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### Entry mode and performance of foreign direct investment : the role of strategic orientation

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**ENTRY MODE AND PERFORMANCE  
OF FOREIGN DIRECT INVESTMENT:  
THE ROLE OF STRATEGIC ORIENTATION**

**ABSTRACT**

Multinationals have distinctive strategic orientations toward the host country when investing overseas: to explore the local market or to establish efficient manufacturing for export. Analyses of FDI operations in China suggest that local market oriented firms tend to rely on the joint venture mode while export oriented investors mostly choose to be wholly owned operations. Moreover, there are significant differences between local market oriented and export oriented firms across four different performance measures. Results of the study suggest that researchers should consider the difference in FDI's strategic orientation when attempting to identify success factors and recommending performance-enhancing strategies.

**Key words**

strategic orientation, foreign investment, entry mode, and performance

## INTRODUCTION

Foreign direct investment by multinational corporations (MNCs) has been characterized as a business activity associated with deliberate objectives and strategic goals based on investor's strengths and resources. While research to date has examined the effect of many factors on firms' foreign market entry and performance such as host government policies, firm size, and international experience, investors' strategic orientation toward the host country has received scanty treatment. Neglecting the strategic orientation toward the host country hampers the validity of previous research findings and the applicability of recommended strategies for enhancing FDI performance. Existing literature suggests that two major orientations dominate the entry into foreign countries by MNCs: 1) seeking local market opportunities or 2) establishing efficient manufacturing for export to other countries (Erramilli, 1990; Lan, 1996; Pan and Chi, 1999). Since investors presumably adopt different strategies to match with their respective competence and investment objectives, knowledge of how investors' orientations towards the host country affect their strategies such as choice of entry mode and subsequent performance can greatly enhance the understanding of FDI strategies and performance.

This study elaborates the concept of strategic orientation toward the host country and its role in international investment. Secondly, we discuss the effect of strategic orientation on entry mode and FDI performance and further propose that the consistency between strategic orientation and entry mode can enhance FDI performance. Then, we analyze the data of five hundred FDI operations in China. The results suggest that local market oriented investors tend to choose joint venture as an entry mode while export-oriented FDI projects mostly rely on wholly owned operations. While controlling for a number of key industry- and firm-level variables, the MANOVA results indicate that local market oriented FDI projects record superior market share and profit margin, while export oriented operations have higher assets turnover. However, there is no significant difference in return on assets between these two groups. Overall, results of the study show that strategic orientation has a significant effect on MNCs' entry mode and various measures of FDI performance. These findings suggest that future research must consider the distinction between investors' strategic orientations toward the host country when identifying the critical success factors and exploring strategies for MNCs to improve FDI operations and performance.

## **BACKGROUND LITERATURE**

In light of increasing foreign direct investment (FDI) worldwide in recent decades, successful entry into a foreign country and satisfactory performance of FDI operations have been subjects of intensive study. For many years, entry mode has been considered the “frontier issue” in international business, and is presumed having great impact on MNCs' successful expansion overseas (Wind and Perlmutter, 1977). This is consistent with the concerns of many investors when they enter a foreign country: success entry, minimizing risks, and overcoming the barriers to market access. Numerous environment and firm-level factors including cultural similarity with the host country, firm size and resources, and management experience have been found to affect the choice of entry mode for investors (Hu and Chen, 1996; Luo 1998b). An appropriate mode of entry is critical for the success of FDI projects as it can reduce transaction cost, reduce risks, and improve performance of FDI projects (Brouthers, Brouthers, and Werner. 1999; Lee ad Beamish, 1995).

As MNCs face increasing competition and dynamic and sometimes volatile environment in many countries, performance of FDI projects has been the subject of many recent studies (e.g., Luo, 1997; Woodstock and Beamish, 1994). Researchers have identified many factors that contribute to the international expansion of MNCs and the performance of FDI projects. Studies have found that various environment factors including socio-economic systems and investment policies in the host country affect FDI operations (Vonhanocker and Pan, 1997; Luo, 1997). Certain investment strategies such as mode of entry, order of entry, location, and partnership selection have proved to be important for enhancing FDI performance (Hill, Hwang, and Kim, 1990; Luo, 1997; Lee and Beamish, 1995). In addition, many business strategies have been found to contribute to FDI performance, including technology transfer, conflict management, product quality, and sales force marketing (Luo 1997; Yan and Gray, 1994).

While existing studies have helped explaining the patterns of foreign investment and elevated our understanding of the nature and challenges of FDI operations, findings regarding the effect of these variables on entry mode and FDI performance have been inconsistent. For instance, while a number of studies found that wholly owned operations performed better than joint ventures, and joint ventures than acquisitions (Lee ad Beamish, 1995; Nitsch, Beamish and Makino, 1996), several studies indicate that mode of entry has no significant effect on FDI

performance (Luo, 1995), or contrary to previous findings, equity joint ventures (EJVs) have a higher profit level than wholly foreign-owned subsidiaries (Pan and Chi, 1999; Pan, Li, and Tse, 1999). These inconsistencies may be due to the increasing complexities of the international business environment as well as limitations of existing studies (Buckley and Casson, 1998; Rugman and Verbeke, 1993).

One of the notable limitations is that studies to date have focused on identifying critical success factors for FDI operations without considering the role of investor's strategic orientation toward the host country. Many researchers have observed that companies enter a foreign market for a variety of reasons such as to expand their market, exploit low-cost labor, access natural resources, or gain investment incentives in the host country (Erramilli, 1990; Lan, 1996, Pan, 1996; Yang, 1997). However, few studies have rigorously examined the role of such differences in FDI operations and performance. Export activity has been mostly studied as a home country initiative in the international business literature, for instance, treating export from the home market as an integral part of the internationalization process as firms progress from the least risky mode of exporting to the more involved phase of foreign production (Kwon and Hu, 1995). Some researchers such as Kumar (1994) examined the determinants of export orientation of foreign production by multinationals in a foreign country, but they were not compared to the firms within a local market orientation. Meanwhile, others only focused on the market-seeking multinationals without referring to the export-oriented firms (Luo and Park, 2001). Thus, existing studies have largely neglected the differences in firms' strategic orientation toward the host country in FDI operations or focused only on one type of investors.

