

The Empirical Test of Chinese OFDI and Overseas Corporate Business Performance—Based the Perspective of Investment Location and Access Mode

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Abstract

The choice of entry mode and investment location is the core of two strategic decisions for the corporate to carry out foreign direct investment. With corporate foreign direct investment from 2002 to 2010 as samples, which respectively examined the impact of the location choice on overseas companies survival rate from the cultural level and economic level. The results show: enterprises carry out the investment in the host market of small cultural distance, but large economy distance, foreign companies can obtain a higher survival rate; the survival rate of overseas companies through the entry mode of newly established enterprise is higher than overseas companies through the entry mode of the patterns of M&A.

Key words: OFDI; Regression analysis; Location selection; Entry mode

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INTRODUCTION

In 2012, the profound impact of the international financial crisis further appears, the tendency of the

world economic recovery is weakening significantly. European debt crisis continue to ferment and form global impact, the economic growth of developed economies is sharply declining, and emerging markets and developing countries' economies are in a difficult adjustment. As countries increase the response of policy efforts to the crisis and promote the growth, the European debt crisis is eased; a slight recovery in the world economy, but the annual growth rate is still significantly lower than last year (Zhao, 2007). International Monetary Fund (IMF) recently released the report of "World Economic Outlook" shows that the world economy grew by 3.2% in 2012, the growth rate 0.8 percent down compared to 2011 (Zhu, 2007). Of which the developed countries grew 1.2 percent, the emerging markets and developing countries increased by 5.1 percent, down by 0.4 and 1.3 percent respectively. In 2013, low growth but high-risk situation of the world economy has not fundamentally changed. Recovery in developed economies is diverged. The real estate market, the job market, and stock markets in US have been improved; the international competitiveness of the manufacturing sector partially is restored, but the mechanism of automatic spending cuts to some extent drags on economic growth. The stability of financial stability in Europe is enhanced, but the economy falls into a second recession, both of the fiscal consolidation and the resistances of integrated construction are increasing. Japanese government introduced a combined "abonomics" of fiscal stimulus, quantitative easing, economic growth strategy to boost the confidence of business and consumer, but the sustainability will be put to the test. The emerging markets and developing countries continue to grow moderately; industrial production in some emerging powers has slowed momentum. (Li & Ran, 2008).

With the effects of global economic growth in downturn, the high financial risk, and investment protectionism in a number of nations and other factors, the recovery tendency of the global foreign direct investment (FDI) suffers a setback in 2012. According to the United

Nations Conference on Trade and Development estimates that the amount of global FDI dropped by 18.3% in 2012, about 1.3 trillion US dollars, which fell again to low levels in 2009. Among them, FDI inflows of the developed countries is from \$807.8 billion in 2011 to \$548.9 billion, a sharp decline by as much as 32.1%; FDI inflows in developing countries fell from \$702.7 billion to \$680.4 billion, but it's first time more than developed countries. In 2013, Multinational Corporations slightly increase the confidence of foreign investment; International investment is expected to increase moderately, the UNCTAD report predicts that the global FDI scale is \$1.4 trillion. (Chang, 2011)

Chinese foreign investment flows exceeded \$100 billion for the first time in 2013; it continues to hold a title of the world's third largest foreign investor. In 2013, with the background of Chinese flows grew at 1.4% compared with last year's on the global foreign direct investment, Chinese foreign direct investment flows reached a record high of \$107.84 billion, with an increase of 22.8%, China is among the world's three major outward investors for two consecutive years (Ban & Ren, 2008). Specifically, in 2013 Chinese foreign direct investment has the following characteristics: First, the stock is two positions forward in the world's top, covering a wider range of investment countries. Second, in addition to the decline of foreign investment in Europe, there is varying degrees of growth in other areas. Third, the investment involves all sectors of national economy; five industries take up over eighty percent. Fourth, the diversification of M&A field, the amount of individual transaction to be the largest in history. Fifth, the steady growth of local enterprises to invest overseas, local enterprises accounted for three percent of non-financial investment in the stock for the first break. Sixth, foreign direct investment stock of non-financial is \$543.4 billion, state-owned enterprises accounted for 55.2%, non-state-owned enterprises accounted for 44.8%, which upgrades 4.6 percentage compared with last year. Seventh, the sales revenue of the overseas enterprises has achieved double-digit growth, providing outstanding contribution to the host country (Liu, Gao, & Chen, 2006). In 2013, Chinese non-financial overseas enterprises realized sales income is 1.4268 trillion US dollars, an increase of 14.5% over the previous year; Chinese overseas enterprises (including financial) paid a variety of total taxes amounted to \$37 billion for the country where the investment in 2013, an increase of 67%, at the end of 2013, the total number of employees of overseas enterprises reached 196.7 million, of which 96.7 million of foreign workers are directly employed, accounting for 49.2%; the employees from developed countries have 10.2 million, an increase of 1.3 million over the previous year. (Liu & Wang, 2010)

