Determinants of multinationals' performance and the impact of FDI in China: recent evidence

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Declaration of Authorship

I, Chuang Wang, hereby declare that this thesis and the work presented in it is entirely my own. Where I have consulted the work of others, this is always clearly stated.

Signed: 

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Abstract

Under the pressure of economic globalization, firms are seeking to expand their business to foreign markets and governments are thinking of opening up their markets to foreign investors. However, the factors which affect market share performance and the survival rate of foreign firms in the host market need to be investigated. As the banking sector is the core sector in financial markets, the Chinese government also need to be aware of the impact of opening up to foreign investors on domestic banks as well as on financial markets. This study contributes to the the existing literature in the following ways. Firstly, entry timing, entry mode, investment size, firm location, advertising intensity and their interaction effects have been used to investigate the market share performance of multinationals. Secondly, this study empolyes both Hofstede's index and Global Leadership and Organizational Behaviour Effectiveness (GLOBE) index to analyse the impact of cultural distance on multinationals' survival. Furthermore, when analysing the factors which affect the foreign firm's survival, country risk is also included in the analysis. Thirdly, this study combines both disaggregate measure (foreign exposure index) and aggregate measure (foreign banks numbers and foreign bank assets share) to investigate how foreign bank entry affects domestic banks' performance and the financial liberalization of the domestic market. The results of the study show that: early entrants and high advertising intensity are positive factors which relate to multinationals' performance in foreign markets; 'wholly owned subsidiaries' is a better entry mode which helps achieves improved market

performance and survival rate than other entry modes; cultural distance and country risk are negatively related to the survival of multinationals in the host market; market size moderates the negative impact of cultural distance and country risk on multinational's survival; multinationals in eastern China enjoy better market performance and the negative impact of cultural distance and country risk on survival rate is less than other parts of China; foreign banks entry improves the performance of domestic banks and promotes financial liberalization.

Table of Content

List of Tables and Figures

List of Abbreviation

CBRC	**China Banking Regulatory Commission**
FDI	**Foreign direct investment**
FEI	**Foreign exposure index**
GATS	**The General Agreement on Trade and Services**
GDP	**Gross Domestic Product**
GLOBE' index	**The Global Leadership and Organizational Behaviour Effectiveness index**
GNP	**Gross National Income**
MNEs	**Multinational enterprises**
MOFCOM	**Ministry of Commerce of People's Republic of China**
PRS	**Political Risk Services**
VIF	**Variance inflation factor**
WTO	**World Trade Organization**

Chapter 1. INTRODUCTION

After the Third Plenum of the 11th Central Committee of the Chinese Communist Party in 1978, the restrictions that had been imposed on foreign investment since 1949, was lifted. The growth of foreign investment since then, has been dramatic. Up until now, China has become the second largest recipient of foreign investment in the world. Accompanied by the expansion of foreign investment, China has enjoyed an extremely high level of economic growth since the reform started. Thus, it is important to ask what factors have influenced multinationals in China and what is the influence of foreign investment on the Chinese economy.

The determinants of multinationals' performance still puzzle academics as well as practitioners (Tian and Solcum, 2014; Kostova et al., 2016; Dhams, 2017). In previous research, a variety of frameworks were employed to explain the performance of multinationals, including network perspectives (Andersson et al., 2002; Venaik et al., 2005; Liu et al., 2014), a competence-based view of firms (Birkinshaw et al., 1998; Cantwell and Mudambi, 2005), location factors (Buckley and Ghauri, 2004; de Jong et al., 2015) and the decision-making authority (O'Donnell, 2000; Gammelgaard et al., 2012). Although the number of frameworks used in current literature is quite large, there is still very little evidence for what factors are most prevalent in understanding the performance of multinationals (Dahms, 2017; Tian and Solcum, 2014; Hsu et al., 2016). As Lo and Lin (2015) and Gammelgaard et al. (2012) argue that these frameworks are often tested by themselves alone. Thus, the question, which

multinationals' managers and host country policy makers are most interested in, is where and how certain factors should be taken into account, which is left open. Also, most of previous studies are focused on developed countries, which provides limited evidence for emerging markets (Dhams, 2017; Lin and Hsieh, 2010; Hoskisson et al., 2013; Tian and Solcum, 2014).

