

Chinese MNEs Ownership Global Strategy: Do Geographical Distance, Market Size, & Regulatory Quality Matter?

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Abstract - This study investigates the cross-border M&As performed by CMNEs in 25 developing countries from 2016 – 2018. Using econometrics approach, this study provides an empirical analysis of the role of geographical distance, host market size, and host government quality on the cross-border M&As performed by CMNEs. We find that geographical distance does not significantly affect the portion of ownership of CMNEs in cross-border M&As. We also find that host country market size and host country regulatory quality significantly influence the portion of ownership of EMNEs in cross-border M&As. Specifically, a larger host country market size and a better regulatory quality of the host country leads to higher portion of EMNEs ownership in their cross-border M&As. These findings contribute to cross – border M&As literature, especially in the context of CMNEs ownership in developing countries. Our study also offers practical implication with regard to the subject matter.

Keywords - Cross – border M&As; Geographic distance; Market size; Regulatory quality

I. INTRODUCTION

Today, China has become one of the major players for Outward Foreign Direct Investment (OFDI). During 2018, China's OFDI ranked second in the world, second only to Japan [31]. This is a significant change from 2007, when China's OFDI only ranked 13th in the world [6]. China's OFDI also largely increase in value, from \$22.4 billion in 2007, to \$143 billion in 2018 [30, 31]. Chinese Multinational Enterprises (CMNEs) are one of the main contributors of China's OFDI. A Multinational Enterprises (MNE) itself is an enterprise that perform business activities (production and marketing) in more than one country [3]. In the 20th century, MNEs come mostly from developed countries that are known as the three great market regions or 'the triad' (Japan, Europe, and the United States) [17]. However, in the 21st century, MNEs from developing countries started to rise and internationalize rapidly, especially MNEs from China. Since the opening of China's economy in 1978, the flow of Inward Foreign Direct Investment (IFDI) in the form of capital and technological know-how has facilitated the foundation of many Chinese enterprises, either privately owned or state-owned (SOEs), that were eager to expand further [35]. Thus, with the inception of 'Go Global'

policy in China from 2000 and the admission of China into World Trade Organization (WTO) in 2001, these Chinese enterprises have aimed to reach rapid internationalization, and for 20 years, CMNEs have successfully entered many countries in different continents around the world [12, 25]. To achieve internationalization, enterprises usually started from exporting their products into other countries. Enterprises could also sell their valuable technical know-how or unique patented products to firms from other countries (licensing) or sell their know-how, brand, intellectual property, procedures, and business model to firms from other countries (franchising) [13]. However, to be a true MNE, an enterprise needs to perform OFDI into another countries, in order to have tangible footholds in the host countries. This could be achieved either through cross-border Mergers and Acquisitions (M&As), joint ventures or greenfield investments [11]. In the cross-border M&As, MNE acquired the ownership of a local firm in the host countries. In the joint ventures, MNE forges a strategic alliance with firms from the host countries to create a new company. For greenfield investment, MNE does not acquire or ally with local firms. Instead, MNE establish its own company in the host countries from scratch [11]. From these several options, CMNEs preferred to perform cross-border M&As as the main activity for their OFDI's, rather than joint ventures or greenfield investments. In fact, CMNEs are more aggressive in cross-border M&As activities than their counterparts, the Developed Multinational Enterprises (DMNEs) [7, 26]. This is because M&As offer several advantages that facilitate rapid internationalization, such as rapid control of valuable and complementary resources and capabilities that belong to target firms in host countries [19]. Thus, with these resources and capabilities, CMNEs could achieve faster adaptation in the local environment of the host countries, enabling faster internationalization in many countries around the globe [1].

During the cross-border M&As, CMNEs would decide their equity participation in the target firms [26]. There are several variables that might influence CMNEs equity participation, namely geographical distance, host country market size, and regulatory quality of the host country. The geographical distances, host country market size, and regulatory quality of the host country might

affect the transaction costs, market opportunities, and institutional uncertainties that CMNEs incurred and experienced in the host countries [15, 18, 25]. Several scholars have called for further analysis of the role of these variables in CMNEs' cross-border M&As [20, 22]. There is also a call to examine the CMNEs' cross-border M&As in the global setting [36]. Therefore, we intend to further investigate the role of geographical distance, host country market size, and regulatory quality of the host country in the global setting. Thus, our research objective is to investigate the role of geographical distance, host country market size, and regulatory quality of the host country on CMNEs global M&A activities.

We claim two main contributions. First, our study extends the growing literature on CMNEs. Second, our study adds to the growing literature on cross-border on CMNEs cross-border M&As. M&A activities, especially in the global context. The structure of the paper is organized as follows. Section 2 explains the research hypotheses of this research. Section 3 provides methodology of this research. Section 4 explains the results and discussions of this research. Section 5 contains the conclusions of this research.

