward M&As. Politically connected firms have benefits in terms of access to information and capital resources. The impact of political connections on Chinese cross-border M&As performance remains an unresolved empirical issue that I address herein. To the best of my knowledge, one under-researched area is related to the role played by political connections and financial constraints in China's outward investment. This study draws on a sample of 986 Chinese listed firms' outward cross-border mergers and acquisitions from 1997

to 2011 in an attempt to fill this gap.

This paper distinguishes itself from previous studies in the following aspects. First, the impact that political connections have on financial constraints by Chinese listed firms involved in outward M&As is an under-researched area. Liu et al. (2013) examines the impact of political connections on firm M&As by employing a sample of Chinese listed firms from 1998 to 2010. However, their research considers all M&A activities without discrimination between domestic and cross-border M&As. Firms joining cross-border M&As clearly have different motivations from those joining domestic M&As. This article focuses on the effects of political connections on the financial constraints of Chinese listed firms involved in outward M&A activities. Secondly, many previous studies in this area have exclusively used investment-cash-flow sensitivity as the proxy for a firm's financial constraints (Lin and Bo, 2012). I adopt another measure for financial constraints, such as tangibility, as a proxy for the external constraints. After controlling for other factors, politically connected listed firms are less likely to be financially constrained.

The remainder of the paper is structured as follows. Section 3.2 describes the institutional background and develops my hypotheses. Section 3.3 describes the research design. Section 3.4 details the data and presents the empirical results. Section 3.5 offers concluding remarks.

3.2. Institutional background and hypothesis development

Due to the involvement of various government departments, such as the State Administration of Foreign Exchange, the National Development and Research Commission, and the Ministry of Commerce, in the approval of Chinese outward mergers and acquisitions (M&As) projects, institutional factors have the

potential to explain the distinctiveness in the behaviour of outward-investing Chinese firms, given the extent of state control of the Chinese economy. There are two conflicting views about China's outward M&As behaviour at firm level. The first view is institution-based and states that a Chinese firm's overseas investment is facilitated, or constrained, by a multitude of institutional forces, including government policies (Wang et al., 2012). Abundant research points out that Chinese outward M&As of the 1980s and 1990s have been directed by government economic growth policies towards the support of the export function of state owned manufacturers and the provision of stability in the supply of domestically scarce natural resources, and so on. Consistent with the government policy of increasing openness and liberalisation in the late 1990s and early 2000s, although the outward M&As projects of this time period still needed to promote exports and to meet economic growth needs at home, their aims have become more diversified. For example, to gain better access to foreign proprietary technology, strategic assets and capabilities, to exploit new markets, and to diversify business activities in a manner that seeks to improve their international competitiveness (Buckley et al., 2007b). The second view is of institution escapism and suggests that poor institutional and environmental factors in China, such as regional protectionism, quota allocations, high tax rates, corruption, regulatory uncertainty, insufficient intellectual property rights protection, and government interference, may also push firms to invest abroad in pursuit of more efficient institutions (Wang et al., 2012).

Both Chinese listed and non-listed companies have been involved in outward M&As, and compared with non-listed companies, listed ones are generally larger in size, more profitable, more transparent, and they have better auditing quality, investor protection, and corporate governance (Lin and Bo, 2012). There are several types of listed firms in terms of controlling shareholders, state owned

when the controlling shareholder is government-related, privately owned when the controlling shareholder is private firm-related, foreign owned when the controlling shareholder is foreign firm-related.

The incentives, political connections, and financial constraints of listed companies involved in overseas investments tend to be very different across various ownership structures. State owned enterprises (SOEs), on the one hand receive greater encouragement from the government to engage in overseas expansion in order to support national development targets, while on the other hand, they have stronger political capabilities that in turn help them get access to strategically important factor resources that the state controls, such as bank loans at a lower cost, subsidies, and foreign exchange assistance, compared to non-SOEs (Buckley et al., 2007b, Wang et al., 2012). Thus, SOEs have higher political connections and less financial constraints than non-SOEs, but are more likely to be involved in non-profitable overseas investment activities. One typical case to support this argument is that of the investment in Greece by a Chinese shipping giant, a port operator subsidiary of China's State-owned shipping giant, the China Ocean Shipping (Group) Co (COSCO). It signed a $4.2 billion deal to take over management of an Athens container port, it also signed a 35-year lease in June 2010, and promised to spend $707 million to upgrade port facilities, build a new pier, and almost triple the volume of cargo the port is able handle. This deal damaged the firm's profits to a very large extent and generated very negative valuation effects on share prices. It can be seen then that political incentives and government guarantees induce some SOEs to take too much risk in their cross-border M&As.

SOEs can also be divided into central and local government controlled ones. Wu et al. (2012) suggest that central and local SOEs also have many differences. From the perspective of motives, central SOEs want to maintain control over key

industries and guarantee the safety of the national economy, while those of local SOEs hope to increase local GDP and reduce local unemployment. Different motivations lead to different levels of intervention in SOEs, with local governments tending to intervene more in firm operations, and hence the operations and performance of these two types of SOEs are different (Chen et al., 2009, Wang et al., 2012, Wu et al., 2012). Due to the high degree of government intervention, local SOEs are more likely to be forced to achieve social and political objectives, such as to increase GDP and employment, and such policy burdens make their political ties prone to play a negative role on firm performance and to decrease the firm's value (Wu et al., 2012). Therefore, I hypothesise as follows:

Hypothesis 3.1: Government-related firms, such as SOEs, enjoy government support and guarantees and are less likely to face financial constraints.

As for listed firms with other ownership types, their incentives, political connections and financial constraints in cross-border M&As also have distinctive features. Firms ultimately controlled by foreign or private firms have fewer political or social objectives, such as reducing unemployment, and are more concerned about profitability and firm value. Thus they are more market-driven in their investment incentives.

One of the striking features of the Chinese financial system is the poor allocation of capital and the subsequent restrictive funding sources for private firms. In comparison with SOEs, private firms are more financially constrained (Xu et al., 2013), and informal finance, which compensates for the lack of formal finance, is a very important channel for private firms making corporate investments (Tsai, 2004). However, foreign or private firms with some degree of foreign capital may face fewer financing constraints than those without because the foreign

partners are able to access overseas financial markets and, in this way, are able to bypass the financing constraints they face in China (Huang, 2003). Greenaway et al. (2014) find that joint ventures typically perform better than purely domestic firms, which provides evidence for this argument. Similarly, by building political ties, or by teaming up with state firms, private firms could benefit from softer budget constraints and get better access to financial support, which would enhance firm value and facilitate overseas investments. Based on the foregoing analyses, my next predictions are presented in hypothesis form as follows:

Hypothesis 3.2: Foreign firms and private firms are more likely to have financial constraints, but political connections release a firm's financial constraints involved in outward M&As.

The effects of political connections on a firm's performance are mixed. There are two categories concerning this research area which are based on past literature. On the one hand, government connections create benefits for firms to access key resources in the market, like bank loans with the support of government guarantees, which significantly increase the company's value. For example, based on research of Chinese firms, Brandt and Li (2003) find that banks prefer to make loan decisions based on their knowledge of certain group characteristics. If there is bad credit record within a particular types of firms, there will be discrimination against these kinds of firms in terms of bank loans. Ladd (1998) also points out that firms' performance in the market also influence banks' estimations of borrowers' credit. State-owned firms are more likely to receive bank loans than private firms because of the political support they enjoy (Brandt and Li, 2003). Empirical research done by Charumilind et al. (2006), concerning the effects of political connections on firms' bank loans during the period of the Asian crisis between 1997-1998, shows there is a positive connection here. Politically connected firms receive preferential treatment

concerning bank loans, such as a lower required collateral and a longer loan period. Similar research has been conducted by Claessens et al. (2008). They investigate Brazilian firms' political connections and their involvement in election campaigns. They reach the conclusion that there is an advantage for politically connected firms in receiving bank loans. Houston et al. (2014) study listed firms in the US. They collected panel data and conclude that firms with political connections to the Democratic Party obtain bank finance at a lower cost when the Democratic Party wins an election campaign. In other words, political connections reduce the liquidity distress of firms, which decreases the monitor cost of banks and increases firms' market value.

However, the effects of political connections negatively correlate with firms' performance. Chen et al. (2009) investigate Chinese listed firms during the period between 2001 and 2004. SOEs that are related to the Chinese government present weaker investment efficiency than non-connected firms. The politically connected firms are less likely to gain investment opportunities. However, they also point out that political connections still incentivise the investment efficiency of listed private firms. Hung et al. (2012) find out that overseas listed firms which have political connections display worse performance than non-connected firms. Similar research can be found in Faccio et al. (2006), Fan et al. (2007), and Yuan (2011). Faccio (2006) employs data from 35 countries during the period 1997 to 2002 to analyse the government bailout of 450 politically connected firms. She concludes that politically connected firms have a higher probability of obtaining government bailouts compared to similar non-connected firms when the International Monetary Fund or the World Bank provides financial assistance to local government. This means that, to some extent, political connections affect the allocation of capital by local government. However, Fan et al. (2007) investigate the personal career backgrounds of 270

CEOs of new, partially privatized Chinese listed firms and find that almost 27% of CEOs have experience of government bureaucrats. Their results show that CEOs' political ties have negative effects on firms' stock returns. Yuan (2011) employs a sample of CEOs of partially privatized firms listed on the Shanghai stock market to investigate whether or not regional institutions and their CEOs' political connections influence firms' employment decisions. It is believed that the presence of politically connected CEOs leads to a reduction in the sensitivity of turnover to firm performance. Based on the previous arguments, I make the following hypothesis:

Hypothesis 3.3: Although government support reduces firms' financial constraints, government intervention reduces firms' stock returns.

3.3. Research design

This section firstly describes the data. It then presents the measurement of the key variables. The regression model and control variables are described in the final part.

3.3.1 Cross-border M&As data availability

The data set used in this study contains outward cross-border mergers and acquisitions with announcement dates by China's listed companies between 1998 and 2011, which are taken from the China Stock Market and Accounting Research (CSMAR) and the WIND databases. The sample includes Chinese listed firms and their parent companies as well as subsidiaries that are doing outward M&As. These two databases provide information about domestic and cross-border M&A cases, including detailed information such as deal status, date of announcement, and date of completion of the transaction. I manually select cross-border M&A cases based on these criteria: a) the acquirer or its patent

company or subsidiary must be listed on the Shanghai or Shenzhen stock markets (include A- and B- shares); b) Chinese company that is listed in abroad stock markets is excluded; c) the country location of acquiring firms are Chinese, and target firms are foreign countries; d) exclude the cases that are repeated. The details of data selection procedure can be seen in Table 3.1. As a result there are 986 outward M&A cases.

Table 3. 1 Sample selection procedure of outward M&As

Description	Deleted cases	Final number of outward M&A cases
Initial number of outward M&A cases		1812
Delete acquirers that are not listed	106	1706
Delete acquirers that are listed in abroad	191	1515
Delete the repeated cases	116	1399
Delete acquirers are not Chinese listed firms related	413	986

Following Wu et al. (2012), I manually collect politically related information about the CEOs and chairmen of the boards of the listed companies involved in outward M&A activities from annual reports, and I trace political ties by examining whether or not the CEO is currently, or was formerly, an officer of the government or military.

3.3.2 Statistical description

Following Wu et al. (2012) my sample of firms is first classified into three ownership categories: state-owned and non-state owned firms; private or non-private firms; foreign or non-foreign firms, based on the ownership of the ultimate controlling shareholder. A company is defined to be: (1) a state-owned enterprise (SOE) if the largest shareholder is government related; (2) a private

company if the largest shareholder is not state-related but is domestically privately-related; and (3) a foreign company if the largest shareholder is related to foreign ownership. SOEs have also been divided into two sub-categories, namely central or local government controlled.

Table 3.2 reports the distribution of listed firms involved in the outward M&As by location and ownership. Following Qin and Song (2009), I classify the location of the sample into coastal region, and central and western region, based on firms' registration addresses. A cursory look at the firm locations of China's outward M&As by listed companies reveals that among the 986, there are 765 firms located in coastal regions. In the coastal regions sample, 53.99% of firms are SOEs and 32.41% are private firms. Foreign companies only occupy 5.23%. The distribution of central SOEs and local SOEs is 28.90% and 24.96%, respectively. In the central and western regions sample, the share of SOE firms is 64.17%, which is higher than the coastal regions sample, followed by central SOEs (28.96%), and local SOEs (35.75%). The percentage of private firms located in central and western regions is 26.7%, which is lower than the coastal regions sample. Foreign firms occupy 4.07%.

The full sample is divided into four groups based on the ultimate controlling shareholder, namely the SOEs, private firms, foreign firms, and other types. SOEs are also divided into two subcategories, namely central and local SOEs. Table 3.3 reports the descriptive statistics of political connections for Chinese listed firms involved in outward M&A activities during 1998 – 2011 by ownership types. For the full sample, 55.27% of Chinese firms involved in outward M&As have political connections. Specifically, this shows that among 986 outward M&A cases, central SOEs have the highest level of political connection (68.88%), followed by local SOEs (54.44%), foreign firms (48.98%), and private firms (43.65%).

Table 3. 2 Distribution of the firms in outward M&A activities by location and ownership

This table present the distribution of the firms in outward M&As based on firm ownership and numbers of firms located on coastal regions and central and western regions.

Numbers	Total	SOEs	Central SOEs	Local SOEs	Private	Foreign	Others
Coast	765	413	222	191	248	40	64
% of Coast	100.00	53.99	28.90	24.96	32.41	5.23	8.36
Central and Western	221	143	64	79	59	9	10
% of central and west	100.00	64.71	28.96	35.75	26.70	4.07	4.52
total	986	556	286	270	307	49	74

Table 3. 3 Distribution of the firms in outward M&A activities by political connections and year

This table present the distribution of the firms in outward M&As based on the numbers of political connected firms in each year.

	Total			Total SOEs			Central SOEs			Local SOEs			Private			Foreign		
		Political connected			Political connected			Political connected			Political connected			Political connected			Political connected	
Year	# of firms	#	%	# of firms	#	%	# of firms	#	%	# of firms	#	%	# of firms	#	%	# of firms	#	%
1998	8	2	25.00	6	1	16.67	2	0	0.00	4	1	25.00	1	0	0.00	1	1	100.00
1999	15	13	86.67	8	7	87.50	1	0	0.00	7	7	100.00	4	3	75.00	2	2	100.00
2000	14	6	42.86	9	6	66.67	3	1	33.33	6	5	83.33	2	0	0.00	1	0	0.00
2001	15	4	26.67	6	3	50.00	2	2	100.00	4	1	25.00	9	1	11.11	0	0	0.00
2002	18	6	33.33	7	4	57.14	4	3	75.00	3	1	33.33	6	1	16.67	2	0	0.00
2003	21	8	38.10	10	5	50.00	1	0	0.00	9	5	55.56	6	1	16.67	2	1	50.00
2004	12	5	41.67	7	2	28.57	1	1	100.00	6	1	16.67	5	3	60.00	0	0	0.00
2005	35	9	25.71	25	7	28.00	10	1	10.00	15	6	40.00	6	1	16.67	2	0	0.00
2006	36	19	52.78	23	12	52.17	6	2	33.33	17	10	58.82	11	6	54.55	0	0	0.00
2007	106	53	50.00	52	27	51.92	26	17	65.38	26	10	38.46	36	19	52.78	6	2	33.33
2008	160	115	71.88	107	83	77.57	65	56	86.15	42	27	64.29	30	15	50.00	6	4	66.67
2009	219	139	63.47	143	96	67.13	81	61	75.31	62	35	56.45	51	24	47.06	13	8	61.54
2010	162	73	45.06	86	47	54.65	48	29	60.42	38	18	47.37	64	21	32.81	5	1	20.00
2011	165	93	56.36	67	44	65.67	36	24	66.67	31	20	64.52	76	39	51.32	9	5	55.56
Total	986	545	55.27	556	344	61.87	286	197	68.88	270	147	54.44	307	134	43.65	49	24	48.98

3.3.3 Measurement of the key variables

(1) Measure of political connections

Following Xu et al. (2013), I define a firm as politically connected when its CEO, or chairman, is currently, or formerly, a government official. I use an original hand-collected data-set on the political connections of board members of the cross-border M&As listed companies to sort companies into those connected and those not connected to government officials. Political connection is a dummy variable that equals 1 if the firm has a politically connected CEO or chairman, and zero otherwise.

(2) Measurements of financial constraints

Two proxies are used to measure Chinese multinationals' financial constraints in outward M&As: investment to cash flow sensitivity; and tangibility.

Investment to cash flow sensitivity

To investigate the investment behaviour of Chinese multinationals and their sensitivity to cash flow, I follow Fazzari et al. (1988) and Hadlock (1998). Fazzari et al. (1988) present a pioneering work on the empirical estimation of a firm's financial constraints. They classify the firms into four groups based on their financial constraints by using Value Line data for 422 large US manufacturing firms over the 1970 to 1984 time period. Firms with higher retention ratios face higher informational asymmetry problems and are more likely to be financial constrained. Financial constraints created by the imperfect capital market have sensitive impacts on firms' investment decisions. A company that has a lower dividends-income ratio displays higher sensitivity of investment to cash flow. A firm retains more of its income when it suffers a higher cost of

external financing. Firms who use internal finance are more sensitive to the change of cash flow and liquidity than are firms paying high dividends (Fazzari et al., 1988). The sensitivity of investment to cash flow by firms will increase when combined with the situation that the cost of external financing is higher than internal financing. I use the following baseline specification to test investment-cash flow sensitivity:

$$I_{it} = \beta_0 + \beta_1 CF_{it} + \beta_2 Controls_{it} + \epsilon_{it} \quad \text{(Equation 3.1)}$$

Where I_{it} is the dependent variable of firm *i*'s, investment, expressed by gross investment to total assets ratio at the end of year *t*, CF_{it}, is firm *i*'s, cash flow, expressed by cash flow to total assets ratio at the end of year *t*. Control variables are also included in the regressions.

Tangibility

I construct the sample for my main test by using a priori measures of the financial constraints faced by firms. There are a number of approaches to sorting firms into financial constraints and unconstrained categories. Following previous studies (Almeida and Campello, 2010, Xu et al., 2013), firms with greater tangible assets have lower probability to be financially constrained because such assets mitigate contractual problems, and tangibility can increase the value captured by creditors in default states. I use tangibility as a proxy of financial constraints and measure tangibility using the following formula:

$$\text{Tangibility} = \begin{pmatrix} Cash + 0.715 * Receivables + 0.547 * Inventory \\ +0.535 * Capital \end{pmatrix} / Total\ Assets$$

(Equation 3. 2)

where cash is a firm's year-end cash holdings; Receivables includes the firm's

accounts receivable and other receivables; Inventory is the firm's year-end inventory; Capital is the net value of property, plant, and equipment; and Total Assets is a firm's book value of total assets. Firms whose tangibility values are higher than the sample median tend to be a less financially constrained group, others are financially constrained.

3.3.4 Event study methodology

The event study method is used to analyse the performance of Chinese listed firms when there is an announcement of cross-border M&As. Event study examines the effects of an event on the value of assets. It is generally used to test for the existence of an "information effect" and to identify factors that explain changes in firms' value (Prabhala, 1997). Thus, the effects of an announcement of cross-border M&A on the stock price of Chinese firms can be analysed by this method. The aim of event study is to analyse abnormal returns in the stock market associated with an announcement of an exogenous impact (Diepold et al., 2008). In my article, the exogenous impact is the announcement of Chinese firms acquiring, or merging with, foreign firms. MacKinlay (1997) defines the abnormal return (AR) as equal to the actual return minus the expected return if an announcement does not happen. The model of abnormal return can be written as:

$$AR_{it} = R_{it} - E(R_{it}|X_{it}) \qquad \text{(Equation 3.3)}$$

Where AR_{it}, R_{it}, and $E(R_{it}|X_t)$ present, respectively, the security *i*'s abnormal return, actual return, and expected return in the time *t*.

Estimation of expected return by market model

The expected return $E(R_{it}|X_t)$ can be estimated through the market model by

multi-linear OLS regression (Baker et al., 2010):

$$R_{it} = \alpha_i + \beta_i R_{mt} + \varepsilon_{it} \quad \text{(Equation 3.4)}$$

with $\mathrm{E}(\varepsilon_{it}) = 0$, and $\mathrm{var}(\varepsilon_{it}) = \sigma_{\varepsilon_i}^2$ where R_{it} and R_{mt} are the returns of security *i* and market *m* at the time of *t*. Combined with equation 3.3 and equation 3.4, the abnormal return equation is as follows:

$$\widehat{AR_{\iota t}} = R_{it} - \widehat{\alpha_\iota} - \widehat{\beta_\iota R_{mt}} \quad \text{(Equation 3.5)}$$

The estimation of equation 3.5 presents the abnormal returns of each firm at announcement date. There is a hypothesis that investors in the market are rational, and that there is a quick response when there is a shock announcement. The abnormal return implies investors' anticipation of the performance of cross-border M&As.

Daily stock closing price of Chinese listed firms and market index (Shanghai composite index and Shenzhen composite index) are collected for the period starting 205 trading days prior to the announcement date (t=0) till the 31 trading days prior to the announcement date as estimation period (from t= -205 to -31) to estimate the coefficients of $\widehat{\alpha_\iota}$ and $\widehat{\beta_\iota}$ of the Equation 3.5. A 41-day period around the announcement data (from t= -20 to t=20) is designed as the event window.

Estimation of expected return by market adjusted model

In order to verify the empirical results, I also use market adjusted model to estimate the abnormal returns. The abnormal return equation is as follows:

$$\widehat{AR_{\iota t}} = R_{it} - \widehat{R_{mt}} \quad \text{(Equation 3.6)}$$

where R_{it} and R_{mt} are the returns on security i and returns on market m equally weighted index for day t. The event period of market adjusted model is 20 trading days prior the announcement date till the 20 trading days after the announcement date for a total of 41 days.

In most event studies, the cumulative abnormal return (CAR) around the event data will also be analysed, where it is calculated as the sum of the abnormal return between the dates t_i and t_{i+t}. Both AR and CAR can be used to calculate the value of a firm when there is an announcement. A positive value of abnormal return implies an optimistic anticipation about the firms and value is created for the investors.

3.3.5 Regression models

Three main regression models are employed in the empirical study to work on the relationship between political connections, financial constraints, and outward M&As by Chinese multinationals. In order to estimate the variation of investment-cash flow sensitivity across firms with different levels of financial constraints, following Xu et al. (2013), and based on Equation 3.1, I structure the following model:

$$I_{it} = \beta_0 + \beta_1 CF_{it} + \beta_2 Tangibiligy_{it} + \beta_3 CF_{it} \times Tangbility_{it} + \beta_4 Controls_{it} + \epsilon_{it}$$

(Equation 3.7)

Firms are partitioned into two groups (financially constrained and less financially constrained) based on the median value of *Tangibility*. Then, I add one interaction term ($CF_{it} \times Tangbility_{it}$) into Equation 3.6 to test whether the investment-cash flow sensitivity is significantly different for firms with different

levels of financial constraints. I especially focus on the coefficient of interaction term β_3 to see whether it is significantly different from zero, or not. Control variables are also included in the regressions.

I then investigate whether a firm's political connection can release the firm's financial constraints and investment-cash flow sensitivity by utilising the following baseline specification:

$$I_{it} = \beta_0 + \beta_1 CF_{it} + \beta_2 PC_{it} \times CF_{it} + \beta_3 PC_{it} \times Tangbility_{it} + \beta_4 Controls_{it} + \epsilon_{it}$$

(Equation 3.8)

I add two interaction terms ($PC_{it} \times CF_{it}$ and $PC_{it} \times Tangbility_{it}$) into Equation 3.7 to test whether the firm's political ties with the government can release its financial constraints. PC_{it} indicates firm *i*'s political connection in outward M&A deals at the end of last year. I focus on the coefficient of interaction terms β_2 and β_3 to see whether β_2 is insignificant and β_3 is significantly different from zero. The insignificant coefficient β_2 means that the firms do not present sensitivity of investment-cash flow when they build political ties with the government, and the financial constraints are reduced.

In order to examine the effects of political connections and financial constraints on the stock returns of firms involved in outward M&As, I use the following baseline specification:

$$CAR_{it} = \beta_0 + \beta_1 PC_{it} + \beta_2 Tangbility_{it} + \beta_3 Controls_{it} + \epsilon_{it}$$

(Equation 3.9)

CAR_{it} is the cumulative abnormal return of Chinese multinational enterprises

when there is an announcement of outward M&As estimated by the event study method. The coefficients of β_1 and β_2 present the effects of political connections and financial constraints on Chinese firm's stock returns when there is an announcement of outward M&A.

3.4. Empirical results

3.4.1 Sensitivity of investment to cash flow

The sensitivity of investment to cash flow is identified by Fazzari et al. (1988). They classify a sample into subgroups based on a dividend to income ratio as a proxy of financial constraints, then investigate the value of investment-cash flow sensitivities of each subsample. The theoretical logic is that firms facing financial constraints have higher sensitivities of investment to cash flow because they have greater costs of external financing than of internal financing. This method of sensitivity to cash flow of investment is widely used in studies such as those by Xu et al. (2013), Carpenter and Petersen (2002), and Carpenter and Guariglia (2003).