Despite Chinese huge foreign investment flows and stocks, however, in reality there is a lot of foreign direct investment in the disappearance every year, which also makes the related issues about the operating performance

of foreign investment become one of the most concern focal issues of academe and practice areas. Previous studies found that the survival rate is positive-going related with overseas business performance. In the international business studies, location selection and control of the level are also the most cores of strategic decisions for foreign direct investment, of which control of the level is directly reflected in selection of different entry modes, but at present the researches at home and abroad are lack of analysis against these two important strategic decisions at the same time. In this paper, taking the foreign direct investment of Chinese companies from 2002 to 2010 as samples, having tested the relationship of overseas companies survival rate with investment location choice and enter mode selection, and compared the location choice and access mode for explanation intensity of the performance differences of overseas companies (Wang, 2010). By this usual manner of the survival rate of foreign investment enterprises to test overseas corporate performance, and having examined overseas companies survival rate under the two enter modes of M&A and overseas new-building enterprises, so as to fill the shortcoming about the explanation of enterprise performance, which is lack of the background of China.

1. THEORETICAL STUDIES

Buckley put forwarded that there was no research of foreign direct investment's location selection decisions in the present existing international business studies in the research of 2007, particularly for the analysis between the national level characteristics of the host country and the impact of enterprise location selection (Zhang & Zhou, 2007). At present, the scholars in this field mainly carried out the research from two traditional perspectives: On the one hand is from the transaction cost theory and industrial organization economics, emphasizing that the corporate behavior is profitable and with the type of rent extraction; on the other hand is with the representative of operational stage theory of multinational enterprises (Uppsala internationalization), explaining the international behavior of companies from the perspective of organizational learning. Thus, we can mainly classify the influencing factors of international behavior of companies into two categories according to two perspectives, namely the factor of economy and cultural society. This paper will explore the economic factors, which are on the country level of host country how to affect regional selection of enterprises' foreign investment, because companies economic behavior is not happening under the isolated as a single social background, social or economic factor alone can not explain the enterprises' foreign investment behavior.

1.1 Economic Distance and Survival Rate of FDI

Ghemawat defined the economic distance as the gap at

the level of economic development between home and host countries, which reflects the difference in wealth and scale of economies between the two countries, mainly reflecting in aspects of factor costs, technical capacity, the level of infrastructure and others, economic distance is also considered as an important factor of affecting FDI business performance and failure (Wan, Peng, & Li, 2007). Economic distance has two cases, the first is that the economic development level of the host country is significantly higher than the home country; the second is the level of economic development of the host country is significantly lower than the mother country. In the developed countries' markets with higher level of economic development compared in the home country, which often have advanced technology, new business models, customers with strong purchasing power, well-trained staff, a mature industry chain etc. In today's knowledge-based global economy system, whether multinational corporations can obtain and maintain dynamic competitive advantage is an important factor to the success of corporations, and the higher level of economic development of the host country just can provide enterprises with access to a dynamic competitive advantage. The other hand of greater economic distance reflected in the host country with low level of economic development compared with the economy of home country. In less developed country markets, companies often can obtain lower-cost input factors (including natural resources and labor) to continue develop their own competitive advantages. In addition, in the country with low economic development level, its infrastructure, innovation ability and others are relatively backward, the opportunity of mutual benefit among enterprises in the industry is very little, which makes local enterprises which are long embedded in such situation are not as good as foreign investors in the performance of research and development, management experience, marketing and other aspects, which happens to provide more generous living space for subsidiaries of multinational companies, so multinationals can fully use their own technology and management advantages. (Chang, 2011)

In short, under situation of other conditions being equal, while carrying out the investment in host country which has great economic distance compared with home country, the companies are more likely to survive due to greater access to get strategic resources and the development and utilization of their competitive advantages, in contrast, while carrying out the investment in host country which has small economic distance compared with home country, due to both the enterprises are in similar development stage, multinational corporations do not have a significant competitive advantage, it is difficult to obtain complementary strategic resources and capabilities, but easily lead to resist and fight back of local governments and stakeholders.