II. METHODOLOGY

More distant host countries usually provide greater challenges for multinational enterprises, including CMNEs. In the more distant host countries, CMNEs usually confront external uncertainty (volatility of the host countries environment) and internal uncertainty (CMNEs perceived inability to operate in the host countries environments) [10]. CMNEs will incur significant transaction costs, in the form of larger costs of monitoring and coordination of newly acquired subsidiary. CMNEs will also be a subject of larger transportation and communication costs for monitoring and coordination [9, 16]. In addition, CMNEs will likely meet several challenging issues in their cross-border M&As at more distant host countries. CMNEs might lack in international management capabilities and also lack in experienced individuals, thus it will be more difficult for CMNEs to manage newly acquired subsidiary in the environments that are very dissimilar to what CMNEs is familiar with [28]. Thus, CMNEs will also confront considerable problems to employ, trained, and manage managers that are able to take on leadership roles in the newly acquired subsidiaries [8]. These factors will influence CMNEs to lower their portion of M&As ownership in more distant host countries. Therefore, we propose the following hypothesis:

H1: A greater geographical distance between CMNEs' home countries and the host countries of their M&A targets leads to a lower portion of CMNEs ownership in their cross-border M&As.

Essentially, CMNEs always interested in chasing new market opportunities in other countries [14]. Therefore, a larger host country market size might attract CMNEs to invest and enter that country [24]. This is because a larger

host country market size provides several benefits for CMNEs. First, a larger host country market size would enable for more efficient use of CMNEs' resources and capabilities [24]. Second, CMNEs would also be able to utilize the economies of scale and the economies of scope in a larger host country market size [23]. Third, a larger host country market size provides better chance for CMNEs to earn more profits rather than in smaller host country market size, thus it would enable CMNEs to grow faster [4, 5]. Lastly, these several benefits could also enable CMNEs to better capitalize their competitive advantage (such as their cost-effective manufacturing capabilities) [37]. Because of these several benefits, CMNEs would choose to have a higher portion of ownership during M&As activities in a larger host country market size. Thus, we propose the following hypothesis:

H2: A larger host country market size leads to higher portion of CMNEs ownership in their cross-border M&As.

Regulatory quality of the host countries consist of policies and regulations related to businesses (such as price controls, bank supervision, and business licenses) [2]. Thus, a better regulatory quality of the host country might attract CMNEs to perform cross-border M&As in that country [27]. This is because a better regulatory quality will reduce information asymmetry and regulatory ambiguity in the host countries business environment, thus reducing the risk that CMNEs face in the host countries [15]. A better regulatory quality will further reduce the risk for CMNEs by reducing uncertainties in the policies and regulations of the host countries market size, and also reducing the risk of asset exposure from government expropriation of foreign assets [36]. Therefore, CMNEs would choose to have a higher portion of ownership during M&As activities in the host countries with better regulatory quality. Thus, we propose the following hypothesis:

H3: A better regulatory quality of the host country leads to higher portion of CMNEs ownership in their cross-border M&As.

III. RESULTS

3.1. Sample Design

We tested our hypothesis by analyzing 75 CMNEs' M&A transactions in 25 developing countries on 4 continents (Asia, Africa, Europe, and the Americas) between 2016 and 2018. This data is reported in the Thomson Financial SDC Platinum Database for Worldwide M&A. SDC Platinum is the main source of the latest information on cross-border transactions around the world, and this database has been used by many studies focusing on cross-border M&As [21, 29]. Regarding geographic distance, host country market size, and host country regulatory quality, we obtained these data from the Wharton School of the University of

Pennsylvania, World Bank Development Indicators, and Worldwide Governance Indicators.

3.2. Measurement of Variables

3.2.1. Measurement of The Degree of Ownership of CMNEs in Cross-Border M&As

The dependent variable of this study is the degree of ownership of CMNEs in cross-border M&As. This variable is measured by the percentage of equity held by CMNEs after the cross-border M&As. The SDC Platinum database provides the degree of ownership as a continuous variable with values extending from 0.1% to 100%. We use 10% as the cut-off value to eliminate cross-border M&As in similar portfolios. Other studies on cross-border M&As have proposed this, such as Liou *et al.* [26].

3.2.2. Measurement of Geographical Distance

The geographic distance is measured from the great circle distance between China and the host countries based on the coordinates of the geographic centers of the two countries. This measurement is suggested by Berry *et al.* [9]. Great circle distance comes from the Wharton School of Business, University of Pennsylvania [32].

3.2.3. Measurement of Host Country Market Size

The size of the host country's market is measured based on the host country's per capita GDP. Buckley *et al.* [24] used this measurement method in their previous study. The per capita GDP of the host country comes from World Bank Development Indicators [33].