Table 3.4 reports the sensitivity of investment to cash flow of Chinese listed firms involved in outward M&As. The results show that the coefficients of cash flow variable (*CF*) is positive and significant in all of the models within the range of 0.0242 to 0.0260, which implies that corporate investment is positively correlated with a firm's internal cash flow. The asymmetric information caused by the imperfect capital market may push corporations to give up positive investment opportunities in the future (Myers and Majluf, 1984). I also investigate the corporate ownership effects on firm investment. Central SOEs, local SOEs, private, and foreign are dummy variables of firm ownerships which allow me to examine whether corporate ownerships influence firm investment.

The coefficients of local SOEs (*LSOE*), central SOEs (*CSOE*), and foreign are positive and significant. Consistent with hypothesis 3.1, government-related firms, such as central and local SOEs, are less likely to face financial constraints and are positively related with corporate investment, while the private firms, who are more likely to face financial constraints in China, have a negative and significant coefficient, which supports hypothesis 3.2. There is a statistically negative correlation between private firms and investment. Allen et al. (2005) point out four main financing sources in China: domestic bank loans; self-fundraising; state budget; and FDI, with bank loans and self-fundraising the most important sources. Firms in the state sector are more reliant on bank loans, which make up more than 25% of their total loan amount. However, private firms rely mostly on self-fundraising because of the obstacles for them to access bank loans.

Table 3. 4 Sensitivity of investment to cash flow of Chinese listed firms involved in outward M&As

This table presents the sensitivity of investment to cash flow of Chinese listed firms concerning outward M&As by OLS regression. The dependent variable is the gross investment to total assets. The definitions of all variables can be found in Appendix 3.A. The t-statistics are reported in parentheses. *,** and *** present the significance level at 10%, 5% and 1%, respectively.

Variables	Model 1	Model 2	Model 3	Model 4	Model 5
C	0.2743*** (2.3259)	0.2527** (2.1402)	0.2220* (1.9152)	0.2807** (2.3906)	0.2222* (1.9326)
CF	0.0260*** (7.3413)	0.0260*** (7.3539)	0.0255*** (7.3470)	0.0245*** (6.8659)	0.0242*** (6.9882)
Tobin Q	-0.0064** (-2.1213)	-0.0058* (-1.9173)	-0.0053* (-1.7951)	-0.0068** (-2.2629)	-0.0027 (-0.8965)
Sales growth	-0.0014* (-1.9235)	-0.0015** (-2.0808)	-0.0013* (-1.7761)	-0.0014* (-1.9061)	-0.0015** (-2.1731)
GDP per capital	-0.0227 (-0.9725)	-0.0240 (-1.0308)	0.0060 (0.2557)	-0.0273 (-1.1729)	-0.0055 (-0.2400)
Market capital	-0.0017 (-0.1750)	-0.0001 (-0.0140)	-0.0097 (-0.9977)	-0.0007 (-0.0678)	-0.0021 (-0.2153)
LSOE		0.0260** (2.1882)			
CSOE			0.0702*** (6.0530)		
Foreign				0.0733*** (2.9375)	
Private					-0.0808*** (-7.0691)
Obs.	876	876	876	876	876
R-squared	0.0650	0.0702	0.1029	0.0742	0.1159

3.4.2 Investment-cash flow sensitivity with different levels of financial constraints

I further investigate the investment-cash flow sensitivity of Chinese listed firms involved in outward M&As across firms with different levels of financial constraints. I divide the full sample into two groups according to the measurement of financial constraints (*Tangibility*) by using the median value of Tangibility, as mentioned in section 3.3.3. *Dtangibility* is a dummy variable measuring a firm's financial constraints and which equals 1 if the tangibility value is higher than the median value and is indicated as less financially constraining.

Table 3.5 reports the investment-cash flow sensitivity for Chinese listed firms involved in outward M&As portioned by level of financial constraints by OLS regression. The interactions terms (*Dtangibility*CF*) test whether investment-cash flow sensitivity differs with different levels of financial constraints. The coefficients of cash flow (*CF*) is positive and significant within the range of 0.0562 to 0.0627. The coefficients of *Dtangibility*CF* are negative and significant within the range of -0.0444 to -0.0381, which means that financially constrained firms are more likely to rely on their internal cash flow. Access to financial markets is an important determinant for a firm's investment and growth, but Chinese firms are more likely to face financial constraints caused by imperfect capital market development and information asymmetries (Poncet et al., 2010). Allen et al. (2005) compare the Chinese financial system with those of the LLSV-sample countries used by Porta et al. (1997). They conclude that the Chinese stock market is smaller than those of most LLSV-sample countries in terms of market capitalisation and the ratio of total traded value to GDP. Chinese banks play the most important role in the financial system which is dominated by the government. Firms without government relationships are more

likely to face financial constraints. Firms with a higher investment-cash flow sensitivity face greater obstacles to obtain external funds.

Table 3. 5 Investment-cash flow sensitivity for Chinese listed firms involved in outward M&As partitioned by level of financial constraints

This table presents investment-cash flow sensitivity for Chinese listed firms involved in outward M&As portioned by level of financial constraints by OLS regression. The dependent variable is the gross investment to total assets. The definitions of all variables can be found in Appendix 3.A. The t-statistics are reported in parentheses. *,** and *** present the significance level at 10%, 5% and 1%, respectively.

Variables	Model 1	Model 2	Model 3	Model 4	Model 5
C	0.0892*** (8.5758)	0.1005*** (8.6985)	0.1007*** (8.7320)	0.2349*** (2.6533)	0.2731** (2.3474)
CF	0.0562*** (6.7273)	0.0623*** (7.2180)	0.0627*** (7.2782)	0.0607*** (6.8791)	0.0610*** (6.8553)
DTangibility	0.0718*** (5.4818)	0.0744*** (5.5405)	0.0745*** (5.5603)	0.0748*** (5.3590)	0.0743*** (5.2827)
DTangibility*CF	-0.0381*** (-4.1908)	-0.0444*** (-4.7492)	-0.0437*** (-4.6745)	-0.0415*** (-4.3440)	-0.0420*** (-4.3525)
Tobin Q		-0.0064** (-2.2375)	-0.0066** (-2.3059)	-0.0070** (-2.3695)	-0.0072** (-2.4303)
Sales growth			-0.0014* (-1.9441)	-0.0014* (-1.9122)	-0.0014* (-1.9230)
GDP per capital				-0.0295 (-1.4805)	-0.0253 (-1.0902)
Market capital					-0.0046 (-0.4768)
Obs.	981	935	935	881	876
R-squared	0.0819	0.0901	0.0938	0.0955	0.0954

3.4.3 The effects of political connections on investment-cash flow sensitivity

In order to test whether or not political connections can release financial constraints on firms involved in outward M&As, Table 3.6 reports the effects of political connections on firm investment-cash flow sensitivity. The coefficient of cash flow (*CF*) is still positive and significant, while the interaction term between political connections and cash flow (*PC*CF*) is insignificant, with the coefficient value of 0.0030, which is consistent with hypothesis 3.2 - politically connected firms do not have sensitivity of investment to cash flow and are less financially constrained. This empirical result shows that politically connected firms have a lower dependence on internal cash flow in corporate investment, and political connections mitigate the level of corporate financial constraints. Table 3.6 also reports the effects of political connections on firm investment across different levels of financial constraints. The interaction terms of *PC*Dtangibility* are statistically significant with the coefficient value of 0.2527, which means that political connections help to release firms' financial constraints.

Chinese firms are more likely to face financial constraints due to information asymmetry and agency costs (Poncet et al., 2010). My empirical results are consistent with Cull et al. (2015) who empirically examine the role of government connections in determining the severity of financial constraints in China. Firms associated with government connections are less likely to face financial constraints and present lower investment-cash flow sensitivity. My empirical results support the important role of government connections in explaining the imperfect Chinese capital market and prove the misallocation of capital resources in China.

Table 3. 6 Effect of political connections on investment-cash flow sensitivity of Chinese listed firms involved in outward M&As with different levels of financial constraints

This table presents the effect of political connections on investment-cash flow sensitivity of Chinese listed firms involved in outward M&As by OLS regression. The dependent variable is the gross investment to total assets. The definitions of all variables can be found in Appendix 3.A. The t-statistics are reported in parentheses. *,** and *** present the significance level at 10%, 5% and 1%, respectively.

Variables	Model 1	Model 2
C	0.2044* (1.8438)	0.2657** (2.4421)
CF	0.0232*** (2.6936)	0.0232*** (6.6995)
Sales growth	-0.0014* (-1.9021)	-0.0815*** (-4.2958)
GDP per capital	-0.0105 (-0.4860)	-0.0015** (-2.0469)
Market capital	-0.0023 (-0.2358)	-0.0302 (-1.4168)
PC	0.0155 (1.0566)	-0.0001 (-0.0102)
PC*CF	0.0030 (0.3130)	
PC*Dtangibility		0.2527*** (6.2611)
bs.	918	918
R-squared	0.0612	0.0999

3.4.4 The effect of political connections and financial constraints on acquirers' value

I investigate whether outward M&As create value for Chinese listed firms, or not. I divide the sample into two groups, higher than median value and lower than median value, based on each of the financial constraint measures. The political connections are also classified into politically connected firms and non-politically connected firms. I use multiple OLS regressions, with abnormal return as the dependent variable, on the event window [-20, 20] to verify the validity of the results after accounting for the effects of the well-known determinants of political connection and financial constraints. And I try to figure out to what extent the political connections and financial constraints impact Chinese firms' value when there is an announcement of outward M&As.

Table 3.7 reports the effects of political connections and financial constraints on average abnormal returns. The evaluation of abnormal returns are estimated based on the market model. As can be seen from Table 3.7, the coefficients of political connections (*PC*) are insignificant, which reject the hypothesis 3.3 that political connections have negative effects on stock returns for the firms involved in outward M&As. However, the coefficients of financial constraints (*Dtangibility*) are significant positive at 5% level within a range of 3.09 and 3.4259. This means that financial constraint is a considerable determinant on stock returns when there is an announcement of outward M&As by Chinese listed firms. Firms with less financial constraints are more likely to have higher and positive stock returns when there is an announcement of outward M&As.

I further verify the empirical results using other methods such as market adjusted model to examine the abnormal returns when I test the effects of political connections and financial constraints on stock returns. As Table 3.8 shows, the

results are consistent. The political connections do not significantly correlated with stock returns, which is consistent with Fisman et al. (2012). The politically connected firms do not have better stock returns in short-term than those of non-politically connected firms, although political connections bring the benefits of accessing bank loans and government subsidies (Cull et al., 2015). One explanation is that the effects of political connections on cooperate performance are significant based on long-term aspects (Fan et al., 2007, Liu et al., 2012), while the daily cumulative abnormal returns are short-term evaluation. However the empirical results support that less financially constrained firms present higher percentage value of abnormal returns based on event study estimation, which is consistent with Lamont et al. (2001) that financially constrained firms earn lower degree of returns than less financially constrained firms.

Table 3. 7 Determinants of average abnormal returns based on market model around political connection and financial constraints

This table shows the results of the OLS regressions of the cumulative abnormal returns over one event window ([-20, 20]) for political connection and two financial constraints proxies. The abnormal returns are measured based on market model. The definitions of all variables can be found in Appendix 3.A. ***, ** and * denote statistical significance at the 1%, 5% and 10% significance levels, respectively. Numbers in parentheses are t-statistics.

Variables	Model 1	Model 2	Model 3	Model 4	Model 5
C	12.9615	12.9219	13.6172	10.5429	5.0058
	(10.678)	(10.691)	(10.630)	(16.535)	(19.256)
PC	-0.0499	-0.0531	-0.0722	-0.0487	0.0413
	(1.306)	(1.307)	(1.300)	(1.342)	(1.354)
Dtangibiligy	3.0900**	3.1007**	3.2819**	3.3678**	3.4259**
	(1.538)	(1.542)	(1.534)	(1.579)	(1.591)
Firm size	-0.5518	-0.5445	-0.6240	-0.6209	-0.6044
	(0.914)	(0.917)	(0.912)	(0.940)	(0.962)
Tobin's Q	-0.5500	-0.5482	-0.6496	-0.6523	-0.6460
	(0.476)	(0.476)	(0.474)	(0.482)	(0.485)
Leverage	0.5152	0.5170	0.4787	0.6522	0.6636
	(0.599)	(0.600)	(0.596)	(0.633)	(0.636)
BTMV	0.0048	-0.0007	0.0838	0.1063	0.1082
	(0.549)	(0.552)	(0.549)	(0.563)	(0.565)
Cash holdings	0.0758	0.1075	-0.0843	0.7426	0.6070
	(5.991)	(6.001)	(5.966)	(6.079)	(6.110)
Cash flow		-0.0448	0.1987	0.1889	0.2050
		(0.409)	(0.413)	(0.414)	(0.424)
Sales growth			-0.2851***	-0.2902***	-0.2885***
			(0.085)	(0.085)	(0.085)
GDP per capita				0.6240	0.4932
				(2.546)	(3.011)
Market capital					0.5141
					(1.267)
Year effects	Yes	Yes	Yes	Yes	Yes
Obs.	880	880	880	827	822
R-squared	0.0339	0.0339	0.0464	0.0469	0.0473

Table 3.8 Determinants of average abnormal returns based on market adjusted model around political connection and financial constraints

This table shows the results of the OLS regressions of the cumulative abnormal returns over one event window ([-20, 20]) for political connection and two financial constraints proxies. The abnormal returns are measured based on market adjusted model. The definitions of all variables can be found in Appendix 3.A. ***, ** and * denote statistical significance at the 1%, 5% and 10% significance levels, respectively. Numbers in parentheses are t-statistics.

	Model 1	Model 2	Model 3	Model 4	Model 5
C	11.1018***	11.2041***	11.4428***	8.3086	3.9196
	(4.125)	(4.129)	(4.111)	(6.366)	(7.405)
PC	0.2304	0.2388	0.2323	0.2834	0.2956
	(0.505)	(0.505)	(0.503)	(0.517)	(0.521)
Dtangibiligy	1.0124*	0.9847*	1.0469*	1.1707*	1.1404*
	(0.594)	(0.596)	(0.593)	(0.608)	(0.612)
Firm size	-0.7713**	-0.7900**	-0.8173**	-0.7363**	-0.7806**
	(0.353)	(0.354)	(0.353)	(0.362)	(0.370)
Tobin's Q	-0.0383	-0.0429	-0.0777	-0.0423	-0.0486
	(0.184)	(0.184)	(0.183)	(0.185)	(0.186)
Leverage	0.3928*	0.3880*	0.3749	0.4281*	0.4336*
	(0.232)	(0.232)	(0.231)	(0.244)	(0.245)
BTMV	0.1779	0.1921	0.2211	0.2365	0.2352
	(0.212)	(0.213)	(0.212)	(0.217)	(0.217)
Cash holdings	-1.8700	-1.9521	-2.0179	-1.8411	-1.8299
	(2.314)	(2.318)	(2.307)	(2.340)	(2.350)
Cash flow		0.1158	0.1993	0.1945	0.2428
		(0.158)	(0.160)	(0.159)	(0.163)
Sales growth			-0.0979***	-0.1001***	-0.0980***
			(0.033)	(0.033)	(0.033)
GDP per capita				0.4989	-0.4065
				(0.980)	(1.158)
Market capital					0.7681
					(0.487)
Year effects	Yes	Yes	Yes	Yes	Yes
Obs.	880	880	880	827	822
R-squared	0.0586	0.0592	0.0688	0.0687	0.0713

3.4.5 Robustness check

To address the concern that many Chinese listed firms involved in outward M&As might be affected by the largest shareholder investment decisions, I classify the full sample into four subsamples: central SOEs, local SOEs, foreign firms, and private firms. The listed firms' ownership information is collected from WIND databases. I examine the effects of political connections on investment-cash flow sensitivity of Chinese listed firms involved in outward M&As with different levels of financial constraints on each of the four subsamples. Table 3.9 reports the empirical results. The coefficients of interactions terms between political connections and measurements of financial constraints for the private firms and local SOEs are significant, which means that political connections help the Chinese listed firms to mitigate financial constraints for these kinds of firms. However, for the central SOEs and foreign firms, the political connections do not present significant effects in the release of financial constraints they face when conducting outward M&As.

Table 3. 9 Effects of political connections on investment-cash flow sensitivity of Chinese listed firms involved in outward M&As with different levels of financial constraints

This table shows the effects of political connections on investment-cash flow sensitivity of Chinese listed firms involved in outward M&As with different levels of financial constraints by OLS regression. The definitions of all variables can be found in Appendix 3.A. ***, ** and * denote statistical significance at the 1%, 5% and 10% significance levels, respectively. Numbers in parentheses are t-statistics.

Panel A	Central SOE		Local SOE		Foreign		Private	
Variables	Model 1	Model 2	Model 1	Model 2	Model 1	Model 2	Model 1	Model 2
C	0.1425	0.1091	0.1772	0.2386	-3.7318**	-3.7276**	0.1464	0.0919
	(0.8078)	(0.6016)	(0.7734)	(1.0548)	(-1.9766)	(-1.9717)	(0.8501)	(0.5370)
CF	0.0406*	0.1048***	0.0361**	0.0166	0.0284	0.0228	-0.0047	-0.0020
	(1.9100)	(7.4624)	(2.2169)	(0.0166)	(0.8355)	(1.0568)	(-0.4000)	(-0.2109)
Sales growth	-0.0561**	-0.0926***	-0.0012*	-0.0013*	-0.0223	-0.0256	0.0055	0.0028
	(-2.1905)	(-3.7244)	(-1.7169)	(-1.8750)	(-1.0134)	(-1.3274)	(0.3994)	(0.2091)
GDP per capital	0.0455	0.0375	-0.0178	-0.0385	1.2491**	1.2499**	0.0115	0.0147
	(1.2892)	(1.0229)	(-0.3996)	(-0.8566)	(2.5298)	(2.5159)	(0.3345)	(0.4324)
Market capital	-0.0154	-0.0149	0.0047	0.0091	-0.1423	-0.1423	-0.0069	-0.0037
	(-0.8767)	(-0.8244)	(0.2318)	(0.4509)	(-1.3475)	(-1.3378)	(-0.5727)	(-0.3112)
PC	-0.0538	0.0397	0.0295	-0.0490**	0.1124	0.1071	-0.0161	-0.0292**
	(-1.4907)	(1.4921)	(0.9567)	(-2.1910)	(1.3681)	(1.2221)	(-0.7694)	(-2.0937)
PC*CF	0.1011***		-0.0403*		-0.0096		0.0051	
	(3.8434)		(-1.8404)		(-0.2304)		(0.2722)	
PC*Dtangbility		0.0282		0.0674***		-0.0102		0.0438**
		(1.0280)		(2.6396)		(-0.1065)		(2.4191)
Obs.	269	269	247	247	44	44	291	291
R-squared	0.2266	0.1862	0.0377	0.0517	0.3163	0.3156	0.0054	0.0252

3.5. Conclusion

This paper uses firm level data to test whether stock markets reward firms' political connections and financial constraints. It contributes to the literature by linking political connection and financial constraints to investor confidence in Chinese outward M&A. The paper is generally in line with previous literature examining the effects of financial constraints and political connections on Chinese firms' investments. I adopt one proxy of financial constraints (*Dtangibility*). The investment-cash flow sensitivity is investigated. A hand-collected political connections variable has been employed to investigate firms' political connections.

The empirical results show that corporate investment is positively correlated with firms' internal cash flow. Central SOEs, local SOEs, and foreign firms who are less likely to face financial constraints are positively correlated with corporate investment, while private firms who are more likely to face financial constraints in China have negative and significant coefficients. Politically connected firms do not have sensitivity of investment to cash flow and are less financially constrained. For firms' stock returns, politically connected firms do not present significant effects on abnormal returns when there is an announcement of outward M&A. However, less financial constraints is positively corrected with cumulative abnormal returns when there is an announcement of outward M&As by Chinese listed firms. A robustness check has been done to test the effects of political connections on investment-cash flow sensitivity of Chinese listed firms involved in outward M&As with different levels of financial constraints by classifying the sample into four groups according to ownership type. The empirical results are useful to firms involved in the outward M&As of emerging countries around the world and who suffer from imperfect capital markets, misallocation of key resources, and weak

property rights protection.

Appendix 3.A Definition and sources of the variables on outward M&As

Variable	Definition	Sources
Firm level variables		
Sales growth	(sales-lagged sales)/lagged sales	WIND database
Gross investment/Total assets (*I*)	(Fixed assets-lagged fixed assets+ depreciation)/Total assets	WIND database
Cash flow/Total assets(CF)	(total income+ depreciation)/Total assets	WIND database
Tobin Q	Total market value of firm/Total asset value of firm	CSMAR database
DTangibility	A dummy variable is equal to 1 if a firm's tangibility value is larger than the sample median, and 0 otherwise.	WIND database
Firm size	Log of real total assets at the end of last year	WIND database
Leverage	(net income+ income tax expense+ financial expense + depreciation+ intangible assets amortization + long-term prepaid expenses)/(net income+ income tax expense+ financial expense)	CSMAR database
BTMV	Book-to-Market ratio is the ratio of total assets to market value.	CSMAR database
Cash holdings	Ratio of cash and cash equivalents to total assets	WIND database
Central SOE	Variable value is equal to 1 if a firm's ultimate owner is central government, and 0 otherwise.	WIND database
Local SOE	Variable value is equal to 1 if a firm's ultimate owner is local government, and 0 otherwise.	WIND database
Private	Variable value is equal to 1 if a firm's ultimate owner is individuals and non-government entities, and 0 otherwise.	WIND database
Foreign	Variable value is equal to 1 if a firm's ultimate owner is foreign companies, and 0 otherwise.	WIND database

Appendix 3.A Definition and sources of the variables on outward M&As (continued)

Country level variables		
GDP per capita	A common logarithm of GDP per capital in foreign countries.	World Bank
Market capital	A common logarithm of market capitalization in foreign countries.	World Bank

Chapter 4. Effects of Foreign Acquisitions on Financial constraints, Productivity, and Investment in R&D of Target Firms in China

4.1 Introduction

Inward FDI flows to developing economies reached their highest level in 2014 (United Nations Conference on Trade and Development, 2015). As one of those developing economies, China provides a useful setting for studying cross-border M&As, and there are a number of reasons for this. First of all, China recently overtook the US to become the largest FDI recipient in the world. Since the economic reforms and opening-up of China were initiated in 1979, China has experienced a dramatic increase in inward cross-border M&As and Chinese multinationals now play an increasing role in the global market. China, as the top choice for FDI, based on the report of (United Nations Conference on Trade and Development, 2015), has identified foreign investment as one of the key engines for the growth of its economic development for the past few decades. The stock of FDI inflows to China was valued at US$129 billion at the end of 2014 with an increase of 4% (United Nations Conference on Trade and Development, 2015). Inward cross-border M&As, which have experienced dramatic growth in recent years, have also become a common and important form of FDI in China by providing a viable method for foreign investors to enter the Chinese market. As Hopkins (1999, p.208) states, ‘cross-border mergers and acquisitions have become by far the single biggest means of integrating the world’s economies’.

Nevertheless, there is limited literature on inward M&As in China, a point which can initially be justified by the fact that the transactions of inward M&As taking place there tend to be much smaller in scale and number than those of outward M&As. Expressed in terms of the value of transactions, in 2014 inward M&As

accounted for 22% of FDI flowing into China, while more than half of the outward FDI took the form of outward M&As (KPMG, 2015). However, since China joined the World Trade Organization (WTO) in 2001, the government gradually loosened its restrictions on foreign takeovers of Chinese assets and made moves to attract foreign M&As. At the same time, a growing number of Chinese firms are encouraged by the government to engage in cross-border M&As of their own. Based on international norms of reciprocity, a rapid increase of outward M&As in China must, in most cases, combine with the growth of inward M&As (Peng, 2006).

In addition, with the important role of cross-border M&As in China, a number of researchers have explored inward M&As, such as Buckley et al. (2007a), Chen and Findlay (2003) and Peng (2006). Most existing papers discuss the impact of inward FDI on China, considering M&A as a means of FDI. For example, Buckley et al. (2007a) empirically examine a relationship between the ownership of inward FDI and productivity spillover effects in China by employing a sample of Chinese multinational enterprises from the manufacturing industry for the year 1995. There is a curvilinear relationship between Hong Kong, Macau, and Taiwan capital and locally owned enterprises' productivity rather than a linear relationship. Once past a certain level of penetration, the spillover effects start to reduce. In addition to the direct effects on the productivity growth of local firms, inward FDI is generally beneficial for economic growth and domestic investment. Employing a dataset of inward FDI from 1996 to 2004, Ouyang and Fu (2012) find a link between 'inter-regional spillovers' of inward FDI in Chinese coastal cities and a positive impact of FDI on economic growth. Multinational enterprises develop technical progress through the transmission of ideas from inward FDI and hence improve the whole economy in the long-term (Dees, 1998).

