



International Journal of Development and Sustainability

ISSN: 2186-8662 – www.isdsnet.com/ijds

Volume 7 Number 12 (2018): Pages 3002-3012

ISDS Article ID: IJDS18120501



Insufficient risk management of Chinese overseas industrial parks: Case of Ethiopia

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Abstract

Recent two decades witness China has invested a number of industrial parks overseas, especially in Africa. Although it has generated positive experiences, the negative outcomes and lessons to be learnt are also significant, as widely reported in media. A significant factor of such negative outcomes is the insufficient risk management at the planning and developing stages of Chinese overseas industrial parks. Taking Ethiopia as a case, this study examines the major risks experienced by Chinese overseas industrial parks. These include three main dimensions: administrative risks, business risks, and institutional risks, which all have more specific and detailed aspects. The main reasons of the risks experienced by Chinese overseas industrial parks are also outlined, which mainly include institutional factors, cultural reasons, and China's relatively insufficient experience in internationalization. A few recommendations are provided based on the above analysis.

Keywords: Industrial Parks; China; Risk Management; Ethiopia

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Cite this article as: Liu, S. and Jiang, X. (2018), "Insufficient risk management of Chinese overseas industrial parks: case of Ethiopia", *International Journal of Development and Sustainability*, Vol. 7 No. 12, pp. 3002-3012.

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1. Introduction

The past two decades witness the development and expansion of Chinese overseas industrial parks. For example, Zeng et al. (2018, p2) report that up to 2018, there are 81 Chinese overseas industrial parks with notable scale and influence in 45 countries. The development and expansion of Chinese overseas industrial parks are more significant under the 'Belt and Road' strategy, as 45 Chinese overseas industrial parks are located alongside the 'Belt and Road', which counts over half of the above-mentioned 81 Chinese overseas industrial parks (Zeng et al., 2018, p2-3). The development of Chinese overseas industrial parks obtain support from financial institutions and developmental agencies. For example, Wang (2018) reports that taking China Economic Trade Cooperation Area in Zambia as an example, Export-Import Bank of China, as one of the most influential financial institutions, has provided USD 83 million as loans to support this industrial park. Similarly, Yang (2018) introduces that the China-Africa Development Fund has invested Chinese overseas industrial parks in three countries: Egypt, Nigeria, and South Africa.

Although the development and expansion of Chinese overseas industrial parks demonstrate a rapid progress and significant positive impact, it is nevertheless essential to notice the challenges. In the past years, the negative news of Chinese overseas industrial parks, which significantly reduce the sustainability of Chinese overseas industrial parks, can be noticed in public media and research publications (e.g. Yan, 2017, Zeng, et al., 2018). For example, Chinese overseas industrial parks have experienced a number of industrial actions, which have resulted in significant negative impact on their sustainability and profitability. A large number of such negative news are significantly associated with insufficient risk management.

The aim of this research is to use Chinese overseas industrial parks in Ethiopia as a case to study what are the main risks experienced by Chinese overseas industrial parks, the reasons of these risks, and how insufficient risk management leads to negative impact. Recommendations are also provided based on analysis. It is expected that some implications can be generated and applied for China and other countries. Before proceeding to the discussion, this paper reviews relevant literature and defines essential concepts.

2. Literature review and methodology

2.1. Industrial parks

The definition and scope of industrial park vary. As per Cambridge Dictionary, an industrial park is defined as 'a special area on the edge of a town where there are a lot of factories and businesses', and in the business context it is simply equalized as an 'industrial estate'¹. However, an industrial park does not only refer to industrial production or manufacturing. For example, it is widely accepted that trade zones, science parks and business clusters are also within the category of industrial parks. In addition, with the urbanization process and the development of transport, an industrial park is not necessarily located on the edge of a town (Sosnovskikh, 2017). Nevertheless, scholars such as Geng and Zhao (2009) and Ratinho and Henriques (2010)

¹ <https://dictionary.cambridge.org/dictionary/english/industrial-park>, accessed 25 November 2018

explain that industrial parks are still widely located in urban suburbs or far away from residential areas of cities as to reduce negative environmental impact on urban areas.