Understanding the factors which influence the multinationals' performance is important. The reason for this, is that better-performing multinationals attract follow up investment (Dahms, 2016); thus, it is essential to find out the most important factors.

Previously, a research study carried out by Lieberman and Montgomery (1988), examined the relationship between entry timing and firm performance in a host country, concluding that first movers can enjoy the advantages through three primary sources: leader position in technological aspect, the pre-emption of assets, and the creation of buyer switching costs. Magnusson et al. (2009), by using a sample of 379 subsidiaries in 43 developing countries covering the period 1986 to 2001, found that there was a critical relationship between entry timing and firm performance.

However, Gaba et al. (2002) stated that the entry-timing performance relationship is also depend on other factors. Furthermore, apart from entry timing, other strategic choice also plays a significant role in explaining the performance of multinationals in China. Cui and Lui (2005) found out that entry mode and investment size are potentially the most fundamental factors. For example, Gaur and Lu (2007), by using a sample of 20,177 subsidiaries covering the years 1986 to 2001, analysed the effect of entry mode on foreign subsidiaries of Japanese multinationals. They argued

that entry mode is a critical reason to explain why some firms succeed in a foreign country, while other firms failed in the same context. Notwithstanding, after the investigation of multinationals' performance in China from 1998 to 2002, Murray et al. (2012) found that investment size influences the ability of a firm to make full use of first-mover advantages or reduces the risk of late followers.

Given the fact that Eastern China comprises only 36.5% of the population of the entire country but contributes to 55.3% of GDP (Gross Domestic Product) and 87.3% of foreign investment, a significant imbalance among different parts of China still exists. The choice of location to invest in China, will affect the output and performance of multinationals (Sridhar and Wan, 2009; Hu and Chen, 1996). Therefore, chapter three which is the first empirical chapter, focuses on the relationship between the factors mentioned above and the multinationals' performance in China. Different from the previous study, this thesis focuses on the Chinese market and uses the most recent dataset.

The factors mentioned above are firm-level factors, so in the meantime, country-level factors also affect multinationals. When entering a foreign country, multinationals face additional dimension of risk. the same plan with the same rate of return and commercial risk may entail different risks for different countries (Vijayakumar et al., 2009). This risk is the so-called 'country risk'. Country risk has mainly three dimensions: economic, political and financial. Understanding how country risk affects the survival and performance of multinationals in a foreign country, would help decision makers to build a clear view of the obstacles they will face in the future.

Other than country risk, cultural distance is another country-level factor that needs to be considered when performing international expansion. Williamson (1985), states that cultural distance should be taken into consideration when analysing the success, failure and performance of multinationals in the international market. Moreover, López-Duarte et al. (2016) have reviewed 265 selected articles from 2000 to 2012 and they conclude that cultural distance affects multinationals' performance.

However, the effect of country risk and cultural risk can be mitigated by market size (Rothaermel et al., 2006). They also argue that larger markets can offer more opportunities and incentives for firms to invest; thus, chapter four will research the effects of country risk and cultural distance on multinationals' survival.

As highlighted before, it is important for decision makers or policy makers to not only know what factors influence the multinationals' performance, but also to know the effect of foreign investment on domestic firms and markets. It is widely known that foreign investment is an important factor, causing economic growth (Wei et al., 2001). Also, by employing quarterly time series data from 1988:1 to 2003:4 of foreign investment in Chinese market, Tang et al., (2008, p. 13) stated that foreign investment has "a complementary relationship with domestic investment. FDI has not only assisted in overcoming shortage of capital, it has also stimulated economic growth through complementing domestic investment in China". However, research conducted by Gunby et al. (2017), by using meta-analysis and employing a sample of 37 studies with a total of 280 individual coefficient estimates in order to establish a relationship between foreign investment and Chinese economic growth, suggests that foreign

investment is unlike to successfully stimulate Chinese economic growth, because there is no significant evidence of a spill over effect of foreign investment at the aggregate level. Therefore, it is essential to find the effect of foreign investment on domestic market.