However, FDI occurs in various forms, including joint venture, greenfield investment, and M&As. These kinds of studies do not provide specific knowledge on the impact of cross-border M&As in China. Previous analysis of the effects of inward M&As in China is largely targeted at the macroeconomic level. Past studies focus on two main categories. On the one hand, there are those which describe an overall map of inward M&As. For instance, Chen and Findlay (2003) review the cross-border M&As in APEC countries in terms of rapid growth, imbalance between purchases and sales of cross-border M&As, classification and motivations for cross-border M&As, and effects on corporate performance and economic growth. Peng (2006) also describes some idiosyncrasies that relate to inward M&As in China. However, these kind of papers fail to provide in-depth analysis of the impact of inward M&A flows in China. On the other hand, researchers tend to articulate the effects of inward M&A flows in China on macroeconomic development and local firms. Cooke (2006) investigates the determinants, barriers, and implications for human resource management of the acquisitions of Chinese state-owned firms by foreign multinational enterprises in China. Nagano and Yuan (2013) examine the causes and consequences of inward M&As in two developing countries, China and India. They determine that foreign acquirers prefer to target firms that have higher cash-reserve ratios and growth opportunities. Foreign acquisitions create higher investment returns in comparison with those of returns created by domestic acquisitions, which explains why there is an increase in cross-border acquisitions in developing countries. Liu et al. (2015) analyse the causal effect of foreign acquisitions on the labour market of Chinese manufacturing firms. Their empirical results show that foreign acquisitions in China have their own particular characteristics which are different, but comparable, to those in developed countries found in past papers. Foreign acquisitions have positive effects on the levels of Chinese firms' employment and wages, but reduce the

employment growth and do not influence wage growth. By employing an industry panel study over the period of 1991-2005, Zou and Simpson (2008) also empirically investigate the factors which drive cross-border M&As in China, and show that industry size, profitability, and technological intensity positively determine the level of foreign acquisition activity.

While recent studies have examined whether acquisitions can potentially mitigate financial constraints of target firms and increase the number of investments in the context of developed countries, little evidence exists for emerging countries. Erel et al. (2015) identify the main reason that few studies work on the acquisitions relationship with financial constraints is that it is difficult to observe data on target firms subsequent to their acquisition. They employ a sample of European acquisitions occurring between 2000 and 2009 to overcome this obstacle and test whether acquisitions relieve target firms' financial constraints. They conclude that acquisitions significantly mitigate the target firms' financial constraints at the time the acquisition takes place. Khatami et al. (2015) use a sample of US acquisitions over the period 1985 to 2013 to examine the effect of financial constraints on firm gains and acquisition likelihood. They find that financially constrained firms are more likely to be acquired and experience benefits by being able to access financial capital through the reallocation of resources. Both acquirers and targets enjoy the acquisition premium and abnormal returns. The extensive theoretical and empirical work on cross-border M&AS has centred exclusively on the antecedents and value creation of the cross-border M&As of emerging country's firms making acquisitions in foreign countries. For instance, Du et al. (2016) examine the effects of state ownership, institutions, and resource-seeking motives of Chinese firms on long-term stock price returns based on the dataset of cross-border M&As over the period of 1998-2008. They empirically prove

the positive effects of SOE, institutional distance, and acquisition size, on long-term acquired returns, while the tangible resources and acquirers cash holdings have negative impacts on long-term returns. Aybar and Ficici (2009) employ event study methodology to explore the value implication of cross-border M&As by multinational firms from emerging markets. They find that there are many factors influencing the bidder value, such as target size, ownership structure of target firm, and structure of the bidder. However, firms in developing countries are more likely to face severe financial constraints compared with firms in developed countries due to the severity of capital market imperfections. For example, the Chinese government still controls key resources and inputs, and state-owned enterprises enjoy priority access to bank loans at lower loan rates (Chow et al., 2010, Poncet et al., 2010), while small and private firms have less access to bank loans (Shen et al., 2015). While it may be argued that acquisitions can potentially lessen the target firms' financial constraints and increase investment in R&D and productivity in emerging countries, policy makers have raised concerns about the beneficial effects of acquisitions to the target firms (Bertrand, 2009, Miozzo et al., 2016). Foreign acquisition seems an effective method for domestic firms in developing countries to access external financial resources because it is advantageous for foreign acquired firms to get external debt from parent companies and access to international financial markets through a global network (Wagner et al., 2013). Indeed, the effects of foreign acquisitions on financial constraints of the target firms, and the extent to which acquisitions can alleviate financial constraints and improve R&D activity and productivity of target firms, have not been examined in the emerging country context.

In response to this past literature and the fact of recent rapid growth of cross-border M&As in China, this research considers the effect of inward M&As on

firms' financial issues, productivities, and innovations, as well as whether, and to what extent, foreign acquisitions release financial constraints on Chinese firms, and improve both productivity and investment in R&D. To do this a sample of 914 inward cross-border M&As are investigated over the period of 1994-2011.

In addition, one of the potential reasons for M&A studies to concentrate on acquiring firms is due to the lack of data in respect of target firms. However, all the target firms in my sample are listed in Chinese Shanghai or Shenzhen Stock Exchange market, thereby providing a rare opportunity to evaluate financial constraints before and after the target acquisition. As the largest economy among the emerging countries, China provides an ideal context within which to demonstrate the impact of foreign acquisitions on financial constraints, productivity, and investment in R&D.

The results of this study indicate that foreign acquisitions in China are associated with a reduction of target firms' financial constraints, irrespective of the ownership type of the target firm. However, the extent of constraint reduction is more pronounced for non-SOEs (i.e. domestic and foreign private-owned enterprises) compared to state-owned enterprises (SOEs). My results also suggest that foreign acquisitions increase both the productivity and investment in R&D of the target firms. The study contributes to the literature in the following ways. First, I contribute to the large body of literature on capital market imperfections and firm investment, particularly how state ownership of banks in emerging markets affects efficient allocation of capital in the formal financing sector. Second, obtaining the technological know-how and developing technical capabilities are increasingly important motives for acquisitions but remain under-researched (Granstrand et al., 1992). The resource based view

suggests that acquisitions (market for firms) are an important part of the business process of redeploying resources into more productive uses compared to the market for some resources (Capron et al., 1998, Gupta and Govindarajan, 2000). By examining the effects of acquisitions on target resources (financial constraints), investment in R&D, and productivity, I provide evidence of efficiency gains derived from cross-border M&As.

The remainder of this article proceeds as follows. The next section 4.2 reviews the literature on the effects of foreign acquisition on the target's financial constraints, productivity, and R&D investments, and develops the research hypotheses. Section 4.3 presents the sample selection as well as the analytical method used and is followed by a discussion of results in section 4.4. The final section concludes the paper and identifies implications of the study.

4.2 Literature Review and Hypothesis Development

4.2.1 Foreign Acquisitions and Financial constraints

The neoclassical models of investment assume that capital markets are perfect (Modigliani and Miller, 1958). However, the assumption of the perfect market is inconsistent with what happens in the real world where some investors tend to have better information than others and non-market factors, such as government directed-credit, abound. In this regard, a firm's investment decisions reflect the imperfections and financial constraints in that market (Carpenter and Petersen, 2002). In short, scholars point out that financial constraints stem predominantly from capital market imperfections, such as information asymmetry, agency problems, and the introduction of non-market factors in formal financing. For example, based on a panel data of 1600 small manufacturing firms, Carpenter and Petersen (2002) empirically prove that for growth most small firms face

internal financial constraints. Poncet et al. (2010) test whether there are financial constraints faced by Chinese firms by employing a dataset of 1300 Chinese firms over the period of 1998-2005. They find that private firms are more likely to face financial constraints while state-owned and foreign-owned firms are not. But the geographical and sector presence of foreign capital relieves private firms' financial constraints, while the geographical and sector presence of stated owned firms crowd private firms out of the domestic capital markets. Héricourt and Poncet (2009) examined 1300 Chinese firms over the period 2000-2002 and reach the conclusion that foreign direct investment alleviates domestic firms' credit constraints, it especially relieves the financial and legal obstacles private firms face at home. While it is well documented that the presence of financial constraints has a deleterious effect on a firm's investment decisions as financial constraints impede firm growth and survival (Hubbard, 1998, Stein, 2003), considerable disagreement exists on how financial constraint is measured and this remains an empirical issue (Erel et al., 2015). Prior literature has put forward several criteria to identify the level of financial constraints faced by firms, but no consensus has emerged on which is the best proxy. Fazzari et al. (1988) are pioneers in working on the relation between financial constraints and investments. They divide their dataset of 422 US manufacturing firms over the period 1970-1984 into three groups according to earnings retention ratios. They argue that firms with higher earnings retention ratios have less financial constraints because they have a higher probability of facing information asymmetry in the imperfect market. However, an alternative financial constraints index is advanced by Whited and Wu (2006), which is followed by Gomes et al. (2006) and Livdan et al. (2009). Despite this, many researchers support the use of investment-cash flow sensitivity as an indicator of financial constraints (Allayannis and Mozumdar, 2004, Fazzari et al., 2000). This study therefore uses the investment-cash sensitivity approach together with Whited and Wu's (2006)

index to identify financial constraints.

Recent studies in the context of developed countries document that M&A has an effect on the target firm's financial constraints. For example, Erel et al. (2015) examined 5,187 European acquisitions which occurred from 2001 through 2008 and reported that subsequent to an acquisition the level of target cash holdings, the sensitivity of cash holdings to cash flow, and the sensitivity of investment to cash flow declined, while the quantity of the target's investments increased after the acquisition. Using a sample of US acquisitions, Khatami et al. (2015) rendered some support to the view that acquisitions improve financially constrained firms' ability to access capital through a better re-allocation of resources. Other studies which focus generally on the role of FDI in funding the corporate sector, report that foreign direct investors play an important role in alleviating domestic firms' financial constraints by bringing scarce capital with them (Harrison and McMillan, 2003, Héricourt and Poncet, 2009). However, it is pertinent to point out that studies that focus on M&A are in the context of developed countries and relatively little attention has been given to emerging countries where financial constraints appear severe because of state interference in credit allocation.

4.2.2 Effects of Foreign Acquisitions on Target R&D and Productivity

If acquisitions indeed ease financial constraints of the target firms, then the intriguing question that follows is: do the acquisitions lead to an increase in investment in R&D and improve productivity of the relieved firms? This is an important question because policy makers have raised concerns about whether acquisitions benefit the target firms in terms of R&D and productivity improvements (Bertrand, 2009, Miozzo et al., 2016). The results thus far regarding the target's productivity and investment in R&D appear mixed. On the

one hand, Cassiman et al. (2005) argue that cross-border M&As increase the potential to generate scale and scope of economies in R&D, thereby enhancing R&D investment and productivity efficiency. Supporting this line of thinking, foreign investment is an effective way to improve domestic firms' innovation capability through technology transfer and technology spillovers (Bwalya, 2006). Cull et al. (2015) contend that FDI via acquisitions is associated with increased investment in R&D and improvement in productivity of the target firms. Earlier studies by Bertrand and Zuniga (2006), Hagedoorn and Duysters (2002), and Arora and Gambardella (1994) on the effects of cross-border M&AS in OECD countries also document that M&As contribute to increased R&D spending and enhancement of firms' technological performance and productivity. Overall, the above studies suggest that acquisitions affect both innovative inputs and outputs (Hitt et al., 1991).

On the other hand, some researchers argue that M&As can also lead to a reduction in R&D because of reduced competition and the reorganisation of business units which tend to disrupt R&D departments. Acquisitions can disrupt the established routines of both the acquiring and the target firm and consequently reduce productivity (Haspeslagh and Jemison, 1991, Jemison and Sitkin, 1986). Another strand of literature also points out that acquisitions may lead to the innovation activity of target firms being reduced and shifted away, thereby depriving the local economy of strategic technology and technological spillovers (United Nations Conference on Trade and Development, 2005). Stiebale and Reize (2011) empirically examine the effects of FDI, through mergers and acquisitions, on target firms' innovation by employing a large sample of small- and medium-sized German firms. They show that foreign acquisitions do not successfully improve product innovation of target firms. It is therefore not surprising that a number of past empirical efforts have found

acquisitions to decrease the R&D investment of the merging firms. For example, Hitt et al. (1991) empirically test the effects of acquisitions on R&D inputs and outputs. The acquisitions do not always lead to positive firm performance, which in turn leads to a decrease in R&D investment. It is explained that the firms have achieved economies of scale and scope after the acquisition.

The improvement of R&D intensity through technology transfer by cross-border M&As leads to higher productivity growth in the domestic market. The foreign acquisitions are not only associated with hard technology, like machinery and blueprints, but are also related to soft technology, like management and information technologies (Djankov and Hoekman, 2000). The ownership changes caused by foreign acquisitions is associated with the change of productivity of target firms, but this correlation is mixed. On the one hand, there will be an improvement of operating efficiency for the target firms where the acquiring firms have higher levels of productivity (McGuckin et al., 1995). Djankov and Hoekman (2000) find that foreign investment has predicted positive influences on the productivity growth for Czech enterprises over the time period of 1992-1996. Kamal (2015) empirically investigates Chinese firms' performance after receiving FDI by employing a sample of Annual Surveys of Industrial Production (ASIP) conducted by China's National Bureau of Statistics from 1998 to 2006. Chinese firms acquired by foreign firms with Organisation of Economic Cooperation and Development (OECD) experience significantly higher productivity, profits, average wages, and capital per worker post-acquisition than those of firms acquired by foreign investors from Hong Kong, Macao, and Taiwan. The performance of target firms after foreign acquisition is differentially determined by the origin of the foreign investors.

However, foreign acquisition does not always result in improvements in

productivity post-acquisition. The success of knowledge transfer through foreign acquisition depends on the technological capabilities of target firms which determine their capability of assimilating knowledge (Pack and Westphal, 1986). The transfer of technology and knowledge through foreign investment is not guaranteed, it depends on the target firms' absorptive capacity for turning superior know-how into commercial gains (Cohen and Levinthal, 1990). Harris and Robinson (2002) empirically compare the performance of foreignly acquired UK plants with those plants that are domestically acquired. They find that foreign acquisition most frequently happens in plants with higher levels of productivity, but there is a decrease in productivity caused by the difficulties in assimilating the existing plants into a new organisation. This study therefore sheds lights on whether acquisitions relieve financial constraints and facilitate the financing of R&D and improve productivity, or not.

4.2.3 Quality of management and foreign acquisitions

The performance and outcomes of foreign acquisitions depend on the strategic fit between acquirers and target firms and on the quality of the post-M&A management. There is a positive adjusted gain when there is an announcement of international mergers and acquisitions, which is based on a re-evaluation of the company under its new management (Ghauri and Buckley, 2003). Chatterjee et al. (1992) not only examine strategic fit between the firms in mergers and acquisitions and firm shareholder gains and relatedness, but they also examine the effects of culture fit on the success of the combination after M&As. Based on the survey of 73 firms, their results show a strong inverse relationship between the perception of a target firm's cultural difference and shareholder gains. The lower tolerance of a buyer's top management team for multiculturalism negatively impacts on shareholder gains. Datta (1991) studies

the impact of organisational differences on post-acquisition performance by using a sample of 173 US acquisitions. Results indicate that different management styles between buyer and seller in acquisitions can result in conflicts and create obstacles in the achievement of operational synergies. There is a negative relationship between the differences in top management style and post-acquisition performance.

Despite the importance of management practice and strategic fit on post-acquisition performance, post-acquisition managerial learning is another factor relating to post-acquisition integration and efficiency of firms. By investigating Western firms' cross-border acquisitions in Central and Eastern Europe, Villinger (1996) explains post-acquisition managerial learning and issues related to the integration of the acquired company into the acquiring firm. There are substantial managerial and organisational challenges which may be overcome by post-acquisition learning when Western firms acquire target firms in Central and Eastern Europe. Compared to business skills for management efforts, post-acquisition management skills are much more important to the success of integration. Knowledge of language and sensitivity to cultural issues for acquired firms' top managers determine the degree of the efficiency and efforts of management after cross-border M&As. Similar research has been conducted by Vaara et al. (2012), who analyse the influence of organisational and national cultural differences, and knowledge transfer on cross-border acquisitions. The organisational cultural differences contribute to social conflict, while there is negative association between national cultural differences and social conflict, but both kinds of cultural differences contribute to learning in terms of knowledge transfer. Excluding the knowledge transfer of cross-border mergers and acquisitions, human resource management plays a value-adding role in cross-border M&As. For instance, Aguilera and Dencker (2004) provide a

strategic fit framework to demonstrate the role of human resource management in cross-border M&AS in terms of resources, processes, and values. Effective human resource management provides a line of communication and helps to set up a new productive system to facilitate knowledge transfer between firms.

A growing number of foreign companies use cross-border mergers and acquisitions as a global strategic tool to access the Chinese market. However, there are conflicts caused by the organisational and cultural differences between foreign acquiring firms and acquired Chinese firms. For example, employees in China are characterised by traditional cultural values like Confucian ideas, collectivist culture, and socialist ideology, while the Western human resource management style is characterised by liberalism, individualism, and capitalism (Du and Choi, 2010). Chung et al. (2014) use a theoretical model to examine how employees adapt to organisational changes through cross-border mergers and acquisitions in China. Their empirical work surveyed 174 Chinese employees who work for firms unexpectedly acquired by a Western company. They find that employees' behaviour changes during the process of international M&A transitions and that communication and cultural learning programs are crucial in person-change fit perceptions during the change in management practices and in post-change performance.

4.2.4 Foreign acquisitions and financial constraints

In a world with imperfect capital markets, firms have a higher probability of facing financial friction because of information asymmetry, thus they are subject to an under-investment problem. China's banking system is largely dominated by four state owned banks and has a problem of capital distribution inefficiency and non-performing loans (Allen et al., 2005). Firms, especially small firms, in less developed capital markets are more likely to exhibit higher investment to

cash flow sensitivities (Love, 2003).Aghion et al. (1999) point out that financial constraints are likely to be more severe in developing countries compared to developed countries because of government intervention and unavailability of external financing. Ayyagari et al. (2010) render some support to the contention that financial constraints faced by firms in developing countries are more pronounced due to poor access to finance. The above discussion leads to the following hypothesis:

Hypothesis 4.1a: Chinese target firms are more likely to have financial constraints prior to acquisitions.

Stated owned enterprises in China are bank-dependent, while small and private firms have low access bank loans (Shen et al., 2015). Bank financing is a major source of external financing in all countries (Mayer, 1990), however, governments in developing countries play a larger role in the allocation of financial capital than those in developed countries, and they tend to distribute more resources to firms with stronger ties to the state (Ayyagari et al., 2012). Large and stated owned Chinese firms have a lower probability to use internal financing because of their higher ability to access external funds, while relatively small and private firms are likely to face financial constraints. However, government ownership of banks and interference in the credit allocation in the formal financing sector are pervasive in emerging countries (Sapienza, 2004). State ownership of firms can generate corruption and misallocation of resources (Banerjee, 1997). This is consistent with the view that agency problems directly influence the allocation process of financial resources to firms (Poncet et al., 2010) . Some studies have conducted empirical work on financial constraints and firm ownership. For example, Poncet et al. (2010) find that credit allocation in China is driven by government intervention through state-owned banks which

give preferential treatment to SOEs, compared to non-SOEs, despite economic reforms. Harrison et al. (2004) find that SOEs are less financially constrained than other domestic enterprises. I therefore hypothesise that:

Hypothesis 4.1b: The financial constraints of Chinese target firms are more pronounced for non-SOEs compared to SOEs.

However, foreign acquisition relieves these firms' financing constraints by bringing in scarce capital. For example, it is argued that being part of a larger organisation following an acquisition can improve financing through better access to capital markets, and also the possibility of a re-allocation of capital across divisions (Stein, 2003, Wagner et al., 2013). Foreign acquisitions can be recognised as a form of equity financing. A number of studies have found that FDI and foreign acquisitions reduce the financial constraints of domestic and target firms. For example, Harrison et al. (2004) empirically prove that the cash flow through FDI results in a reduction of firm-level financial constraints, even for domestically owned enterprises. Héricourt and Poncet (2009) not only empirically examine the extent to which firms face financial constraints, but also investigate whether foreign investment alleviates the domestic firms' financial constraints by employing a dataset of 1300 Chinese firms over the period of 2000-2002. Foreign investment in China helps private firms to overcome the financial and legal obstacles faced by domestic firms. However, Harrison et al. (2004) argue that domestic firms' financial constraints will be more severe and be crowded out of domestic capital markets if their foreign partners borrow heavily from local banks. In light of the above argument, I put forward the following hypothesis:

Hypothesis 4.2: Foreign acquisitions will alleviate Chinese target firms' financial constraints.

4.2.5 Effects on R&D and productivity

Based on the previous discussion, foreign acquisitions are associated with a reduction of firms' financing constraints. A release of financial constraints by firms facilitates greater internal financing for R&D. However, prior literature indicates that the relationship between foreign acquisitions and an increase in R&D investment appears mixed (Stiebale and Reize, 2011). On the one hand, Cassiman et al. (2005) contend that cross-border M&As enable scale and scope of economies in R&D efforts and facilitate reorganisation of the combined firms' R&D efforts. For example, a case study by Larsson and Finkelstein (1999) based on the integration of theoretical perspectives from economics, finance, strategy organisation theory, and human resource management, reveals that firms gain from the integration of products and marketing operations after the mergers and acquisitions. A causal effect of foreign acquisitions on R&D activity has been examined by Bertrand (2009), and empirically proves that foreign acquisitions positively boost R&D spending of French acquired firms. These foreign acquired companies not only gain financial capital from internal resources but also access external funds from their parent companies. Although cultural differences in international acquisitions lead to the potential for social conflicts during the post-acquisition integration process, these conflicts can be alleviated by learning in terms of knowledge transfer in various aspects including management, marketing, production, and R&D (Vaara et al., 2012). On the other hand, it is argued that M&A can lead to a reduction in R&D because of reduced competition (Kamien and Schwartz, 1982). In particular, Kumar (2001) suggests that there is a danger that acquiring firms may centralise R&D in their home country to avoid the costs of coordinating dispersed R&D centres. Consequently, innovative activity of the target firm could be reduced or shifted away, thereby reducing the potential of R&D as a source of innovation and technological

spillover in the host country. Given that Chinese firms receive a growing number of foreign investments and present relatively lower levels of innovation capability in the domestic market, I expect that foreign acquisitions should have a positive impact on R&D budgets and I put forward the following hypothesis.

Hypothesis 4.3: Foreign acquisitions will increase R&D investments of Chinese target firms.

Apart from R&D, foreign acquisitions are associated with the target firms' productivity. However, the relationship between them is mixed. On the one hand, Agarwal et al. (2014) found that lack of access to sources of external finance represents a major obstacle to the absorption of productivity spillovers originating from foreign firms in China. It is believed that foreign acquisitions can potentially mitigate such financial constraints faced by domestic firms and enable the acquirer to exploit its ownership advantages in foreign markets as posited by the eclectic paradigm (Dunning, 1984, Dunning, 1977). Moreover, an improvement of R&D through knowledge transfer caused by foreign acquisitions also leads to economic scale and scope post acquisition (Djankov and Hoekman, 2000). Theoretically, as multinational firms possess these firm-specific assets which can be transferred to the acquired firms abroad, technology spillover is expected to raise efficiency and productivity of target firms (Bwalya, 2006). On the other hand, although the foreign acquirers may prefer to acquire firms with better performance pre-acquisition, there are no guarantees that post-acquisition assimilation will be problem free (Harris and Robinson, 2002). The productivity of target firms may experience a decline in performance in the short term post-acquisition (Ravenscraft and Scherer, 2011). Hale and Long (2011) empirically investigate whether there are productivity spillovers from FDI in China by using a firm-level dataset from a survey of the World Bank. They

believe that there is bias in earlier literature in the estimation of productivity spillovers from FDI. After controlling the endogeneity of FDI, they empirically failed to support the productivity spillovers from FDI in China, which may be restricted by domestic institutions and domestically limited skilled human capital to adopt new technologies. Based on the argument of foreign acquisitions' effect on target firm productivity, I put forward the following hypothesis:

Hypothesis 4.4: Foreign acquisitions improve Chinese target firms' productivity.

4.3 Data and measurements

4.3.1 Data source

To investigate the effects of foreign acquisitions on Chinese target firms, I use a sample of foreign acquisitions that occurred in China during the period 1994 to 2011. The data that relates to acquisitions and target firms are derived from the China Stock Market & Accounting Research (CSMAR) and WIND Merger & Acquisition databases. Macroeconomic data are collected from the World Bank database. CSMAR and Wind Merger & Acquisition databases include domestic and cross-border M&A cases. These databases provide information on M&A transactions such as deal status, dates of announcement, and deal completion dates. The sample includes the Chinese firms and their parent companies as well as subsidiaries that are acquired by foreign companies. The sample is restricted to the following criteria: a) the target firms must be listed on the Shanghai or Shenzhen stock markets (include A- and B- shares); b) Chinese company that is listed in abroad stock markets is excluded; c) the country location of target firms is Chinese, and acquirers are registered in foreign countries; d) exclude the cases that are repeated. The details of data selection procedure can be seen in Table 4.1.

