

## A Comparative Study of China's OFDI Entry Modes

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**Abstract:** The proposal and implementation of the "One Belt And One Road" strategy not only promotes the integration of China's economy with the world economy, promotes the coordinated and balanced development of regional economy, and builds the new open economic system in an all-round way, but also plays a great role in promoting and promoting the foreign direct investment of Chinese enterprises. In the decision-making of OFDI, the choice of entry mode is crucial to the success or failure of investment. At present, there are two main ways for Chinese enterprises to enter OFDI: Greenfield Investment and cross-border M&A. From investment scale, investment regional, investment main body, industry and so on four aspects, this paper analyzes the different choices and the changing characteristics of China's OFDI, and probes into the internal laws of China's OFDI.

### 1. Introduction

In recent decades, FDI has become an important form of China's participation in globalization. The development of OFDI is not only a strategic choice for Chinese enterprises to seek for new markets, cope with trade barriers, give play to their comparative advantages and obtain advanced technologies and information, but also an inevitable trend in the development of China's economic globalization.[1] According to statistics, China's outbound direct investment reached US \$158.29 billion in 2017, ranking the third in the world. At present, China's foreign investment methods coexist, but there are two main ways: one is known as Greenfield Investment. Another way is to acquire the operational control of a foreign enterprise through the purchase of part or all shares of the foreign enterprise, also known as cross-border mergers and acquisitions. Due to the lack of separate statistics on the indicators of Greenfield Investment at home and abroad, this paper intends to analyze the basic situation of Greenfield Investment from the side by combining the data of China's total OFDI and cross-border mergers and acquisitions, and to compare the two OFDI methods of Greenfield Investment and cross-border mergers and acquisitions.

### 2. Selection of Enterprises' OFDI Modes

As the main entry mode of OFDI, Greenfield Investment and cross-border M&A have their own advantages and disadvantages in the selection and application of actual OFDI. According to various considerations, enterprises make decisions on the way of OFDI.

Dunning (1977) proposed the international production eclectic theory, which summarizes the conditions of transnational business operations as ownership advantage, market internalization advantage and location advantage.[2] Ownership advantage refers to the competition or monopolistic advantage of a multinational company, including the size of the company and the economic status it has acquired, the proprietary technology, the experience gained in international operations, and product differentiation. The advantage of market internalization means that transnational corporations can reduce transaction costs by internalizing foreign enterprises and obtain favorable information to ensure the security and sustainable competitiveness of enterprises' unique advantages. Location advantage is related to the unique superiorities of the host country, including the host country's natural resources, labor resources, policy measures to restrict imports.

Dunning used a combination of three different advantages to illustrate the choice between multinational companies in the three main international market entry modes of export, investment and licensing. By the eclectic theory of international production shows that the main factors influencing the decision of OFDI mode include host country's economic level, market development, technological level, investment environment, labor cost, etc. Whether an enterprise chooses cross-border M&A or Greenfield Investment for OFDI is an equity choice made by the enterprise according to its production status and investment location.

In short, the entry mode is a very important part of the internationalization process, and for enterprises, choosing the right entry method in a specific foreign market is one of the most important decisions in the international marketing of enterprises.[3] After years of research and accumulation of results, a number of theoretical frameworks have been established that influence the choice of international market entry modes. There are mainly seven theoretical systems: Transaction Cost Theory, Resource Based Theory, Organizational Capability Theory, Ownership, Location and Initialization Theory, Evolution Theory, Decision Making Process Theory and Foreign Market Entry Mode Selection Theory. Enterprises always make the choice of foreign investment entry mode after comprehensive consideration of various factors.

### **3. Comparative Analysis of China's OFDI Entry Modes**

The current OFDI methods of Chinese enterprises are mainly cross-border mergers and acquisitions and Greenfield Investment. With the continuous development and expansion of China's OFDI, great changes have taken place in the two main entry modes of Greenfield Investment and transnational investment. The proportion of traditional Greenfield Investment in OFDI is gradually decreasing, the status of transnational mergers and acquisitions is becoming more and more important.

#### **3.1 Perspective of Development Scale and Process**

From the perspective of development scale and process, the early stage of investment is dominated by new construction investment, but M&A investment has become an important form of China's foreign direct investment.