Since the start of reform and opening-up in 1978, the Chinese economy has maintained a rapid growth rate, whilst the total amount of outstanding loan relative to GDP, increased from 51% in 1949 to 107% in 2007. Zhang et al., (2012) argued that the financial market, especially the banking sector, plays a significant role in Chinese economic growth; thus, in this thesis, we use the banking sector as an example, to demonstrate the effect of foreign investment on Chinese economy.

As Saleh (2015), Bonin et al., (1998) and Dages et al., (2000) stated, foreign bank entries could allow external capital to flow into the domestic banking sector together with new technologies, management practices and new financial innovations. Domestic banks could learn from the foreign banks, to improve their operations (Clarke et al., 2003). However, Denizer (2007) insists that foreign bank presence will create unbalanced competition in developing countries, due to the strong and great reputations of foreign banks. Therefore, in chapter five, this thesis will analyse the effect of the foreign bank presence on domestic banks and the domestic banking sector.

In summary, this thesis aims to investigate: i) the relationship between entry timing, entry mode, investment size, firm location and the interaction effect of these factors on multinationals' performance in China; ii) the effect of country risk, cultural

distance, entry mode and the market size on multinationals' survival in China; iii) the effect of foreign bank presence on domestic bank performance and financial markets.

The main contributions of this thesis to the literature are as follows:

(1) Previous research has tried to evaluate the effect of entry timing on multinationals' performance as well as some other factors such as entry mode, investment size and advertising intensity. However, the results are conflicting. For example, even though some researchers are insisted with early mover advantages (Gaba et al., 2002; Frynas, Mellahi & Pigman, 2006; Murray et al, 2008), some other researchers support the late mover advantages (Vakratsas et al., 2003 and Barnes et al. 2009). This thesis shows that the first-mover advantages are high enough for multinationals to choose to enter the market early than choose to apply a 'wait-and-see' strategy. Wholly owned subsidiaries perform better than other entry modes and a large investment size is better for multinationals in foreign countries. Moreover, previous research examining the above factors is limited to developed countries. The thesis moves the focus on to the Chinese market.

(2) While country risk and cultural distance are two important country-level factors for multinationals' survival, research is limited to include either one of them in studies conducted mainly in developed countries. This thesis has employed both factors and analysed the effect of them on multinationals' survival in China. Moreover, as there is no clear view about which index for cultural distance is

the most acceptable for the research, this thesis uses both Hofstede's index and the GLOBE index, to provide more convincing evidence. This approach will provide a more convincing answer to the mixed findings of previous research.

(3) Previous literature mainly uses aggregate measures such as foreign bank numbers and foreign bank assets shares, to investigate the effect of foreign bank presence on domestic banks and markets. The thesis has empolyed both aggregate measures and disaggregate measures (foreign exposure index), to do the analysis. The approach includes both measures to provide a better understanding of the influence of foreign bank entry. Furthermore, unlike previous research which only focuses on the effect on domestic banks, this thesis examines not only the domestic banks but also the whole financial sector too. It shows that foreign bank entry, promotes the financial liberaliation of the Chinese financial market.

This thesis is structured as follows: Chapter two presents an overall review of existing literature covering all topics discussed throughout the whole thesis, including entry timing, entry mode, investment size, cultural distance, country risk and foreign bank entry. Chapter two, aims to provide the theoretical foundation for the whole thesis, demonstrating the findings of previous research, but most importantly identifies gaps in previous literature to highlight the findings of this thesis.