Table 4. 1 Sample selection procedure of inward M&As

Description	Deleted cases	Final number of outward M&A cases
Initial number of inward M&A cases		2113
Delete target Chinese firms that are not publicly listed	500	1613
Delete target Chinese firms that are listed in abroad (e.g. Hongkong stock exchange market, NSADAQ stock market and so on)	190	1423
Delete the repeated cases	253	1170
Delete acquirers are not foreign registered firms or the target firms are not Chinese firms	256	914

These restrictions allow a final usable sample of 914 cross-border M&AS of Chinese target firms. The primary and control variables are collected using panel data in the sample. The observation years of the variables for the full sample consist of three year's pre- acquisition and three year's post-acquisition information which is long enough to observe changes in financial constraints, investments in R&D, and productivity. Table 4.2 provides details of the definitions of the variables and data sources for the sample used in this study.

Table 4. 2 Definition and sources of the variables

This table presents the definition and sources of the variables used in empirical regressions. Firm level data and country level data are collected at the annual frequency.

Variable	Definition	Sources
Firm level variables		
Total assets(*TA*)	Log value of total assets	WIND database
Gross investment/Total assets (*I*)	(Fixed assets-lagged fixed assets+ depreciation)/Total assets	WIND database
Cash flow/Total assets(*CF*)	(total income+ depreciation)/Total assets	WIND database
Tobin's Q	Total market value of firm/Total asset value of firm	CSMAR database
Leverage	(net income+ income tax expense+ financial expense + depreciation+ intangible assets amortization + long-term prepaid expenses)/(net income+ income tax expense+ financial expense)	CSMAR database
DWW	A dummy variable is equal to 1 if a firm's WW value is larger than the sample median, and 0 otherwise.	WIND database
Age	The number of years the firm has been listed	
Expense to revenue	Log value of the ratio of firm operation expenses to revenue	
Central SOE	Variable value is equal to 1 if a firm's ultimate owner is central government, and 0 otherwise.	WIND database
Local SOE	Variable value is equal to 1 if a firm's ultimate owner is local government, and 0 otherwise.	WIND database
Private	Variable value is equal to 1 if a firm's ultimate owner is individuals and non-government entities, and 0 otherwise.	WIND database
Foreign	Variable value is equal to 1 if a firm's ultimate owner is foreign companies, and 0 otherwise.	WIND database
After	A dummy variable that equals one for the years after inward M&As, and 0 otherwise.	
Productivity	Log value of the ratio of a firm sales to employee at the end of year	WIND database
R&D expenditure	A dummy variable equals to 1 if a firm has a positive R&D expenditure at the end of year	WIND database

Table 4.2 Definition and sources of the variables (Continued)

Country level variables		
GDP growth	Annual percentage growth rate of GDP in foreign countries.	World Bank
Domestic credit	Common logarithm value of domestic credit provided by financial sector (% of GDP)	World Bank

4.3.2 Measuring Financial Constraints

Prior studies indicate that financial constraints occur when financial frictions prevent firms from undertaking all desirable investments. While a large body of literature has been devoted to the identification of the level of financial constraints faced by firms, there appears to be no consensus on which measure is the best proxy (Erel et al., 2015, Khatami et al., 2015). However, Moshirian and Vadilyev (2013), and Cull et al. (2015) note that for countries with lower levels of financial development, such as China, investment-cash flow sensitivity is a reasonable indicator of financial constraints. Consequently, I employ an investment-cash flow sensitivity approach as one of the measures of financial constraints. Further I utilise the Whited and Wu (WW) index to determine the level of financial constraints faced by different firms. To check the robustness of the results, I also use target firms' cash holding as a proxy of financial constraints to analyse the effects of foreign acquisitions on Chinese target firms. I briefly describe the proxies of financial constraints used in previous literature below.

Investment-cash flow sensitivity

Introduced by Fazzari et al. (1988), investment-cash flow sensitivity as an indicator of financial constraints involves estimating the sensitivity of a firm's investment to its cash flow. Using dividend payout, Fazzari et al. (1988) exogenously separated firms into financially constrained and unconstrained firms. They point out that firms paying low dividends have financial constraints and show high investment-cash flow sensitivity. In comparison, firms paying high dividends have no financial constraints and exhibit low investment-cash flow sensitivity. Thus they conclude that firms with high investment-cash flow sensitivity are typically cash constrained. A number of studies, such as Carpenter and Petersen (2002), Carpenter and Guariglia (2003), Moyen (2004), and Xu et

al. (2013) have used investment-cash flow sensitivity to measure the financial constraints of firms in both developed and developing country contexts. To examine a firm's investment to cash flow sensitivity, I use the following specification:

$$I_t = \beta_0 + \beta_1 CF_t + \beta_2 Controls_t + \epsilon \quad \text{(Equation 4.1)}$$

Where *I* is the dependent variable of a firm's investment expressed by gross investment to total assets ratio at the end of year *t*, *CF* is a firm's cash flow expressed by cash flow to total assets ratio at the end of year *t*. The control variables contain target country level variables and firm level variables that vary across specifications. Since I have data in respect of three years of each pre- and post-acquisition, a panel of firm-years are estimated in the regression. I have controlled for both industry and year effects in each model specification by adding year and industry dummies. The industry dummies are derived on the basis of a one-digit China Securities Regulatory Commission (CSRC) code collected from the WIND database.

Whited and Wu (WW) index

Whited and Wu (2006) use an investment Euler equation to construct an index of the external financial constraints on firms. As an alternative index of financial constraints, Whited and Wu (2006) argue that their index is a much better way to estimate a firm's degree of financial constraints because the index is based on characteristics associated with external finance constraints. Prominent researchers who have used the WW index as a measurement of financial constraints include Li (2011), Carreira and Silva (2010), and Gomes et al. (2006). I use the estimated coefficient by Whited and Wu (2006); WW indices are constructed based on following equation:

$$WW = -0.091 * \frac{CF_t}{TA_{t-1}} - 0.062 * Divpos_t + 0.021 * \frac{LD_t}{TCA_{t-1}} - 0.044 * TA_t - 0.035 * SG_t$$

$$+0.102 * ISG_t \qquad \text{(Equation 4.2)}$$

Where $\frac{CF_t}{TA_{t-1}}$ is cash flow CF_t deflated by beginning of year total assets TA_{t-1}, $Divpos_t$ equals a value of one if the firm pays cash dividends on year *t*. $\frac{LD_t}{TCA_{t-1}}$ is long term debt LD_t deflated by beginning of year total current assets TCA_{t-1}, TA_t is a natural logarithm of total assets adjusted for the inflation rate, SG_t is a firm's sales growth, and ISG_t represents the firm's 3-digit industry sales growth. This study uses WW indices as an added measurement to identify the level of financial constraints.

4.3.3 Sample Characteristics

Table 4.3 reports the event sample summary over the 1994-2011 period. Panel A of Table 4.3 reports the acquisitions by year. The largest share of the acquisitions (15.3%) occurred in 2008, followed by 13.5% in 2006, and 12.0% in 2011, with 103 (11.3%) occurring in 2009. The lowest number of acquisition events occurred in 1994 and 1996. The ownership type of Chinese target firms is classified into four categories: central government SOEs; local government SOEs; foreign owned firms; and domestic privately owned firms representing non-SOEs. Local government SOEs constitute the largest ownership type of the sample firms (35.7%), followed by domestic privately owned firms (31.0%) and central government SOEs (25.2%). The remainder represent foreign owned firms in China (8.2%). Given that prior studies suggest that SOEs have better access to bank loans administered by the big five state owned banks compared to private and foreign firms, this classification enables me to investigate the

relationship between ownership type and financial constraints. Moreover, central and local government SOEs have different political motivations and social objectives than simply maximisation of shareholder wealth. Following recent studies I further group SOEs into those of central government and those of local government because central government SOEs tend to be key strategic government industries, while local government SOEs tend to concentrate on improving the local economy (Wu et al., 2012). Panel C of Table 4.3 reports my sample distribution by industry. It shows that the sample covers all major CSRC industries, with slightly more than half of M&A events clustering in the manufacturing sector (50.3%). This is followed by real estate (12.3%) and then the transportation, storage, and postal industries (8.3%). These top 3 industries account for around 71% of total M&A deals. The rest of the industries include retail and wholesale industries (7.8%), the financial industry (5%), information transmission, computer service and software industries (3.5%), power, gas, and water industries (3.1%).

4.3.4 Summary statistics

Table 4.4 provides basic summary statistics of characteristics of the full sample, showing that each variable used in my analysis. The mean ratio for the key variable *I* (gross investment to total assets) is 0.118, while the mean value of total assets *TA* is 9.586. The mean ratio of cash flow to total assets *CF* is 0.843 with a maximum value of 4.468 and a minimum value of 0.024. The average operating leverage value is 1.375, which implies that Chinese listed acquired firms generally have high percentages of fixed operating costs and lower levels of variable costs. The average log value of expense to revenue is -0.018. There are seven dummy variables in the analysis, including one financial constraint measurement (DWW), four ownership types (central SOE, local SOE, foreign,

and private), positive R&D expenditure, and whether observation years occur after inward M&As (*After*). The average value of productivity is 5.953 and the Tobin's Q mean value is 1.542. The average GDP growth and domestic credit are 2.971 and 2.215 respectively.

Table 4. 3 Sample Characteristics

This table presents the distributions of inward M&As by ownership, year and industry for the full sample.

Panel A: Year			**Panel B: Ownership**		
Year	Number	Percent	Ownership Type	Number	Percent
1994	1	0.1	Central SOE	230	25.2
1996	1	0.1	Local SOE	326	35.7
1997	4	0.4	Private	283	31.0
1998	2	0.2	Foreign	75	8.2
1999	11	1.2	**Total**	**914**	**100**
2000	16	1.8	**Panel C: Industry Type**		
2001	14	1.5	Manufacturing industry	461	50.4
2002	26	2.8	Real Estate Industry	112	12.3
2003	19	2.1	Transportation, Storage and Post	76	8.3
2004	68	7.4	Retail and Wholesale Industries	71	7.8
2005	97	10.6	Financial Industry	46	5.0
2006	123	13.5	Information Transmission, Computer Service and Software Industries	32	3.5
2007	86	9.4	Power, gas and water	28	3.1
2008	140	15.3	Mining	20	2.2
2009	103	11.3	Conglomerate	20	2.2
2010	93	10.2	Leasehold and Business Service	17	1.9
2011	110	12.0	Constructions	13	1.4
Total	**914**	**100**	Agriculture	9	1.0

Table 4.3 Sample Characteristics (Continued)

	Panel C: Industry Type		
	Water Conservancy, Environment and Public Facility Management	4	0.4
	Culture, Sports and Entertainment	3	0.3
	Scientific Research, Technology Service and Geological Prospecting	1	0.1
	Hoteling and Catering	1	0.1
	Total	**914**	**100**

Table 4. 4 Summary Statistics

This table presents summary statistics of the full sample.

Variable	Obs	Mean	Std. Dev.	Min	Max
TA	6332	9.586	0.741	8.164	12.227
I	6331	0.118	0.621	-2.629	2.910
CF	6325	0.843	0.671	0.024	4.468
Tobin's Q	6012	1.542	1.390	0.070	7.859
Leverage	6121	1.375	0.704	-1.146	4.643
Expense to revenue	6300	-0.018	0.447	-1.439	12.563
DWW	6398	0.500	0.500	0	1
Central SOE	6398	0.201	0.401	0	1
Local SOE	6398	0.306	0.461	0	1
Foreign	6398	0.082	0.274	0	1
Private	6398	0.258	0.438	0	1
Productivity	5975	5.953	0.512	4.767	7.703
R&D expenditure	6398	0.240	0.427	0	1
GDP growth	5873	2.971	3.316	-5.638	9.779
Domestic credit	5831	2.215	0.167	1.784	2.542
After	6398	0.571	0.495	0	1

4.4 Results and Discussions

Due to data limitations, the ordinary least squares (OLS) model is employed throughout the regressions, this follows most studies in cross-border M&As. For example, Buckley et al. (2007a) use the OLS model to estimate the relationship between inward FDI and spillover effects in China based on the consideration that the heteroskedasticity is expected to be widespread because different sized firms or industrial branches of the data are sampled together. Zhou et al. (2002) empirically examine the influence of FDI on the productivity of Chinese domestic firms based on tests of OLS regressions. A robustness check is employed to test the empirical results in this article. Stata 11 is used to analyse the empirical tests.

4.4.1 Financial constraints and target firms before acquisition

In order to examine the existence of pre-acquisition financial constraints on Chinese target firms, and whether these financial constraints change after the acquisition, I divide the full sample into pre- and post- acquisition groups. These two groups are analysed separately.

Investment to cash flow sensitivity

Based on Equation 4.1, I use investment-cash flow sensitivity to measure the financial constraints of the target firms before acquisition. The idea behind the investment-cash sensitivity approach is that, under frictionless capital markets, investment should be a function of the value of the investment opportunities and independent of the firm's financial position (Fazzari et al., 1988). Consequently, if a firm is not financially constrained and has enough financial funds, it should undertake all value enhancing investment opportunities. However, a financially

constrained firm should choose value increasing investments because of limited cash flow availability (Fazzari et al., 1988). Table 4.5 reports the estimation of the investment to cash flow sensitivity of the target firms before foreign acquisitions. The results show that cash flow, Tobin's Q, leverage, expense to revenue, and ownership type have coefficients that are significantly different from zero. Focusing on the cash flow, the results indicate that the cash flow (CF) variable in all four regression models has positive and statistically significant coefficients, suggesting that target firms in China were financially constrained before acquisition. The results are in line with the findings of Harrison et al. (2004) and Aghion et al. (1999) who found target firms to be financially constrained due to lack of access to external financing in developing countries. Hypothesis 4.1a is therefore supported. Regarding the control variables, I find the coefficients of ownership type (central SOE, local SOE, private and foreign firms), Tobin's Q, and leverage are statistically and positively significant in the regressions. However, the expense to revenue is negatively correlated with a firm's investment. The empirical results which show different ownership types have different effects on investment-cash flow sensitivity appear interesting and suggest SOEs are less financially constrained compared to private and foreign owned firms. More specifically, central government SOEs and local government SOEs have significant and positive coefficients, while private owned firms and foreign owned firms have a negative, significant influence on investment-cash flow sensitivity. The results suggest that SOEs still have cash to undertake value-creating investment opportunities whereas foreign and private firms do not.

Table 4. 5 Investment-cash flow sensitivity of Chinese firms before foreign acquisitions

This table presents the empirical results of investment-cash flow sensitivity of Chinese firms before foreign acquisitions by OLS regression. The dependent variable is gross investment to total assets. The definition and sources of the other variables can be seen in Table 4.1. I have controlled both industry and year effects in each model specification by adding year and industry dummies. The industry dummies are derived on the basis of a one-digit China Securities Regulatory Commission (CSRC) code collected from WIND database. The standard errors are presented in parentheses. The symbols *,** and *** indicate statistical significance at the 10%, 5% and 1% level, respectively.

	(1)	(2)	(3)	(4)
C	0.0605	0.0925	0.0920	0.1029
	(0.111)	(0.112)	(0.112)	(0.112)
CF	0.0321***	0.0317***	0.0306***	0.0336***
	(0.004)	(0.004)	(0.004)	(0.004)
Tobin's Q	0.0049**	0.0044**	0.0047**	0.0047**
	(0.002)	(0.002)	(0.002)	(0.002)
Leverage	0.0045***	0.0044***	0.0044***	0.0045***
	(0.001)	(0.001)	(0.001)	(0.001)
Expense to revenue	-0.0491***	-0.0581***	-0.0560***	-0.0576***
	(0.008)	(0.008)	(0.008)	(0.008)
Central SOE	0.0650***			
	(0.008)			
Local SOE		0.0231***		
		(0.007)		
Private			-0.0323***	
			(0.007)	
Foreign				-0.0242**
				(0.012)
Year effects	Yes	Yes	Yes	Yes
Industry effects	Yes	Yes	Yes	Yes
Observations	2517	2517	2517	2517
R^2	0.169	0.150	0.153	0.148

Investment-cash flow sensitivity partitioned by level of financial constraints

To observe whether a firm's cash flow correlates with investment and whether investment-cash flow sensitivity varies across different levels of financial constraints, the WW index is used. I employ the following equation to examine the different levels of financial constraints.

$$I_t = \beta_0 + \beta_1 CF_t + \beta_2 FC_t + \beta_3 CF_t * FC_t + \beta_4 Controls_t + \epsilon$$

(Equation 4.3)

I add measurements of financial constraints (FC_t) and interaction terms ($CF_t * FC_t$) in Equation 4.1. Financial constraints (FC_t) represents the WW index. A dummy variable is created for the WW index in regression. In estimation, the firms are partitioned into a higher financial constraint group (FC_t=0) and a lower financial constraint group (FC_t=1) by using the median value of the WW index in the observed sample. The coefficient β_3 interprets whether investment-cash flow varies with different levels of financial constraints. Both industry and year effects are controlled in each model specification by adding year and industry dummies. The industry dummies are derived on the basis of a one-digit China Securities Regulatory Commission (CSRC) code collected from WIND database.

Table 4.6 documents the following results. The cash flow is positively and significantly correlated with investment and confirms the results seen in Table 4.5. I find that the coefficients β_3 of *DWW*CF* are negative and significantly different from zero. The interaction term of coefficient β_3 indicates the different investment-cash flow sensitivities between more financially constrained (higher value of WW index) firms and less financially constrained firms (lower value of WW index). The theoretical explanation for investment to cash flow sensitivity is that the financially constrained firms will exhaust all their

cash flow to satisfy capital spending on investment. Thus, these firms are more sensitive to the volatility of cash flow availability than are high dividend paying firms due to information asymmetries (Fazzari et al., 1988). The criteria to determine a firm's sensitivity of investment to cash flow is based on information regarding firm size, age, dividend to income ratio, and access to capital markets, which can be regarded as firms' capability to obtain external funds in the market (Guariglia, 2008). However, the WW index measuring firms' degree of external financial constraints is based on the indicators relating to firms' financial statistics, such as total assets and cash dividends. Table 4.6 shows the analysis of the different sensitivities of cash flow to investment on the basis of different degrees of internal financial constraints faced by firms. The values of interaction term β_3 are negative and between -0.1115 and -0.1160, indicating that financially constrained (higher WW value) firms rely more on their internal cash flow when they make investment decisions. Firms facing higher sensitivity of investment to cash flow have a relatively high level of financial constraints measured by the WW index.

On the ownership front, columns 1 and 2 of Table 4.6, representing central and local government SOEs respectively, have positive coefficients which are significantly positive. However, the coefficients for private and foreign owned enterprises in columns 3 and 4 have negative and statistically significant effects. Hypothesis 4.1b is therefore supported, indicating that non-SOEs are financially constrained. The findings that non-SOEs in China face challenges when accessing external funds compared to SOEs appear consistent with previous studies that show privately owned firms are financially constrained (Allen et al., 2005; Poncet et al., 2010). The findings are explained by the fact that SOEs in China tend to obtain favourable treatment in credit allocation from state-owned banks compared to non-SOEs. The results support the conclusion drawn by Cull

et al. (2015) who reported that government ownership of banks has distorting effects on the financial allocation of resources and that SOEs are less financially constrained than other domestic enterprises. However, it is important to point out that the finding that foreign firms also face financial constraints appears surprising in that it was expected that foreign owned enterprises have the capacity to raise more finance in the international capital markets. This finding appears contrary to the results of Poncet et al. (2010) who report that foreign firms are not financially constrained in China. Perhaps this finding can be explained by the financing policies adopted by foreign firms to not borrow in international capital markets in order to manage currency and interest rate risks.

Table 4. 6 Investment-cash flow sensitivity for firms partitioned by level financial constraints before foreign acquisitions

This table presents results of investment-cash flow sensitivity of Chinese firms partitioned by level financial constraints before inward M&As by OLS regression. Dependent variable is gross investment to total assets. The definition and sources of the other variables can be seen in Table 4.1. I have controlled both industry and year effects in each model specification by adding year and industry dummies. The industry dummies are derived on the basis of a one-digit China Securities Regulatory Commission (CSRC) code collected from WIND database. The standard errors are presented in parentheses. The symbols *,** and *** indicate statistical significance at the 10%, 5% and 1% level, respectively.

	(1)	(2)	(3)	(4)
C	0.0110	0.0407	0.0383	0.0484
	(0.109)	(0.110)	(0.110)	(0.111)
CF	0.1250***	0.1244***	0.1266***	0.1270***
	(0.013)	(0.013)	(0.013)	(0.013)
DWW	0.0929***	0.1027***	0.1001***	0.1019***
	(0.011)	(0.011)	(0.011)	(0.011)
DWW*CF	-0.1115***	-0.1135***	-0.1160***	-0.1144***
	(0.013)	(0.013)	(0.013)	(0.014)
Tobin's Q	0.0055***	0.0052***	0.0054***	0.0054***
	(0.002)	(0.002)	(0.002)	(0.002)
Leverage	0.0045***	0.0044***	0.0044***	0.0045***
	(0.001)	(0.001)	(0.001)	(0.001)
Expense to revenue	-0.0430***	-0.0497***	-0.0484***	-0.0496***
	(0.008)	(0.008)	(0.008)	(0.008)
Central SOE	0.0597***			
	(0.008)			
Local SOE		0.0222***		
		(0.007)		
Private			-0.0307***	
			(0.007)	
Foreign				-0.0195*
				(0.012)
Year effects	Yes	Yes	Yes	Yes
Industry effects	Yes	Yes	Yes	Yes
Observations	2517	2517	2517	2517
R^2	0.194	0.179	0.181	0.176

4.4.2 Financial constraints and target firms after acquisitions

Table 4.7 reports results of whether the target firms' constraints are alleviated after the foreign takeover. The results indicate that coefficients of cash flow are all negative and insignificant suggesting that foreign acquisitions in China generally reduce the target firms' financial constraints, but not significantly. The findings provide some support for prior research evidence in developed countries such as Erel et al. (2015) and Khatami et al. (2015) which indicate that foreign acquisition lessens financial constraints. Foreign acquirers bring additional sources of external funds and free up scarce domestic credit for firms that have been crowded out of the domestic capital markets (Harrison et al. 2004). The results also are in line with the findings of Wang and Wang (2015) who employed firm-level observations in China covering the period 2000 to 2007 to examine the foreign ownership effects on post-acquisition performance changes of foreign acquired firms, using domestically acquired firms as a control group. The empirical results show that foreign ownership can improve Chinese target firms' financial conditions. My empirical results shed light on the importance of foreign capital inflows as a mechanism to remedy the inefficiency and discrimination of the Chinese capital market. To some extent, the foreign acquisitions may push the reforms of financial markets in China and improve both business environment and efficiency. The coefficients of control variables, namely leverage, expense to revenue, and ownership type, are insignificant. However, the Tobin's Q appears to have significant effects on investment for foreign acquired Chinese firms.

I carried out further analysis on whether investment-cash flow sensitivity varies across different degrees of financial constraints post-acquisition by adding one proxy of financial constraints (WW index). Table 4.8 shows that the coefficients

for DWW*CF are insignificant after controlling for ownership type, leverage, expense to revenue, and Tobin's Q. The results imply that there are no significant differences in the sensitivity of investment-cash flow among different levels of financial constraints as measured by the WW index. The coefficients of the cash flow variable are negative and insignificant.

Table 4. 7 Investment-cash flow sensitivity of Chinese firms after foreign acquisitions

This table presents the empirical results of investment-cash flow sensitivity of Chinese firms after foreign acquisitions by OLS regression. The dependent variable is gross investment to total assets. The definition and sources of the other variables can be seen in Table 4.1. I have controlled both industry and year effects in each model specification by adding year and industry dummies. The industry dummies are derived on the basis of a one-digit China Securities Regulatory Commission (CSRC) code collected from WIND database. The standard errors are presented in parentheses. The symbols *,** and *** indicate statistical significance at the 10%, 5% and 1% level, respectively.

	(1)	(2)	(3)	(4)
C	-0.6819	-0.6998	-0.6839	1.926
	(38.791)	(38.792)	(38.792)	(38.857)
CF	-0.7897	-0.7925	-0.7850	-0.6073
	(0.875)	(0.876)	(0.877)	(0.890)
Tobin's Q	0.4238***	0.4238***	0.4238***	0.4251***
	(0.012)	(0.012)	(0.012)	(0.012)
Leverage	0.0102	0.0085	0.0088	0.0108
	(0.127)	(0.127)	(0.127)	(0.127)
Expense to revenue	0.9082	0.8199	0.8032	0.7453
	(2.060)	(2.044)	(2.058)	(2.044)
Central SOE	0.6612			
	(1.661)			
Local SOE		0.4033		
		(1.455)		
Private			-0.0031	
			(1.551)	
Foreign				-2.7315
				(2.476)
Year effects	Yes	Yes	Yes	Yes
Industry effects	Yes	Yes	Yes	Yes
Observations	3443	3443	3443	3443
R^2	0.283	0.283	0.283	0.283

Table 4. 8 Investment-cash flow sensitivity for firms partitioned by level financial constraints after foreign acquisitions

This table presents the empirical results of investment-cash flow sensitivity of Chinese firms partitioned by level financial constraints after foreign acquisitions by OLS regression. The dependent variable is gross investment to total assets. The definition and sources of the other variables can be seen in Table 4.1. I have controlled both industry and year effects in each model specification by adding year and industry dummies. The industry dummies are derived on the basis of a one-digit China Securities Regulatory Commission (CSRC) code collected from WIND database. The standard errors are presented in parentheses. The symbols *, ** and *** indicate statistical significance at the 10%, 5% and 1% level, respectively.