1.2 The Relationship Between Entry Mode and FDI Survival Rate

In the process of entering the international market, the importance of the selection of entry mode for companies' competitive advantage has been extensively studied, but most of these studies had not been tested the performance. This article will study the two establishment modes of foreign direct investment—the effect of overseas M&A and overseas new-building enterprises for FDI survival rate. Multinational corporations can establish subsidiaries abroad in the form of overseas M&A and overseas new-building enterprises (Zhao & Li, 2009). Overseas new-building enterprises mean creating a new subsidiary from scratch, but this subsidiary can be a multinational owned, it also could be with overseas partners to jointly build. Overseas M&A represents purchasing the interests of all or a portion of an existing business, so that M&A is also possible some or all owned. After completing the deal of M&A, the business of M&A is facing the problem of integration of the target company. In view of the home and host countries differ in terms of values and institutional environment, multinational companies operating in the host country will face more challenges, such as during the process of multinational corporations transfer the organization or management practices and other intangible assets from the home country to host country will take on additional costs, such as additional training, supervision and control costs. However, the increasing degree in both modes of these extra costs overseas M&A and overseas new-building enterprises are different. For the entry mode of overseas M&A, because the employees of subsidiaries have been adapted to the former company's corporate culture and the concept of practice, which will make the multinational companies face higher transferring-costs, and with the distance increasing between the home and host countries, the more likely that there is a conflict between overseas subsidiaries and acquirers (Ou, 2007). However, for the entry mode of overseas new-building enterprises, the cost of habitual practice transferred from the home country to the host country will not increase by the generation of distance between each other, because of the entry mode of overseas new-building enterprises, the subsidiaries of multinational corporations are newly established in host country market, it would need to recruit new staff, because there is no presence of the original corporate culture and practices, new employees will quickly accept the new corporate culture.

1.3 The Effect Comparison of Location Selection and Entry Mode Selection on the Operating Performance

At present, scholars explored explanation mechanism about corporation performance differences from different perspectives. The researchers of industrial organization economics proposed that industrial structure is a main determinant factor of long-term profitability of the

enterprise; therefore industrial structure predicted that the corporation performance differences among industries is greater than the enterprises within the industry. On the contrary, the research based on the enterprise resource-based view proposed the enterprise resources and capabilities are the source of sustainable competitive advantage, so there is a greater difference in performance among companies, rather than inter-industry (Li et al., 2007) Although these studies effectively improve the understanding for the effecting factors for companies' performance, they always focused on different company units under the same country background, and taking country effect as an external objective factor. An overseas subsidiary can be seen as an integrated part of the parent company, its core resources transferred and delivered through the parent company. However, it also can be seen as the full use of local human and material resources, using local infrastructure to carry out the competition with local enterprises, and complying with local laws and regulation (Tian, 2010). From this perspective, the overseas subsidiaries are neither completely part of the parent company, nor entirely independent. Thus, the thorough understanding of internal mechanism of the differences' performance of overseas subsidiaries gives a profound guiding significance for strategic management theory and practice.

The research in the field of international business is emphasizing the importance of economic, political, social, cultural and institutional differences among countries; location selection is mainly for the location-specific advantages. Location-specific advantages are from different essential factor cost of inter-country (e.g., capital, labor and land), which can provide the opportunity of developing a competitive advantage for the enterprise.

2. THE DESIGN OF STUDY

2.1 Sample Characteristics and Data Sources

The data set of study sample was from 2002 to 2010 Chinese corporation foreign direct investment. According to research needs, this paper conducts the screening of research samples. (1) The average annual sales amount of overseas investment is carried out by Chinese foreign investment enterprises at least 50 million Yuan (that is, mainly medium-sized enterprises). (2) The enterprises have been officially registered at least 10 years before did FDI. (3) This paper also excludes those exited foreign investment, which are not because of failure. After screening, the study sample of this article finally contains 984 cases; these are across 48 countries or areas. All the required data of study is from the information putted on record of the Ministry of Commerce, the data set covers the ownership, operating period, type of industry, sales amount, total assets, the scale of foreign investment, FDI entry modes, investment deadlines and others of foreign-invested enterprises.