Nowadays, China's foreign investment methods are more diversified, and Greenfield Investment, cross-border mergers and acquisitions, strategic alliances and joint investment, etc. coexist. Among them, Greenfield Investment and cross-border mergers and acquisitions are the main ones, and other methods account for a small proportion. Figure 1 shows the changes in the proportion of M&A in China's foreign direct investment from 1992 to 2017. As can be seen from figure 1, China's OFDI entry mode changes from time to time, and the investment modes selected vary greatly in different historical backgrounds. Especially from 1998 to 2002, the choice of Greenfield Investment and transnational merger and acquisition mode fluctuated greatly, which may be closely related to China's economic development policies and the world economic situation. China's OFDI has the following five iconic development opportunities in the development of cross-border mergers and acquisitions. The return of Hong Kong in 1997 led to a surge of enterprises going to Hong Kong for merger and acquisition. In 2000, the "going out" strategy was put forward, which opened the growth prelude for Chinese enterprises' transnational mergers and acquisitions. After joining WTO, merger and acquisition in 2002 ushered in a golden period of rapid growth. The global economic crisis broke out in 2008 has provided rare development opportunities and laid a solid foundation for the transnational merger and acquisition to become the main form of China's foreign direct investment. The proposal and implementation of the "One Belt And One Road" strategy in 2013 not only accelerated the integration of China's economy with the world economy, promoted the coordinated and balanced development of regional economy, and then comprehensively constructed the new open economic system, but also played a huge role in promoting and boosting the foreign direct investment of Chinese enterprises.[4]

At the very moment of the financial crisis in 2008, when the global M&A amount fell by 34.7%, China's multinational companies rose against the trend and attracted global attention in the M&A market. After the financial crisis, cross-border mergers and acquisitions are still hot, and become an important form of China's foreign direct investment. After 2013, China further expanded its foreign direct investment. In 2017, Chinese enterprises completed a total of 431 M&A projects with the actual transaction amount of 119.62 billion US dollars. Among them, the direct investment was 33.47 billion US dollars, accounting for 28% of the total amount of mergers and acquisitions and 21.1% of the total amount of China's foreign direct investment in that year. Overseas financing was 86.15 billion US dollars, which was 70% higher than the previous year and accounted for 72% of the total amount of mergers and acquisitions. It is the largest year for overseas financing.

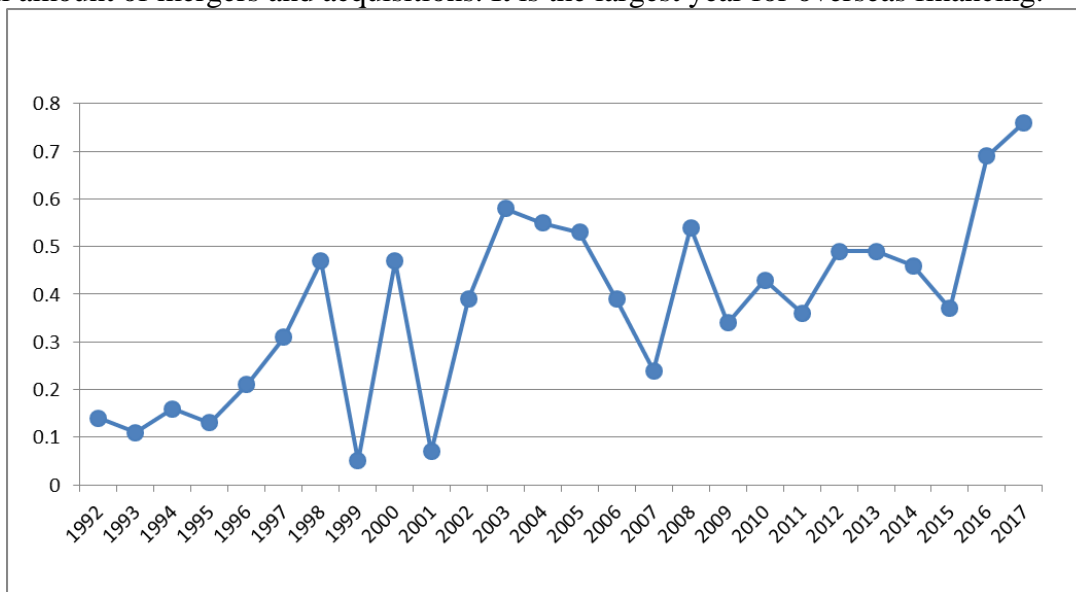


Figure 1. Changes in the proportion of M&A

### 3.2 Perspective of Investment Location

From the perspective of investment location, investment in developing countries is mainly based on new construction, while in developed countries or regions, most of them adopt M&A investment.

In general, the location distribution of green investment in China has the following characteristics. Firstly, Greenfield Investment is mainly concentrated in underdeveloped countries or regions such as Asia and Latin America.

