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The impact of outward FDI on the performance of Chinese firms

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ABSTRACT

Using new firm-level data from the Emerging Multinationals' Events and Networks DATAbase (EMENDATA), this paper investigates the effects on Chinese firms of Outward FDI (OFDI) into advanced European countries. Propensity score matching is combined with a difference-in-difference (DiD) estimator to reduce the problem of self-selection of treated firms in foreign markets, and to eliminate time-invariant and unobservable differences between those firms and the controls. The results provide robust evidence supporting the view that China's OFDI so far have had a positive impact on domestic activities in enhancing firms' productivity and scales of operation, measured by sales and employment. When we distinguish among investments on the basis of entry mode, accounting for endogeneity in the selection process, acquisitions facilitate early access to intangible assets, but are detrimental to financial performance, while greenfield investments have a stronger impact on the scale and productivity of Chinese multinationals investing in Europe.

1. Introduction

Outward Foreign Direct Investments (OFDIs) from China have become a popular topic in the academic literature because of their rapid increase and unconventional patterns (among many others, see Child and Rodrigues, 2005; Buckley et al., 2007). The rise of Chinese investments follows the provisions of the "Going Out" strategy, launched with the 10th Five-Year Plan in 2000 and reinforced in subsequent plans, which foster the internationalization of domestic firms. The aim is to promote industrialization and technological upgrading to support growth in the domestic economy (Gu and Reed, 2013). However, empirical research on the effect of OFDIs on the performance of Chinese investor companies is limited. The related empirical literature focuses mainly on analysing the drivers of internationalization and the location choices, at both country (Buckley et al., 2007; Deng, 2009) and firm levels (Amighini, Rabellotti & Sanfilippo, 2013; Ramasamy, Yeung & Laforet 2012). Some recent notable exceptions include a paper by Chen and Tang (2014) investigating the impact of Chinese OFDIs on firm performance, on the basis of data from the Chinese Ministry of Commerce, and a study by Edamura, Haneda, Inui, Tan & Todo (2014), dealing with the impacts of acquisitions, based on a Chinese financial database (ChinaVenture).

In this paper, we investigate whether and how OFDIs have a positive impact on the performance of Chinese investing companies, analysing a sample of 368 Chinese investors with at least one affiliate in Europe, for the period 2003–2011. The empirical analysis is based on the new Emerging Multinationals' Events and Networks DATAbase (EMENDATA), which merges greenfield investments and mergers and acquisitions (M&As) with firm level financial information from Bureau van Dijk's (BvD) *Orbis*.

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We measure the impact of OFDIs on the investing companies, covering different dimensions of firm performance such as productivity, scale, sales and profitability. In addition, we disaggregate OFDIs according to mode of entry – M&As or greenfield investments – assessing whether there is any difference in their impact on investors. To the best of our knowledge, this is the first study examining the impact of Chinese OFDIs (a) into advanced economies and (b) accounting for the specific effects of the different modes of entry.

Our geographical focus is on Europe, which receives 30% of all Chinese investments.[1] It is an interesting destination also because Chinese OFDIs in EU countries are motivated mainly by the search for new markets aimed at creating overseas platforms for sales and distribution, and strategic assets to acquire foreign technologies, knowledge and brands that are not always fully available at home (Amighini et al., 2013). Therefore, it is of particular interest to investigate whether these investments – by introducing more efficient production techniques and improving the overall performance in terms of scale, sales and profitability – generate positive effects on the performance of the investing firms.

We use the propensity score matching (PSM) technique to investigate the impact of OFDIs on treated firms with one affiliate company in Europe, to compare them with a closely matched control group, selected from the subgroup of all the Chinese companies included in BvD *Orbis* with no investment abroad. We combine PSM with difference-in-difference (DiD) estimators to further eliminate time-invariant and unobservable differences between the treated and control firms.