Both researchers and practitioners emphasize that foreign direct investment is motivated by specific objectives and strategic foci. Thus, this omission raises several concerns and questions for the study of FDI. The first concern is the narrow focus on the economics of international production. The eclectic paradigm, one of the dominant theories of international investment, considers the ownership, location, and internalization advantages as the key factors determining FDI activities (Dunning, 1983). While studies based on the eclectic paradigm have focused on the ownership and internationalization advantages that help reduce the transaction cost of international production, few have rigorously examined the locational advantages of the host market (Rugman and Verbeke, 1993). Recently, Buckley and Casson (1998) noted the distinction between investment in production facilities and investment in marketing capabilities such as distribution - an important distinction that has been overlooked in much of the

international business literature. Thus, the micro-economic emphasis in the literature has elaborated the characteristics of the ownership and internalization, but neglected firm-driven competition.

The second concern arising from the omission of investors' strategic orientation in existing literature is the validity of their findings and the applicability of recommended strategies for enhancing FDI performance. Existing studies have found many investment strategies and business practices affecting FDI performance, including technology transfer, research & development, conflict management, product quality, and sales force marketing. However, due to their distinctive competencies, firms may have advantages and face constraints that are different from others (Brouthers, 1998). Likewise, various country markets differ greatly in terms of economic development, natural resources, market demand, and government policies. Consequentially, firms have very different objectives for investing in a particular country (Anand and Delois, 1996; Erramilli, 1990). The same advantages or strategies thought to be the drivers of success for some firms would not accrue similar benefits to others. For instance, advantages or strategies meaningful to investors focusing on the local market such as sales force development and R&D intensity may not be relevant to export-oriented investors. To suggest that firms should apply all the performance-enhancing strategies regardless of their strategic orientations toward the host country may be misguided and ill-advised.

The eclectic theory and transaction cost theory have been described as both descriptive and "normative," i.e., being able to predict FDI behavior and performance (Brouthers, Brouthers and Werner 1999). However, several authors have argued that the neo-classic economic assumptions of the eclectic theory such as perfect competition and market failure or imperfections cannot fully explain the complexities of international investment (Chang, 1997; Rugman and Verbeke, 1993). Meanwhile, a substantial body of research in strategic management stresses the effect of firm driven competition on international performance, emphasizing the role of a firm's strategic orientation towards the market (Porter, 1990, 1986). An increasing number of studies in management and international business has investigated the role of strategic orientation in assessing the performance of firms, for instance, those based on the resource-based theory (Peng and York, 2001; Rugman and Verbeke, 1998; Pan and Chi, 1999).

Apparently, MNCs come from various countries, industries, economic and cultural

systems, and are not equal in terms of resources, management expertise, and international experience. Likewise, different countries vary greatly in terms of resources and opportunities for foreign companies. Thus, investors tend to differ in their strategic orientation when investing in a particular country. These observations highlight the need to examine the role of investors' strategic orientation toward the host country. First, to what extent investors differ in their strategic orientation toward the host country? Secondly, to what extent firms' strategic orientations affect FDI activities and performance? Therefore, this study elaborates the concept of strategic orientation, focuses on the distinction between local market orientation and export orientation, and examines their effect on MNCs' entry mode and performance in the host country.

## **THE ROLE OF STRATEGIC ORIENTATION**

Given the multitude of factors that influence firms' international investments, investors' intrinsic orientations towards a host country provides a sensible starting point for understanding the activities and performance of FDI operations. Both academic researchers and practitioners have characterized foreign direct investment as a business activity based on specific objectives (Miller, 1993; Rheem, 1996). MNCs' foreign markets entry may be motivated by many different objectives such as seeking new market opportunities, acquiring low cost raw materials and labor, serving existing clients from home, or maintaining competitive parity (Erramilli, 1990; Pan, 1996; Yang, 1997). Some environment factors such as preferential investment policies and investment risk also represent strong motives for entering a specific foreign market. Investors then enact certain strategies and make operational decisions to achieve their investment objectives (Luo, 1998b).

Strategic orientation is the relative emphasis on one strategic archetype among several alternatives. For foreign direct investment, strategic orientation represents the primary objective for a firm's investment in another country and specifically how the investor perceives its own strength vis-a-vis the attractiveness of the host country for certain type of investment. Among many motives behind the FDI decisions, two strategic investment objectives have appeared repeatedly in the literature and emerged as the dominant strategic orientations, i.e., local market orientation and export orientation. For instance, Chen and Tang (1987) divided foreign companies into import-substitution oriented vs. export-oriented investment in a country. Norvell, Andrus, and Gogumalla (1995) examined how local market orientation and

efficiency-export orientation were related to the level of involvement of U.S. multinationals in international markets. More recently, Luo and Park (2001) suggest that market-seeking investors are different from resource-seekers in terms of investment objectives as well as business strategies. These studies suggest that there is an important distinction between local market-oriented FDI operations and those which use the host country as a platform for export, and that the strategic orientation toward the host country plays a critical role in assessing FDI activities and performance.

The role of strategic orientation in assessing FDI activities and performance can find its roots in existing as well as emerging FDI theories. The eclectic theory of foreign investment suggests that firms seek various advantages when investing overseas, including ownership, location and internationalization (OLI) advantages (Dunning, 1980). These advantages presumably help firm choose the optimal mode of entry and reduce the transaction cost. Country-specific endowments can confer locational advantages such as low labor costs, incentives to local production extended by host governments, and economies of product specialization and concentration. Such locational advantages derive from the comparative advantage of countries. Dunning (1988) further posits that the locational advantages would vary depending on the nature of the task that the firm intends to perform in the country. However, exactly how the local advantages interact with the investment objectives of firms was not advanced in subsequent research.

However, a number of studies based on the OLI paradigm reveals that the perceived locational advantages affect FDI operations in a foreign market. Agarwal and Ramaswani (1992) consider market potential in terms of size and growth rate as locational advantages. In high market potential countries, investment modes are expected to provide greater long-term profitability to a firm than the export mode through the opportunity to achieve economies of scale and consequently lower marginal cost of production to capture the local market potential. Meanwhile, low cost for production input such as labor and raw materials and efficient industrial infrastructure may be attractive for export-oriented operations (Kumar 1994). Thus, the structural characteristics of a country affect managerial perceptions of its locational advantages and its attractiveness as a major market opportunity or a location for export-oriented production.