Compared with Greenfield Investment, the location choice of cross-border mergers and acquisitions is dominated by developed countries and regions. As can be seen from figure2, from the perspective of the announced number of mergers and acquisitions, the Americas, Europe and Asia are in a three-point world, and are mainly concentrated in North America, EU member states and developed regions such as Hong Kong, Macao and Taiwan. On the whole, when Chinese enterprises conduct cross-border mergers and acquisitions, the main destination is developed countries, but in recent years, the amount of investment flowing into Africa, South America and other developing countries is also gradually increasing. Africa has not been a hotspot for cross-border M&A in China, but at this stage, the number of cross-border M&As of Chinese companies in Africa has increased year by year. In the most recent 2017, the number of Chinese enterprises' cross-border M&A in Africa and the Middle East has reached 20.

Chinese enterprises' outbound investment and M&A were distributed in 56 countries (regions) in the world in 2017. From the perspective of country and region, the target countries and regions of overseas M&A are mainly Hong Kong and the United States. In 2017, there were 76 M&A projects by Chinese enterprises in countries along the "One Belt And One Road", with the value of 16.28 billion US dollars, accounting for 13.6% of the total amount of M&A. Among them, Indonesia, the

United Arab Emirates, Singapore, India, Israel, Russia and other countries have attracted over 1 billion US dollars of investment from Chinese enterprises in mergers and acquisitions. Returning to the essence of Chinese enterprises' overseas mergers and acquisitions, the connotation of Chinese enterprises' mergers and acquisitions has been significantly improved, and they are undergoing a transformation from resource-occupying type to technology-acquiring type and market-expanding type. Overseas mergers and acquisitions no longer focus solely on the acquisition of means of production, but take the market as the guide and cater to the strategic positioning and layout of enterprises' globalization through the update and iteration of products, technologies and channels.[5]

region	Number of announced acquisitions	Proportion(%)	
Asia Pacific region	southeast Asia	59	13.7
	Australia	38	8.8
	Japan	17	3.9
	Other asia-pacific region	34	7.9
European region	Germany	35	8.1
	The UK	30	7
	France	13	3
	Central and eastern Europe	11	2.6
	Other European regions	58	13.5
Middle East and Africa region	Africa	7	1.6
	Israel	7	1.6
	The rest of the Middle East	6	1.4
North America and Central America	USA	86	20
	Canada	12	2.8
	Other North America and Central	4	0.9
South American region	Brazil	7	1.6
	Other South American regions	7	1.6
The global	431	100	

Figure 2. number of overseas mergers and acquisitions by region in 2017

### 3.3 Perspective of Investment Subject

From the perspective of investment subject, state-owned enterprises' investment mode is mature, while private enterprises' M&A is developing rapidly.

For a long time, large state-owned enterprises have occupied a dominant position in China's OFDI, but recently, the main body of China's OFDI has been gradually diversified from state-owned enterprises. After the financial crisis, China's private enterprises began to actively participate in overseas investment activities.

According to statistics, by the end of 2017, state-owned enterprises accounted for 49.1% of the \$1,606.25 billion stock of outbound non-financial direct investment, down 5.2 percentage points from the previous year. Non-state enterprises accounted for 50.9 percent. In China's non-financial outbound investment flow in 2017, the non-public economy holding domestic investors' outbound investment amounted to 67.94 billion US dollars, accounting for 48.7%. Publicly owned economy holding's overseas investment was 71.56 billion US dollars, accounting for 51.3%. It can be clearly seen from this series of data that China's private enterprises are constantly expanding their investment abroad, and private enterprises account for an increasing proportion of China's enterprises' overseas M&A transactions, becoming an indispensable force in China's foreign direct investment. However, different from large state-owned enterprises with strong strength, private enterprises in China prefer to acquire advanced foreign technologies, brands and sales channels in overseas markets through direct investment, so most of them choose M&A investment with more advantages.

### 3.4 Perspective of Investment Industry Distribution

From the perspective of investment industry distribution, the choice of investment entry mode varies with the nature of different industries

The initial purpose of Chinese enterprises to go out is to obtain scarce resources to make up for the shortage of resources in the process of domestic economic development. Therefore, China's OFDI has two important characteristics in industry distribution. First, the overseas investment industry is widely distributed. Second, the main purpose of OFDI is to seek natural resources or strategic resources. Mergers and acquisitions industry is mainly concentrated in oil, natural gas, aluminum ore, etc., industry concentration is high. Most of the natural resource-seeking investment that makes use of existing assets flows to developing countries or regions, and the investment mode gradually turns from Greenfield Investment to M&A Investment. In order to break the technological monopoly, obtain the strategic resources of developed countries, and improve the level of their own operation and management, strategic resource-seeking industries, they mostly carry out foreign investment in the form of cross-border M&A.