Chapter three, is the first empirical chapter of this thesis. It is aimed at examining the relationship between multinationals' performance and different strategic

choices in the Chinese market. While prior research has focused on developed countries, this thesis is focused on the Chinese market, which is the second largest recipient of foreign investment all over the world. It includes several explanatory factors: entry timing, entry mode, advertising intensity and firm location. We use multiple linear regressions, and the results show that our explanatory factors play a significant role in determining the multinationals' performance.

Chapter four, investigates the country level factors influencing the survival of multinationals in China. The factors that we tested included entry mode, country risk, cultural distance, market size, firm age and firm location. The results show that the survival rate of multinationals is significantly affected by the explanatory factors, while market size has moderated the negative effect of country risk and cultural distance.

Chapter five, investigates the effect of foreign bank presence in the domestic market. Most previous research has been using aggregate measurements, providing conflicting results. In this thesis, we use the foreign exposure index as a disaggregate measure to examine the effect. We provide convincing evidence, that foreign bank presence significantly influences the domestic banks' performance and speeds up the process of Chinese financial market liberalization.

Chapter six, provides the conclusion and summary of the main findings of the thesis, the limitations of the thesis, the direction for future research and policy implications.

Chapter 2. LITERATURE REVIEW

2.1 Introduction

China's economic reform and openness policy to the global market, from the 1980s, have been exemplified by the extraordinary growth of foreign direct investment (FDI) in China (Tseng and Zebregs, 2002). As the Chinese market has intensified its openness, the number of multinationals in China has increased: their role in the domestic market is becoming stronger (Chen et al, 2013). Many studies have investigated this trend, mainly from three dimensions: macro-level (the impact of the host country on multinationals); micro-level (the impact of multinationals on domestic firms); and management perspective (the impact of management decisions of multinationals on its performance) (Stahl and Tung, 2015; Lipuma et al., 2013; Rasmusen and Yoon, 2012; Manlagñit, 2011; Lin, 2011; Papyrina, 2007; Hermes, 2004; Delios and Makino, 2003; Clarke, 2003; Gaba et al., 2002; Pan et al., 1999; Luo, 1998; Lensink and Brouthers, 1995). In other words, it is important to ask: what are the important determinants of multinationals' performance in China, and what are the effects of foreign firm entry on Chinese domestic firms and its domestic market (Dees, 1998)? However, apart from the literature related to the factors which affect the multinationals' performance, research on the impact of foreign investment on domestic firms and market is mainly focused on manufacturing industries (Xu, 2011). Nevertheless, other than manufacturing industries, the banking sector, which is at the heart of China's economy reform (Tong, 2018), needs to be investigated. Thus, in this thesis, the banking sector

has been employed as an example to illustrate the relationship between foreign investment and domestic firms and market. After the Chinese government gradually lifted the restriction of foreign investment in the banking sector in 2006, the assets of foreign banks have increased from 300 billion RMB in 2001 to 3.24 trillion RMB in 2017 (China Banking Regulatory Commission (CBRC), 2001, 2017). Moreover, the average size of individual foreign bank entities in Shanghai is 5.78 billion RMB which is far above the size of a state-owned bank (1.4 billion RMB) and joint-stock bank (3.6 billion RMB) (CBRC, 2006). Thus, with the rapid increase of foreign bank presence in China, it is essential for both researchers and policy-makers to understand how foreign investment will affect the domestic market.

The literature review is structured as follows. Section 2.2 provides an overview of the determinants of multinationals' performance and the impact of foreign firm entry on domestic firms and the market. Section 2.3 will focus on the first mover advantages of multinationals in foreign markets, while section 2.4 is concerned with the late mover advantages. Section 2.5 is related to the entry mode, from which multinationals can choose, when entering the foreign market. In section 2.6, previous literature concerning firm size is presented. In section 2.7, the influence of cultural distance is discussed. In the early part of this section, a discussion about different cultural distance indexes is provided. The subsequent part examines the impact of cultural distance on multinationals' performance, based on Hofstede's index and GLOBE index. Section 2.8 focuses on the discussion about country risk. Overall, these three sections are related to the first empirical chapters. Section 2.9 is related to the third empirical chapter. It

reviews the literature, focusing on the impact of foreign bank presence on domestic banks and the market, overall. In the last section, all research questions investigated in this thesis are presented.