Recently, the resource-based theory of the firm has been adopted to explain international



investment behavior such as joint venture formation and presented an alternative explanation for different strategic orientations of firms (Chang, 1997; Rugman and Verbeke, 1998; Tsang, 2000). According to the transaction cost theory and the eclectic theory, a necessary condition for foreign investment to occur is the presence of inefficiencies in markets for intermediate inputs, which include raw materials, components, knowledge, and so on. Investment is made overseas to internationalize such advantages while minimizing the transaction costs. In contrast, the resource-based view regards international investment as a means to exploit and develop the needed resources (Tsang, 2000). Some firms engage in foreign production to take advantage of scarce resources to establish efficient manufacturing. Other investors may want to exploit its competitive advantages such as leading technology, quality product and brand image in a foreign country. Thus, the resource-based view argues that factors such as market failure alone are not sufficient to explain the variety of FDI behaviors. It is the "complementarity" between locational factors and firms' unique resources and strengths that provides a better explanation for FDI entry modes and performance (Chang, 1997).

We believe the strategic orientations of investors explain well the interaction between the locational advantages and unique resources possessed by firm. The local market orientation and the export orientation are broad strategic orientation that are inclusive of many advantages and incentives sought by foreign investors. First, local market oriented investors and export oriented operations differ greatly in their perceptions of the types of resources and opportunities available in a target country. Local market oriented businesses invest in another country to capture the untapped market opportunities due to market growth and increasing demand there. In light of globalization of the world economy, many foreign markets have become increasingly viable and provide new space for "growth-oriented" companies who face saturated market and fierce competition at home (Lan, 1996; Luo, 1997). On the other hand, export oriented businesses face rising costs at home or in other markets and invest in a new country to explore various resources such as inexpensive labor and raw materials in order to establish efficient manufacturing for export (Kumar, 1994; Luo and Park, 2001; Sun, 1996). Thus, export oriented businesses view the host country as a manufacturing base for its home market or a platform for export to other markets as an integral part of its global supply chain. For many multinationals, international sourcing has become an integral part of global rationalization and an important strategy for optimizing production and logistics across an international network of facilities that depend on each other for raw materials and components (Sawmidass and Kotabe, 1993).

The distinction between local market and export orientations as the dominant strategic orientations toward the host country is consistent with existing theories of international investment such as the eclectic theory and the resource-based view. First, the decision for overseas investment is highly dependent on the types of advantages that a firm possesses and wants to internalize in a foreign setting. Secondly, whether a firm would invest in a particular country is also determined by the types of resources available there that the investor seeks to acquire and further develop, i.e., the locational factors (Chang 1997). Thus, it is the combination of these two factors that drive firms to make foreign investment decisions, whether to invest, where to invest, and what kind of investment it would be. Several studies found that depending on the level of economic development and host country economic structures, firms generally tended to invest in certain countries for market access and penetration, increasing host-country import levels, while their objectives in other countries were to gain resource advantages leading to increased exports and trade surpluses (Anand and Delois, 1996; Brouthers, Werner, and Wilkinson, 1996). Therefore, many of the observed differences in FDI operations and performance may reflect firms' strategic orientations toward the host country.

The role of strategic orientation has many implications for FDI operations including the two central issues in FDI research, i.e., entry mode and performance. Several studies suggest that strategic orientation toward the host country affects both FDI entry mode and performance (Anand and Delois, 1996; Pan and Chi 1999). First, due to differences in resource advantages and competitive position in the market place, firms have distinctive reasons for entering a specific foreign market and adopt different strategies such as entry mode. Secondly, based on firms' unique strengths and advantages, strategic orientation also influences FDI performance in the host country (Anand and Delois, 1996; Erramilli, 1990; Pan and Chi 1999). In the following section, we elaborate the effect of strategic orientation on the entry mode and performance of FDI operations.

### **Strategic Orientation and Mode of Entry**

Pan (1996) posits that the problem of appropriate entry mode reflects the differences across various countries in the country-specific locational advantages and the varying degrees of internalization efficiency among firms. Erramilli, Agarwal, and Kim (1997) suggest that a certain mix of locational and internalization factors may entice the firm to a higher level of ownership while other factors may deter it from doing so. These authors stress the need to

incorporate location-specific factors and its interaction with ownership and internalization advantages that may affect the level of equity ownership. Apparently, a firm has to find the right fit between the location-specific factors and its ability to internalize these advantages in that overseas location. However, the interaction of ownership and internalization advantages with locational advantages is a highly complex issue as well as a critical missing link in explaining foreign direct investments (Erramilli, Agarwal, and Kim, 1997).

Firm's strategic orientation toward the host country, in our view, can clarify how firms perceive the specific advantages of the location as well as their internalization advantages to capture those locational advantages. As previously stated, due to the endowment of different resources and opportunities in the host country as well as the unique resources of individual firms, investors tend to have different strategic orientations toward a foreign market. A particular strategic orientation represents the complementarity between the types of locational advantages as perceived by the investor and its own unique resources. Given their different orientations toward a host country, investors need to choose a mode of entry that is consistent with the orientation and that can help gain access to the critical advantages and resources to achieve their investment objectives. Therefore, due to their different strategic orientations toward a host country, local market oriented investors and export oriented FDI projects may choose different entry modes.

Specifically, local market oriented businesses that expand beyond their national boundaries in search of new opportunities for their products. These market seeking multinationals tend to possess unique strengths and resources that they can internalize in a foreign country, such as superior quality, brand image, and technical know-how (Luo and Park, 2001). Erramilli (1990), for instance, found that local market oriented businesses focusing on developing new customers in the host country tended to form joint ventures as a means to explore the local expertise that a more aggressive mode such as wholly owned subsidiary can not provide. This is especially true for foreign companies that enter a country market for the first time as they lack the cultural knowledge, critical relationships, and management expertise in the country (Cui, 1998). Thus, in order to develop the local market, these investors are more likely to seek a local partner that may have local marketing expertise, critical relationships, and channels of distribution.