From the nature and function of industrial parks, Bale (1974, p33) defines that 'an industrial estate is a grouping of industrial establishments provided certain common services and utilities laid down in advance of demand, and established as a result of enterprise and planning by an independent organization'. This definition has been expanded by United Nations Industrial Development Organization (UNIDO), which refers an industrial estate as 'a tract of land developed and subdivided into plots according to a comprehensive plan with provision for roads, transport and public utilities with or without built-up (advance) factories, sometimes with common facilities and sometimes without them, for the use of a community of industrialist' (UNIDO, 1978, p6). In addition, in this definition, 'comprehensive plan' not only means the physical planning, but also refers to the estate's immediate economic and social environment, as well as the estate's role in relation to the regional or urban development plan (UNIDO, 1978). This definition has been widely accepted in the practice of industrial estate planning, development and management. To ensure the proper function of an industrial park, it is understood that usually a management organization should be established to enforce essential restrictions within the confines of the industrial park (Murphy and Baldwin, 1959).

Based on the above literature review, in the paper, a 'Chinese oversea industrial park' is defined as a tract of land of industrial establishments out of the territory of China, and (primarily) invested or managed by Chinese investor(s). Chinese industrial establishments usually have significant influences in a Chinese oversea industrial park. For example, in a Chinese oversea industrial park, the leading or dominant firm is often a firm invested and/or operated by Chinese investor(s) and/or operators.

2.2. Risk management

The definition of risk varies from context to context. A recognized academic definition of risk in non-technical context is 'situations in which it is possible but not certain that some undesirable event will occur'. International Organization of Standardization (2009, p1) defines risks as 'effect of uncertainty on objectives'. This is an expansion of the scope of risk, as it extends the term to refer both positive and negative effects of uncertainty.

From the perspective of project management, risk is defined as 'an uncertain event or condition that, if it occurs, has a positive or negative effect on one or more project objectives...Project risk has its origins in the uncertainty present in all projects' (Project Management Institute, 2013, p310). Given the judgement of and attitude to uncertainty, risks are further segmented into known risks and unknown risks. 'Known risks are those that have been identified and analyzed, making it possible to plan responses for those risks...Unknown risks cannot be managed proactively and therefore may be assigned a management reserve' (Project Management Institute, 2013, p310).

Considering that industrial parks are often developed as projects, it is suitable to use the definition of risk in the context of project management. Risk management is therefore the process to plan, analyze and execute relevant activities to identify, analyze, and control risks, which is an important component of project management, especially in complex and long-term projects such as industrial park development. As shown in

the following sections, risk management in Chinese industrial parks in Ethiopia is insufficient, which has led to a number of negative effects on these industrial parks.

2.3. Methodology

This paper uses case study as the main methodology. With the examination of the case, it is able to obtain findings for the specific countries involved in the case. In addition, given suitable consideration of variations of different countries, the findings of this case may also be extended to other contexts. Practical implications may also be generated.

This study obtains relevant information mainly from second-hand materials such as existing documents and publications. In comparison with first-hand data such as fieldwork and interviews, second-hand materials are usually not very down-to-earth. Future studies in this area may incorporate more first-hand data if available.

3. The case: Chinese industrial parks in Ethiopia

3.1. Brief introduction of Ethiopia

Federal Democratic Republic of Ethiopia (shortened as 'Ethiopia' in this paper) is located in the Horn of Africa, with a land occupation of around of 1,100,000 square kilometers (Central Intelligence Agency, 2018). Ethiopia is a member country of Common Market for Eastern and Southern Africa (COMESA). Therefore, Ethiopia also enjoys preferential market access to these countries.

Though Ethiopia is widely perceived as a country with low national income (e.g., World Bank 2017), its economy grows rapidly in the past decade. For example, the average growth rate of GDP in Ethiopia between 2003 and 2015 was around 10.8%. (China-Africa Capacity Cooperation Project, 2017, p4). The World Bank data shows that the GDP in Ethiopia was around current US dollars (USD) 80.56 billion.

Industrialization is officially promoted as a fundamental strategy of Ethiopia economic development. A few core principles of Ethiopian industrialization include: export-orientation, priority of labor-intensive industries, and attracting foreign investment (China-Africa Capacity Cooperation Project, 2017, P5). In comparison with many other African countries, Ethiopian industrialization is in a leading position. For example, with the estimated population of around 100 million as the second most-populous country in Africa, the Manufacturing Value Added in Ethiopia was near current USD 225.9 million¹. Ethiopia's international trade also increased significantly, with its merchandise exports from USD 903 million in 2005 to USD 3161 million in 2017, including USD 331 million were exported to China, its top trade partner².

Industrial parks play important roles in Ethiopian industrial strategies. For example, as outlined by Zhang et al. (2018), industrial parks prioritize industrialization in growth and transformation, increase the openness

¹ <https://stat.unido.org/database/MVA%202018,%20Manufacturing>, accessed 2 December 2018

² <http://unctadstat.unctad.org/CountryProfile/MaritimeProfile/en-GB/231/index.html>, accessed 2 December 2018

and attractiveness to FDI, and seek to replicate the successful experience in East Asia, particularly the good experience of industrial park development in China. Ethiopia's strong connection with China and its efforts to attract foreign investment in industrialization call for specific research on Chinese overseas industrial parks in Ethiopia.