	(1)	(2)	(3)	(4)
C	-0.0978	-0.1160	-0.1082	2.4023
	(38.808)	(38.808)	(38.809)	(38.874)
CF	-2.4885	-2.4450	-2.3991	-2.2697
	(2.943)	(2.937)	(2.941)	(2.937)
DWW	-0.3530	-0.2183	-0.2107	-0.4374
	(2.539)	(2.514)	(2.528)	(2.522)
DWW*CF	1.7020	1.6304	1.5946	1.6778
	(3.078)	(3.068)	(3.072)	(3.067)
Tobin's Q	0.4237***	0.4237***	0.4237***	0.4250***
	(0.012)	(0.012)	(0.012)	(0.012)
Leverage	0.0004	-0.0014	-0.0009	0.0014
	(0.128)	(0.128)	(0.128)	(0.128)
Expense to revenue	0.9574	0.9170	0.8903	0.7656
	(2.164)	(2.159)	(2.165)	(2.161)
Central SOE	0.6410			
	(1.679)			
Local SOE		0.4627		
		(1.457)		
Private			0.0375	
			(1.562)	
Foreign				-2.6475
				(2.491)
Year effects	Yes	Yes	Yes	Yes
Industry effects	Yes	Yes	Yes	Yes
Observations	3443	3443	3443	3443
R^2	0.283	0.283	0.283	0.283

4.4.3 Effects of foreign acquisition on target firms' R&D activity

To test the effects of foreign acquisition on the target firms' R&D, a dummy variable of R&D expenditures is used as a measurement of target firm R&D activity. A firm's R&D expenditure is equal to 1 if it has positive R&D expenditure at the end of year, and 0 otherwise. The dependent variable is R&D expenditure. Table 4.9 reports the effects of foreign acquisition on target firm R&D expenditure. In each specification, the coefficient of *After* is positive and significant at 1%. The coefficient values are between 0.0397 and 0.0643, implying that R&D expenditure increased by 3.97% and 6.43% following the foreign acquisition. Hypothesis 4.3 is therefore supported. The results appear consistent with conclusions drawn by Vaara et al. (2012), Bertrand (2009), and Bertrand and Zuniga (2006) who found evidence that cross-border M&As are positively associated with R&D and increase R&D spending of the target firms. One explanation for the results may be that cross-border M&As enable scale and scope of economies in R&D efforts, reduce financial constraints, and improve target firms' access to international capital markets thereby increasing investment in R&D. Another plausible explanation may be that foreign firms engaged in cross-border acquisitions tend to have ownership advantages, such as superior technology, and this provides target firms with opportunities to improve the quality of product technology and profits through an increase of R&D activity to gain competitive advantage over domestic rivals (Bandick et al., 2014).

Table 4. 9 Effects of foreign acquisitions on R&D expenditure of Chinese target firms for full sample

This table present the empirical results of foreign acquisition effects on target firm investment involved in inward M&As by OLS regression. The dependent variable is a dummy variable that equals to 1 if a firm has positive R&D expenditure, and 0 otherwise. *After* is a dummy variable that equals one for the years after inward M&As, and 0 otherwise. The definition and sources of the other variables can be seen in Table 1. I have controlled both industry and year effects in each model specification by adding year and industry dummies. The industry dummies are derived on the basis of a one-digit China Securities Regulatory Commission (CSRC) code collected from WIND database. The standard errors are presented in parentheses. The symbols *,** and *** indicate statistical significance at the 10%, 5% and 1% level, respectively.

	(1)	(2)	(3)	(4)
C	-3.1038***	-3.1492***	-3.2214***	-3.7556***
	(0.395)	(0.426)	(0.434)	(0.433)
After	0.0643***	0.0638***	0.0519***	0.0397***
	(0.010)	(0.011)	(0.011)	(0.011)
CF	0.0463***	0.0463***	0.0489***	0.0496***
	(0.006)	(0.006)	(0.006)	(0.006)
TA	0.7232***	0.7323***	0.7488***	0.7206***
	(0.079)	(0.085)	(0.087)	(0.086)
TA*TA	-0.0380***	-0.0385***	-0.0393***	-0.0379***
	(0.004)	(0.004)	(0.004)	(0.004)
Leverage	-0.0001	-0.0001	0.0007	0.0009
	(0.001)	(0.001)	(0.001)	(0.001)
Age	-0.0081***	-0.0080***	-0.0084***	-0.0087***
	(0.001)	(0.001)	(0.001)	(0.001)
Expense to revenue		-0.0056	-0.0036	-0.0037
		(0.012)	(0.013)	(0.013)
GDP growth			0.0032**	0.0098***
			(0.002)	(0.002)
Domestic credit				0.3018***
				(0.030)
Year effects	Yes	Yes	Yes	Yes
Industry effects	Yes	Yes	Yes	Yes
Observations	6114	6096	5607	5565
R^2	0.281	0.281	0.287	0.301

4.4.4 Effects of foreign acquisition on target firms' productivity

Table 4.10 reports estimates of the effect of foreign acquisitions' on Chinese target firms' labour productivity. Following Conyon et al. (2002), firm productivity is measured by sales per employee. I find the coefficient of the variable *After* in regressions to be significant and positively related with firm productivity. The coefficient value of *After* is between 0.0383 and 0.0436, implying that foreign acquisitions increase Chinese target firms' labour productivity by 3.8% and 4.4%.

The increase in the Chinese target firm's productivity following foreign acquisition is consistent with the conclusion reached in the studies of Conyon et al. (2002) and Girma and Görg (2007)who found acquisitions have a positive impact on the labour productivity of UK target firms. From the theoretical standpoint, the results support internalisation theory (Caves, 1996, Dunning, 2012). A transfer of intangible assets, such as high level technology and management skills from the parent company to its affiliate, enables target firms to improve productivity. An increase of a firm's labour productivity following foreign acquisition reflects an increase of target firm performance as a result of foreign acquisitions.

Table 4. 10 Effects of foreign acquisitions on productivity of Chinese target firms for full sample

This table present the empirical results of foreign acquisition effects on target firm investment involved in inward M&As by OLS regression. The dependent variable is sales per employee. *After* is a dummy variable that equals one for the years after inward M&As, and 0 otherwise. The definition and sources of the other variables can be seen in Table 4.1. I have controlled both industry and year effects in each model specification by adding year and industry dummies. The industry dummies are derived on the basis of a one-digit China Securities Regulatory Commission (CSRC) code collected from WIND database. The standard errors are presented in parentheses. The symbols *, ** and *** indicate statistical significance at the 10%, 5% and 1% level, respectively.

	(1)	(2)	(3)	(4)
C	-2.553***	-0.6171	-0.6079	-0.5449
	(0.496)	(0.514)	(0.527)	(0.531)
After	0.0398***	0.0436***	0.0391***	0.0383***
	(0.012)	(0.012)	(0.013)	(0.013)
CF	0.1852***	0.1831***	0.1780***	0.1789***
	(0.008)	(0.008)	(0.008)	(0.008)
TA	1.5136***	1.1540***	1.1336***	1.1304***
	(0.099)	(0.102)	(0.105)	(0.105)
TA*TA	-0.0648***	-0.0487***	-0.0473***	-0.0471***
	(0.005)	(0.005)	(0.005)	(0.005)
Leverage	0.0010	0.0010	0.0006	0.0006
	(0.001)	(0.001)	(0.001)	(0.001)
Age	-0.0051***	-0.0039***	-0.0006	-0.0005
	(0.001)	(0.001)	(0.001)	(0.002)
Expense to revenue		-0.1842***	-0.1790***	-0.1777***
		(0.015)	(0.016)	(0.016)
GDP growth			0.0012	0.0006
			(0.002)	(0.002)
Domestic credit				-0.0263
				(0.037)
Year effects	Yes	Yes	Yes	Yes
Industry effects	Yes	Yes	Yes	Yes
Observations	5831	5828	5359	5324
R^2	0.253	0.273	0.275	0.276

4.4.5 Robustness check

In order to check the robustness of my results, I employ a full sample of Chinese inward M&As data both three years before and after the acquisitions to test whether Chinese firms' financial constraints have been mitigated following foreign acquisitions. One way of assessing this is to observe managerial actions regarding the firm's financial position (Almeida et al., 2004; Fazzari et al., 1988). Almeida et al. (2004) argue that value maximisation leads managers to employ financial policies which ensure that the most important investments continue to be financed. Managers of financially constrained firms therefore tend to hoard cash, hence cash holdings should be higher (Fazzari et al., 1988). A reduction in the cash holdings of a target firm following an acquisition suggests the target firm's financial constraints are lessened. Therefore, the level of cash holdings is associated with financial constraints.

To test the effects of foreign acquisitions on target cash holdings after acquisition, I add a dummy variable *After* which is equal to the value of 1 after the acquisition, following the study of Erel et al. (2015). I also define the deal completion year as post-acquisition firm-year observations. To test this hypothesis 4.2, the following equation is used to predict the quantity of cash being held by the target firms after acquisition:

$$Cashholdings_t = \beta_1 + \beta_2 After_t + \beta_3 Control_t + \varepsilon_t \qquad \text{(Equation 4.4)}$$

The dependent variable is cash to total assets ratio. *After* is a binary variable that takes a value of 1 after the acquisition. I employ firm level controls and two foreign country macroeconomic variables that vary across specifications and are potentially related to firm's growth opportunities: cash flow, Tobin's Q, leverage,

total assets, expense to revenue, total assets squared, GDP growth, and domestic credit as provided by the financial sector.

Table 4.11 presents the results of the cash holdings positions of the target firms after the foreign acquisition. The coefficients of *After* in models 1-6 are negative and significantly different from zero suggesting that Chinese target firms reduce their cash holdings within the range of 0.68% and 0.93% after acquisition. The results support the hypothesis 4.2 that target firms' financial constraints are reduced following acquisition. The results confirm my earlier findings that Chinese target firms are financially constrained before takeover, however, the constraints are reduced after acquisition. The findings are in line with the conclusion drawn by Erel et al. (2015).

Table 4. 11 Effects of foreign acquisitions on cash holdings of Chinese target firms

This table presents the empirical results of cash holdings of Chinese firms for full sample by OLS regression. The dependent variable is cash to total assets ratio. The definition and sources of the other variables can be seen in Table 4.1. I have controlled both industry and year effects in each model specification by adding year and industry dummies. The industry dummies are derived on the basis of a one-digit China Securities Regulatory Commission (CSRC) code collected from WIND database. The standard errors are presented in parentheses. The symbols *, ** and *** indicate statistical significance at the 10%, 5% and 1% level, respectively.

	(1)	(2)	(3)	(4)	(5)	(6)
C	0.1621***	-0.5522***	-0.5352***	-0.2781*	-0.3171**	-0.2273
	(0.025)	(0.146)	(0.146)	(0.147)	(0.152)	(0.153)
After	-0.0093***	-0.0089***	-0.0093***	-0.0068**	-0.0073**	-0.0075**
	(0.003)	(0.003)	(0.003)	(0.003)	(0.003)	(0.003)
CF	0.0234***	0.0223***	0.0222***	0.0217***	0.0209***	0.0207***
	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)
TA	-0.0091***	0.1338***	0.1349***	0.0924***	0.1009***	0.1061***
	(0.002)	(0.029)	(0.029)	(0.029)	(0.030)	(0.030)
Tobin's Q	0.0004***	0.0005***	0.0005***	0.0005***	0.0005***	0.0005***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
TA*TA		-0.0070***	-0.0071***	-0.0055***	-0.0059***	-0.0062***
		(0.001)	(0.001)	(0.001)	(0.001)	(0.001)
Leverage			-0.0009***	-0.0009***	-0.0011***	-0.0011***
			(0.000)	(0.000)	(0.000)	(0.000)
Expense to revenue				-0.0632***	-0.0652***	-0.0651***
				(0.004)	(0.004)	(0.004)
GDP growth					0.0004	-0.0010
					(0.001)	(0.001)
Domestic credit						-0.0294***
						(0.010)
Year effects	Yes	Yes	Yes	Yes	Yes	Yes
Industry effects	Yes	Yes	Yes	Yes	Yes	Yes
N	5940	5940	5905	5895	5424	5383
r2	0.0874	0.0912	0.0927	0.129	0.131	0.132

4.5. Conclusion

This study examines the effects of foreign acquisitions on financial constraints, investment in R&D, and the productivity of target firms in China. While a number of studies have examined the consequences of cross-border M&AS on acquiring firms, I know little about the effects of foreign acquisitions on target firms in emerging countries. Utilising unique data containing pre-acquisition and post-acquisition information of Chinese target firms over the period of 1994-2011, I find that Chinese target firms are financially constrained before acquisition. The financial constraints appear severe for private and foreign owned targets compared to SOE targets. My results are robust to an alternative measure of financial constraints (cash holdings) and to a number of controls, including leverage, Tobin's Q, growth of GDP, and domestic credit. The results suggest that Chinese firms appear to suffer financial constraints due to the dominance of state-owned banks which tend to discriminate against non-SOEs in credit allocation. I also find that foreign acquisitions mitigate the financial constraints of target firms indicating that acquisitions improve target finances through better access to capital markets and the possibility of a reallocation of capital across divisions, as pointed out by Stein (2003) and Wagner et al. (2013). The implications here are that despite two decades of financial reforms in China, non-SOEs still encounter discrimination in formal financing. The Chinese government should therefore pay more attention to the nature and scope of financial sector reforms carried out so far in China, and embark on appropriate reforms to make the financial system a level playing field for both private sector and state enterprises. Specifically, the level of state ownership of banks should be reduced and non-state ownership of banks encouraged as the private sector constitutes an important engine of growth in all economies. Regarding the impact of foreign acquisitions on target firms' R&D and productivity, my results

suggest that acquisitions lead to increases in R&D expenditure and productivity of the target firms. The positive impact of foreign acquisitions on R&D investments and productivity may result from the alleviation of financial constraints enabling more investments in innovative activities and an increase in target firms' efficiency.

From an economic policy standpoint, the results of this study raise the important issue that cross-border M&As bring in capital which is often scarce in developing countries and also aid the technological progress and productivity of the host country. The results suggest that policy makers should favour the use of cross-border M&AS as an entry mode for their countries as a market for firms (acquisitions), rather than a market for resources, constitutes an important vehicle for a target to develop innovativeness, improve productivity, and enhance the competitive advantage of firms in the host country.

Chapter 5. Location-takeover choices of Chinese multinationals: strategic asset seeking motive with firm heterogeneity explanation

5.1 Introduction

Recently, a growing number of multinational firms from emerging countries have joined international expansions. China, a typical developing country, has attracted the attention of economists because of its rapid expansion of outward foreign direct investment (FDI). China plays an important role in global investment because of its large volume of outward FDI. In 2014, the Chinese outward FDI increased by 14.2% compared to that of the previous year (Minitry of Commerce of the People's Republic of China (MOFCOM), 2015). China represents the 3rd largest country in terms of outward FDI flow in the world over three consecutive years. According to MOFCOM (2015), nearly half of Chinese outward FDI is via mergers and acquisitions (M&As) covering 69 foreign countries.

Considering the rapid expansion of Chinese outward investment, extant research interprets the motivations and determinations behind this economic action. For example, the study by Buckley et al. (2007b) is one of the first attempts to empirically investigate the determinants of Chinese outward FDI by employing official annual outward flow FDI data from 1998 to 2001. They test the extent to which traditional, mainstream theory works in emerging country contexts. Their empirical results suggest that market size, geographic distance, inflation, and market openness are significant for the locational determinants of Chinese outward FDI over the early period of 1984-1991, but they find that the data prior to 2001 does not support the asset seeking FDI of Chinese firms. However, they explain that Chinese firms are more likely to be motivated to acquire strategic assets in foreign markets when the Chinese ‘go abroad’ policy becomes fully

implemented following its introduction in 2001.

A number of studies pay attention to the explanation and interpretation of the motivation for Chinese multinationals to engage in FDI from both a qualitative and a quantitate perspective based on various aspects. Wang et al. (2012) test the explanatory power of three theoretical frameworks (institutional theory, industrial organisation economics, and the resource-based view) on the determinants of outward Chinese FDI by using a sample of 679 firms, from 2006 to 2008, and determine that the government support and industrial structure in the home country have a significant effect on Chinese multinationals outward FDI. Yao et al. (2010) use the case of Chinalco's bid for Rio Tinto to study the governmental effect on Chinese firm's international strategy and the risks that SOEs may face to compete with foreign companies in the overseas market. Kang and Jiang (2012) empirically study the determinations of FDI location choices of Chinese multinational enterprises by employing cross-section data of eight Asian economies from 1995-2007. Their empirical results show that the institutional factors have a higher level of significance in determining the Chinese FDI location choice, while there is limited support for the effects of traditional economic factors on FDI location choice of Chinese multinationals in East and Southeast Asia. Ramasamy et al. (2012) investigate the relationship between international location decisions and ownership of Chinese listed firms. They show that determinants of outward FDI vary depending on firms' ownership, and that traditional theories are more applicable to private firms than to state-owned firms. The state-owned firms prefer to invest in foreign countries with rich natural resources and higher political risks, while the private firms are motivated to simply seek markets.

Economists have empirically and theoretically interpreted the different perspectives of Chinese multinationals' overseas investment. However, only a

small number of researchers have explored the relationship between the strategic asset seeking and international location decisions. Existing studies can be divided into two main categories. The first category consists of the qualitative studies on cross-border M&As of Chinese multinational firms. Rui and Yip (2008) use a survey methodology to investigate the foreign acquisitions made by Chinese firms based on the analysis of three strategic intent related companies. Chinese firms use foreign acquisitions to gain strategic assets in terms of intellectual property, brands, and technology, with the aim of offsetting their competitive disadvantages and leveraging their ownership advantages. Deng (2009) conducts similar research on the rationale for strategic assets to motivate outward M&As by Chinese firms based on a case study of three firms. However, these studies take a theoretical approach and fail to access a large number of multinationals to carry out applied work. In the second category, a small number of researchers quantitatively articulate the determinants of Chinese outward M&As. Cui et al. (2014) employ a sample of 154 Chinese firms during 2007-2010 to analyse what kinds of motivations drive the Chinese multinationals' intention to seek strategic assets in the foreign market. It is concluded that Chinese multinationals' strategic asset seeking intent is affected by exposure to foreign competition, governance structure, and the capabilities of finance and management.

In response to the previous analyses, this article adds new insights to the current knowledge set and empirically enriches the literature on the impacts of strategic asset seeking on location-takeover choices by Chinese multinationals. It also considers what kinds of strategic assets drive Chinese firms to go abroad by focusing on the listed Chinese firms' outward M&As. My findings demonstrate the search for strategic assets to be the most important motivation for listed Chinese multinationals, even for government controlled or supported multinational enterprises.

Moreover, the literature fails to provide an in-depth analysis of strategic asset motivation for location-takeover choices. Much of the literature on the relation of location-takeover choice of cross-border M&As and strategic assets is based only on independent measures of technology, such as patents, R&D expenses, high technology exports, trademarks, brands, and so on. For example, Buckley et al. (2007b) use the host country's patent registration to measure Chinese asset seeking FDI, as do Ramasamy et al. (2012) who also add the host country's exports of high technology products to measure the determinants of Chinese outward FDI. However, a country's strategic assets contain various aspects, such as tacit knowledge, proprietary technologies, R&D capability, and brand name, as examples (Teece et al., 1997). Most previous studies pay more attention to upstream technology, like R&D capability, with less attention paid to downstream capability, like distribution systems, advertising, and existing brands. These kinds of downstream capabilities have limited cross-border transferability, but are important to complement a firm's intangible strategic assets (Anand and Delios, 2002).

Based on these considerations, my findings offer new and valuable insights for understanding the strategic assets that influence location decisions in cross-border M&As, and also extend the knowledge about strategic motives over a wide arrange of areas, including technology, innovation, branding, and management practices. This article not only provides systematic empirical data on many strategic assets across firms and countries, but also constructs composite strategic asset indices based on three underlying components of the host country's strategic assets, namely technology, brands, and management practices. In other words, I not only empirically provide an overall map of the importance of the strategic assets of a host country in attracting Chinese multinationals, but I also give details of what kind of strategic asset is mostly attracted by Chinese multinational firms in cross-border M&As. It empirically

reveals that the host country's technology matters more to Chinese multinationals' outward M&As in comparison to brands and management practices, i.e., Chinese multinationals care more about the applied technology that is commercially viable rather than intangible capabilities, like brands and management practices.

Furthermore, a number of studies scrutinize the relevance of Chinese strategic asset-driven cross-border M&A strategies examining mainly determinants related to macro-economic factors at the country level of analysis. For instance, Buckley et al. (2007b) use the annual outflow of Chinese FDI as a dependent variable combined with several macroeconomic variables as independent variables to examine the determinants of Chinese outward FDI. Deng and Yang (2015) use a sample of cross-border M&As by emerging market firms from nine countries during the period 2000-2012 to analyse the major determinants of cross-border M&As by emerging market enterprises in developed and developing countries. However, understanding the effects of firm heterogeneity on location-takeover choices is crucially important. For example, Wang et al. (2012) employ a large firm-level Chinese dataset to consider what drives Chinese outward FDI based on three levels of analysis (firm, industry, and country).

In response to earlier studies, this article not only considers the macro-economic environments at the national level of analysis, but also investigates heterogeneous firms to empirically and theoretically explain whether the strategic asset motivation is dynamic with firm heterogeneity, or not. Three perspectives of firm heterogeneity (firm size, firm R&D expenses, and government involvement) are examined respectively in the empirical section. Small-sized listed Chinese multinationals are not sensitive to a host country's strategic assets. Firms with a higher level of R&D expense have prior R&D

efforts and the capability to absorb external technology and skills, thus, they show more interest to acquire foreign firms located in countries with a higher level of strategic assets. Government-involved firms are attracted by the strategic assets of the host country. The impact of the interaction of technology with government support is quantitatively more important. A 'hard' innovation (a change in product, plant, or equipment) in technology is usually more favoured by Chinese firms than a 'soft' innovation (a change in ideas, processes, or systems), and I find this pattern is particularly salient for government supported firms in cross-border M&As. My findings provide further evidence and new insights on the pragmatism of government supported firms in the process of internationalization. This not only helps to stimulate further theoretical and empirical studies on government supported firms, but is also important as it draws policy implications for future state-owned enterprises' reform in China.

This article is organised as follows. In section 5.2, I review the traditional determinants of outward FDI and the impact of strategic assets on location-takeover choices. I focus on the extent to which the host county's strategic assets influence location-takeover choices by emerging market firms like Chinese multinationals. In section 5.3, I describe the conditional logit model used to analyse the determinants of location-takeover choices by Chinese multinationals. Section 5.4 provides sample details and explains how I construct the composite strategic asset indices, control variables, and firm heterogeneity that is used in the empirical regressions. In section 5.5, I empirically test the impact of strategic assets on location-takeover choices by Chinese multinationals. Finally, in section 6, a conclusion by implications for future research is presented.

5.2 Literature review and hypotheses

This section discusses traditional determinants of cross-border M&As that are generally mentioned in the literature. Then, it aims to theoretically interpret the impact of the strategic assets of a host country on attracting multinational enterprises from emerging markets.

5.2.1 Traditional determinants of cross-border M&As

Multinational firms prefer to use FDI to internalise imperfect external markets for the purpose of minimising costs and maximising operational profits (Buckley and Casson, 1976a). Dunning's eclectic paradigm is generally considered as the mainstream theory for FDI location choices, and it has been built on by a large number of experiences of international businesses. Dunning's eclectic paradigm suggests three primary motivations for FDI (market seeking, resource seeking, and efficiency seeking), as specified by Dunning and Lundan (2008).

First of all, the market seeking FDI refers to an enterprise that invests in a foreign country in order to sustain existing markets or to exploit new ones (Dunning and Lundan, 2008). Four main reasons exist for multinational enterprises to make this choice. Firstly, firms go abroad because they have to follow those of their suppliers, or customers, who have built facilities in foreign markets in order to retain their business. Secondly, firms invest abroad rather than export their goods or services because they have to meet the local tastes or needs of the host country. There is cultural distance between the home country and the host country, but FDI seems an effective way to narrow this gap and for firms to become familiar with the local language, business customs, and legal requirements. The third reason concerns the reduction of transaction costs between two countries. The host country's import controls, tariffs, or other cost-raising barriers, may incentivise firms to build their production facilities in a foreign country. Finally,

firms engage in international investment because they consider it as part of their global strategy to maintain a presence in the leading markets.

Furthermore, multinational firms go abroad to acquire particular and specific resources, like raw materials and energy sources, in the host country, this is known as resource seeking FDI of which there are three main types (Dunning and Lundan, 2008). Firstly, a firm engages in FDI to seek physical resources, such as minerals, fuels, metals, and agricultural products, with the purpose of decreasing costs and for the security of supply sources. The second type of resource seeking FDI concerns cheap and well-motivated unskilled or semi-skilled labour. Another type of resource seeking FDI is to acquire advanced technology, management or marketing expertise, and organisational skills in the host country in order to complement the less developed technological skills in the home market.