Our results confirm that OFDIs have an impact on Chinese investors. We find a positive effect on efficiency and performance, which materializes at different points in time, and productivity enhancement which accrues over the long term (as in Mansfield, 1985 and Chen, Li & Shapiro, 2012). We find an immediate impact on company size, indicated by an increase in the number of employees. Total sales also show an upsurge as a result of the investment, confirming the importance of market-seeking motives. Some interesting differences in these results occur if we distinguish investments by entry mode, taking into account the potential endogeneity of the choice. We find that acquisitions favour early access to intangible assets, but result in negative financial performance. However, Chinese firms are more likely to increase their size and sales via greenfield investments.

Our analysis has some important implications; it adds to existing knowledge on Chinese OFDIs, shedding new light on the spillovers resulting from the internationalization strategies in more advanced markets, and on which modes of entry better enable Chinese companies to gain competitive advantage.

The remainder of the paper is structured as follows. Section 2 reviews the literature on the effects of OFDIs on the performance of the investors. Section 3 presents the original data used for the analysis and discusses the methodology. The results are presented in Section 4 and Section 5 concludes.

2. The effect of OFDIs on performance

The nexus between OFDIs and investors' performance has been investigated mainly in an advanced economy context and has produced no clear-cut findings. Firms exploring foreign markets through FDIs can expect high returns, but also face large costs related to complexity, coordination and resource trade offs (Bertrand and Capron, 2014). The empirical literature on heterogeneous firms shows that typically MNEs enjoy productivity advantages over other types of firms (Helpman, Melitz & Yeaple, 2004), but the evidence on other dimensions of performance, including employment and profitability, is less straightforward. Several studies show that both horizontal and vertical OFDIs generally have positive effects on productivity and on the size of their domestic activities (Barba Navaretti, Castellani & Disdier, 2010; Desai, Foley & Hines 2009), but the effects of vertical FDIs on employment are more ambiguous (Castellani and Barba Navaretti, 2004; Hijzen, Jean & Mayer, 2011).

For emerging and developing countries, the empirical evidence on the impact of OFDIs on the investing firms is more limited. Unlike traditional MNEs, firms from emerging economies invest abroad in order to gain new competitive advantages and acquire lacking strategic resources (Ramamurti, 2012; Luo and Tung, 2007). Thus, it is not uncommon for emerging market MNEs (EMNEs) to undertake OFDIs as a deliberate growth strategy, increasing the overall scale of their activities (Luo and Tung, 2007).

Furthermore, both the motivations for and the final destination of the investments have an important influence on performance. This is pertinent to the present study, which focuses on OFDIs from emerging economies into advanced countries, characterized by a prevalence of *market*- and *strategic asset-seeking* motivations (Amighini et al., 2013).

In the case of *market-seeking* FDI, the resulting increase in the scope of operations of EMNEs may enable exploitation of economies of scale for both the parent and affiliate companies. This might be the consequence of sharing sunk costs or information, or learning by doing (Hijzen et al., 2011). In addition, economies of scale may have a significant impact on the performance of the parent company, which may provide both specialized services and intermediate goods to the affiliate, if the affiliate is involved in overseas production activities to serve foreign markets. In this context, the overall size of the EMNE will increase, and domestic and foreign production will combine to enhance productivity and competitiveness in both the home and host countries (Herzer, 2012; Desai et al., 2009).

The effects are potentially stronger in the case of *asset- or technology-seeking* FDI, which usually are directed to advanced economies,[2] and are frequent among EMNEs. In this case, the foreign affiliate can be considered a vehicle for acquiring knowledge, technologies, know-how and management capabilities, all of which assets are then transmitted back to the parent company in the form of reverse technology and knowledge transfers (Chen et al., 2012). However, in some circumstances the potential

[1] Europe is the second most important destination for Chinese investments after Asia, accounting for almost 40% of total OFDIs (based on EMENDATA). If Chinese investments to Hong Kong (11.5%) are excluded, Europe is the main destination (Chaminade, 2015).

[2] The MNE literature shows that the investment destination matters, with increases in productivity being associated with investments in higher technology intensive countries (de la Potterie and Lichtenberg, 2001; Barba Navaretti et al., 2010).