2.2 Determinants of multinationals' performance in China and effects of foreign investment on domestic firms and market - an overview.

2.2.1 Overview of foreign investment in China

Foreign investment has been the most important income of global capital in China. Before 1979, there were no foreign-owned firms in China because Chinese leaders treat foreign capital import as suspicious activities (Dees, 1998). However, after the open-door policy was implemented, the Chinese market opened its door to global investors. Also, in 1979, the law of foreign direct investment was published. This law was aimed at 'limiting the establishment of foreign firms in China geographically to the four Special Economic Zones and in the coastal areas, organizationally to equity joint ventures (entry mode) and in limited sectors' (Dees, 1998, p. 176). However, these restrictions were relaxed over time, and now foreign investors are allowed to invest in nearly all sectors and the entry mode is no longer restricted. The objective of attracting foreign investment is summarised as: "i) developing a diversified industrial base; ii) introducing and adopting new technology; iii) stimulating economic growth; iv) introducing and adopting managerial skills; v) increasing exports" (Kamath, 1990, p.111). In fact, in 2014, China became the world's number one on the scale of foreign

investment. In 2016, the amount of foreign investment rose to 133843.02 million dollars: in 1983, it was only 920 million dollars (Ministry of Commerce of the People's Republic of China (MOFCOM), 2016, 1983). The annual growth rate is over 400%. Meanwhile, from 1978 to 2014, Chinese GDP grew from 148 billion dollars to 10.36 trillion dollars (National Bureau of Statistics, 1978, 2014). This growth is, indeed, related to increased foreign investment (Doucouliagos et al., 2010; De Vita and Kyaw, 2009; Li and Liu, 2005; Durham, 2004; Chanda et al., 2004). This provides strong evidence that one key element explaining the success of China's economy is the growth of foreign investment. China's growth is due to its embracing of the global market. Furthermore, Barajas et al. (2000), Claessens et al. (2001) and Unite and Sullivan (2003) conclude that foreign investment is advantageous to domestic banks. Levine (1997), quoted in Lee and Hsieh (2014), argues that foreign investment in banking sector improves the quality and availability of financial services, stimulates the development of bank supervisory and legal framework, and enhance the country's access to international capital. Thus, to understand how multinational companies in China can perform better and how the foreign firm entry affects Chinese firms and the market is essential, not only for researchers but also for policymakers.

2.2.2 Determinants of multinationals' performance in China

Identifying and understanding the determining factors that affect foreign investment is the core subject in foreign investment literature. In previous literature, there have been mainly two dimensions in the research - country level and firm level (Gopalan et al.,

2019). From the firm-level perspective, when deciding to enter a foreign market, multinationals generally face three questions: where they should enter (firm location), when they should enter (entrance timing) and how they should enter (entrance mode and size) (Klingebiel and Joseph, 2015; Steigner and Sutton, 2015; Kim and Gray, 2008; Papyrian, 2007; Cateora and Garman, 2006; Pearce, 2005; Vakratas et al., 2003; Robinson and Min, 2002; Lieberman and Montgomery, 1988). On the other hand, country-level factors including country risk and cultural distance also play a significant role in multinationals' performance (Wang and Larimo, 2019; Malhotra et al., 2018; Tao et al., 2017; López-Duarte et al., 2016; Crook et al., 2013; Huztschenreuter et al., 2011; Pogrebnyakov and Maitland, 2011; Weber, 2011; Berry et al., 2010; Johanson and Vahlne, 2009).