The final traditional motivation for FDI is efficiency seeking, which refers to firms looking for lower costs of operation and labour in the host country (Buckley et al., 2007b). There are two kinds of efficiency seeking FDI (Dunning and Lundan, 2008). On the one hand, firms from an emerging market take advantage of the difference in the availability of traditional factor endowments in different countries in terms of relatively cheap capital resources and advanced technology in the host country, and the lower cost of labour and natural resources in the home country. On the other hand, firms invest in foreign countries that have similar economic structures to the home country to achieve economies of scale and scope. The macro and micro economic factors and institutional policies play more important roles in their FDI location.

Both empirical and theoretical research has been undertaken as to whether traditional determinants are applicable to firms from emerging markets, such as

Chinese multinationals, or not. Although in certain aspects, the traditional theory of FDI can be applied to emerging market firms, there are inevitable gaps (Buckley et al., 2007b). Due to the imperfect capital market in emerging markets, special theories may be needed to explain Chinese outward FDI. For example, state-owned firms in China enjoy lower levels of capital rates than private firms who do not gain capital subsidies and need to self-fund or raise internal financing (Allen et al., 2005). Moreover, institutional factors may shape a firm's strategy in overseas markets. Although the highly government-supported firms enjoy the privilege of low cost inputs, they also suffer from government intervention on international business (Buckley et al., 2007b).

Due to market imperfection and institutional factors, a number of economists investigate the outward FDI taken by emerging market firms to test whether the traditional theory of FDI applies to international firms from emerging markets. Yao et al. (2010) believe that the Chinese 'go abroad' strategy can be considered as a resource seeking strategy as being part of a national power-building international strategy based on the case study of Chinalco's foreign acquisition of Rio Tinto. Ramasamy et al. (2012) study on whether the determinants of Chinese outward FDI vary with firm ownership by employing firm level data for the period 2006-2008, finds that state-owned firms are attracted to invest in the foreign countries with higher capability in natural resources and a more risky environment, while private firms prefer to engage in market seeking outward FDI rather than resource seeking. Kang and Jiang (2012) investigate the determinants of Chinese FDI to eight countries in East and Southeast Asia and determine that institutional factors are more significantly important in determining the location choices of Chinese multinationals when compared to traditional economic factors, like market size and growth, natural resource endowment, and availability of strategic assets in the host economy.

5.2.2 Strategic assets and cross-border M&As

As discussed above, various traditional determinants of Chinese outward FDI have been examined in the literature. However, there is no agreement on the effects of the host country's strategic assets on attracting firms from an emerging economy. Most early studies focus on FDI undertaken by firms from developed countries, such as Hymer (1976) and Dunning (1977). They believe that firms conduct international value-added activities to earn profits because they have specific advantages when they compete in the foreign market. Firms use FDI as a channel to transfer, or exploit, their specific advantages, such as intangible or tangible resources and advanced technology, into a host country (Makino et al., 2002). However, recent studies have shown that apart from strategic exploitation, firms also intend to develop their specific advantages and acquire strategic assets in a host country through strategic seeking FDI. Strategic assets are defined as "the set of difficult to trade and imitate, scarce, appropriable and specialized resources and capabilities than bestow the firm's competitive advantage" (Amit and Schoemaker, 1993, p.36). Almeida (1996) investigates foreign multinationals in the US semiconductor industry and concludes that foreign firms, like European and Korean firms, are more likely to use regional knowledge in innovation to offset their technological weakness in the home country. Foreign firms that undertake learning-oriented investment in the US prefer to build plants in regions where knowledge is prevalent and to acquire regional knowledge in their innovation. Chang (1995) does similar research by focusing on the international expansion strategy of Japanese firms in the US from 1976 to 1989. It is seen that the Japanese firms make sequential FDI to build and expand their operations in the US. Firms engage in foreign value added activities not only to exploit their existing advantages, but also to acquire complementary assets to create new ownership specific advantages in the host country (Dunning, 2000). Narula (2012) states that it would be feasible for local

firms to acquire the strategic assets of foreign companies through cross-border mergers and acquisitions or internalisation of foreign assets.

Multinationals from emerging markets lack the strength of ownership advantages, such as technological, managerial, and marketing competences, which are dominated mainly by firms from developed countries (Mathews, 2002). Accordingly, these relative ownership disadvantages incentivise multinationals from emerging markets to acquire complementary assets from developed countries through cross-border M&As. Multinational firms from emerging markets expand into foreign markets with the purpose of upgrading owner specific assets through learning, acquiring, or leveraging knowledge resources not available in the home country (Jindra et al., 2016). Emerging market firms acquire strategic assets by acquiring foreign firms, or their sub-units, which possess sophisticated technology and brands to complement the resource void in their home country (Luo and Tung, 2007). Anand and Delios (2002) not only consider upstream asset seeking, like R&D activities and advanced technologies, but also consider downstream asset seeking, like advertising and distribution, in their foreign investment strategy. There are different endowments and advantages for different countries. A growing number of firms from emerging markets have to compete for global dominance. Acquiring the most advanced and scarce technology in the global market by foreign acquisitions has been a solution for emerging market firms to improve their competitive advantage. In China for example, Chinese multinationals go abroad because they want to address the competitive disadvantages of internationalisation, which is different from the mainstream theory that firms' international investment is a result of the desire to exploit existing advantages (Child and Rodrigues, 2005). Chinese multinationals have late-comer disadvantages in global competition (Luo and Tung, 2007). The 'late coming' firms have to catch up with firms from earlier developing countries which have

competitive advantages in core technology and know-how in manufacturing to support their international competitiveness (Child and Rodrigues, 2005). For instance, the ambition of Chinese multinational enterprises Lenovo and TCL is to both become first-class multinationals (Deng, 2010). In order to achieve this goal, they have to engage in strategic asset seeking foreign acquisitions to acquire valued brands, sophisticated technology, and respected business methods

The empirical evidence on the motive to access strategic assets by Chinese multinationals' outward investment is mixed. On the one hand, there is no significant empirical result supporting strategic asset seeking by Chinese multinationals. Buckley et al. (2007b) use host country patent registration to measure asset seeking FDI by Chinese firms over the period 1984-2001 and find that the coefficient of patent is insignificantly correlated with Chinese outward FDI flows. Ramasamy et al. (2012) believe that Chinese firms are pragmatic in their acquisition of strategy assets in a host country. They prefer technologies which they are able to convert, through core R&D, into commercially viable products. Firms are limited by the less developed human capital and other capabilities in China, and as a result they do not have the capability to add value to core technology taken from foreign countries. However, Deng and Yang (2015) empirically prove that firms from emerging markets are significantly attracted to the strategic assets of a host country by examining a sample set of cross-border M&As from nine emerging countries (including China) from 2000-2012. Based on the above discussion, I propose the hypothesis:

Hypothesis 5.1: The strategic asset of a host country is positively attracting the Chinese multinationals' location-takeover choices.

5.2.3 Firm heterogeneity and cross-border M&As

The impact of a firm's heterogeneity on firm level globalisation strategies has

attracted the attention of economists. There are new insights into why some firms conduct international investment and others do not, and why some firms prefer to engage in strategic asset motivated FDI while others are motivated by resource or market seeking investment. It is recognised that not only do the country level aggregate data contribute to the location choices for FDI, but also data on the influence of strategic formulation at firm level need to be understood (Duanmu, 2012). I provide a synthesis and evaluation of this kind of literature based on three widely recognised perspectives (firm size, firm innovation, and government involvement).

A firm's global strategy is largely determined by its size. Relatively large-sized firms that are more profitable and productive have higher probability of building foreign affiliates to increase profits (Buch et al., 2005). Horst (1974) investigates US food-processing firms' overseas expansion and identifies a positive correlation between firms' proprietary assets and the success of their international expansion. The size the firm has already attained in the domestic market, before engaging in international business, determines its opportunities for investment (Caves, 1996). Subsequent statistical studies have detected the effects of firm size on firm's foreign investment decisions. Forssbaeck and Oxelheim (2011) examine the role of firm specific advantages in the support of the cross-border acquisitions based on a sample 1,447 foreign acquisitions by European multinationals. They empirically prove that firm size and high knowledge intensity are positively correlated with the occurrence of cross-border acquisitions. However, there is controversial discussion on the impact of firm size on foreign investment. Belderbos and Carree (2002) employ a sample of 229 Japanese entries into the Chinese electronics industry over the period 1990-1995 to examine the influence of agglomeration, keiretsu, and firm heterogeneity on the location preference of Japanese investments in China. Their empirical results show that small and medium-sized Japanese firms are more

likely to have location preferences when they invest in China compared to large firms, which is measured by the number of employees. Small-sized firms have a disadvantage in the domestic market because of their limited capability in technology and operation management compared to large-sized firms (Kojima, 1985). Relatively small-sized firms have more incentives to acquire sophisticated technology and management skills from foreign markets in order to create competitive advantages. Thus, the hypothesis follows that:

Hypothesis 5.2: The Chinese listed firms with relatively smaller size are more likely to locate outward M&As in countries with a higher degree of strategic assets.

Excluding firm size, a firm's R&D intensity is another important resource that drives a firm to exploit its innovation and unique technology abroad. Firms have specific comparative advantages when they invest abroad to maximise their profits (Dunning and Lundan, 2008). Firms with a higher level of R&D intensity can combine their strategic assets advantage with benefits in the host country, like the skilled labour and preferential policies provided by the host government (Aswicahyono and Hill, 1995). However, most firms from emerging markets, as latecomers, do not possess strong sophisticated technological resources and innovation capabilities as do those firms from developed countries (Wang et al., 2012). Firms from less developed countries, like Chinese multinationals, are more likely to seek advanced resources and skills in a developed host country by acquiring innovative firms (Deng, 2009). Firms are forced to access strategic assets to reduce their gap in technological capabilities. However, this does not mean that a firm's existing R&D capability and technological resources are not important. Chinese companies prefer technologies they can transfer into commercially viable products because they do not have the capability to add value to core technologies that are brought back from host countries (Ramasamy

et al., 2012). If a firm has a high R&D intensity, it means it has the ability to absorb external technology (Wang et al., 2012). Therefore, the hypothesis is:

Hypothesis 5.3: The Chinese multinationals have higher the degree of R&D intensity are more likely to locate outward M&As in countries with a higher degree of strategic assets.

Government involvement is an enduring differentiator for firms in China. To understand this it is also necessary to understand the legacy of significant government involvement in international expansion. For example, although the Chinese government has made great efforts towards fading out of state ownership, it nevertheless still retains ownership of Chinese multinational enterprises in some industries like finance industry and energy industry (Wang et al., 2012). The Chinese 'go abroad' policy has encouraged domestic firms to expand overseas (Zhang et al., 2011). State-owned firms have priority access to critical resources and can obtain funds at a lower interest rate than non-state owned firms in China because many key industries, like the finance industry, are state-owned institutions (Allen et al., 2005). Private firms build political connections with the government in order to take advantage of such favourable regulatory policies in international expansion. There are a number of regulations and government agencies involved in Chinese multinationals' outward investment. State-owned firms gain preferential treatment and the processes for them are much more straightforward than the challenges faced by for private firms in many industries, from the Internet to biotechnology. (Backaler, 2014). However, the government's involvement does not always work for firms' international expansion. Government-involved firms may face political sensitivity and public concerns in the host country so that their international strategies may fail for political reasons.

Why do government-supported multinational enterprises in China tend to make strategically optimal decisions in cross-border M&As? There are two possible explanations. First, Cui et al. (2014) point out that an important means for MNEs in emerging markets to catch up with, or even overtake, incumbent global leaders is to acquire strategic assets overseas. Hence, strategic asset seeking has become an important strategic intention which motivates FDI. Second, due to the unique institutional environment of China's stock market, the listed MNEs are disposed to pursue long-term growth objectives, especially those of sustaining, or advancing, global competitiveness. On the one hand, many listed Chinese multinational enterprises typically have a more complex ownership structure than those in developed countries, and a considerable proportion of their shares are held by the government. On the other hand, listed multinational enterprises require a higher level of information disclosure and are prohibited from selective disclosure of private information. Constrained by ownership structure and higher standards of information disclosure, transforming and upgrading core competence by identifying, acquiring, and reverse-transferring intangible strategic assets is very important for government-supported listed multinational enterprises in China. Thus, this hypothesis:

Hypothesis 5.4: The Chinese multinationals have greater the government involvement are more likely to locate outward M&As in countries with a higher degree of strategic assets.

5.3 A model of location choice

In order to investigate the Chinese multinational location-takeover choice for their outward M&As, I use a conditional logistic regression, in which the strategic asset motive is introduced, along with other foreign direct investment factors. In practice, Chinese multinational firms choose one of a set of location-takeover choices, and each choice has different characteristics.

The conditional logit model, first developed in economic analysis by McFadden (1973), has been widely used in previous studies in various areas, including FDI location choice. For example, Head et al. (1995) employ a location choice model to estimate the relationship between agglomeration benefits and location choice of Japanese investors by using survey data of Japanese manufacturing greenfield investment in the US from the 1982 and 1987 censuses. Debaere et al. (2010) analyse the location decision of South Korean multinational enterprises' investments across Chinese regions to explore the link between agglomeration, upstream and downstream, by employing a conditional logit model. Tan and Meyer (2011) also use a conditional logit model to examine the effects of country-of-origin agglomeration and industry FDI agglomeration on foreign investors' location decisions. De Beule and Duanmu (2012) use a conditional logit model to analyse the location determinants of Chinese and Indian foreign acquisitions based on aspects of host country market size, institutional environment, natural resources, and strategic assets. It is generally believed that a conditional logit model is a useful economic method to explain to what extent the different locations' characteristics influence the probability of investors investing in a particular place, rather than in another.

In order to model the location-takeover choice of Chinese multinationals in foreign countries, it is assumed that the Chinese firms undertake foreign

acquisitions in a place where they can gain the highest expected profitability. Based on this, it is assumed that a firm has a production function of Cobb-Douglas form. Firms' profits and outputs are determined by firms' inputs and production functions. Rational prices are set which are equal to marginal cost to achieve maximum profits. In this case, I assume the profit (π) of Chinese multinational firm i, gained from undertaking outward M&A in country j, then the log-linear form of profit function can be explored as follows:

$$\pi_{ij} = \beta X_{ij} + \varepsilon_{ij} \qquad \text{(Equation 5.1)}$$

Where $X_{ij}$is a vector of independent variables of determinants of outward M&A in theoretical interests, such as strategic asset indices and control variables that may affect location-takeover choice, and ε_{ij} is a randomly distributed Type-I extreme value. Following McFadden (1973), in order to maximum profits, the probability that firm *i* will choose country *j* from among *m* location choices equals the following logit expression:

$$P_{ij} = \frac{\exp(\beta X_{ij})}{\sum_{k=1}^{m} \exp(\beta X_{ik})} \qquad \text{(Equation 5.2)}$$

Equation 5.2 can be estimated by the maximum likelihood technique. The positive coefficients indicate that country *j*, with a higher value of the independent variable *X*, is more likely to be chosen as a target country compared with other location choices. For instance, if *X* is an independent variable strategic asset index, the positive coefficient of variable *X* means that a higher level of strategic assets of a foreign country increases the probability of that country being chosen by Chinese multinationals for a takeover. In other words, the sign and significant level of the coefficient reveal the presence, or absence, of the host country's strategic assets effect on Chinese multinationals location choice.

The conditional logit model interprets and relatively computes the selection probabilities, and makes it easier to confirm the effects of choosing a new alternative to an alternative set (McFadden, 1973). However, the conditional logit model does not explain the substitutability and complementarity between choices, and the coefficients do not interpret the marginal effects of independent variables on location choice (Tan and Meyer, 2011).

5.4 Sample and measurements

This section focuses mainly on a description of the sample selection and data cleaning, then it introduces the measurements of key and control variables concerning the Chinese multinationals location-takeover choice.

5.4.1 Sample selection

To test the hypotheses, a dataset of Chinese outward M&A cases are collected from two sources. One is the China Securities Market and Accounting Research (CSMAR) database developed by GA Information Technology. The other is the WIND information database. Both databases provide information which includes the announcement date of M&As, the names of the acquirers and their targets, a detailed description of deals, the target country of origin, deal payments. I also collect the acquirers' financial information and ownership classification from the WIND database.

Based on the selected sample in section 3.3.1, I extend the observation time period till 2014. Based on the same criteria in section 3.3.1, I collected 284 outward M&As cases during 2012-2014 from CSMAR and WIND M&A databases. Then the initial sample over the time period of 1998-2014 is 1270. I further excluded 60 outward M&A cases that the Chinese firms have foreign ownerships in the full sample. I also deleted 107 failed cases. I have excluded the outward M&A cases that have missing values in the target countries' information. For this reason I have deleted 81 Chinese firms' outward M&A cases located in the following 16 countries: British Virgin Islands; Cayman Islands; Luxembourg; Netherlands; Taiwan China; Congo Dem Rep; Bermuda; Gabon; Zimbabwe; Barbados; Bolivia; Papua New Guinea; Samoa; Oman; Yemen Rep; and Saudi Arabia. I deleted 20 cases prior the year of 2000 and target the observation time period from 2000 to 2014. I further exclude 24

outward M&A cases that have incomplete value of variables in sample structure. Table 5.1 summarises the sample selection procedure. Finally, I have a dataset of 978 outward M&A cases over the time period 2000-2014 covering 50 foreign countries.

Table 5. 1 Sample selection of outward M&A cases from 2000 to 2014

Description	Deleted cases	Final number of outward M&A cases
Initial number of outward M&A cases till 2014		1270
Exclude foreign owned Chinese firms	60	1210
Exclude failed cases	107	1103
Exclude countries have missing values	81	1022
Exclude cases prior 2000	20	1002
Exclude cases that have incomplete data	24	978

During the data collection process, I have compared CSMAR M&A databases and WIND M&A databases with other kinds of databases, such as the China Global Investment Tracker, which is a public dataset of Chinese global investments and contracts developed by the American Enterprise Institution. However, following comparison between them, I discover that Chinese firms involved in the Global Investment Tracker are either unlisted or overseas listed, which means that most information on the Chinese firms is either not publicly available or is incomplete, while the CSMAR and WIND databases cover a larger size of Chinese outward M&A cases with a longer observation time period. Detailed information about Chinese firms relating to outward M&As in the CSMAR and WIND databases are publicly available.

5.4.2 Measurements

Based on theoretical interests concerning the determinants of location-takeover choices made by Chinese multinationals, I have developed the following

independent variables in the conditional logit regressions. The dependent variable of each regression is the location-takeover choice, which is a dummy variable equal to 1 if the foreign country is chosen by Chinese multinational firm, and 0 otherwise.

Strategic assets

It has not been ascertained in the literature as to what is the best way to measure a host country's strategic assets. However, there are a number of plausible approaches that strategic assets measurements should exhibit. For example, Buckley et al. (2007b) use patent registration as a proxy for asset seeking motivation of Chinese outward FDI; Ramasamy et al. (2012) employ high technology exports as technology or strategic asset seeking measures; Zhang and Roelfsema (2014) use five items (high technology exports, patents registration, R&D expenditure, and trademark applications) to construct a composite index of the technology intensity of the host country. Perhaps the measures widely used in the literature relate to one dimension of a host country's strategic assets, e.g., the degree of the host country's technological development. However, strategic assets include many aspects, such as tacit knowledge, proprietary technologies, R&D capability, and brand name (Teece et al., 1997). Different to previous studies, I use three dimensions of a host country's strategic assets that are based on multiple characteristics rather than a single scheme, i.e., technology, brands, and management practice. Each of these three schemes are composed of three sub-components, which are explained as follows. Panel A, in Table 5.2, summarises the description, data sources, and summary statistics of these three schemes. I use the firm-level and country-level data at the end of last year. Figure 5.1 presents the composite of strategic asset indices and their components.

When I are constructing a comprehensive index to give an overall map of

strategic assets, I firstly consider the theoretical perspectives of the measurements of strategic assets on Chinese perspectives in the literature, such as technology, brands, and management practices. Apart from the theoretical perspectives, the availability of data also impacts on the choice of indicators when building a comprehensive composite index. I compared a variety of sources in order to access sufficient data to construct a comprehensive strategic assets index.

There are three comprehensive indices of strategic assets: SA 1, SA 2 and SA 3. Each composite index has three related components, meanwhile, each component is constructed of three sub-components. I classify each sub-component into groups by ranking in quartiles rather than the factor analysis method. Factor analysis is the most used method to reduce less relatable variables from a large set, which results in a smaller finalised set of variables to create a composite index. However, in this study, only three variables are designed to create a composite index, and therefore it is not appropriate to apply factor analysis.

SA 1

I construct one composite proxy SA 1 with a score of 0 to 27 over the time period 2005-2014 to measure the host country's degree of strategic assets by employing three components: technology; brands; and management practices. Each component has three specific sub-components to indicate their different compositions of strategic assets, which are interpreted as follows:

Table 5. 2 Variables description and data sources with summary statistics

Panel A	Description	Sources	Obs.	Mean (Std. Dev)
1. SA 1	The index comprises of three components: technology, brands and management practices		19047	17.6072 (6.144)
Technology	Technology is coded from 0 to 9 with the component of Patents, High technology and R&D		19047	5.7504 (2.305)
Patents	Patents coded as a score of 0 to 3 when I rank the countries in quartiles based on the value of patents by each year; Patents is log of total (resident plus non-resident) annual patent registrations in host country.	World Development Indicators	19047	2.1219 (1.003)
High technology	High technology is coded as a score of 0 to 3 when I rank the countries in quartiles based on the value of high technology by each year. High technology is log of annual high-technology exports (% of total exports)	Same as above	19047	1.7044 (0.948)
R&D	R&D is coded as a score of 0 to 3 when I rank the countries in quartiles based on the value of R&D expenditure by each year. R&D is the log of annual research and development expenditure (as a % of GDP)	Same as above	19047	1.9241 (0.898)
Brands	Brands is coded from 0 to 9 with the component of trademarks, Forbes and Interbrand		19047	7.1425 (1.680)
Trademarks	Trademarks coded as a score of 0 to 3 when I rank the countries in quartiles based on the value of trademark by each year. Trademark is log of total (resident plus non-resident) annual trademark applications in host country.	World Development Indicators	19047	2.1594 (0.966)
Forbes	Forbes coded as a score of 0 to 3 when I rank the countries in quartiles based on the value of Forbes by each year. Forbes is log of maximum annual number of firms listed in Forbes Global 2000 during 2009-2014.	Forbes Global 2000 website	19047	2.1905 (0.906)
Interbrand	Interbrand is coded as a score of 0 to 3 when I rank the countries in quartiles based on the value of Interbrand by each year. Interbrand is log of annual number of firms listed in Interbrand Best Brands.	Interbrand Best Global Brands website	19047	2.7927 (0.405)
Management Practices	Coded from 0 to 9 for three components of People, Operation, Monitor		19047	4.7143 (3.057)
People	People is coded as a score of 0 to 3 when I rank the countries in quartiles based on the value of people.	Bloom and Reenen (2007)	19047	1.5714 (1.137)
Operations	Operations coded as a score of 0 to 3 when I rank the countries in quartiles based on the value of operations.	Same as above	19047	1.5714 (1.137)
Monitor	Monitor is coded as a score of 0 to 3 when I rank the countries in quartiles based on the value of monitor.	Same as above	19047	1.5714 (1.137)

Table 5.2 Indicator component variables used in the calculation of strategic assets index (Continued)

Panel A	Description	Sources	Obs.	Mean (Std. Dev)
2. SA 2	The index comprises of two components only, namely technology 2 and brands 2, but for a larger sample size.		45350	10.4071 (4.389)
Technology	Technology has the component of patents, high technology and R&D, but for a larger sample size.		45350	4.5600 (2.610)
Brands	Brands has the component of trademarks, Forbes, and Interbrand, but for a larger sample size.		45350	5.8471 (2.102)
3. SA 3	The index comprises of two components only, namely technology 3 and brands 3, but for a longer time period.		48900	7.2884 (2.766)
Technology'	Techonology' comprises of patents and high technology only. Each component is coded as 0 to 3, with longer time period over 2000-2014.		48900	3.0400 (1.811)
Brands'	Brands' comprises of trademarks and Interbrand only. Each component is coded as 0 to 3, with a longer time period over 2000-2014		48900	4.2484 (1.258)
Panel B				
Firm level variables				
Firm size	Log of real total assets	Wind databases	45350	22.4670 (2.191)
R&D expense	Log of firm R&D expense	Same as above	45350	8.2297 (8.817)
Stateown1	A dummy variable that equals to 1 if a firm is a central or local SOE, and 0 otherwise.	Same as above	45350	0.4906 (0.500)
Stateown2	Stateown2 equals to 2 if a firm is a central SOE, equals to 1 if a firm is a local SOE, and 0 otherwise.	Same as above	45350	0.7442 (0.835)
State patronage	State patronage is coded as 0 to 2 with the components of stateown1 and political connection. Political connection equals to 1 if a firm's CEO or chairman is currently or formerly a government official, and 0 otherwise.	Same as above	45350	1.0066 (0.753)