2.2 Variable Definition

2.2.1 The Dependent Variable

The dependent variable of the Paper is "foreign direct investment survival rate", the researchers are using dummy variables to measure FDI survival rate, that is, when the first three years of foreign investment ended, if the overseas company is still alive, then the value is 1, and otherwise is 0.

2.2.2 The Independent Variable

Economic Distance: This paper adopts five indicators to measure the economic distance between the host country and China, including the total cost (labor cost, water, energy, logistics, raw materials and land), the situation obtained of the required raw materials, the technology level, infrastructure and potential growth opportunities in markets. All these data can be obtained through the Ministry of Commerce, in addition to the total cost from the 0 to 9 score (China as the reference standard with score of 4), the other are marked by experts from 1 to 7 Score (China as the reference standard with score of 4).

Entry Mode: When deciding to conduct the foreign investment in the overseas markets, the first selection of multinationals is made by way of new-building enterprises (either independent investment new-building or the new joint venture with a local partner), or by way of overseas mergers and acquisitions. According to data provided by the Ministry of Commerce records, this study will be measured through two dummy variables into the mode: overseas mergers and acquisitions, if the mergers and acquisitions of cross-border companies investment are from local companies to obtain at least partial interest, then value is 1, otherwise is 0; new-building company, if the cross-border investment creates a new company from scratch (either in the form of wholly-owned or joint ventures), then value is 1, otherwise is 0.

2.2.3 Control Variables

The control variables in this study include ownership. As a transitional economy, Chinese state-owned enterprise is set up by the government-led, enjoying preferential policies and protection granted by the government in the process of operational management. However, the private enterprises have no such benefits. Through a dummy variable (if foreign investment enterprises are state-owned businesses, the value is 1, otherwise is 0) to measure the ownership of the parent company. At the same time, this article also controls registration date, firm size, and shape of the industry of the enterprise.

3. RESULTS AND DISCUSSION

3.1 Analysis of the Results

Table 1 lists the descriptive statistical analysis results of samples, reporting all the variables average value, standard deviation, and the corresponding quantity of

observations value involved in this study. From the correlation modulus matrix of explanatory variables, the correlation coefficients among all variables are less than 0.3, so there is no multicollinearity among variables. Data shows that the total sample of 984 foreign investments, there is about 30 percent of overseas subsidiaries fail after

three years, they are either forced out of the host country, or were acquired by other companies. In these foreign investments, there is approximately 65% establishing a subsidiary through the way of mergers and acquisitions, the remaining 35% is through investment way to new build enterprises in the host countries.

Table 1
The Descriptive Statistical Analysis and Coefficient Matrix

Variables	Average value	Standard deviation	The Correlated coefficient						
			Economic distance	Survival rate of subsidiaries	M & A	New-building company	Ownership	Age	Starting time of FDI
Economic distance	-1.964×10 ⁻⁸	0.9999999	1	-	-	-	-	-	-
Survival rate of subsidiaries	0.75248623	0.4852584	0.23	1	-	-	-	-	-
Investment way of M&A	0.71185762	0.4571265	0.00	-0.22	1	-	-	-	-
New-building company investment	0.30249871	0.4571506	-0.00	0.19	-0.99	1	-	-	-
Ownership	0.72186273	0.4215867	0.05	0.39	-0.04	0.04	1	-	-
Age	2.742825	1.425757	0.39	0.13	0.02	-0.03	0.06	1	-
Starting time of FDI	1.259548	0.450061	-0.21	-0.13	-0.01	0.02	-0.08	-0.08	1

