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Research on the Choice of Foreign Direct Investment Mode for Chinese Enterprises

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ABSTRACT

How to enter the host market is the core content of its strategic decision when an enterprise decides to invest overseas. Different entry modes mean different ownership and different investment commitments and risks. Therefore, under the background of economic globalization, it is of great theoretical and practical significance to study the choice of foreign direct investment mode of Chinese enterprises. In this paper, Chinese enterprises invested in German, British, French, Dutch and Italian from 2005 to 2014 are selected as the research samples and they were registered in the Ministry of Commerce. The least squares regression result shows that under the same conditions, the performance of subsidiaries which source from Cross-border mergers and acquisition is better than the subsidiaries which are set up in the way of greenfield investment. With time going on, all of the subsidiaries performance are improved. But the performance of subsidiary coming from greenfield investment is more obvious over time and during a long time, the difference between two investment modes becomes smaller and smaller. This indicates that we should consider the management, experience, the actual situations of enterprises and other factors at the same time to choose the appropriate entry model in order to achieve long-term development.

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1 Introduction

The economic globalization has already become the world trend. Outward foreign direct investment (OFDI) through the multinational corporations is becoming the basic access of communicating and connecting for different countries, thus making it become an important and hot research topic in the field of international economy. Mode selection is an important decision of OFDI. When a company decides to carry on the foreign direct investment, it must make two important strategic decisions at least. One is about the investment location and the other is the investment mode. The former shows which country we will invest, while the latter tells us that in which way we do want to carry out the investment, the greenfield investment or the cross-border M&A. Because the mode determines the relationship between Chinese enterprises and foreign enterprises, directly affecting the China enterprises' risk and profit. The choice of investment mode has been an important and active research field. Especially with the "One Belt and One Road" being put forward, more and more enterprises choose to invest overseas. In the year of 2016, China has invested in 164 countries and regions and the investment amount is up to 170.11 billion dollars, increasing by 44.1% than 2015. The amount of investment in the along countries of the "One Belt and One Road" is up to 14.53 billion dollars, which is the highest so far. Faced with such a huge number of foreign investment, we should be careful with the investment modes to insure our profits. Based on this, this paper selects major developed countries of the European Union as the sample to research the optimal foreign investment mode for Chinese enterprises, providing references and suggestions for the Chinese enterprises.

2 Literature Review

The mode of foreign direct investment is the third-biggest research field in the globalization

study (Werner S., 2002). Current researches of foreign direct investment mainly focus on different factors that will affect the entry mode.

The size of the enterprise. Generally speaking, the scale of enterprises is positively related to the control of entry mode. Because the larger an enterprise internationalization is, the stronger its ability of resource integration is. Therefore in order to reach a good performance level, the larger companies tend to choose a higher degree of control of the entry mode (Kogut & Singh, 1988; Barkema & Vermeulen, 1998).

R&D investment. Generally speaking, in order to protect the enterprise' right to the technology exclusive, more investment in the research and design, it will choose greenfield investment. Because the greenfield investment can reduce the risk of transmission and is conducive to the protection of enterprise technology and proprietary technology spillover suppression (Zaheer, S., 1997).

Cultural differences. The earliest discovered cultural differences into multinational market influence mode is Kogut & Singh (1988). However, there are two different views. The first view is that the greater the social and cultural differences between the home country and the host country, the more enterprises prefer green land investment (Kogut & Singh, 1988; Harzing A.W., 2002). This is because the choice of site green investment can be flexible, and is not affected by the original plant, equipment, personnel and other conditions, can effectively transfer the parent company's resources and capabilities, so as to effectively avoid conflicts caused by cultural differences. Another idea is that the difference is low, enterprises should choose greenfield investment, because new enterprises get more development in the host country (Wu, W&Lin, C, 2010).

The host country's economic level. In general the host country economic development level is higher, enterprises tend to enter the country in transnational merger (Miller, S., 2006). This is because the higher the economic development level of a country, the higher the efficiency of its various industries and enterprises, the more

likely to meet the technical needs of investment companies

The host country's policy. National policy is the direct embodiment of the attitudes of the country to foreign investment, mainly related to the host country's political and legal aspects of the policy. The government of the host country may also enter the setting of foreign direct investment barriers in the system, such as some developing countries in order to protect the national industry, the introduction of foreign investment, encourage foreign investors to greenfield, but limited to cross-border mergers and acquisitions. In the empirical analysis, using dummy variables, including "1" said the host countries have restrictions on foreign entrants, "0" means the host country not to limit foreign entrants (Barkema & Vermeulen,1998).

3 Research Hypothesis

The consistency of the cost of an important role in explaining the entry mode performance. Slangen & Hennart(2008) believe that the two entry modes compared to Greenfield is more vulnerable to the incumbent revenge, this is because the green investment to enter the industry brings additional production capacity, when incumbent firms have a higher status in the industry market, crowding out new entrants will be more strongly motivated (Chatterjee,1990). The acquisition of existing enterprises did not bring extra capacity, there will be no reprisals (Sharma, 1998). Therefore in the initial stage of the establishment of subsidiaries, the income of the acquired enterprises is more stable than the green land investment, so the following assumptions are proposed H1: Other conditions remaining unchanged, in the initial stage, the performance of subsidiaries established by M & A is better than that of subsidiary companies established by greenfield investment.