3.2. Chinese overseas industrial parks in Ethiopia

Based on the definition in Section 2.1 of this paper, there are four Chinese overseas industrial parks in Ethiopia. These include: Eastern Industrial Park, Huajian Light Industry City, China Communications Construction-Arerti Industrial Park, and (Hunan-)Adama Industrial Park. Currently, China Communications Construction-Arerti Industrial Park and (Hunan-)Adama Industrial Park are still under construction (China-Africa Trade Research Centre, 2017; Zhang, 2018, p20). Therefore, in this paper, only Eastern Industrial Park and Huajian Light Industry City will be taken into consideration.

Eastern Industrial Park is the first industrial park in Ethiopia. It is located in Dukem, which is situated on the Addis Ababa-Djibouti highway and the Addis Ababa-Djibouti Port railway, 35 km southeast of Addis Ababa. 'Eastern Industrial Zone has the area of 5 square kilometers ...Six functional areas include the living area, business and trade area, industrial warehouse and storage, inland road area, the public infrastructure facilities area, and greenland¹. It has a 'one-stop service' administrative office building as well. 82 companies including 6 non-Chinese firms have invested a total of around USD 200 million in this industrial park (Zhang et al., 2018, p24)

Eastern Industrial Park is privately owned and managed by Chinese investor Jiangsu Qiyuan Group. 'Eastern Industrial Park focuses on export-oriented manufacturing and processing industries including textile, leather, agricultural products processing, metallurgy, building materials and mechanical & electrical equipment that are suitable for the market demand in Ethiopia and Africa' (Zhang et al., 2018, p23). It is widely believed as a good example of Chinese overseas industrial park, especially in the field of manufacturing.

Huajian Light Industry City is located in Addis Ababa, and its main industry is shoes garment. The planned investment is USD 1 billion, with a land occupation of near 140 hectares and construction area of around 1.6 million square meters (Zhang, 2018). The construction of Huajian Light Industry City started in April 2015, and it is partially operational in 2018. The construction of Huajian Light Industry City is expected to complete in 2020.

Huajian Light Industry City is invested and managed by Chinese private investor Huajian Group. Established in 1996, Huajian Group's headquarter is in Guangdong Province, China. The Group is specialized in the production of medium-high-grade women's leather shoes. Ethiopia is one of its production bases. Huajian Light Industry City is the second attempt of the Group's expansion in Africa. The first attempt was in 2011, when the Group established the International Shoes City within the Eastern Industrial Park. From the start of construction, it only took 3 months to begin production and increase the exports of local leather products by 57%, creating the so-called 'Huajian speed' (Zheng, 2017).

¹ Eastern Industrial Zone homepage <http://e-eiz.com/planning.php?lg=en>, accessed 2 December 2018

Although Chinese industrial parks in Ethiopia have made significant achievements and contributions, they have experienced a number of problems, especially unexpected risks. These have demonstrated their insufficient risk management at different stages. The next section will introduce the main risks experienced by Chinese industrial parks in Ethiopia, and analyze the core reasons of the insufficient risk management of these industrial parks.

4. Discussion

4.1. Risks experienced by Chinese industrial parks in Ethiopia

Throughout the past decade, Chinese industrial parks have experienced different risks in Ethiopia, which can be classified into political risks, business risks, and institutional risks. These three types of risks are discussed in the following sub-sections.

4.1.1. Political risks

Political risks include three major components. The first one is the instability of political power and governance. Although the Ethiopian People's Revolutionary Democratic Front has successfully obtained and retained its power since early 1990s, the multiparty elections have led to significant instabilities. Such instabilities resulted in a number of risks to Chinese industrial parks in Ethiopia, for example, planned official support may be delayed or temporarily unavailable. This is particularly the situation because the Ethiopian federal government and each State member both have legislative, executive and judicial powers. They may have conflict interest and complex political arrangements, which exacerbate the risks for Chinese industrial parks. For example, as noticed by Zhao (2018), as Eastern Industrial Park is located in Oromia region, and the privileges of federal level Industrial Park Proclamation may not be easily implemented in practice.

The second easily perceived political risk is public security problem. Although Ethiopia has generally better public security situation than some other countries in Africa, violent actions and crimes on oversea investors are still sometimes reported. Public security problem in Ethiopia is also associated with political unrest, for example, in 2016 and 2018, the federal government has declared state emergencies in response to public security problems linked with political unrest. These state emergencies have negatively affected the Chinese industrial parks in Ethiopia.