2.2.3 Relationship between foreign investment and domestic firms and market

As highlighted before, from 1978 to 2014, Chinese GDP grew from 148 billion dollars to 10.36 trillion dollars while foreign investment grew from 430 million dollars (0.21% of GDP), in 1982, to 347.8 billion dollars (3.7% of GDP) in 2013 (National Bureau of Statistics, 1978, 2013). This gives rise to the question: did foreign investment play a significant role in Chinese economic development? However, the research findings regarding this question are mixed. Some studies have found evidence to support the notion that foreign investment affects domestic market growth (Monaheng et al, 2019; Tang et al, 2008; Wang and Wang, 2005; Liu et al, 2002). Furthermore, some research has provided strong evidence from firm-level data. The evidence shows that foreign

investment stimulates domestic firms by the spill over effect of productivity (Irsova and Havranek, 2013; Havranek and Irsove, 2011, 2012; Lin et al., 2009; Liu, 2008). However, Batten and Vo (2009) argue that the effectiveness of foreign investment is dependent on pre-existing conditions. These factors include financial deregulation (He et al., 2013); a moderate technology gap (Todo, 2006); the home country of foreign investment (Gorodnichenko et al., 2013); and the ownership type of both foreign and domestic firms (Monastiriotis and Alegria, 2011; Javorcik, 2004). In summary, foreign investment is linked to economic growth in China (Gunby et al., 2016).

In this thesis, in order to examine and understand the effect of foreign investment on the domestic market and companies, the financial market and banking sector has been used as examples, for two reasons. First, before 2006, the restrictions on foreign banks in China were very stringent. The consumer type, location and range of business, such as currency denomination, were also regulated for foreign banks. For example in 1985 foreign banks could operate only in Shanghai, customers were limited to foreign firms and individuals, and the currency denomination was foreign currency only. After 2006, the restrictions were lifted, and most foreign banks received the same treatment as domestic banks. Thus, the banking sector provides a good example to demonstrate how foreign investment affects domestic banks under different degrees of policy stringency. Secondly, the banking sector is the foundation of China's financial reform (Hsu, 2016). Even though previous literature argues that capital account liberalization should take place prior to domestic financial development (Eichengreen et al., 2011; Gupta et al., 2011), China is an exception. Johnston (1998) argues that

capital account liberalization will lead to urgent external financial sector reform and the capital inflows will either be channelled through domestic intermediaries or compete with them. In other words, after the capital account liberalization, foreign capital will flow into the domestic market. The domestic intermediaries will need to help ensure the efficient use of these capital inflows. Also, these capital inflows will put competitive pressure on domestic financial institutions. In China, not only were the capital account and exchange rate controlled to varying degrees before the financial reform began but also, the banking sector was implicitly controlled (Hsu, 2016). Without the banking sector reform, the liberalization of the capital account and exchange rate regime would be distorted. Thus, using the banking sector as an example to illustrate the impact of foreign investment on the domestic market is meaningful.

2.3 First-mover advantages

On a basic level, the first-mover advantages theory suggests that pioneers can earn positive economic profits as a result of early market entry. Lieberman and Montgomery (1988) argue that initial asymmetry among competitors is the key part of the first-mover advantages theory, which enables first movers to gain a head start over their rivals. Numerous studies point out that the order of entry is related to market share performance. First movers have a higher market share than early followers, who in turn have a higher market share than late entrants (Urban and Star, 1991; Kerin et al., 1992). Previous conceptual contributions to first-mover advantages have some of the same elements. According to Kerin et al. (1992), four mechanisms are used to analyse first-

mover advantages: economic mechanism related to cost advantages; pre-emption mechanism, related to cost asymmetry in factor input and spatial pre-emption; technology mechanism, related to produce, process and organizational innovations; and behaviour mechanism, related to differentiation advantages. Moreover, Lieberman and Montgomery (1998) also specify four mechanisms that largely correspond to Kerin's et al. classification: pre-emption of geographic space (corresponding to spatial pre-emption); pre-emption of technology space (technological); pre-emption of customer perceptual space (behaviour); and moulding the cost structure of customers (economic). Based on these mechanisms, researchers have investigated various factors that affect the first-mover advantages, including firm size (Lowe and Atkins, 1994) and industry difference (Robinson and Min, 2002).