Export oriented businesses, on the other hand, are more interested in exporting to

other countries (including its home market) rather than developing the local markets (Pan and Chi, 1999). For these FDI operations, the demand for local partnership advantages is not as acute as possession of local market information is relatively unimportant. In contrast, the need for control to establish efficient manufacturing operations is more pressing, because the main purpose of export oriented operations is to explore economical resources and comparative advantages in the host country such as inexpensive labor and raw materials or preferential investment policies for their export processing facilities (Kumar, 1994). Given these priorities, export oriented businesses tend to adopt a choice of entry mode that allows greater control and efficiency, i.e., wholly owned operations. Thus, investors' strategic orientations toward a foreign market affect their mode of entry into a host country.

**Hypothesis 1.** Local market oriented investors tend to choose the joint venture mode while export oriented businesses are more likely to rely on the mode of wholly owned subsidiary.

### **Strategic Orientation and FDI Performance**

Given the increasing attention to FDI performance, exploring the effect of strategic orientation on performance would help define the role of strategic orientation in international investment. While many factors have been found to contribute to superior FDI performance, several recent studies suggest that strategic orientation has a significant effect on FDI performance in the host country. Rheem (1996) reported that a study of multinationals in China found that the most profitable firms were those that sold their China-made products internally rather than overseas. Luo (1995) attributed profit growth of foreign investors in China to local market expansion rather than the export orientation. Pan and Chi (1999) also found that investors focusing on the domestic market achieved higher profitability than those export oriented firms. Thus, these findings suggest that a firm's strategic orientation toward a host country may have significantly implications for its FDI performance in that location.

The differential performance of local market oriented operations versus export oriented projects in the host market may be due to the distinct characteristics of these firms and their resource advantages. Local market oriented businesses make and market their products in the local market to capture the growth opportunities there (Luo, 1995). Their objectives are to increase sales in the local market and improve profitability for continuous growth. These

aggressive investors tend to be large multinationals that rely on their competitive advantages in technology, product quality, and marketing expertise (Porter, 1990; Sun, 1996). They can leverage their unique strengths, thus are able to enjoy better growth prospect (Luo and Park, 2001; Pan and Chi, 1999). Such resource advantages often help companies achieve superior returns in the host country market.

Export oriented businesses, on the other hand, focus on the comparative advantages of the host country such as labor and raw materials, and aim at establishing efficient manufacturing for re-export (Luo, 1998b; Porter, 1990). Their *raison d'être* is to supply other market rather than domestic sales. Several studies have found that these investors often come from smaller and less developed economies (Sun, 1996). They are often down-stream manufacturers that supply low-end products to other multinationals, thus facing the pressure of rising cost and/or downward price pressure in the international market place (Yang, 1997). Their main investment objective is to establish low-cost manufacturing using the comparative advantages of the host country to keep their products competitive in the other country markets. Therefore, due to these different advantages and constraints among the firms, local market oriented businesses are likely to achieve better performance than export oriented businesses in the host country market.

**Hypothesis 2.** Local market oriented businesses tend to achieve superior performance in the host country market than export oriented businesses.

### **The Fit between Strategic Orientation and Entry Mode**

Theoretically, firms adopting strategies that are consistent with their strategic intent should achieve superior operating results, and vice versa (Burgelman and Grove, 1996). Thus, the effect of the "fit" between entry mode and strategic orientation should have a positive effect on FDI performance is an important issue. The consistency between a firm's strategic orientation and entry mode allows the firms to leverage its own strengths and resources while benefiting from the locational advantages it is seeking, and can enhance FDI performance. In contrast, lack of such a consistency leads to misdirected effort and difficulties in garnering the needed resources and advantages, thus hampers the attainment of investment objectives. In a study of FDI operations, for instance, Brouthers, Brouthers, and Werner (1999) found that when firms' mode of entry were in line with the advantages based on the eclectic theory, they

tended to have more satisfactory performance.

Entry mode is one of the most important investment strategies that investors adopt to achieve success in the host country. As stated in Hypothesis 1, we propose that local market oriented firms tend to use joint venture to explore the local partnership advantages they may need. In contrast, export oriented investors are more likely to adopt wholly owned operations in order to exert total control in the operation, which is critical for establishing low cost and efficient manufacturing for export. In that case,, investors in a mode of entry that fits their strategic orientation should be able to the advantages and resources they need to fulfill their investment objectives. Thus, by definition, firms in a mode of entry that is consistent with their strategic orientation should achieve superior FDI performance than those whose entry mode is inconsistent with their strategic orientation.

**Hypothesis 3.** Firms in the mode of entry that is consistent with their strategic orientation tend to achieve superior FDI performance than those whose entry modes are inconsistent with their strategic orientation.

## METHOD

To test the effects of various firm and industry factors, data from a country that has received investment from many regions and in various industries would be helpful. The data of this study come from China, which has received increasing attention in the study of FDI in recent years. Since the late 1970s, China has reformed its economy and opened industry after industry for foreign participation. In the last two decades, China has become one of the largest recipients of foreign direct investment. Due to rapid economic development and continuous influx of foreign capital, performance of foreign direct investment (FDI) in China has been of considerable interest to both practitioners and researchers (Rheem, 1996; Pan, Li, and Tse, 1999). In addition, focusing on one country allow controlling across-country variations in other areas such as culture and economic development.

The primary data come from China's Ministry of Foreign Trade and Economic Cooperation (MOFTEC). These data contain the financial reports of 500 foreign invested enterprises submitted to the Chinese government about their operations in 1997. These companies represent various sizes, industries, product categories, and countries including those

from North America, Europe, and Asia. The data contain financial and other types of information such as annual sales, pre-tax profit, total assets, export sales, industry category, location of the project, and the party of controlling interest. Industry data such as industry output and the number of firms in an industry are extracted from the 1998 Statistical Yearbook published by the China Statistical Bureau and appended to the primary data.