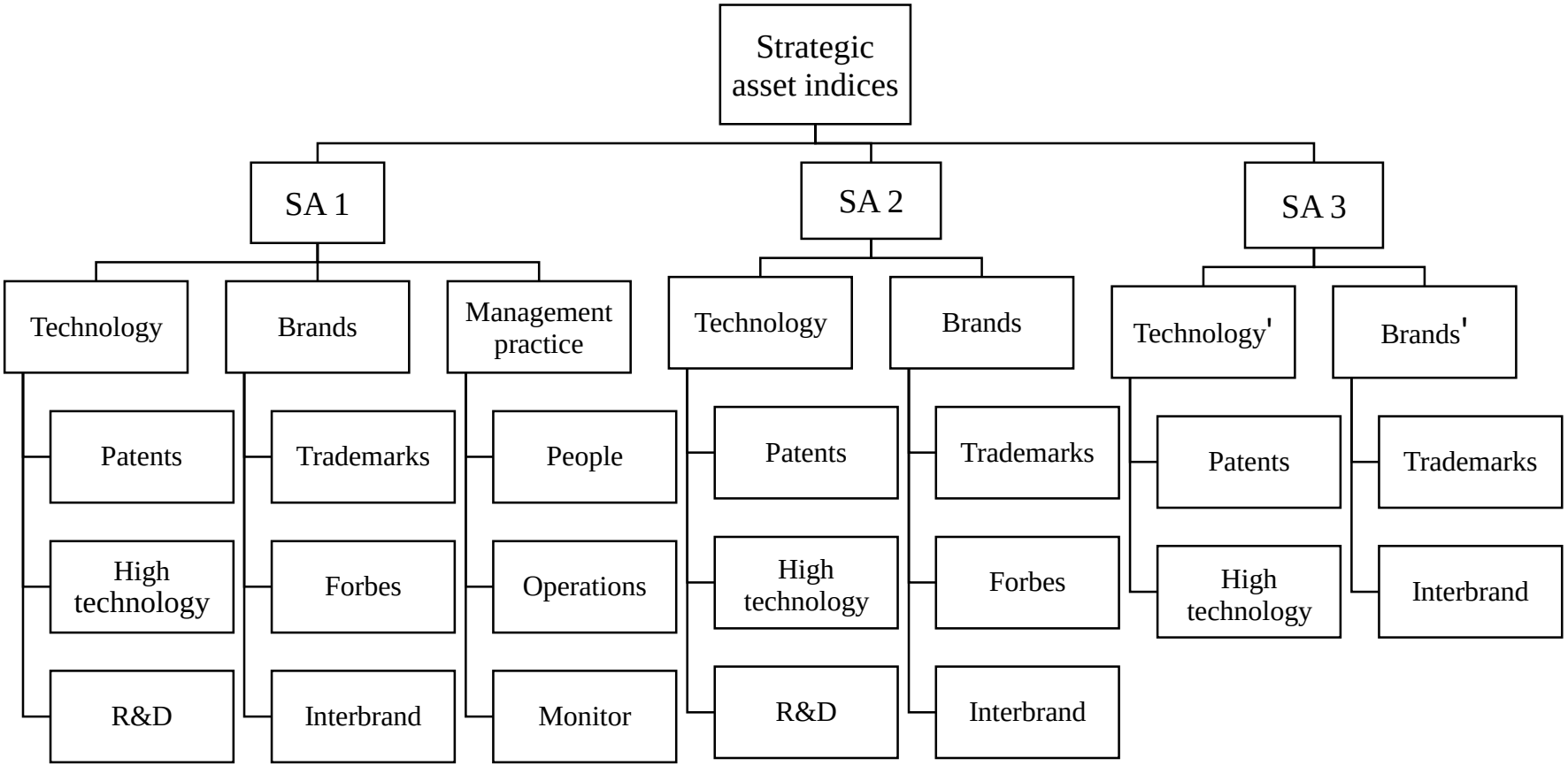


Figure 5. 1 Strategic asset indices and their components

Technology

The degree of a host country's technology development indicates that country's capability of immobile strategic assets and the higher probability for Chinese multinationals to access advanced proprietary technology from abroad. As mentioned above, a number of papers use a series of proxies to measure a host country's strategic assets. Anderson et al. (2015) use patenting activity data to analyse the effects of Chinese multinationals' strategic asset acquisitions in developed countries on the innovation of acquirers and targets by employing event study methodology. Empirical results from Ramasamy et al. (2012) indicate that the registered patents in a host country do not attract Chinese multinationals, but their findings show that Chinese investors are attracted to countries that excel in high technology exports. Through acquisitions firms can learn technological skills and competencies to exploit the knowledge of the host country (Vermeulen and Barkema, 2001). Anand and Delios (2002) use the difference in R&D expenditure intensity between home and host country to assess the technological capabilities and determine a significant relationship between upstream assets (technology intensity) and the entry mode of foreign investment. Chinese multinationals go abroad to acquire the advanced technologies which can maintain their competitive advantage over their domestic counterparts. For example, due to the fast growth of the domestic market, the new emerging competitors are likely to access products at the same technical level, which means that the companies have no choice but to innovate or to go abroad to acquire the latest technology through outward M&As or investments (Backaler, 2014).

Based on the literature, I summarise the three proxies generally used, patent registration, high technology exports, and the host country's R&D expenditure, to construct a composite index of technology over the observed time period

2005-2014. Firstly, according to Buckley et al. (2007b), I use the total (resident plus non-resident) annual patent registration from the World Development Indicator (WDI) to indicate a host country's patent registration (*Patents*). Secondly, based on Ramasamy et al. (2012), annual high-technology exports (% of total exports) in the host country are used to measure high technology exports (*High technology*). Thirdly, following Zhang and Roelfsema (2014), I employ annual research and development expenditure as a % of GDP to measure the R&D expenditure in the host country (*R&D*). I separately sort the countries by year based on three different sub-components: *patents; high technology; and R&D*. Next, I rank the countries in quartiles and assign a score of 0 to 3 to each of those three rankings; the number 3 indicates the highest level of strategic assets of the country, and the number 0 indicates the lowest degree of strategic assets of the country. Then, I construct a new component index of *Technology* with a score of 0 to 9 by totalling the score of each country by year based on all three sub-components (*Patents, High technology, and R&D*) as one of the components of *SA 1* over the period 2005-2014.

Brands

It is well recognised that a brand is a crucial firm-specific intangible resource which can determine a firm's success in the market. However, most Chinese firms fail to build globally recognised brands as a result of their relative youth in terms of international experience (Backaler, 2014). Building a brand requires millions of dollars and shrewd knowledge of public relations, marketing, and advertising (John and Percy, 1997). However, brands are precious and rare resources for a company and difficult for competitors to imitate. Consequently, it is necessary to create a long-term brand as part of an enterprises' business strategy. Buying an existing recognised global brand and operating under the acquired firm's name are crucial moves for Chinese multinationals in their

overseas expansion and can contribute to Chinese multinationals' benefits. Firstly, acquiring a global brand helps to bridge the 'consumer trust gap' between the company and customers in the overseas market, especially with the consideration that most Chinese products are recognised as low-quality products in that market. For example, a Chinese company named Bright Food acquired Synliat Milk in New Zealand to earn customers' trust of its milk products following the 2008 dairy product safety scandal in China (Backaler, 2014). Secondly, acquiring an internationally recognised brand can help Chinese multinationals enter the foreign market more quickly, and at a lower cost. It is difficult to transfer brands between different regions because consumers tend to be brand loyal (Anand and Delios, 2002). Considering that building a recognized brand in the overseas market is financially costly and time consuming, acquiring a recognised international brand can help Chinese enterprises quickly build greater advantages to compete with their rivals in the overseas market (Backaler, 2014). Thirdly, acquiring an existing global brand benefits the company's ability to operate their business in the foreign market. Consumers in the overseas market are attracted by brand names with which they are familiar and which are easily remembered. Backaler (2014) claims that Western consumers are reluctant to relate to a brand name with a Chinese style, like "Wanxiang", "Haier", and "Huawei", which are challenging for them to pronounce. However, operating a business under the acquired firm's name can overcome this issue.

In order to construct a comprehensive index of brands, I employ three proxies, *Forbes, Trademarks, and Interbrand*, which provide three aspects of a host country's brands over the observation time period 2005-2014. Firstly, *Forbes* refers to the Forbes Global 2000 list from Forbes' website. Forbes Global 2000 list ranks the 2000 biggest public companies in the world based on value of sales, profits, assets, and market value in U.S. dollars, by using the most recently available one year financial data. I compare the Forbes Global 2000 list with

another global brands list, 'Gartner Supply Chain', which ranks companies based 50% on financial performance and 50% on corporate social responsibility. Gartner Supply Chain's list ranks the top 50 supply chain leaders around the word based on the combination of the Fortune Global 500 and Forbes Global 2000, which suggests that not only does the Gartner Supply Chain list overlap the Forbes Global 2000 list, but also the Gartner Supply Chain list is highly dependent on financial performance, rather than on the supply chain measure per se. What is more, the Gartner Supply Chain list has fewer observations of countries over shorter time periods than the Forbes Global 2000 list. This confirms that the Forbes Global 2000 list is more comprehensive in its coverage of financial performance and of countries. Forbes Global 2000 list covers the period from 2009 to 2014. I collect the Forbes Global 2000 lists year by year and count the number of brands listed for each country, then use the maximum number of brands from 2009 to 2014 as the value for *Forbes* across the observation time period 2005-2014. I sort and rank the observation countries in quartiles, based on the value of *Forbes,* which is coded as a score of 0 to 3, with a higher number indicating a higher degree of strategic assets on the brand perspective of the host country.

The second sub-component is the trademark applications (*Trademarks*). According to Zhang and Roelfsema (2014), I define the trademark applications as a log of total (resident plus non-resident) annual trademark applications in a host country from the WDI dataset. I sort and rank the countries in quartiles based on the value of trademark applications by year, then assign a score of 0 to 3. Countries in the highest (lowest) ranked group are considered as having a relatively high (low) degree of strategic assets.

The third subcomponent of brands is Interbrand, which refers to Interbrand's Best Global Brands, and which lists the top 100 most valuable brands and

leadership strategies in the world based on the evaluation of financial performance of the branded products or services, the role of the brands in attracting consumers, and the brand's competitive strength. I collect the top 100 brands from the Interbrand's Best Global Brands website and count the number of brands of each country over the time period 2000-2014. I sort countries by year and rank them in quartiles based on the number of brands listed with a score of 0 to 3 for each ranking, where a higher number indicates a higher degree of strategic assets. Finally, I add the total score of each country by year based on all three sub-components (*Forbes, Trademarks, and Interbrand*) to construct a component index of *Brands* with a score of 0 to 9 as one of the components of *SA 1* over the period 2005-2014.

Management practices

Like technological practice and brands, management practices are another dimension of strategic assets relating to knowledge transfer and spillovers of multinational enterprises. Management practices significantly determine the competitive advantages of a firm in terms of managerial intellectual property and human resource management (David and Pisano, 1994). A substantial literature indicates the imperative relationship between management practices and multinational enterprises. Fu (2012) interprets the relationship between tacit and explicit elements of managerial knowledge spillovers and FDI through the diffusion of management practices by employing 1079 observations concerning the manufacturing and services industries in UK. His empirical results show that management practices spillovers of multinational enterprises not only benefit local firms, but also benefit other local firms within the sectorial system. First, there is labour movement from multinational enterprises to indigenous firms. The higher-quality training of the foreign companies provides knowledge of new management practices to local firms; the employees in local firms learn

advanced management practices from the foreign firms and this improves their own productivity and benefit for further building of knowledge. Secondly, the improved management practices learned by local firms through foreign acquisition have a significantly strong effect in the home country by way of demonstration. The explicit management practices used by the multinational enterprises, such as management briefing teams and rewarding loyal customers, are more likely to be observed by competitors, suppliers, and clients in the home country. By assessing post-acquisition changes in the competitive performance of 201 UK companies, Child et al. (1999) determine that there is post-acquisition performance improvement. There is more than one path for the local firms to achieve advanced management practices following foreign acquisition. For example, in the Japan-UK acquisitions, Japanese investors try to improve the price competitive strategy of UK firms by adopting a long-term human resource management policy to reduce operation costs. French acquirers emphasise cost control by providing open communication and decentralization. Child et al. (2000) reach a similar conclusion, i.e., foreign acquired and controlled subsidiaries in the UK always have post-acquisition improvements in their management practices, but the effects on post-acquisition performance vary between multinational enterprises of different countries.

Based on the theoretical interpretation of the link between foreign acquisitions and management practices, I employ the country level data constructed by Bloom and Van Reenen (2007). In order to measure the different levels of management practices across firms and countries, Bloom and Van Reenen (2007) provide a detailed interpretation by developing a survey methodology to measure the management practices of 34 observed countries. They use the practice evaluation tool developed by an international consulting firm to investigate the 18 key management practices of manufacturing firms by scores. For 18 basic management practices, each has defined scores from 1 to 5, with the highest

value indicating the best management practice of this item for the firm. These 18 management practices are also grouped into four categories (*people, operation, monitor, and target*) using the average of scores as the main measures of management practices. I average the scores in each category, based on observation of firms in each country, to obtain the overall score of each country's management practices on the aspects of people, operation, monitor, and target. I choose people, operation, and monitor as three characteristics of management practices of the countries chosen by the Chinese multinationals in the sample. Twenty-one countries in my sample are included in the survey by Bloom and Van Reenen (2007), which means that there are a smaller number of observations when I use management practices in regressions. I separately sort the observation countries based on the value of three criteria: *people, operation, and monitor.* Next, I rank countries in quartiles and assign a score of 0 to 3 to each of those three rankings. I code 3 to the countries with the highest rankings and code 0 to the countries with the lowest rankings. I then add the total score of each country based on all three characteristics of management practices as the composite index of management practices (*MP*) with a score of 0 to 9 as one of the components of *SA 1* over the period 2005-2014. Countries with higher (lower) value of *MP* have a higher (lower) degree of strategic assets.

SA 2

The algorithm used to compute *SA 2* is similar to that of composite index *SA 1*. However, the *SA 2* index comprises two components only, namely *technology* and *brands*, but for a larger sample size. Unlike *SA 1*, I do not include *MP* index as the component of *SA 2*, which means that I have a larger number of observed countries in the regressions because the *MP* index only covers 21 countries (I have 50 location choices in the sample). *Technology* and *brands* respectively include the sub-components of patents, high technology, and R&D, and the sub-

components of Trademarks, Forbes, and Interbrand. The observation time period of *SA 2* is the same as *SA 1,* 2005-2014. Each sub-component is coded as 0 to 3, then SA 3 is coded as 0 to 18.

SA 3

Like *SA 2,* the algorithm used to compute *SA 3* is similar to that of composite index *SA 1,* but *SA 3* has a longer observation time period of 2000-2014, which means that I have a full sample observation for *SA 3*. Secondly, similar to *SA 2*, *SA 3* comprises two components only, namely *technology'* and *brands'*. *Technology'* comprises patents and high technology only, without R&D, while *brands'* contains Trademarks and Interbrand only, without Forbes. Each sub-component is coded as 0 to 3 with a longer observation time period, then SA 3 is coded as 0 to 12.

Control variables

Based on the theoretical literature, the traditional determinants of Chinese outward FDI are included in the regression as control variables to reveal the impact of the main variables. Firstly, *GDP* captures the absolute market size of a host country and is measured by the host country's GDP. Secondly, *GDP per capita* captures the relative market size of a host economy and is used as a proxy of host country GDP per capita. Thirdly, *inflation* is another economic variable that measures the host country's uncertainty and determines its price-setting and profit expectations (Buckley et al., 2007b). Higher inflation in a host country reduces the real value of earnings and discourages the market from seeking outward investment. Inflation is measured by the host country's annual inflation rate. Fourthly, the exchange rate between China and a host country is another determinant of outward investment. An appreciation of home country currency vis-a-vis host country currency reduces the cost of investment in the host country

and gains more profits. Following Buckley et al. (2007b), exchange rate is measured by a host country's official annual average exchange rate against RMB (fixed to the US dollar). Finally, resources represent the natural resource endowment of a host country. Chinese companies go abroad with the purpose of resource seeking encouraged by the government to ensure the supply of domestically scarce resources, such as the foreign acquisitions of China National Petroleum Corporation on Canada-based energy company PetroKaz (Wu and Sia, 2002). Resources are measured by the ratio of ore and metal exports to merchandise exports of the host country.

Firm heterogeneity

I highlight three aspects of firm heterogeneity to examine its influence on location choices motivated by strategic assets, i.e.,: the differences in location choice between relatively larger listed firms and smaller and medium-size Chinese listed firms; differences in location choices between relatively larger and smaller values of a firm's R&D expenditure; and differences in government-related firms and non-government-related firms. First of all, there is a controversial argument relating to the effects of firm size on foreign investment. Large scale firms have benefits in overall resource capability (Cui and Jiang, 2009). By examining 1,447 European firms' cross-border acquisitions, Forssbaeck and Oxelheim (2011) determine the firm's specific financial advantages on conducting foreign acquisitions and conclude that firm size and high knowledge intensity statistically positively correlate with the number of foreign acquisitions undertaken. However, in contrast to the evidence on large sized firms' advantages, some studies believe that small and medium-sized firms may react more strongly to conduct foreign acquisitions due to the relatively lower capability in their home country. For example, Kojima (1985) points out that small sized Japanese firms are more likely to undertake FDI because these

kinds of firms do not have advanced technologies or comparative advantages of competition in the home country compared with large firms. I combine the firm size with strategic asset indices to examine the impact of firm size on location decisions made by Chinese multinationals motivated by strategic assets. The firm size is measured by the firm's log value of real total assets at the end of last year from the WIND dataset.

Secondly, firm R&D expenditure is an important resource that determines the firm's expansion abroad, which determines Chinese multinationals' R&D intensity and innovation capability (Dunning and Lundan, 2008). Petit and Sanna-Randaccio (1998) use a two-country model to explain the positive effect of R&D on the foreign expansion chosen by a firm. Multinational enterprises are highly concentrated in R&D intensive industries in Japan and the R&D intensive firms have advantages in FDI because of the reduction in production costs (Tanaka, 2010). I measure the Chinese firm's R&D expenditure by the proxy of the log value of a firm's R&D expenses at the end of last year, which is combined with the strategic assets index to analyse the difference between R&D intensive firms and less R&D intensive firms on outward M&As motivated by strategic assets.

Thirdly, government involvement in outward M&A affairs is an attempt by Chinese multinationals to escape domestic institutional limitations (Wang et al., 2012). Government support drives Chinese firms to go abroad. Chinese multinationals enjoy the benefits of government support in terms of privileged access to natural resources, lower cost of financial capitals and subsidies, in order to alleviate the disadvantages these firms face in the global market (Buckley et al., 2007b). Indeed, state-related firms enjoy the benefits of getting approvals from the government on outward M&As. For example, Backaler (2014) states five main government institutions involving Chinese firms'

overseas investment: the National Development and Reform Commission (NDRC); the Ministry of Commerce (MOFCOM); the State-owned Asset Supervision and Administrative Commission of the State Council (SASAC); and the State Administration of Foreign Exchange (SAFE). However, the process for Chinese firms to invest abroad is convoluted. For the large state-owned firms, who receive preferential treatment from the government, the regulated process is straightforward, but for private firms it is a challenge for them to gain approval for outward investment and the regulatory process is, in fact, bewildering (Backaler, 2014). Based on these considerations, I use three state-involved proxies to measure the degree of government involvement in Chinese multinationals: *Stateown1; Stateown2; State patronage*. The ownership of the Chinese firms can be classified as central SOEs which are primarily controlled by the central state, local SOEs which are primarily controlled by the regional government, private firms which are primarily controlled by private institutions and individuals, and foreign firms which are primarily controlled by foreigners and foreign institutions. Stateown1 is defined as a dummy variable equal to 1 if a firm is a central or local SOE, and 0 otherwise. Stateown2 equals 2 if a firm is a central SOE, equals 1 if a firm is a local SOE, and 0 otherwise. For the state patronage, this is coded as 0 to 2 with the components of stateown1 and political connection. Political connection equals 1 if a firm's CEO or chairman is currently or formerly a government official, and 0 otherwise. Each state-involved index is combined with the strategic assets index to examine the difference between state-involved firms and non-state-involved firms on outward M&As motivated by strategic assets.

5.5 Empirical results

5.5.1 Strategic assets and location-takeover choices

This section discusses the conditional logit estimates for effects of strategic assets on Chinese multinationals location-takeover choices. I analyse the importance of the three strategic assets composite indices (*SA 1, SA 2, and SA 3*) one by one, with control variables. The estimation results are given in Table 5.3. I consider four different regressions over two periods of time: 2005-2014 and 2000-2014. The first three regressions use data from the sample period 2005-2014. The *SA 1, SA 2,* and *SA 3* have positive coefficients with a statistical significance level of 5% within a range of 0.1895 to 0.3578, which empirically supports hypothesis 5.1. These results show that Chinese multinationals prefer to invest in those countries that have a higher degree of strategic assets, suggesting high importance of strategic assets in determining the location-takeover choice of Chinese outward M&As. The empirical evidence I have provided supports the importance of the strategic-seeking motives of emerging markets' multinational enterprises' outward FDI reported in several previous studies, such as Deng (2007), Rui and Yip (2008), Ramasamy et al. (2012), and Jindra et al. (2016). They find that Chinese outward FDI is made with the strategic intention of acquiring technology, brands, and management. Wu et al. (2016) also argue that multinational enterprises in emerging markets operate in environments characterized by under-developed institutions that constrain the development of internal capabilities for innovation and managerial practices, and thus they are very keen to enhance their innovation performance and global competitiveness.

However, it is found that the coefficient of *SA 3,* in the longer time period of 2000-2014, is insignificant. The development of Chinese outward M&As is

made step-by-step. Strategic asset seeking is more likely to be pursued by firms in recent years when the 'go global' policy becomes fully implemented and acted on by firms (Buckley et al., 2007b). The Chinese government encouraged Chinese firms to apply the 'go global' policy in 2001, but this economic objective was well expressed in 2004 after the guidelines of promoting outward FDI by State Administration Reform Commission and the EXIM Bank of China (Ih áu and Pereira, 2012).

Chinese multinationals' international process is divided into three phases by Kang (2008): transition (1979-1995); normal development (1996-2003); and acceleration (2004 onwards). In the transition phase Chinese stated-owned firms made bold moves and started their international process immediately after the opening up policy as these kinds of firms had built their strength during the planned economy stage. However, they faced obstacles in foreign ventures because of a lack of experience. During the normal development phase a number of manufacturers started to invest abroad to seek new markets because of overcapacity in the domestic market. Until 2004, the development of international process by Chinese multinationals entered into a new phase and reached its highest level. Since China joined the World Trade Organisation (WTO) at the end of 2001, Chinese firms have faced competitive pressure from foreign companies, forcing them to accelerate the 'go global' strategy. Cross-border M&A has become an important entry mode into foreign markets for Chinese multinationals. In 2004, the trend of Chinese outward M&As reached its first peak, and this was recognised as a symbol of the 'go global' strategy. Three major foreign acquisitions were made in 2004: Shanghai Automobile-Ssangyong Motor Company in South Korea, TCL-Thomson Multimedia's TV business in France, and Lenovo-IBM's PC business in the US.

Taken together, I can cautiously conclude that the strategic assets of a host

country are one of the significant determinants for Chinese outward M&As in recent years (2005-2014), which is consistent with past studies. Deng and Yang (2015) empirically prove the positive effects of a host country's patents on attracting Chinese multinationals. Similar empirical results are found by Zhang and Roelfsema (2014), which indicates the statistical importance of strategic assets on driving Chinese outward FDI. However, when I expand the observation period to 2000-2014, the impact of strategic assets is not so significant. In contrast to the evidence on the favourable impact of strategic assets on Chinese multinationals, some of the literature expresses a different view. For example, Buckley et al. (2007b) do not find the significant determinants of a host country's patents on Chinese outward FDI over the period of 1998-2001 under study. This may be a consequence of the sample composition. There are dynamics of the impact of strategic assets on Chinese outward M&As. My findings are mainly consistent with past studies which support the importance of strategic assets on Chinese firms' outward investments.

For the control variables presented in Table 5.3, I find that the exchange rate has a positive and statistically significant impact on the location-takeover choices of Chinese multinationals. This suggests that Chinese multinationals tend to choose those host countries that have a higher value of official annual average exchange rate against RMB, with the purpose of reducing investment costs, which is consistent with the empirical results found by Duanmu (2012). The coefficients of resources are statistically significant, even with the surprising negative signs, in models (2)-(4), for model (1) it is insignificant. However, this is consistent with the empirical results of Duanmu and Guney (2009). They explain that the sample composition may cause this surprising result, and that resource seeking is an industry specific motivation for FDI, which is not applicable for aggregate FDI which covers a wide range of industries. Moreover, China's listed multinational enterprises face strong institutional barriers to legitimize resource

seeking activities and are less motivated to secure stable, low-cost, and high quality natural resource supplies than to seek strategic assets. The remainder of the control variables, GDP, GDP per capita, and inflation do not present significant influences on location-takeover choices of Chinese multinationals.

