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Expanding to outward foreign direct investment or not? A multi-dimensional analysis of entry mode transformation of Chinese private exporting firms[☆,☆☆]

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ABSTRACT

This research examines the factors determining whether or not exporting firms expand to outward foreign direct investment (OFDI) as part of their internationalisation strategy, using a recent survey of Chinese private-owned enterprises. We carry out a multi-dimensional analysis to investigate the impact of firm productivity, internal resources and the external environment on OFDI decisions, including both the decision to undertake OFDI and the volume of OFDI flows. It is found that productivity, technology-based capability, export experience, industry entry barriers, subnational institutions and intermediary institutional support affect firms' OFDI decisions. The findings have important policy and managerial implications.

1. Introduction

As one of the fastest growing economies, China has recently accelerated its pace regarding outward foreign direct investment (OFDI). From a negligible annual average of US$0.4bn in the 1980s, OFDI flows grew to an average of US$2.3 billion in the 1990s, then further jumped to an average of US$19.1 billion in the 2000s. By the end of 2011, around 13,500 Chinese firms had made an accumulative investment of US$425 billion in 178 countries (China Ministry of Commerce, 2012). The rise of China's OFDI has drawn the attention of academics and policy-makers and has resulted in increasing research on this topic.

A review of the extant research on China's OFDI (see Table A1 in the Appendix for a summary of published research in English-language journals) shows that most studies have examined the patterns, motivations and determinants of the volume, location and entry mode choice and have adopted several theoretical perspectives, including the linkage-leverage-learning framework (LLL), investment development path theory (IDP), resource-based view (RBV), transaction costs theory (TC) and institutional theory (IT). Research findings indicate that OFDI strategic decisions are influenced by a variety of firm, industry, and country-related factors. These studies have shed light on the issues of China's OFDI. However, few studies have investigated the entry mode transformation of Chinese exporting firms and the role of subnational institutions in such a transformation. The internationalisation path of firms is by no means universally observed. Despite firms' export experience, not all exporting firms expand to OFDI entry mode. What are the factors giving rise to the OFDI decision after exporting? What determines the volume of OFDI flows (VFDI)?

To address the research gaps, this study adopts a multi-dimensional approach based on productivity heterogeneity theory (Greenaway & Kneller, 2007) and the integrated 'strategic tripod' framework (Peng, Wang, & Yi, 2008) to examine the roles of internal factors, industry conditions and institutional environments in the entry mode transformation of Chinese exporting firms. The international business (IB) literature has for some time emphasised the importance of adopting multi-dimensional or multi-level analysis (Buckley & Lessard, 2005). More recently,

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Jormanainen and Koveshnikov (2012), after critically assessed research into the internationalisation of emerging market firms (EMFs) published in 14 top international management journals between 2000 and 2010, issued a similar guideline suggesting that "the development of multi-level models accounting for country, industry and firm-specific factors may shed some light on the observed plurality and allow for making more informed comparison of EMFs following different internationalisation paths" (p. 719). One of the shortcomings of the extant China's OFDI literature is the attention paid to only one group of variables with a few exceptions (see Table A1). In response to the above calls, we consider firm characteristics, industry dynamics and macro-level factors and go on to develop corresponding hypotheses based on productivity heterogeneity theory (Greenaway & Kneller, 2007) and the integrated 'strategic tripod' framework (Peng et al., 2008).

Productivity heterogeneity theory in economics literature explains entry mode transformation from exports to OFDI by looking at the cost implications associated with exports and OFDI (Greenaway & Kneller, 2007). Both exports and OFDI involve sunk costs including, for example, market research, product research (leading to product modification or new development), distribution networks and advertising. OFDI eliminates variable transportation costs associated with exports but incurs higher fixed costs than exports; productivity heterogeneity therefore determines entry mode transformation. The more productive firms become exporters while the less productive ones sell domestically and only the most productive exporters undertake OFDI. Productivity heterogeneity theory has received empirical support in the studies of German, Italian, French, Irish, British, Japanese, and American firms (Arnold & Hussinger, 2010; Castellani & Zanfei, 2007; Engel & Procher, 2011; Girma, Görg, & Strobl, 2004; Girma, Kneller, & Pisu, 2005; Head & Ries, 2003; Helpman, Melitz, & Yeaple, 2004; Kimura & Kiyota, 2006; Tomiura, 2007; Wagner, 2006). However there is no study that empirically tests this theory in the context of China.