Since this study focuses on the distinction between local market orientation and export orientation, the percentage of export from total sales is used to measure a firm's strategic orientation as previous studies (Kumar, 1994; Luo and Park, 2001; Pan and Chi, 1999). Although the Chinese government encourages investment projects that export and help generate foreign currencies, there are no statutory requirements for foreign invested enterprises to export. The export component of a project is usually negotiated on a case to case basis (Rosen, 1999). Thus, firms with high export percentage (e.g.,  $\geq 51\%$ ) are considered voluntary in these efforts and treated as export oriented businesses, and firms with no or low export percentage (e.g.,  $\leq 50\%$ ) suggest a concentration on the domestic market, thus represent local market oriented businesses. In terms of entry mode, we focus on the distinction between wholly owned subsidiaries and joint ventures as stated in the hypotheses.

Previous studies adopted different measures of performance. While some studies used accounting-based measures of performance such as profit margin and return on assets and market-based measures such as sales growth rate and market share (e.g., Luo, 1995), others adopted subjective measures such as perceived satisfaction with performance, perception of goals achieved, length of operation, survival rate, and exit rate (e.g., Osland and Cavusgil, 1996; Brouthers, Brouthers, and Werner, 1999). Different measures may have contributed to inconsistencies in previous findings. Thus, Luo (1998a) suggests that multi-dimensional measures of performance including both financial and market criteria should be adopted. This study adopts four measures of performance: pre-tax profit margin, return on assets (ROA), assets turnover, and market share. Profit margin directly measures the operating results of a venture in the host country. Return on assets measures performance from the investor's perspective. Assets turnover indicates a project's operational efficiency (Luo, 1998a). Market share represents an important criterion for FDI performance, especially for local market oriented businesses.

Previous studies have found that many environmental factors, firms-level variables, and

investment strategies affect FDI entry mode and performance. Thus, to assess the unique effect of strategic orientation, several key control variables are also included in data analysis. Environmental factors include industry growth and level of competition. Based on the economic development priorities and industry history, companies invested in various industries may face different growth prospect and level of competition. Based on the International Standard Industrial Classification (ISIC) codes, an industry's growth rate is the ratio of its total output to that of the previous year. Since the number of firms in the database represents only a small portion of companies in a specific industry, the total number of firms in an industry is used as a crude measure of industry competition.

Several firm-level factors are also included as control variables. Country of origin is measured by the home country of investors and their parent companies. As cultural proximity is of primary interest here, we classify country of origin into two categories: 1) Chinese-based economies including Hong Kong, Taiwan, and Macau, and 2) non-Chinese based economies from Asian, North America, and Europe, etc.. These categories largely represent the cultural proximity of the country of origin to China (Luo, 1997). Due to the uneven economic development and different government policies across regions of China, various locations inside the country offer different resource advantages and opportunities to foreign investors. Guangdong and Fujian provinces, especially the four Special Economic Zones (SEZs) there, were the first to open to the outside world in the early 1980s and attracted the most foreign investment. Such areas have better industry infrastructure in terms of communication and transportation, and business services, and wealthier consumers. Other coastal areas and inland regions were opened for foreign investment in the mid 1980s or later. They are less developed in economic infrastructure and consumer purchasing power. Thus, the location of the project was coded either as SEZs or other areas.

Control is critical for effective management. Management control is indicated by the party who controls the chairmanship of the board. In joint ventures, the party with a controlling interest usually retains the chairperson of the board position, which designates the chief executive officer and allows for control in many areas including human resources, finance, and operations. Furthermore, size of a firm is measured by its total assets. In addition, length of operation has been found to significantly affect FDI performance (Luo 1997). In general, firms who entered the market earlier and had a longer operating history achieved superior performance in terms of profitability and market share (Luo 1998a; Pan and Chi, 1999; Pan, Li,



and Tse, 1999). Length of operation is the number of years between the year of establishing the project and 1997, year of the collected data.

## RESULTS

Based on their export ratio, 69% of these foreign invested enterprises, (345 firms) are classified as local market oriented businesses and 31% of them (255 firms) exhibits an export orientation (Table 1). The ANOVA statistics of the key variables suggest that the average export ratio for local market oriented businesses is 7.27% while that for the export oriented businesses is 92.9%. The histogram in Figure 1 shows a bipolar distribution of investors focusing on the local market or export to other countries. In fact, the average export sales of export oriented businesses are almost nine times those of local market oriented businesses. The difference is statistically significant, indicating a distinct dichotomy between the two groups in their strategic orientations. In addition, local market oriented businesses have larger asset sizes and bigger sales volume than export oriented businesses, although the differences are not statistically significant (Table 1). Overall, these results support our characterization of local market oriented businesses and export oriented investors.

(Insert Table 1 and Figure 1 here)

The results of a chi-square test support the hypothesis (H1) that local market oriented businesses are more likely to choose the joint venture mode while export oriented firms tend to use the wholly owned mode. While only 6.6% of local market oriented businesses choose the mode of wholly owned operations, a large number of export oriented businesses (39.1%) resorts to the same mode. In contrast, 93.4% of local market oriented businesses rely on joint ventures. The Pearson's chi-square value is 63.2, significant at 0.001 level. In addition, to assess the unique effect of strategic orientation on entry mode, we also performed the logistic regression procedure (Table 2) to control for other variables such as country of origin ( $B = 0.863$ ) and location ( $B = -0.709$ ). The results also suggest that local marketer seekers tend to pursue partnership advantages via joint ventures while export oriented businesses focus on control through wholly owned operations ( $B = 2.184$ , sig. = 0.000). The model correctly classifies 86.3% of the firms.

(insert Table 2 here).

As for the second hypothesis, the ANOVA results in Table 1 show that that local market oriented businesses overall perform better than export oriented businesses in three of the four performance criteria. The mean profit margin for local marketers is 7.58%, significantly higher than that of exporters (3.12%). The difference in market share is also statistically significant between local market oriented firms and those with an export orientation (0.348% vs. 0.025%, sig. = 0.01). These two findings support our hypothesis about the effect of strategic orientation on performance. Although local market oriented businesses have higher ROA than export oriented companies, the difference is not statistically significant (10.85% vs. 6.19%). However, export oriented FDI operations achieve a higher level of assets efficiency than local market oriented businesses (2.75 vs. 1.60). This finding, although not predicted by the hypothesis, is consistent with the focus on efficient manufacturing among export oriented businesses and the findings of another study (Chen and Tang, 1987).