Table 5. 3 Results for overall strategic asset indices

SA1 includes technology, brands and management practices. SA2 includes technology and brands only. SA3 includes technology, brands with fewer components. Robust standard errors are in parentheses. * , **, *** indicate that the coefficient is significant at the 10%, 5% and 1% level, respectively.

	Dependent Variable: Location-takeover choice			
	(1)	(2)	(3)	(4)
Estimation time period	2005-2014	2005-2014	2005-2014	2000-2014
SA 1	0.3578***			
	(0.117)			
SA 2		0.2124**		
		(0.088)		
SA 3			0.1895**	0.1185
			(0.094)	(0.084)
GDP	-0.1697	-1.3639	-2.0290	-0.8365
	(2.926)	(2.388)	(2.306)	(1.847)
GDP per capita	1.9449	1.3316	1.7846	-0.5159
	(3.680)	(2.866)	(2.838)	(2.267)
Inflation	-0.9128	-2.1722	-1.9809	-0.6977
	(5.125)	(2.785)	(2.791)	(2.455)
Exchange rate	4.9952***	1.9656**	1.9569**	1.7103**
	(1.234)	(0.958)	(0.953)	(0.837)
Resources	-0.1028	-0.4697**	-0.4446*	-0.5023**
	(0.616)	(0.232)	(0.233)	(0.209)
Country-specific Fixed Effects	Yes	Yes	Yes	Yes
Number of firms	463	907	907	978
Number of Choices	21	50	50	50
Pseudo-R^2	0.2359	0.3857	0.3855	0.3993
Log-likelihood	-1077.0	-2179.5	-2180.5	-2298.2
LR χ^2	372.16***	2134.87***	2144.78***	2407.51***

5.5.2 Components of strategic asset indices and location-takeover choice

I empirically prove that the host country's strategic assets attract Chinese multinationals overseas investment by employing a series of composite strategic asset indices. Based on these main empirical results, I further investigate the impact of each component of each strategic assets index to Chinese multinationals' location-takeover choices in order to specify which specific item plays the most important role for the host country in attracting Chinese multinationals' outward M&As. Table 5.4 summarises the main results of the regressions that contain the components of each strategic assets index. In order to save space, I do not report the control variables in the regressions. As I can see from Table 5.4, Panel A, coefficients of technology are statistically significant and positive, while the coefficients of brands are insignificant, and the coefficient of management practices is only marginally significant in model (6). It can be calculated that a 1% increment in technology will push up the probability of investment by Chinese multinationals within the range of 20.36% - 43.63%. This suggests that a host country's technology is the most important factor in attracting Chinese multinationals' foreign takeovers. This is consistent with the results of Ramasamy et al. (2012) and shows that Chinese multinationals care more about the technology they can convert into commercially viable products and services rather than those kinds of strategic assets that may cost more time to learn, or that require human capital, or other capabilities in China, to complement these core strategic assets.

Models (1), (2), and (3) in Table 5.4, Panel B, present the components of *SA 3* over the time period 2005-2014. Similar to the results in Panel A, *technology'* is significantly correlated with the location-takeover choices of Chinese multinationals, while the coefficients of *brands'* are insignificant. A 1 % increase of *technology'* will raise the probability within the range of 17.51% to 21.36%,

implying the importance of the technology of a host country in attracting Chinese multinationals.

Models (4), (5), and (6) in Table 5.4, Panel B, indicate the sub-components of technology and brands in order to compare the empirical results with the literature. It is determined that patents and R&D play the more important and positive roles in location-takeover choices by Chinese multinationals, rather than the host country's high technology, which has an insignificant coefficient. This is in contrast to the results of Buckley et al. (2007b), which do not find the significant determinants of patents in Chinese outward FDI. However, my findings are consistent with the results found by Zhang and Roelfsema (2014) who prove the importance of technology intensity on Chinese outward FDI. In terms of brands' sub-components, Interbrand and Forbes, with the coefficient values of 1.1793 and 3.6031 respectively, have positive and significant effects on Chinese multinationals' location-takeover choices in overseas investment, while the coefficient of Trademarks is not significant. This means that Chinese firms are attracted to countries that have a higher number of brands listed in Interbrand and Forbes. They prefer to acquire internationally recognised brands to enrich their competitive advantages in operational business expansion. These empirical results of brands are consistent with the qualitative interpretation made by Backaler (2014).

Table 5. 4 Results for strategic assets components

To save space, I do not report control variables. Technology includes patent, high technology and R&D expense. Brands includes Forbes, trademark and Interbrand. Management practices includes people, operation and monitor. Robust standard errors are in parentheses. * , **, *** indicate that the coefficient is significant at the 10%, 5% and 1% level, respectively.

Panel A	Dependent Variable: Location-takeover choice								
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Estimation time period	2005-2014	2005-2014	2005-2014	2005-2014	2005-2014	2005-2014	2005-2014	2005-2014	2005-2014
Technology	0.4363***	0.4360***		0.4360***			0.2380**	0.2036**	
	(0.144)	(0.144)		(0.144)			(0.100)	(0.096)	
Brands	0.2324		0.2299		0.2299		0.1608		0.0773
	(0.187)		(0.182)		(0.182)		(0.124)		(0.118)
Management practices	0.4458	2.0131	2.1035			3.6222*			
	(2.491)	(2.037)	(2.358)			(1.963)			
Country-specific Fixed Effects	Yes	Yes	Yes			Yes	Yes	Yes	Yes
Number of firms	463	463	463	463	463	463	907	907	907
Number of Choices	21	21	21	21	21	21	50	50	50
Pseudo-R^2	0.2362	0.2356	0.2330	0.2356	0.2330	0.2324	0.3858	0.3856	0.3849
Log-likelihood	-1076.7	-1077.5	-1081.2	-1077.5	-1081.2	-1082.0	-2179.4	-2180.2	-2182.3
LR χ^2	372.54***	372.08***	382.92***	372.08***	382.92***	382.49***	2129.35***	2125.79***	2157.49***

Table 5.4 Results for strategic assets components (continued)

To save space, I do not report control variables. Technology' only contains patent and high technology. Brands' includes Trademark and Interbrand only. Robust standard errors are in parentheses. * , **, *** indicate that the coefficient is significant at the 10%, 5% and 1% level, respectively

Panel B	Dependent Variable: Location-takeover choice					
	(1)	(2)	(3)	(4)	(5)	(6)
Estimation time period	2005-2014	2005-2014	2005-2014	2005-2014	2005-2014	2005-2014
Technology'	0.2136*	0.1751*				
	(0.111)	(0.107)				
Brands'	0.1515		0.0773			
	(0.125)		(0.118)			
Patent				0.7419*		
				(0.400)		
High technology				0.3880		
				(0.353)		
R&D				3.2045***		
				(1.179)		
Interbrand					1.1793***	
					(0.402)	
Trademark					0.2432	0.2674
					(0.201)	(0.205)
Forbes						3.6031*
						(1.941)
Country-specific Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Number of firms	907	907	907	907	907	907
Number of Choices	50	50	50	50	50	50
Pseudo-R^2	0.3855	0.3853	0.3849	0.3870	0.3865	0.3851
Log-likelihood	-2180.4	-2181.1	-2182.3	-2175.2	-2176.8	-2181.8
LR χ^2	2140.12***	2136.22***	2157.49***	2121.76***	2154.34***	2151.58***

5.5.3 Firm heterogeneity and location-takeover choices

The conditional logit estimates are used to examine the impacts of firm heterogeneity on location-takeover choices by Chinese multinationals. Table 5.5 presents the estimation results of three aspects of firm heterogeneity: firm size and firm R&D expenditure; and government involvement. Models (1) and (2) include the interaction term between SA 2 and firm size and R&D expense respectively to test whether the strategic assets have significantly different effects on the location-takeover choices made by Chinese multinationals with different levels of firm size and R&D expense. As I can see, the coefficient of SA 2* Firm size is statistically negative but insignificant, which rejects hypothesis 5.2. The coefficient of interaction term between SA 2 and R&D expense is positive and significant in model (4) with the value of 0.0035, implying that Chinese firms with a higher value of R&D expenditure prefer outward M&As that are motivated by strategic assets. Firms with higher technological capabilities will maximise profits or benefits by combining their own R&D resources with location bound advantages in the host country. It is explained that R&D expenditure for multinational firms from a developing country, like China, is still important for international investment motivated by strategic assets because a firm still needs its prior R&D efforts and capability to absorb external technology and skills from the target company after takeover (Wang et al., 2012).

Excluding the impacts of firm size and firm R&D expenditure on location-takeover choices, I also examine the impact of government involvement in outward M&As by Chinese multinationals motivated by strategic assets . As shown above, I construct three proxies (*State patronage, Stateown1,* and *Stateown2*) to measure the degree of government involvement in Chinese multinationals. Each proxy of state involvement is combined with SA 2, which

is presented in Table 5.5 columns (3), (4), and (5). The firms with a higher degree of government involvement are more likely to invest in a host country with a higher level of strategic assets, which supports hypothesis 5.4. There is a strategic predisposition on the part of the Chinese government in targeting certain countries. Government supported local firms have the privilege of access to natural resources and other inputs, low cost capital, and subsidies in the home country, which offset the disadvantages they may face in the foreign market (Aggarwal and Agmon, 1990). Buckley et al. (2007b) state that the Chinese government and its institutions promote the motivations and abilities of firms and encourage them to operate businesses abroad.

In order to further investigate what kind of strategic assets motivate government involved firms, I empirically examine the effects of the strategic assets of a host country on attracting Chinese multinationals' location-takeover choices across firms with different levels of government involvement, as presented in Table 5.6. The coefficients of the interaction terms between technology and governmental involvement indices are statistically positive and significant, while the coefficients of the interaction terms between management practices and government involvement indices are negative and statistically significant. However, the coefficients of the interaction term between brands and government involvement indices are insignificant. This shows that to improve technological competences, government related firms are more attracted to strategic investments in 'hard' technology and innovation in foreign locations than are private firms. However, government supported companies are comparatively not much less attracted to "soft" managerial quality. Ramasamy et al. (2012) argue that Chinese firms are very pragmatic in the sense that bringing core research back home need not necessarily increase their core competencies if the human capital and other capacities in China are unable to add value to this core technology.

Table 5. 5 Results for heterogeneous firms

SA2 includes technology and brands only. Robust standard errors are in parentheses. * , **, *** indicate that the coefficient is significant at the 10%, 5% and 1% level, respectively

	Dependent Variable: Location-takeover choices				
	(1)	(2)	(3)	(4)	(5)
Estimation time period	2005-2014	2005-2014	2005-2014	2005-2014	2005-2014
SA 2	0.2614*	0.1899**	0.1908**	0.1862**	0.1812**
	(0.136)	(0.088)	(0.088)	(0.087)	(0.087)
SA 2*Firm size	-0.0022				
	(0.005)				
SA 2*R&D expense		0.0035***			
		(0.001)			
SA 2*State patronage			0.0209		
			(0.014)		
SA 2*Stateown1				0.0516**	
				(0.022)	
SA 2*Stateown2					0.0425***
					(0.013)
GDP	-1.3424	-0.6391	-1.5071	-1.6602	-1.7362
	(2.384)	(2.442)	(2.387)	(2.381)	(2.387)
GDP per capita	1.3030	1.0552	1.4131	1.4333	1.5143
	(2.865)	(2.890)	(2.864)	(2.857)	(2.862)
Inflation	-2.1657	-2.3158	-2.0590	-2.0798	-2.0774
	(2.786)	(2.755)	(2.794)	(2.795)	(2.799)
Exchange rate	1.9815**	2.2926**	1.8574*	1.8062*	1.7585*
	(0.957)	(0.988)	(0.953)	(0.951)	(0.949)
Resources	-0.4683**	-0.3750	-0.4905**	-0.5082**	-0.5159**
	(0.232)	(0.234)	(0.232)	(0.232)	(0.232)
Country-specific Fixed Effects	Yes	Yes	Yes	Yes	Yes
Number of firms	907	907	907	907	907
Number of Choices	50	50	50	50	50
Pseudo-R^2	0.3858	0.3868	0.3861	0.3866	0.3873
Log-likelihood	-2179.4	-2175.7	-2178.4	-2176.6	-2174.0
LR χ^2	2332.29***	2165.00***	2155.64***	2148.79***	2156.68***

.

Table 5. 6 Results for government involvement and components of strategic assets

In order to save space, I do not report technology, brands, management practice, and control variables. I report interaction terms only. Robust standard errors are in parentheses. * , **, *** indicate that the coefficient is significant at the 10%, 5% and 1% level, respectively

	Dependent Variable: Location-takeover choices								
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Estimation time period	2005-2014	2005-2014	2005-2014	2005-2014	2005-2014	2005-2014	2005-2014	2005-2014	2005-2014
MP*state patronage	-0.1183***								
	(0.035)								
Technology*state patronage		0.0499**							
		(0.020)							
Brands*state patronage			-0.0418						
			(0.034)						
MP*stateown2				-0.0816***					
				(0.030)					
Technology*stateown2					0.0797***				
					(0.018)				
Brands*stateown2						-0.0071			
						(0.032)			
MP*stateown1							-0.1386**		
							(0.055)		
Technology*stateown1								0.1130***	
								(0.031)	

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Table 5.6 Results for government involvement and components of strategic assets (continued)

	Dependent Variable: Location-takeover choices								
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Estimation time period	2005-2014	2005-2014	2005-2014	2005-2014	2005-2014	2005-2014	2005-2014	2005-2014	2005-2014
Brands*stateown1									-0.0574
									(0.053)
Country-specific Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Number of firms	463	907	907	463	907	907	463	907	907
Number of Choices	21	50	50	21	50	50	21	50	50
Pseudo-R^2	0.2368	0.3865	0.3851	0.2355	0.3884	0.3850	0.2352	0.3876	0.3851
Log-likelihood	-1075.8	-2176.9	-2181.6	-1077.6	-2169.9	-2182.3	-1078.1	-2172.9	-2181.8
LR χ^2	371.87***	2149.62***	2179.45***	367.44***	2161.73***	2174.63***	374.28***	2154.75***	2178.67***

5.5.4 Robustness check

There is an assumption of the independence of irrelevant alternatives (IIA) when I apply the conditional logit model to estimate Chinese multinationals' location-takeover choices. Otherwise, the empirical results reported above could be biased if the assumption is violated (Du et al., 2008). The IIA assumption means that the inclusion of other alternatives would not affect the choice between two alternatives. Considering the uneven distribution of Chinese multinationals' outward M&As, I follow Blonigen et al. (2005) and Du et al. (2008) to carry out the robustness check of my main results by focusing on two-subsamples from my data set: (1) I exclude the outward M&A cases located in Hong Kong in my sample and delete the location choice of Hong Kong; (2) I exclude the observations of investments in the US and exclude the US as a location choice variable.

Table 5.7 summarises the main results of the regressions of the sub-samples that exclude Hong Kong or United States to test the robustness of the main results on economic institutions. It is determined that the results for the strategic asset indices (*SA 1, SA 2, and SA 3*) have the same qualitative results as in my main regression (Table 5.3). Actually, the coefficients of each measure do not change much, but the significant level of *SA 3* is slightly increased from 5% to 10%. Overall, my main results on economic institutions are robust to the reduction of the location alternatives.

Table 5. 7 Results for strategic assets for the sample without Hong Kong and United States

To save space, I do not report control variables in regressions. SA1 includes technology, brands and management practices. SA2 includes technology and brands only. SA3 includes technology and brands with fewer components. Robust standard errors are in parentheses. * , **, *** indicate that the coefficient is significant at the 10%, 5% and 1% level, respectively.

	Dependent Variable: Location-takeover choice					
	(1)	(2)	(3)	(4)	(5)	(6)
	Without Hong Kong			Without United States		
Estimation time period	2005-2014	2005-2014	2005-2014	2005-2014	2005-2014	2005-2014
SA 1	0.3578***			0.3998***		
	(0.117)			(0.142)		
SA 2		0.2160**			0.2053**	
		(0.096)			(0.092)	
SA 3			0.1834*			0.1839*
			(0.103)			(0.101)
Country-specific Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
N	9723	26803	26803	7260	39543	39543
Number of firms	463	547	547	363	807	807
Number of Choices	21	49	49	20	49	49
Pseudo-R^2	0.2359	0.2617	0.2612	0.2306	0.4059	0.4057
Log-likelihood	-1077.0	-1571.7	-1572.7	-836.7	-1865.8	-1866.6
LR χ^2	372.16***	822.26***	829.41***	286.75***	2549.82***	2548.17***

5.6 Conclusion and implications

China offers an insightful experience because of its unique institutional environment. The acquisition of strategic assets not only helps to increase the capacity to compete in global markets, but also to maintain market share at home. I attempt to formally model the location-takeover choices of Chinese multinationals based on the various perspectives of strategic assets and related firm heterogeneity. My motivation is to test the extent to which Chinese multinationals are attracted by the strategic assets of a host country, and to specify the detailed information on strategic asset motivations for location-takeover choices. I not only investigate the empirical effects of the host country's strategic assets but also test the influence of firm heterogeneity on motivating Chinese multinationals' strategic asset seeking cross-border M&As. This is done within a conditional logit model using a sample set of cross-border M&A cases by Chinese listed firms from 2000-2014.

In terms of my main strategic asset indices, I find that the composite strategic asset indices *SA 1*, *SA 2,* and *SA 3* have statistically and significantly positive effects on the location-takeover choices made by Chinese multinationals over the period 2005-2014. I further investigate the components of strategic asset indices on my main regressions. Viewed together, I find that among three key strategic assets (advanced technology, brand assets, and managerial quality), China's public firms, in particular those SOEs, are most attracted by hard technology. Branding proxies are less important.

The sub-components of technology and brands are also examined. The patents and R&D expenses of a host country are more important in attracting Chinese investors than high technology, which has insignificant coefficients. The number of brands listed in Interbrand and Forbes are positively correlated with the

Chinese multinationals' location-takeover choices. However, the coefficient of trademarks is insignificant. Chinese firms prefer to acquire internationally recognised brands by outward M&As to enrich their competitive advantages in overseas markets and earn customers' trust in the domestic market (Backaler, 2014).

My analysis also provides evidence of firm heterogeneity in Chinese multinationals' response to strategic assets of a host country. Firms of different sizes are not sensitive to the strategic assets of a host country. Firms with higher R&D expenditure are more sensitive to the strategic asset intensity of a host country compared to those with less R&D expenditure. The existing R&D capability is sufficient to add value to the core technology that is brought back from host countries (Ramasamy et al., 2012). The firms with a higher degree of government involvement are more likely to pursue a higher level of strategic assets in the host country. However, they care more about 'hard' technology than soft ones, like brands and management practices. This shows that Chinese firms are very pragmatic simply because international brands are easily transferred across-borders. The interaction term of the proxy for management practices and government supported firms are consistently negative, at 1% significant level, indicating that the government supported firms are not attracted to good management quality, and their location-takeover choices have even been negatively affected by the proxy of management practices. It is well known that SOEs enjoy preferential resources to finance high-risk and long-term investments, but they lack the managerial capability that enables a firm to identify catch-up opportunities and to better utilize its resources to capture innovation opportunities. Bloom and Van Reenen (2007) emphasize the importance of good management in determining firm productivity. Bloom and Van Reenen (2010) point out that government-owned firms are typically

managed extremely badly and hence usually return low productivity. Thus, to enhance their innovation performance and future global competitiveness, China's government support for companies probably needs to shift their strategic asset acquisitions to seek better management practices.

I also add control variables and country-specific fixed effects in the regressions. Exchange rate is found to be a positive and significant factor, indicating that reduced investment costs are important in location-takeover choices by Chinese multinationals. Moreover, I find that some country-specific variables, controlled as fixed effects, are significant. This means that excluding the determinants investigated in this article, there are other factors influencing the location-takeover choices of Chinese multinationals. For example, Kang and Jiang (2012) show that institutional factors are more important in determining the FDI location choices of Chinese multinationals in comparison with traditional factors. With respect to further work, an issue requiring investigation, possibly of institutional factors, is whether or not the institutional factors of a host country attract the location-takeover choices made by Chinese multinationals.

Chapter 6. Conclusion

6.1 Summary of findings

This thesis presents the empirical evidence on cross-border M&As made by Chinese multinational enterprises including inward M&As and outward M&As. Firstly, in chapter 3, I use cross-section firm level data to examine the effects of political connections on financial constraints and stock returns of Chinese firms involved in outward M&As. It finds that Chinese firms are more likely to have sensitivity of investment to cash flow, especially for private firms. An alternative measure of financial constraints (tangibility), and a number of control variables are used in regressions. However, political connections can help firms to access state-owned bank loans, obtain subsidies, and gain preferential treatment from government (Charumilind et al., 2006), which empirically mitigates financial constraints faced by the firms. The empirical results show that the financial constrained firms have lower stock returns compared with those firms with less financial constraints when there is an announcement of outward M&As by Chinese listed firms.

Secondly, while a number of studies have examined the consequences of outward M&As by Chinese enterprises, there is little evidence about the effects of foreign acquisitions on target firms in China. Utilising unique and more recent data containing pre-acquisition and post-acquisition information of Chinese target firms acquired by foreign firms over the period of 1994-2011, I find that Chinese firms, especially private and foreign owned firms, face financial constraints before the foreign acquisitions. This means that foreign acquisitions provide target firms a better way to access both domestic and international capital markets and the possibility to gain capital inflows from parent firms (Stein, 2003). Moreover, based on my empirical results, since foreign

acquisitions release the target firms' financial constraints, they lead to an improvement in R&D expenditure and productivity of the target firms post acquisition as well. The target firms are able to achieve higher levels of skilled human capital and higher growth rate investment to increase productivity once the financial constraints have been released following the foreign acquisition.

Thirdly, in the examination of strategic asset motivated outward M&As by Chinese multinational enterprises, by constructing composite strategic asset indices, I find that a host country's strategic assets are statistically and positively associated with Chinese multinational enterprises' location-takeover choices during the period 2005-2014. I also examined the components of strategic asset indices (technology, brands, management practice) and find that technology is the most important factor in attracting Chinese firms' outward M&As, rather than brands and management practices. Chinese multinational enterprises gain the latest technology from the overseas market through outward M&As to increase their capacity to compete in the international market (Deng, 2009). Moreover, I find that strategic asset motivated outward M&As vary with firm heterogeneity. Firms of different sizes are not sensitive to the host country's strategic assets, but firms with higher R&D expenditure are more sensitive to the host country's strategic asset intensity. Firms with a higher degree of government involvement prefer to invest in a host country with a higher degree of strategic assets, but they prefer 'hard' technology, like innovation and advanced skills, rather than 'soft' ones, like brands and management practices. This indicates that Chinese firms are pragmatic and prefer the kinds of strategic assets that can be transferred across-borders (Ramasamy et al., 2012).

6.2 Implications and future research

I investigate the effects of political connections on financial constraints of firms

involved in outward M&As in China, which shows the importance of political connections for Chinese firms to access key resources and inputs in outward M&As because resources in the domestic market are misallocated and are still controlled by government agencies. These findings have important implications for managers who wish to expand their business into foreign companies by helping them to understand how domestic resources and other factors influence the process, and the success, of internationalisation. My empirical findings identify the impacts of political connections and government policies on firms' international expansion. Although politically connected firms have advantages in terms of access to capital resources from state-owned banks, these kinds of firms should carefully consider how they can succeed in their internationalisation in the context of government involvement, and based on the consideration that such government involvement can result in weak investments and a higher political sensitiveness and public worries in the host country (Zhang et al., 2011). Future research should explore further how Chinese firms can integrate their domestic resources with foreign target companies' resources after the outward M&As with the purpose of success of internationalisation.

Furthermore, my findings show that despite the financial reforms in China during the past decades, Chinese firms, especially non-state owned enterprises, still face financial constraints because of the less developed domestic market, weak institutions, and poor government systems (Allen et al., 2005). However, my findings indicate that the foreign investment and domestic market openness carried out in China can release financial constraints faced by firms, which will improve the target firms' R&D expenditure and productivity further. Based on the institutional view, the Chinese government should pay more attention to the reform of the financial sector and governmental agencies than has been carried out thus far. Deep reform of regulatory institutions and the financial system to

achieve effective resource distribution is important for both private firms and state owned firms. The government should encourage foreign investors to use foreign acquisitions as an effective entry mode into China. The encouragement of inward M&As' development is an important vehicle for Chinese target firms to improve innovation and productivity.

Finally, my findings indicate that Chinese multinational enterprises are attracted by the strategic assets of host countries. However, they care more about 'hard' technology rather than 'soft', especially the government involved firms. Government involved firms, such as state-owned firms, lack the knowledge of management practices which may help them to uncover further investment opportunities and to improve productivity (Bloom and Van Reenen, 2010). This implies that these kinds of firms should pay more attention to their international strategies to seek better management practices. The findings in the thesis are tested with control variables that are expected to determine the location-takeover choices by Chinese multinational enterprises. Although I have included a variety of dominant factors that determine the location-takeover choices, there remain other factors that are relevant to explore, such as institutional factors. That is, future research can explore whether, or not, institutional factors of a host country influence location-takeover choices of Chinese multinational enterprises.

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