The subsidiary's growth is a continuous learning process. According to the theory of organizational learning, organizational learning

is an important task is to enhance the understanding of the environment from the accumulated experience and new knowledge. The experience can help enterprises to improve internal procedures, to reduce complexity and simplify the process, so the experience and performance should have a significantly positive relationship in essence. Internationalization also includes the process of organizational learning (Winfried & Hardy, 2003). With the passage of time, subsidiary through experience gradually overcome the adverse effects of the early immigrants disadvantage, and with the knowledge obtained from the parent company, the local accumulation of business knowledge and local knowledge system, and constantly improve the performance of overseas subsidiaries (Li Jingxun & Yu Wenying, 2009; Xue Qiuzhi & Hou Shijun, 2005). It made the following assumptions H2: Other conditions remaining unchanged, the longer of the survival time, the better the performance of overseas subsidiaries.

The above analysis does not consider the difference in different entry mode subsidiary experience accumulation effect, which is generally ignored the experience and performance of subsidiaries in the research on the relationship between the degree of globalization. As time goes by, the parent company, for considering whether globalization strategy, mergers and acquisitions investment or greenfield investment, the parent company will gradually strengthen mutual coordination and connection between company subsidiaries, increase integration efforts to subsidiaries. Based on this propose H3: Other conditions remaining unchanged, the longer of the survival time, the smaller of the differences of overseas subsidiaries performance established through mergers and acquisitions and Greenfield investment.

4 Empirical Analysis

4.1 The model

According to the existing literature practices (Ru Yi and Lv Ping, 2014), the dependent variable using "pre tax net profit (EBT) used as the index to measure the performance indicators, in order to eliminate the influence of the rate difference. Countries independent variables including the entry mode and time of entry mode as variables, if the establishment of a subsidiary in mergers and acquisitions, while the value of 1; with Greenfield investment is established, a value of 0. For continuous

variables, used to measure the subsidiaries established in the year to 2014. This paper joined the parent company scale, R&D intensity, per capita GDP, GDP growth rate, industry type, cultural distance and the size of its subsidiaries seven control variables. The type of industry is the classification of variables, if the subsidiary industry level code is manufacturing, while the values of 0 for other services, construction of the specific values of the 1(See 4.1.1).

$$\ln EBT_t = \beta_0 + \beta_1 \ln SCALE_t + \beta_2 \ln R\&D_t + \beta_3 \ln PGDP_t + \beta_4 GGDP_t + \beta_5 \ln CUL_t + \beta_6 \ln INDUS_t + \beta_7 \ln SUBSCALE_t + \beta_8 MODE_t + \beta_9 TIME_t + \beta_{10} MODE_t * TIME_t + \varepsilon_t \quad 4.1.1$$

4.2 Data sources

Considering the availability of data, this paper uses the data derived from 2005 to 2014 in the Ministry of Commerce registration in Germany, Britain, France, the Netherlands and the Italy. The date can also be found in the Wind database and the annual report of listed companies. The reasons to choose them as the samples as follows. Firstly, the largest destinations for China foreign direct investment to the EU countries are Germany, Britain, the Netherlands, Italy and France. These five countries account for 64% of all the European Union countries (Lv Ping and Guo Chenxi, 2015). Secondly, these countries play an important role in the development of the world economy. Thirdly, these countries are very similar in economic and institutional environment and other aspects, which can eliminate the host country's macro location variable interference.

4.3 Regression results

Table 1 shows the OLS regression results. In this table, model 1 and model 2 are used to test the hypothesis 1, this model only contains the control variable and time. Model 1 was significant, the control variables and the time to explain the 0.17. Model performance differences of subsidiary 2 increase "into the model, the whole model was improved from R2 to 0.27. In the model coefficient is significantly

positive, that conditions remain unchanged, mergers and acquisitions than Greenfield investments the short term performance is better, validates H1. Model 1 and Model 2' s time coefficient is not significant, which indicates that in early days, subsidiary experience has no obvious effect.

In Table 1, Model 3 to Model 6 in order to verify the influence of time factor on the performance of the company (assuming H2), and to regulate the relationship between entry modes and performance of subsidiaries (hypothesis 3), Model 3 contains only the control variables not remarkable. The Model 4 increased "into the overall pattern". Obviously, R2 increased to 0.06 in the model coefficient is significantly positive, showed that in the whole sample range, the performance is better than greenfield investment acquisitions. Model 5 increased the time, the whole model was improved from R2 to 0.09. Time coefficient is significantly positive, indicating that, in the sample time range of 10 years of experience. The accumulation does have a positive effect on corporate performance significantly, which validates the hypothesis 2. Model 6 increased "interaction into the mode and time of the whole model was further increased to 0.16 R2 digital display system" into the model "and the time for it, but" The results show that the performance advantage of Greenfield

investment is less and less obvious as time goes by, which strongly validates the hypothesis 3.