Since univariate tests do not control for other characteristics of FDI projects, it is possible that differences in performance are due to variations in other factors. Separate multiple regressions or univariate tests do not consider the correlations among multiple dependent variables, thus do not use the full information for assessing group differences (Hair *et al.*, 1998). Performance measures such as sales, profit, and market share may be significantly correlated with one another. Thus, we adopt the Multivariate Analysis of Variance (MANOVA) procedure to measure the effect of independent variables on the overall performance as well as their univariate effect on specific performance measures (Table 3). More importantly, the MANOVA procedure allows regression analysis of other interval level variables as covariates. The stem-and-leaf plots suggest that there are multivariate normal distributions among the dependent variables, thus satisfying the assumption of joint normal distribution among them. Significant correlations are found among the dependent variables. The sphericity test indicates that the determinant is close to zero and the Bartlett's box is significant, suggesting the data are appropriate for the MANOVA procedure.

The MANOVA results in Tables 3 indicate that the overall multivariate tests of FDI performance are all significant, including the stringent Pillais' criterion (0.709,  $F = 12.844$ , sig. = 0.001). These results indicate that the vectors of means on the four dependent variables across groups are unequal. Moreover, the univariate F-tests are statistically significant for all four dependent variables: profit margin ( $F = 15.517$ , sig. = 0.001), return on assets ( $F = 3.587$ , sig. = 0.01), assets turnover ( $F = 27.226$ , sign. = 0.001), and market share ( $F = 20.282$ , sig. = 0.001).

These results suggest that the vectors of means of the four dependent variables show significant differences collectively and individually across groups. As for the multivariate F-tests of independent variables, strategic orientation has a strong effect on overall performance (F value = 13.981, sig. = 0.001), again supporting hypothesis 2. Moreover, foreign control is an important factor that affects FDI performance (F value = 2.954, sig. = 0.05). This confirms the proposition that FDI projects with greater control achieve superior performance than those without a controlling interest. However, effects of other independent variables, i.e., country of origin, location, and entry mode, on the overall performance, are not significant.

(Insert Table 3 here)

Furthermore, the univariate F-tests of independent variables (Table 3) reveal how the independent variables affect each of the four performance measures. Strategic orientation has a strong influence on profit margin (F = 14.733, sig. = 0.01), assets turnover (F = 6.401, sig. = 0.05), and market share (F = 31.715, sig. = 0.05) of these FDI projects, but not on ROA. Moreover, FDI projects with a controlling interest have better investment results in terms of return on assets and market share, but not in profit margin or asset efficiency. These results are consistent with the findings of another study that the predictor variables have different effects on various dimensions of performance (Luo 1998a). Again, country of origin, location, and mode of entry have no significant impact on any performance measures.

As for the regression analysis of covariates, all variables have statistically significant effects on two or more of the four performance measures (Table 3). FDI projects in high growth industries achieve higher asset turnover ( $\beta = 0.155$ ), but have a smaller market share ( $\beta = -0.191$ ), and industry growth rate does not affect profit margin or ROA. Similarly, industry competition affects assets efficiency positively ( $\beta = 0.135$ ) and market share negatively ( $\beta = -0.262$ ), and does not have any significant impact on pre-tax profit margin or ROA. Furthermore, the results show that while large multinationals achieve larger market share ( $\beta = 0.101$ ), they experience lower return on assets ( $\beta = -0.05$ ). They do not differ significantly from their smaller counterparts in terms of profit margin or asset turnover. Length of operation has significant influence on all four performance measures. Specifically, length of operation has significantly positive effect on profit margin ( $\beta = 0.547$ ), ROA ( $\beta = 0.639$ ), and asset turnover ( $\beta = 0.603$ ), and a negative effect on market share ( $\beta = -0.384$ ) during the early period. Meanwhile, the quadratic function of length of operation indicates that FDI projects in later stages face

significant challenges in profit margin ( $\beta = -0.410$ ), ROA ( $\beta = -0.552$ ), and asset efficiency ( $\beta = -0.587$ ), but firms with longer period of operation in the host country tend to have larger market shares ( $\beta = 0.621$ ).

To further explore whether the "fit" between firms' strategic orientation and their mode of entry affects FDI performance, we created a dummy variable for both local market orientation and export orientation to represent firms whose chosen mode of entry matched their strategic orientation and those whose entry mode did not match their strategic orientation. The overall results of both multivariate and univariate effects of those predictor variables largely remain the same with only small variations for some of parameter estimates, thus not repeated here. More important, the results suggest that multivariate F-tests are significant for local market oriented business ( $F=11.56$ , sig. = .000) and export oriented operations ( $F=7.67$ , sig.=.000), furnishing stronger support for the third hypothesis about the positive effect of consistent strategies on FDI performance. For local market oriented businesses, investors whose entry modes fit their strategic orientation have significantly higher profit margin 8.05 vs. 4.99, sig. = 0.001) and return on assets (14% vs. 0.6%, sig. = 0.05). Among export oriented operations, such fit also leads to superior assets efficiency (2.83 vs. 1.86, sig. = 0.05). In addition, we applied two-way interactions among the predictor variables and covariates to explore their interactive effects on FDI performance. However, the procedure produced few significant interactions, thus not reported here.

## **DISCUSSION**

### **Conclusions**

The bipolar distribution of the export ratio suggests that companies have different strategic orientations toward the host country when investing overseas. Some MNCs invest in the country to develop the local market, and others establish FDI operations to export to other countries. This is consistent with our conceptualization of the dichotomy of strategic orientations among the FDI operations. It also supports that proposition that investors have different perceptions of their unique strengths and the types of resources and opportunities available in the host country. Furthermore, the results indicate that strategic orientation has a significant effect on entry mode. The findings suggest that local market oriented businesses are more likely to form joint ventures and export oriented investors tend to rely on wholly owned

operations. These results confirm the possible interactions between the ownership advantages of the investors and the locational advantages that investors attempt to internalize in the host country (Chang, 1997; Pan, 1996).