According to statistics, Chinese enterprises' outbound investment and mergers and acquisitions in 2017 involved 18 industries, including manufacturing, mining, power/heat/gas and water production and supply. In terms of merger and acquisition amount, the manufacturing industry involved 60.72 billion US dollars, which was twice as much as that of the previous year, and took the lead, involving 163 projects, accounting for 50.8% of the total amount of merger and acquisition. Mining came in second at \$11.41 billion, up 52.1% from a year earlier (see figure 3).

Industry Categories	Quantity	Sum (billions of dollars)	Proportion (%)
Manufacturing	163	60.72	50.8
The mining industry	22	11.41	9.5
Power/heat/gas and water production and supply	30	10.19	8.5
Accommodation and catering	1	6.5	5.4
Leasing and business services	38	6.31	5.3
Information transfer/software and information	42	6.12	5.1
Transportation/warehousing and postal services	13	5.58	4.7
The financial sector	4	3.42	2.9
Wholesale and retail	45	3.12	2.6
The real estate industry	9	2.52	2.1
Health and social work	5	1.17	1
Scientific research and technical services	28	1.12	0.9
Agriculture/forestry/animal husbandry/fishery	13	0.81	0.7
Culture/sports and entertainment	5	0.58	0.5
Water/environment and utilities management	3	0.03	--
The construction industry	3	0.02	--
Residential services/repairs and other services	4	0.01	--
Education	3	0.01	--
Total	431	119.962	100

Figure 3. Composition of China's outbound investment M&A industry in 2017

The industries of foreign Greenfield Investment by Chinese enterprises are mainly concentrated in business service industry, followed by retail industry, energy exploitation industry and manufacturing industry. In addition, manufacturing and telecommunications industry attaches great importance to the establishment of research and development centers and training centers in foreign countries.

In 2017, China's OFDI covered 18 sectors of the national economy. Among them, the flow of tens of billions of dollars involved four sectors (two less than the previous year), with leasing and business services holding the first place and manufacturing holding the second place. Investment in leasing and business services fell 17.5 percent year-on-year to \$54.27 billion, accounting for 34.3 percent of the total. The manufacturing industry reached 29.51 billion US dollars, up 1.6 percent year-on-year, accounting for 18.6 percent of the total flow of the year, 3.8 percentage points higher than the previous year. Main flow of chemical raw materials and chemical products manufacturing, automotive, computer/communication, and other electronic equipment manufacturing, pharmaceutical manufacturing, railway/ship/aerospace and other transportation equipment manufacturing, non-metallic mineral products, special equipment manufacturing, rubber and plastic products, fabricated metal products, textile, non-ferrous metal smelting and rolling processing

industry, etc. Of this, \$11.03 billion went to equipment manufacturing, down 22.6% year-on-year, accounting for 37.4% of manufacturing investment (see figure 4).

Industry	Flow (billions of dollars)	Rose (%)	Proportion (%)
Leasing and business services	54.27	-17.5	34.3
Manufacturing	29.51	1.6	18.6
Wholesale and retail	26.31	25.9	16.6
The financial sector	18.79	25.9	11.9
The real estate industry	6.8	-55.1	4.3
The construction industry	6.53	48.7	4.1
Transportation/warehousing and postal services	5.47	225.6	3.4
Information transfer/software and information	4.43	-76.3	2.8
Agriculture/forestry/animal husbandry/fishery	2.51	-23.7	1.6
Scientific research and technical services	2.39	-43.6	1.5
Power/heat/gas and water production and supply	2.34	-33.9	1.5
Residential services/repairs and other services	1.87	-65.5	1.2
Health and social work	0.35	-28.6	0.2
Culture/sports and entertainment	0.26	-93.3	0.2
Water/environment and utilities management	0.22	-73.8	0.1
Education	0.13	-53.6	0.1
Accommodation and catering	-0.19	--	-0.1
The mining industry	-3.7	--	-2.3
Total	158.29	-19.3	100

Figure 4. Industry distribution of China's OFDI flow in 2017

#### 4. Summary and Prospect

Since China officially implemented the "going global" strategy in 2000, China's OFDI has gone through many hardships and achieved remarkable achievements, and great changes have taken place in the mode of OFDI. In terms of the proportion of the scale of OFDI, it has gradually developed from the early Greenfield Investment to the transnational merger and acquisition. At present, the transnational merger and acquisition investment occupies a dominant position in China's OFDI. In terms of investment location, Greenfield Investment is mainly concentrated in developing countries, while cross-border mergers and acquisitions are relatively dispersed and mainly invested in developed countries or regions. In terms of the main body of investment, state-owned enterprises have two kinds of investment methods are more mature, while private enterprises are mainly mergers and acquisitions; In the investment industry, most cross-border mergers and acquisitions focus on natural resources and strategic resource-seeking industries, while Greenfield Investment mainly focuses on business services, followed by retail and energy extraction.

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