Liberman and Montgomery (1998) provide details, explaining the mechanism mentioned above. They argue that a first mover can pre-empt superior positions, including ideal investment locations, technology leadership (e.g. patents) or consumer preference. Pioneers may be able to sustain their position by blocking product space, with a broadening product line. Furthermore, Liberman and Montgomery state that pioneers may be able to mould customers' cost structure in three ways. Firstly, as Carpenter and Nakamoto (1989) noted, customers' perceptual space may evolve in a manner that favours the pioneers' initial position. Secondly, pioneers can develop switching costs of customers as they accumulate the experience with first movers' products. Lastly, first movers' products may establish the industry standard. Interestingly, instead of residing within the pioneering firm, the superior resource in

these three cases exists at the customer level, whose preference has been shaped to favour the pioneer's products.

However, despite the resource that first movers can pre-empt, early entrants can develop a set of organizational capabilities. Liberman and Montgomery (1988) argue that capabilities in manufacturing or marketing, often referred to as learning or experience curve advantages, provide a significant advantage available to pioneers. Levin et al. (1987) shows that these learning and lead-time advantages are more important than patents and other commonly recognised factors. Cohen et al. (1997) also support this argument.

Vanderwerf and Mahon (1997) used meta-analysis in published studies to identify possible biases in testing for first-mover advantages. They intended to find out whether the findings were influenced by: (1) use of the market share as the dependent variable; (2) industry selection; (3) failure to control for entrant capabilities, and (4) omission of non-survivors. As the results showed, they found that there is an exceptionally strong tendency to detect first-mover advantages when the market share is the dependent variable. Also, they found that industry selection and control for entrant capabilities are also significant. Another meta-analysis carried out by Szymanski et al. (1995) suggests that the interaction of first-mover advantages, with other factors, are more important than the first-mover advantage itself. In other words, first-mover advantages are moderated by differences in firms' resources and capabilities. Experimental studies, such as Kardes and Kalyanaram (1992), Carpertner and Nakamoto (1994), Zhang and Markman (1998), found that entry timing affects

customers' memory, perception of features and formation of judgements about competing brands.

Kerin et al. (1992) provided a more detailed explanation, regarding the economic perspective and behavioural perspective of first-mover advantages. They argue that entry barriers are the main reason why first movers can obtain competitive advantages. According to Von Weizsacker (1980, p. 400), an entry barrier is 'a cost of producing which must be borne by a firm which seeks to enter an industry but is not borne by firms already in the industry'. There are numerous entry barriers that contribute to first-mover advantages. These barriers include "scale effects (Rao and Rutenberg, 1979); experience effects (Smiley and Ravid, 1983); asymmetric information about product quality and risk-averse buyers (Conrad, 1983); differences in marginal effects of advertising between first and later entrants (Comanor and Wilson, 1979); reputational effects (Bain, 1956; Krouse, 1984); 'uncertain imitability', reflected in the ambiguity surrounding the reasons for the success of a first mover (Lippman and Rumelt, 1982); and the positive effects of communication (Teece, 1987)" (Kerin et al., 1992, p.34). Conversely, the behavioural perspective is focused on product or brand-level marketing. Capertner and Nakamoto (1989, 1990) argue that even though the brands can be repositioned and customers switching cost is minimal, what customers learn about a brand and preferences that they form about a brand play an important role in the formation of first-mover advantages. When customers know little about the product attributes or ideal product combination, pioneers can define them, and they will enjoy the benefits from the customer preferences. Moreover, Alpert (1987) and Howard

(1989) suggest that first movers can define the product category as a whole, and thus become the prototype against the later entrants. Furthermore, Schmalensee (1982), Hauser and Wernerfelt (1990) point out that due to the buyer decision and search cost, it is difficult for followers' brands to compete with early entrants.