The third political risk is the limitation in administrative capacity. Zhang et al. (2018, p54-p55) point out that '...the organization capacity of EIC (Ethiopian Investment Commission) in terms of number of qualified human resources, motivation of staffs, and organizational structure is very limited. EIC has limited capacity to design the right regulation, directives and policy incentives for effective implementation of IPD (industrial park development)'. That somewhat explains why Chinese investors often need to wait a long time before obtaining essential permissions.

4.1.2. Business risks

There is a range of business risks which have been experienced by Chinese industrial parks in Ethiopia. The first one is the investment & funding. Unlike the situation in China where investors have access to more advanced financial system and stronger official financial support, Chinese industrial parks in have encountered significant problems in funding. For example, as Zhao (2018) estimated, the initial phase of Eastern Industrial Park invested around USD 200 million. The investor had to sell some of its domestic properties in China to keep the cash flow to operate the oversea industrial park. Relevant restrictions on foreign exchange exacerbates the risk of insufficient investment & funding.

The second business risk is the land obtaining and usage. Both Eastern Industrial Park and Huajian Light Industry City have experienced risks of unable to obtain suitable and sufficient land as planned, or unable to use the obtained land as proposed.

The third business risk is about the production. Due to the limited development of local infrastructure, the production and other business activities were significantly affected. For example, the electricity supply in Ethiopia including the Chinese industrial parks are not stable and power-off is usual. Such situation is not widely seen in China and therefore often affects Chinese industrial parks in Ethiopia in uncertain manners.

Although Ethiopia has a number of comparative advantages in relations to supply chain and market access, the high costs of logistics may erode the comparative advantages. This is especially noticeable for Chinese industrial parks in Ethiopia, which have a strong focus on textile and garment export, and therefore a large proportion of supply chain and market access is related to raw materials and components.

4.1.3. Institutional risks

Chinese industrial parks in Ethiopia have experienced institutional risks. At formal institutional level, Chinese industrial park investors have experienced various risks due to their uncertainties about formal institutions such as the local labour regulations and environmental regulations. For example, some local employees initiated a local trade union within Huajian Group, which was refused by the investor and that caused a strike. Farmers whose land has been earmarked by the Eastern Industrial Park are frustrated¹.

At informal institutional level, the risks were also experienced by Chinese industrial parks in Ethiopia. For example, in Ethiopia, over-time working is not widely accepted or honored as in China, and disputes over working hours and compensation packages between Chinese investors and local employees in Chinese industrial parks are reported in public media. Strictly enforced in-house disciplines also result in informal conflicts between investors and local employees.

The above-mentioned risks experienced by Chinese industrial parks in Ethiopia, however, if with suitable risk management, may be avoided or properly controlled in order to minimize their negative effects. The next sub-section will analyze the reasons of insufficient risk management in Chinese industrial parks in Ethiopia.

¹ "Expansion of Ethiopia's first industrial park reopens old wounds", <https://www.theeastafrican.co.ke/business/Expansion-Ethiopia-first-industrial-park-/2560-4287800-1bks3dz/index.html>, accessed 2 December 2018

4.2. Factor analysis

There is a number of factors of insufficient risk management in Chinese industrial parks in Ethiopia. This subsection analyzes these factors through three perspectives: institutional factors, cultural factors, and path dependence.

4.2.1. Institutional reasons

Although owned and managed by private investors, Chinese industrial parks in Ethiopia significantly rely on state funding and support. For example, Eastern Industrial Park relies on the policy support from Chinese government, under which the Chinese Ministry of Commerce and the Chinese Ministry of Finance are expected to provide subsidies of 300 million Chinese Yuan (Zhang et al., 2018, p57). Private investors do not undertake responsibilities to minimize the risk of financial losses of such financial support from the state. There is not specific measurement indicator (such as return to investment) for the private investors in using the state financial support either. With such strong financial support from the government, the private investors do not have strong incentives to carefully and explicitly plan risk management, and provide sufficient resources for risk management activities.

Another institutional reason is the label of private investor. Although investors' private identity reduces the political and ideological concerns for Ethiopia when accepting investments from China to establish industrial parks in its territory, the label of private investors somewhat reduces Chinese industrial parks' negotiating power with Ethiopia authorities. In the negotiation on relevant policy and business issues, the power between investors and authorities is imbalanced, which is individual firm VS state. Such imbalanced status may lead to difficulties in analyzing and managing risks. The situation is usually different in Chinese overseas industrial parks when the investors are state-owned firms, which can somehow serve as representative of the Chinese government.