3.2 The Inspection of Results

This paper is discussing the effect of investing areas selection and entry mode for the performance of overseas subsidiaries, the explanatory variables of overseas subsidiaries survival rate are 0-1 variables. Table 2 lists the Logistic multivariate statistics results of location selection; enter mode and three-year survival rate of FDI. Model 1 with the explanatory variables of economic distance and control variables, the coefficient of economic distance is 0.45; which is significantly at the level of 1% degree of confidence, namely that the greater of economic distance between the host country and the home country, the higher of the survival rate of overseas subsidiaries. Model 2 only with the explanatory variables and control variables of enter mode of M&A, the results of M&A coefficient is -1.29, the one is significantly at the level of 1% degree

of confidence means that when the enterprises enter the host country market, using the enter mode of M&A is significantly negative correlated with overseas subsidiaries survival rate. Model 3 only with the explanatory variables and control variables of enter mode of new-building enterprises investment, the results coefficient is 1.29, which is significantly at the level of 1% degree of confidence, that is when the enterprises enter into the market of host country, using the enter mode of new-building enterprises investment is significantly positive correlated with overseas subsidiaries survival rate. Model 4 with the explanatory variables of enterprise location and enter mode, the coefficient of economic distance is 0.49, M&A coefficient is -1.57, they are both significantly at 1% confidence level. It can be seen that the effect of enter mode for overseas subsidiaries survival rate is greater than location selection.

Table 2
The Location Selection and Multivariate Statistical Analysis of Enter Mode and Operating Performance

Variables	The Significant Analysis of Logistic Regression Model			
	Model 1	Model 2	Model 3	Model 4
Economic distance	0.45***	-	-	0.49***
M & A	-	-1.29***	-	-1.57***
New-building enterprise	-	-	1.29***	-
Ownership	2.01***	1.87***	1.87***	2.19***
Age	0.39	0.20***	0.20***	0.061
FDI time	-0.22	-0.53**	-0.53**	-0.21
Intercept	-0.19	0.28	0.28	0.84*
Chi-square	108.91	100.08	100.08	129.37
Log likelihood ratio	-209.14	-215.41	-215.41	-201.03
R2	0.20	0.18	0.18	0.24
Number of observations	984	984	984	984

Note. ***, **, * respectively represent the significant level of 1%, 5% and 10%.

CONCLUSION

The operating performance of foreign direct investment is the focal issue concerned by scholars and industrialists, the positivism of this paper examines the effects of location selection and enter mode for overseas operating performance that is the operating performance impact of two enter modes of overseas mergers and acquisitions and overseas new-building enterprises for overseas subsidiaries. The results show that: in the process of foreign direct investment, when carrying out the investment with the host country which has great economic distance with the home country, the operating performance of overseas subsidiaries is better. on the choice of enter mode, multinational investment company which enters the international market through overseas new-building enterprises, in contrast, the companies enter the host country through overseas mergers and acquisitions have poor operating performance. By location selection and enter mode to carried on the comparison of the interpretation of the overseas subsidiaries operating performance, we found that the selection of enter mode has a greater degree of influence on the overseas enterprises operational performance.

RECOMMENDATIONS

Hereby putting forward following recommendations of overseas investment: (1) When multinational companies conduct the foreign direct investment, do well of location selection is a critical step, companies must comprehensively analyze the economic distance between own and potential targets' host country. When selecting location, small economic distance is a foreign investment selection strategy faced by companies with greater risk, because of the similar economic development levels between the two countries, on the one hand, it is difficult for companies to obtain additional strategic assets in the host country, on the other hand, it is also difficult to find mutual complementary company in the local market. For these cross-border investment companies intended to go out of china, the developing countries and regions with lagging economic development are the best host country for Chinese enterprises to invest. (2) When companies establish subsidiaries abroad, adopting the way of overseas new-building enterprises, the operating performance of overseas subsidiaries is higher. On the one hand because of the unfamiliar overseas markets in the cross-border mergers and acquisitions, mergers and acquisitions companies are difficult to assess the true value of the target company, so it often produces out higher transaction premium; On the other hand, companies also need to face dilemma that it's difficult to transfer intangible assets to the host market, and generating high integration costs. Therefore, if Chinese foreign-invested enterprises want to achieve better business performance and less business risk, they should use the first choice of

the way of overseas new-building enterprises. (3) Location selection and enter mode are the two core strategies while enterprises conduct the foreign direct investment, but in real business situations, the choice of two strategies of location selection and entry mode may generate conflict, when enterprises in the selection should be preferred the entry mode of overseas new-building companies.

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