The findings also suggest that strategic orientation has a significant effect on FDI performance in this host country. Local market oriented firms have higher profit margin and larger market share than export oriented businesses. This is consistent with their strategic orientations in that local market oriented firms focus on developing the domestic market while the purpose of export oriented operations is to serve other markets. The return on assets of local market oriented businesses is also higher than that of export oriented operations although the difference is not statistically significant. Therefore, local market oriented businesses focusing on exploring the local market have superior financial and market performance than export oriented businesses that use the host country mainly as a manufacturing base for export. These results are similar to the findings of previous studies (Luo, 1995; Rheem, 1996; Pan and Chi, 1999). On the other hand, assets turnover rate among export oriented businesses is significantly higher than that of local market oriented firms. This finding reinforces the proposition and findings of previous studies that the export oriented businesses place greater emphasis on efficient operations (Luo, 1998a; Chen and Tang, 1987; Yang, 1997). Furthermore, the findings suggest that a firm whose mode of entry is consistent their strategic orientations achieve superior results in the performance dimension that is important for the type of investment.

Findings of the study also suggest that managerial control has a positive effect on both return on assets and market share. Firm size has a positive impact on market share yet a negative effect on return on assets. Meanwhile, several control variables including cultural similarity, mode of entry, and location do not have a significant effect on these measures of FDI performance. Moreover, the results suggest that it is difficult for companies to increase their market share in high growth and competitive industries. On the other hand, better growth prospect and competitive pressure companies drive firms to be more efficient in operations. Length of operation proves to be an important control variable for assessing FDI performance. Length of operation has a positive effect on profit margin, ROA and asset efficiency and a negative effect on market share in the early period of entry. Yet the relationships are reversed in the later period in that firms have a large share in later stages of development while facing challenges in augmenting profit margin and assets efficiency, indicating significant trade-offs between financial performance and marketing performance due to length of operation or order

of entry. As found in a previous study (Luo 1998a), the effect of predictor variables is not uniform across the four measures of performance suggesting that FDI performance may be multivariate in nature.

### **Managerial Implications**

Investors need to examine their strengths and resources and the advantages of the host country to develop a meaningful strategic orientation. Based on their strategic orientation toward the host country, investors have yet to understand how investors' strategic orientations toward the host market relate to strategies and performance outcomes. Given their different objectives, firms may adopt various strategies to achieve their investment goals. In other words, different strategic orientations may call for different strategies to enhance the performance of FDI projects. When a firm's strategies, its management structure, and utilization of resources are in line with its strategic orientation, it may be able achieve superior performance. On the other hand, if a firm's strategies, organizational structure, and operational activities are not consistent with its strategic intent, it will result in "strategic dissonance" and sub-optimal performance (Burgelman and Grove, 1996). Therefore, local market oriented businesses should focus on their competitive advantages and enact strategies and deploy resources that contribute to product leadership and local market expansion. On the other hand, export oriented businesses need to emphasize cost containment and improving operational efficiency. It is such fit between firms' objectives, strategies and the market environment that enable firms to achieve superior performance (Luo and Park, 2001).

Likewise, assessment of FDI performance should be based on the firms' strategic orientation. The multivariate effect of strategic orientation on the multi-dimensional measure of performance found in this study can assist MNCs in evaluating their FDI projects. Accounting-based and market-based measures of performance are all important to MNCs as they often have competing priorities. In addition, other factors also influence FDI performance, such as length of operation or order of entry. Such effects may involve trade-offs in different performance measures over time. For instance, for an investor seeking local market opportunities, a company's primary concern in the early entry stage is to establish a foothold in a new market, sales and growth rate should be the primary yardstick for performance evaluation. Beyond the initial entry stage, accounting-based dimensions such as profitability and ROI as well as market share would be more important. Thus, MNCs can

adjust the parameter for each dimension over time to establish stage-relevant goals for the project. Such a stage-specific scheme for planning and performance evaluation can help MNCs optimize resources utilization and develop sustainable expansion strategies.

The increasing globalization of the world economy, especially cross-border movement of capital, raw materials, and components, and even human resources, have made it possible more than ever for MNCs to integrate their worldwide operations. Some experienced MNCs have reached the stage of global rationalization (Craig and Douglas, 1996). A firm may be an exporter in one country and a local marketer in another. These MNCs have adopted different strategies to match the local environment and their goals in different country markets (Anand and Delois, 1996). Meanwhile, comparative advantages of nations have become less stable due to migration of resources or economic development, driving multinationals to compete globally in various country markets. Multinational corporations should pay close attention to the evolving markets of the world and make strategic decisions that allow them to take advantage of their unique strengths, available resources, and emerging opportunities to optimize performance.

### **Suggestions for Future Research**

This study focuses on the distinction between local market orientation and export orientation. It is possible that an investor has mixed objectives or multiple objectives for FDI, which have different degree of importance for the firm. Sometimes, a company can be a local marketer and an exporter in the same country, such as Motorola's manufacturing operations in China, supplying both the local market and other countries. Thus, research design that considers multiple objectives may contribute to a better understanding of investors' strategic orientations toward the host country. In addition, investment environment and government policies of other country markets may be different. Thus, studies of FDI in other transitional economies such as Eastern Europe, South Africa and Southeast Asia would make meaningful comparisons.

Furthermore, future research needs to adopt an evolutionary perspective and explore the long-term behavior of FDI projects. Firms' objectives in an overseas market are likely to evolve over time as they progress through the different stage of development (Cui, 1998). In some cases, export oriented businesses may turn into local market oriented businesses later. Nike, for

instance, came to Asia to set up its manufacturing facilities for export to the U.S. and other countries. As consumer purchasing power in several Asian countries increased, Nike began to explore the local markets. Similarly, there are also many instances of local market oriented businesses turned into export oriented businesses. Some MNCs came to China to establish manufacturing facilities to supply the local market. As the Chinese market becomes increasingly saturated, these firms have already established efficient manufacturing process in the country and begun exporting their products to other markets. Thus, a firm's orientation towards a country's market may change over time. Longitudinal data can help capture the evolution of their orientations and long-term performance.