4.2.2. Cultural factors

One of the fundamental reasons of Chinese private investors to make decisions of investing in Chinese overseas industrial parks in Ethiopia is patriotism. For example, Huajian Group is proud of that its investment in Ethiopia was presented in a Chinese patriot movie (Zhang, 2018). In the Chinese traditional culture, being able to invest overseas is considered as an important sign of patriotism, as the simple logic is that enables to earn money from another country. In addition, it is perceived in the Chinese culture that having establishments overseas is a symbol of presence of Chinese identity. Chinese private investors are usually very proud of it. That also explains why many Chinese overseas industrial parks raise the national flag at the gates, even the industrial parks are privately owned and/or managed. Therefore, such investment decisions are not fully based on market factors. So, there is insufficient space for rigid risk management based on careful planning, analyzing, and proper preparing of uncertainties.

Another reason is that when Chinese private investors making decisions to invest in industrial parks in Ethiopia, they put strong emphasis on the passion of social responsibility. For example, representative of Lifan

Group, a Chinese private firm settled-in Eastern Industrial Park, is proud that local employees benefit not only higher-than-average wages, but also suitable production skills (Lyu et al., 2018). Similarly, Zhang (2018) points out that an important reason of Huajian Group's investment in Ethiopia is to share its leading experience to meet the needs of 'Belt and Road' countries, in response to China's promotion of 'go-global' and bring the Chinese resources to support the development of local economy alongside 'Belt and Road'. Such social responsibility-oriented investment decisions squeeze out spaces for explicit risk management based on market factors, such as profit-driven considerations.

4.2.3. Path dependence

2018 is the 40th anniversary of China's reform and opening-up. In comparison with other countries, especially the more developed countries, which has centuries of international experience, China's internationalization is still at an early phase. Therefore, Chinese investors, particularly private investors, have rather limited accumulation of experience to invest in other countries. This is especially the case for Chinese industrial parks in Ethiopia, which are long-term and complex business projects in a country which has significant differences from China in many aspects. For example, there is insufficient human resources who are familiar with the local context of Ethiopia. It is even more difficult to find Chinese national who can fluently speak Ethiopia local languages. Therefore, in comparison with more developed countries which has formalized paths to invest overseas, it is rather challenging to establish a suitable standardized path for Chinese investors to invest in industrial parks in other countries including Ethiopia. In this context, the difficulty in conducting suitable risk management could increase significantly.

Such situation increases the Chinese investors' intention to depend their established investment path based on the Chinese context, which has been demonstrated to be successful. For example, a widely known successful path in the Chinese context is to 'think how to fight against a tiger after jumped on it' (Chen, 2013), which means to start solving problems before a thorough planning. This pioneering spirit is considered as an important factor of China's success in its industrial parks such as its domestic special economic zones (UNIDO, 2015, p31), but simply depending on the successful path based on Chinese context significantly reduce the incentives and abilities of Chinese investors to conduct suitable risk management when investing in overseas industrial parks, including those in Ethiopia.

5. Conclusion

This paper adopts the case of Chinese industrial parks in Ethiopia to illustrate the risks experienced by Chinese overseas industrial parks. It argues that the risk management of China industrial parks in Ethiopia is insufficient, particularly at the stage of risk planning. Some reasons of these factors have been Analyzed.

Based on the discussion, it is able to provide some policy implications and recommendations. Firstly, at the planning stage, private investors of Chinese overseas industrial parks should be encouraged to produce suitable risk management plans before actually making investment decisions. For example, it would be useful for the Chinese government to set clear rules to ensure that a proper risk management plan of investing in overseas

industrial parks is a preliminary to apply for state subsidies. The risk management plan may need to be certified by a chartered professional project manager or risk analyst to ensure its quality. Secondly, Chinese oversea industrial park investors should provide with sufficient incentives and opportunities to accumulate and develop essential resources for its investment overseas, for example, applying preferential recruitment and compensation policies in hiring talents who have adequate knowledge of the destination countries. This could significantly reduce possible risks due to strong dependence on the Chinese path and neglecting the local context of the destination countries. Thirdly, relevant insurance products should be developed. Wang (2018) mentions that China Export Insurance and Credit Corporation (Sinasure) has already offered some insurance products to official investment in Chinese oversea industrial parks. However, there is still very limited insurance on private investment in Chinese oversea industrial parks, which is a potential market for service providers. Fourthly, since the advantage of collective bargaining power has been widely demonstrated in negotiations, future private investors of Chinese oversea industrial parks may consider a collaborative approach of investment when negotiating with the local authorities.

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