Table 1 OLS Regression Results

Variable	Hypothesis 1		Hypothesis 2 and Hypothesis 3			
	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
Intercept	-3.00 (23.25)	-6.36 (21.82)	2.52 (12.84)	-1.77 (12.70)	1.46 (12.50)	4.84 (12.45)
Ln SCALE	-0.04 (0.44)	-0.09 (0.41)	-0.35 (0.27)	-0.23 (0.27)	-0.29 (0.26)	-0.38 (0.26)
Ln R&D	-49.65 (29.93)	-54.55 (25.29)	-16.80 13.01	-11.77 (12.89)	-11.00 (12.64)	-13.59 (12.55)
Ln PGDP	-1.73 (1.77)	-1.69 (1.66)	0.06 (1.02)	-0.01 (1.01)	-0.34 (0.99)	-0.39 (0.97)
GGDP	0.60 (0.43)	0.49 (0.41)	0.14 (0.30)	0.09 (0.29)	0.01 (0.28)	-0.02 (0.28)
Ln CUL	-0.10 (0.91)	-0.69 0.89	-0.25 (0.53)	-0.38 (0.52)	-0.41 (0.51)	-0.48 (0.51)
INDUS	1.20 (0.91)	1.68 (0.90)	1.11 (0.59)	1.69*** (0.62)	1.86*** (0.61)	1.79*** (0.60)
Ln SUBSCALE	1.53*** (0.55)	1.23 (0.52)	0.63** (0.29)	0.63 (0.29)	0.52* (0.29)	0.49* (0.28)
MODE		4.52 (1.55)		3.08 (1.07)	3.23*** (1.05)	3.09*** (1.04)
TIME	1.28 (1.62)	1.28 (1.52)			0.58*** (0.19)	0.56 (0.19)
MODE*TIME						-0.89 (0.39)
df	8	9	7	8	9	10
F	2.56**	3.54***	1.59	2.47	3.23***	3.49***
R ²	0.28	0.37	0.06	0.09	0.13	0.16
Adjusted R ²	0.17	0.27	0.02	0.06	0.09	0.11
Scale of sample	74.00	74.00	196.00	196.00	196.00	196.00

Note: the brackets for the P value; *, **, ***, respectively, at 10%, 5%, 1% level significantly.

5 Conclusion

This paper extends the research on the performance of entry mode based on time dimension, which objectively reveals the performance difference of overseas subsidiaries with different entry modes. Through the empirical analysis of the performance of subsidiaries in China using greenfield

investment and mergers and acquisitions in China, it is found that in the case of other conditions, compared with the establishment of subsidiaries by means of green investment, the performance of the subsidiary is better than that of the second year. However, compared with the two modes of entry, the performance of subsidiaries with green investment is more obvious over time, and the performance

difference between two subsidiaries is becoming smaller.

This paper has certain guiding significance for enterprise practice, which is embodied in the following aspects: The decision of entry mode. Compared to greenfield investment, M&A provides an early access to the host country industry. Through M&A, enterprises can not only avoid the structural barriers and the exclusion of local rivals, also reduce the potential cost of being familiar with the local environment. However, M&A not once and for all, compared to the green investment, its integration costs will be obvious over time. If the enterprise pursues the long-term steady growth of the operating performance of the host country, the choice of entry mode is worthy of careful consideration.

The management of subsidiary. This paper reveals that the subsidiaries established by mergers and acquisitions of Chinese enterprises in Europe are in a state of continuous operation and slow development, while the subsidiaries with green investment are steadily improved. The current situation of M&A business is largely related to the internal consistency costs incurred in the integration process, which has become a serious obstacle to the growth of M&A enterprises. But for the considerations of Group's strategic development and global layout, the parent company must also integrate the subsidiary. In the course of business, M&A is more difficult to integrate in theory than greenfield investment, but the potential adverse effects of integration barriers can be circumvented by taking effective measures. Multinational companies should strengthen the promotion and guidance of the values of the acquired subsidiaries, promote the acceptance of the new culture and new ideas of the employees, and promote the integration of the core competencies of the parent and subsidiary companies, thus forming a more competitive core competency system, and making the unfavorable effect of consistent costs as low as possible. If necessary, people can learn from the

operating experience of greenfield investment to set up subsidiaries, so that making the business back on track.

The experience accumulation of overseas subsidiaries. This paper validates the importance of accumulated experience to the performance of European subsidiaries in a decade, but its impact is not significant at the beginning of the establishment, which shows that the parent company funds, labor and technology and other resources do not stimulate the growth of subsidiaries in the short term. This requires that the decision-making level of the company should be based on the deep analysis of the host country's industry, for the subsidiary to develop effective business strategy, including scale-oriented, cost-oriented, technical differentiation when entering the related industries, so that making the subsidiaries an early free from the adverse effects of external consistency, which is very important for the subsidiaries established through greenfield investment.

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