3.2.4. Measurement of Regulatory Quality of the Host Country

The regulatory quality of the host country is measured from the regulatory quality dimension of the Worldwide Governance Index (WGI) [34]. This indicator has been used in a number of previous studies on cross-border M&As [2, 15]. The regulatory quality score is between -2.5 and 2.5. The higher the score, the higher the regulatory quality of the host country.

3.3. Model Specification

The estimation method for analyzing panel data is the random effects model (REM). In order to determine the Fixed Effects Model or the Random Effects Model, the most commonly used specification test is the Hausman test, which tests the null hypothesis that the coefficients estimated by the efficient random effects estimator are the same as the ones estimated by the consistent fixed effects estimator. The equation model can be specified as follows:

$$OWN_{i,t} = \alpha_i + \beta_1 GD_{i,t} + \beta_2 MS_{i,t} + \beta_3 REG_{i,t} + \epsilon_{i,t}$$

Where OWN stands for CMNEs ownership, β for regression coefficient, GD for the geographical distance, MS is the Market Size of host country, REG for regulatory quality of the host country, i is the cross-sectional units and t represents the time period.

IV. DISCUSSION

Table 1 depicts descriptive statistics of all the variables used in the analysis. The mean of CMNEs ownership is 73.80, with a standard deviation of 29.67. On average, CMNEs opted for 73.80% ownership during

M&As in developing countries. The mean of geographical distance is 8536.78, with a standard deviation of 5544.16. On average, the geographical distance between CMNEs home country and the host country is 8536.78 kilometres. The mean of market size is 8253.87, with a standard deviation of 5355.17. On average, the GDP per capita in the host country is 8253.87 USD. The mean of regulatory quality is 0.18, with a standard deviation of 0.75. On average, the regulatory quality score in the host country is 0.18 (from -2.5 and 2.5 range).

TABLE 1. DESCRIPTIVE ANALYSIS

	Descriptive Analysis			
	EMNEs Ownership (OWN)	Regulatory Quality (REG)	Market Size (MS)	Geographical Distance (GD)
Mean	73.80	0.18	8253.87	8536.78
Median	96.00	0.20	9547.85	7047.26
Maximum	100.00	1.84	18686.51	19367.94
Minimum	11.00	-2.16	431.79	1224.62
Std. Dev.	29.67	0.75	5355.17	5544.16
Jarque-Bera	5.46	2.11	4.07	6.56
Probability	0.09	0.35	0.13	0.08
Observations	75	75	75	75

For data analysis, first we perform Jarque Bera test. Jarque Bera test is one of the normality tests of the goodness of fit test which measures whether the skewness and kurtosis of the sample are in accordance with the normal distribution. Prob. > 0.05 shows the univariate normality of the data on the variables. Geographical Distance have continuously remains at a certain period, so matrix is near singular and Fixed Effect (FE) cannot be done, then random effect (REM) is used. An extended Langrange Multiplier (LM) Test (Test for poolability) could be used to check whether a pooled regression is appropriate or not. the Breusch-Pagan probability (both) is less than 0.05 then H_0 is rejected which means that the right estimate for panel data regression is a random effect model. Table 2 shows the results of Langrange Multiplier (LM) Test.

TABLE 2. LANGRANGGE MULTIPLIER (LM) TEST

ull (no random effect) Alternative	Langrange Multiplier (LM) Test		
	Cross-section One-sided	Period One-sided	Both
Breusch-Pagan	5.543332 (0.0186)	0.926230 (0.3358)	6.469562 (0.0110)
Honda	2.354428 (0.0093)	-0.962409 (0.8321)	0.984307 (0.1625)
Standardized Lagrange Multiplier	2.875523 (0.0020)	-0.691668 (0.7554)	

$$\text{OWNit} = 56.895 + 12.622\text{REG} + 0.002\text{MS} - 0.0005\text{GD}$$

The F test or regression coefficient test simultaneously, the effect of the independent variable on the dependent variable. With a significance level of = 5%, it is found that there is influence of the independent variable on CMNEs ownership (prob of F statistic = 0.000 < 0.05).

TABLE 3. HYPOTHESIS TESTING

Variable	Hypothesis Testing			
	Coefficient t	Standard Error	t-Statistic	Probability
Regulatory Quality	12.622	6.275	2.012	0.048
Market Size	0.002	0.001	2.459	0.016
Geographical Distance	-0.0005	0.001	-0.626	0.533
Constanta	56.895	8.494	6.699	0.000

A pooled regression is estimated (Table 3 and Table 4) Probability are significant for regulation (REG) and market size (MS) at 5% significance level, while geographical distance (GD) are not significant. Therefore, our data analysis find that hypothesis 1 is unsupported, while hypothesis 2 and hypothesis 3 are accepted. The coefficient of determination R-squared is a coefficient number that shows the variation of a variable on other variables in percentages. R-squared = 0.224 determine the percentage of the dependent variable (CMNEs ownership) caused by the independent variable is 22.4%.