Building on RBV (Barney, 1991) and the industry-based view (IBV) (Porter, 1980), IB literature traditionally argues that firms' strategic decisions are influenced by their internal resources and capabilities, and industrial conditions. More recently, Peng et al. (2008) suggest that IT is the third preeminent perspective in helping to explain emerging economy (EE) firms' internationalisation, given the strong influence of governments in EEs and the fundamental change of institutions; they propose the strategic tripod framework, integrating RBV, IBV and IT. In this research, we broaden IT in the framework by recognising the subnational-institutional variation across Chinese regions and taking account of both the national and subnational institutions in which the Chinese firms are embedded. A number of studies of Chinese OFDI (see Table A1) have narrowly focused on the impact of regulatory factors and state support. No research addresses the impact of subnational institutions, despite the reorganization of diverse subnational regions in China (Boisot & Meyer, 2008; Xu, 2011). Our focus on subnational institutions complements the studies of Yang, Jiang, Kang, and Ke (2009) and Wang, Hong, Kafouros, and Boateng (2012) and helps generate new insights into how and what institutions matter to Chinese exporting firms' OFDI decisions.

Another important feature of the study is our focus on Chinese private-owned enterprises (POEs). Existing studies have mainly focused on state-owned enterprises (SOEs), listed companies, or a mix of firms with different types of ownership (see Table A1). Only a few studies have centred explicitly on POEs despite the fact that POEs are an important driving force behind China's OFDI, in addition to export growth and economic development (Liu, Xiao, & Huang, 2008). In 2012, POEs accounted for 9.5% of China's OFDI flows (The Economist, 2013), growing from less than 4% 2 years before, and their role in China's 'go global' strategy will continue to increase (Lin, 2010).

It is important to separate firms with different ownership as POEs differ from SOEs in a number of ways. POEs have been systematically discriminated against in China. They were not legitimate in China until the opening up in the late 1970s and were not allowed to invest overseas until 2003. The strategic behaviour of POEs differs from that of non-POEs (Lin, 2010; Ramasamy, Yeung, & Laforet, 2012; Rui & Yip, 2008). POEs are increasingly operating in a free market environment and are more likely to be influenced by market forces and to be commercially motivated (Liu et al., 2008; Ramasamy et al., 2012). They more closely resemble their developed economy (DE) counterparts (Liang, Lu, & Wang, 2012). This is in contrast to SOEs' objectives which can be politically motivated and can be determined by the government's consideration of China's political and economic influence in the world. Examining POEs separately therefore enriches our understanding of their strategic behaviour in terms of their outward internationalisation strategy, enables us to differentiate the impact of different institutional dimensions from ownership effect, and enhances our understanding of these firms' outward internationalisation paths within the institutional context. Such a focus helps provide valuable empirical evidence on the relationship between the characteristics of POEs and their entry mode transformation.

2. Theoretical background and hypothesis development

Firm internationalisation, in general, and entry mode transformation from exporting to OFDI, in particular, is a complex process and is affected by many factors. A single theoretical approach is inadequate to capture such complexity and to reflect the impact of multi-dimensional factors on strategic decisions relating to OFDI. Therefore, we take an integrative approach, drawing on productivity heterogeneity theory (Greenaway & Kneller, 2007) and the strategic tripod framework (Peng et al., 2008; Yamakawa, Peng, & Deeds, 2008) which in turn comprises RBV, IBV and IT. Productivity heterogeneity theory stresses the impact of productivity on internationalisation, which complements RBV, whereas IBV and IT enable us to explicitly examine the impact of industry and the institutional context in which firms are embedded. This integrated approach allows us to examine a wide range of factors affecting firms' strategic decisions on expanding from exporting to OFDI.

2.1. Productivity heterogeneity theory

In the economics literature, considerable attention has been paid to linking productivity heterogeneity to a firm's entry mode decision regarding exports and OFDI (Greenaway & Kneller, 2007). The mode shifts from exports to OFDI as firm productivity increases. When serving international markets, a firm's choice is commonly between exports and OFDI. Firms entering the international market incur fixed costs relating to research into product compliance, setting up new distribution networks, advertising and so on. Therefore, only firms with sufficiently high profits to cover the fixed costs could internationalise. Between exports and OFDI, exports involve lower fixed costs, but higher trade-related costs such as transportation costs, tariff and non-tariff barriers. OFDI, on the other hand, entails lower variable costs, but higher costs in maintaining capacity in multiple markets. Increasing returns to scale at plant level create incentives to concentrate production in one place and use exporting for internationalisation, while transportation and transaction costs associated with the distance between the locations of production and sales provide a countervailing pressure towards engaging in OFDI by producing closer to the foreign market. Firm productivity influences decisions concerning exporting and OFDI. Of those firms that serve foreign markets, only the most productive find it profitable to meet the higher costs associated with OFDI. Exporting