Other issues may complicate the evaluation of FDI performance of multinationals, especially intra-company transfer pricing. Some firms, especially the export oriented businesses, may use transfer pricing to manipulate their financial performance in a particular country (Luo, 1997). However, the Chinese government offered many incentives to foreign investors including generous tax holidays. Thus, MNCs' motivation for tax-induced transfer pricing in China, especially during the periods of tax holiday and tax reduction before 1996, should be low (Sun, 1999). Several empirical studies using both tax audit and customs data from China have not found direct evidence of prevalent transfer pricing among MNCs in China (Chan and Chow, 1997; Sun, 1999). Thus, to what extent companies practice intra-company trading and transfer pricing for tax advantages or profit repatriation remains largely unknown. How such practices affect MNCs' reporting of financial performance is an important subject for future research.

Strategic orientations of investors are based on their perception of resources and attractive opportunities in their host countries as well as unique strengths and resources. Thus, instead of treating domestic and overseas markets as two separate processes, investors' overall corporate strategy at home and in the international marketplace may offer additional insight into its operations and strategies in a specific country. The position and orientation of a firm in a foreign country, as Porter (1986) argues, are greatly affected by its position in the home market and in the international marketplace. Therefore, strategic orientation and performance of an overseas investment cannot be viewed in isolation but must be considered in relation to the overall strategic posture of the firm (Hill, Hwang, and Kim, 1990). Furthermore, although this study has found that export oriented businesses record lower profit margin and lower market share in the host country, how export-oriented FDI operations may contribute to the



performance of their parent companies or sister companies in other countries warrants investigation.

Given its prominent role in foreign investment, studies of foreign investment behavior and performance must make a distinction between firms' strategic orientations. The complex relationships among strategic orientation, investment and business strategies, and various performance measures call for a closer examination. Whether a specific strategic orientation predisposes a firm to adopt certain strategies presents a fruitful avenue for future research and can help establishing the vital link between strategies and performance. This study examines only the effect of strategic orientation on entry mode. Strategic orientation may affect business strategies such as amount of advertising, localization of supplies and human resources, and transfer of technology, and management know-how. Anand and Delois (1996), for instance, found that Japanese FDI in China was motivated by access to local production resources and involved transfer of technology and management skills. Japanese FDI in India, however, was motivated by the desire to access local markets and involved less transfer of technology and management know-how. Thus, FDI performance depends on how investors respond to the unique advantages of a host country, develop capabilities, and apply effective strategies (Anand and Delois, 1996). The objective-strategy-performance relationship in FDI research demands more theoretical input as well as empirical validation.

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**Table 1. FDI Characteristics Based on Strategic Orientation**

Companies /Measures	Local market orientation	Export orientation	Total		F-value	Sig. Level
	Mean	Mean	N	Mean		
Total Assets	1,109,202	780,174	497	1,009,236	2.78	.096
Sales	992,064	812,749	500	937,193	1.59	.209
Export Sales	10,145	89,572	493	34,795	230.14	.000
Export Ratio	7.27%	92.9%	500	33.5%	5724	.000
Pre-tax Profit	84,716	36,424	481	69,556	6.45	.011
Profit Margin	7.58%	3.12%	500	6.21%	22.51	.000
ROA	10.85%	6.19%	496	9.43%	2.13	.145
Asset Turnover	1.60	2.75	496	1.95	15.20	.000
Market Share	0.348%	0.025%	450	2.44%	43.81	.000
Length of Operation	6.5	6.2	349	6.4	.81	.370

Note: All volume numbers are displayed in 1,000 Chinese yuan (RMB), except for export sales (US\$).

**Table 2. Logistic Regression on Mode of Entry (Wholly Owned Operations)**

Items/Variables	Model Coefficients	
Chi-square	81.563	
Degree of Freedom	6	
Sig.	0.000	
Cox & Snell R square	0.167	
Percentage correctly classified	86.3%	

  

Parameter Estimates	B	Sig.
Country of Origin (non-Chinese Economies)	0.863	0.014
Strategic Orientation (Export oriented)	2.184	0.000
Location (inland areas)	-0.709	0.038
Industry Competition	0.000	0.012
Industry Growth	-0.004	0.817
Firm Size (assets)	-0.168	0.260

**Table 3: Multivariate Analysis of Variance of FDI Performance**

Test Name	Value	Approx. F	Sig.
Pillais' criterion	0.709	12.884	0.000
Hotelling's trace	1.256	18.498	0.000
Wilks' lambda	0.398	15.762	0.000

## Univariate F-Tests of Dependent Variables

Dependent Variables	F	Sig.
Profit Margin	15.517	0.000
Return on Assets	3.587	0.004
Assets Turnover	27.226	0.000
Market Share	20.282	0.000

## Multivariate F-tests of Independent Variables

Variable	Hotelling's	F-value	Sig.
Strategic orientation	0.158	13.981	0.000
Country of Origin	0.008	0.551	0.699
Location	0.009	0.668	0.615
Mode of Entry	0.010	0.770	0.545
Foreign Control	0.038	2.954	0.020

## Univariate F-Tests of Independent Variables (F-value)

Variables	Profit Margin	Return on Assets	Assets Turnover	Market Share
Strategic orientation	14.733**	3.287	6.401*	31.715*
Country of Origin	0.200	1.612	0.029	0.145
Location	1.001	2.506	0.600	0.036
Mode of Entry	0.600	2.300	0.253	0.670
Foreign Control	0.300	5.055*	1.621	6.523*

## Regression Analysis of Covariates (Beta Coefficient)

Variables	Profit Margin	Return on Assets	Assets Turnover	Market Share
Industry Growth	-0.090	0.022	0.155*	-0.191**
Level of Competition	-0.084	0.062	0.135*	-0.262**
Size of Firm	0.014	-0.050*	-0.016	0.101**
Length of Operation	0.547**	0.640**	0.603**	-0.384*
(Length of Operation) <sup>2</sup>	-0.410*	-0.552*	-0.587**	0.621**

Notes: \*\* — p &lt; 0.01, \* — p &lt; 0.05

**Figure 1. A Bipolar Distribution Of Local Market Orientation  
And Export Orientation**