TABLE 4. WEIGHTED STATISTICS

	Weighted Statistics		Weighted Statistics
Coefficient of Determination (R-squared)	0.224	Mean of dependent variable	40.903
Adjusted Coefficient of Determination (Adjusted R-squared)	0.191	Standard Deviation of dependent var	23.138
Standard Error (S.E.) of regression	20.812	Sum of squared residual	30753.207
F-statistic	6.822	Durbin-Watson statistic	1.976
Probability (F-statistic)	0.000		

For further analysis, we use Trimming Model for hypotheses testing. Trimming model is used to improve a model by removing independent variables that are not significant. R² of regulation (REG) and market size (MS) on CMNEs ownership is equal to 22%. Table 4 and Table 5 shows the results of the trimming model.

TABLE 5. HYPOTHESIS TESTING (TRIMMING)

Variable	Hypothesis Testing			
	Coefficient t	Standard Error	t-Statistic	Probability
Regulatory Quality	13.014	6.139	2.120	0.037
Market Size	0.002	0.001	2.391	0.019
Constanta	54.870	7.439	7.376	0.000

TABLE 6. WEIGHTED ANALYSIS (TRIMMING)

	Weighted Statistics		Weighted Statistics
Coefficient of Determination (R-squared)	0.220	Mean of dependent variable	41.782
Adjusted Coefficient of Determination (Adjusted R-squared)	0.199	Standard Deviation of dependent var	23.282
Standard Error (S.E.) of regression	20.839	Sum of squared residual	31268.223
F-statistic	10.181	Durbin-Watson statistic	1.951
Probability (F-statistic)	0.000		

V. CONCLUSION

This study has performed an extensive analysis of cross-border M&As activities that performed by CMNEs in the global context, particularly in 25 developing countries from 4 continents (Asia, Africa, Europe, and the Americas) between 2016 until 2018. It provides an empirical analysis about several factors that might influence cross-border M&As activities that performed by CMNEs, particularly geographical distance, host country market size, and host country regulatory quality. Several scholars have called for further analysis of the role of these variables in CMNEs' cross-border M&As [20, 22]. There is also a call to examine the CMNEs' cross-border M&As in the global setting [36]. Therefore, we intend to further investigate the role of geographical distance, host country market size, and regulatory quality of the host country in the global setting. We applied Random Effects Models (REM) in our data panel analysis, with the degree of ownership of CMNEs in cross-border M&As as dependent variable, and geographical distance, host country market size, and host country regulatory quality as independent variables.

We find that geographical distance does not significantly affect the portion of CMNEs ownership in

cross-border M&A. This finding is different from similar studies conducted by Estrin *et al.* [28], which found that larger geographical distance would prevent Emerging Multinational Companies (EMNEs) from making M&As. Perhaps differ from EMNEs, CMNEs are seeking to become a major players in the world economy through a "Go Global" policy. Therefore, this makes geographic distance no longer an important issue. The risk of higher learning and transaction costs due to geographical distance is acceptable because of the prospect of a much greater return on investment, and the prospects for success in rapid internationalization. In other words, CMNEs may be more concern about rapid internationalization by aggressively entering almost every developing countries, including the more distant ones [18, 25].

The next finding is that host country market size and host country regulatory quality significantly affect the degree of ownership of CMNEs in cross-border M&As. Specifically, a larger host country market size and a better regulatory quality of the host country creates a higher portion of CMNEs' ownership in their cross-border M&As. The finding of the significant effect of a larger host country market size is consistent with the results of other studies [4], [24], [37], while the finding of the significant role of a better regulatory quality of the host country is also in line with the results of other study [21]. Considering the findings, this study suggests a practical implication for developing countries. Since geographical distance is not an issue, developing countries should focus to improve the regulatory quality in their countries through a strong commitment to reforming the bureaucracy. With this, it is hoped that the amount of CMNEs' OFDI could be further increased in the future. This research has several limitations and suggestions for future research. First, this research covers CMNEs' cross-border M&As in the global context. Therefore, it is better for future research to investigate CMNEs' cross-border M&As in the regional context, especially in the region that dominated mostly by developing countries (South Asia, Central Asia, Middle East and North Africa, Sub-Saharan Africa, Eastern Europe, and Latin America). Second, this research only focusses on cross-border M&A activities performed by CMNEs. Thus, future research could investigate about cross-border M&A activities performed by other EMNEs, such as EMNEs from India, Russia, Brazil, and South Africa.

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