2.4 Late-mover advantages

As discussed in Section 2.2, the order of entry has a negative relationship with market-share performance. In other words, the earlier a firm enters into a new market, the higher market share it can achieve, compared to late entrants. Furthermore, increased leading time can enhance the first-mover advantages (Min et al., 2006; Brown and Lattin, 1994; Huff and Robinson, 1994). However, late entrants also have the possibility of reducing the penalty for late entry: this is called late-mover advantages.

The benefit of late-mover advantages is that late entrants can put efforts into achieving higher relative consumer preferences. As discussed in the previous section, early entrants could set entry barriers to prevent followers and late entrants; consequently, late entrants may have to settle for smaller target markets (Kardes and Kalyanaram, 1992). Thus, late entrants can concentrate their efforts on increasing their chances of achieving higher consumer preferences (which means consumers tend to choose their products over others) (Vakratsas et al., 2003). Shenkar et al. (1998) also argued that there is a trade-off between innovativeness and entry time, so late entrants may have the opportunity to achieve higher preference. Also, Vakratsas et al. (2003) provided evidence to support this argument, by analysing the 'ASSESSOR' database.

Moreover, as Chandy and Tellis (2000), Golder and Tellis (1993) and Pearce (2005) quoted in Barnes et al. (2009), there are five scenarios supporting the late mover's performance:

> '(1) when a firm has a relative strength in marketing or manufacturing and is better suited to enter after the initial market and technological uncertainties have been resolved; (2) when there is a possibility of experiencing free-rider effects, whereby the late mover can acquire the same technology at lower costs; (3) when shifts in consumers' tastes are possible; (4) in markets where incumbent inertia may exist; and (5) in markets where the pioneer is not properly positioned' (p.165)

Furthermore, a decreased market and technological uncertainty provide another benefit for late entrants. Late entrants also have the chance to enhance the current process and products, in order to meet the changing customer and market opportunities, by utilising the resources with the help of learning from the early entrants (Klingebiel and Joseph, 2015; Steigner and Sutton, 2015; Lieberman and Montgomery, 1998; Scherer, 1990 and Shenkar et al., 1998).

2.5 Entry mode

There are several theories related to entry mode: international product life cycle theory, market imperfection theory, strategic behaviour theory, resource advantage theory,

transaction cost theory, eclectic theory of international production, internationalization theory and network theory (Yuksel and Yuksel-Mermod, 2010). The application of transaction cost theory has gradually become the most common theory in general marketing literature (Anderson and Weitz, 1986; Anderson and Schmittlein, 1984; Dwyer and Oh, 1988; Heide and John 1992; Erramilli and Rao, 1993), especially in entry-mode studies (Anderson and Gatignon, 1986; Anderson and Coughlan 1983; Gatignon and Anderson, 1988; Klein, 1989; Klein et al., 1990; Dhanaraj and Beamish, 2004; Kim and Gray, 2008; Papyrian, 2007).

Transaction cost theory explains why a specific entry mode for a firm is more efficient than other modes, such as the establishment of a new venture, full or partial acquisition of a going firm, or another alliance and a contractual agreement with another firm (Yiu and Makino, 2002). The fundamental tenet of the theory can be stated as follows: firms choose an entry mode to minimise the transaction costs of their international operations (Hennart 1988; Kim and Gray, 2008; Kogut and Singh, 1988; Brouthers, 2002). In other words, 'managers make a choice between equity and non-equity modes of entry by comparing the costs of internal coordination and control to those associated with finding, negotiating with, and monitoring an intermediary or contractor in an external market' (Kim and Gray, 2008, p. 167). Therefore, transaction cost theory has been applied to evaluate the relationship between multinationals' performance and entry mode (Anderson and Gatignon, 1986, 1988; Hennart 1988, 1991; Kougt and Singh, 1988; Kim and Hwang, 1992). By using transaction cost theory, Rugman and Verbeke (2003) suggest that, due to the difficulty of the external market

in determining the optimal pricing of tacit and intangible assets, the transfer of these assets is costly in an imperfect market. Also, Williamson (1985) and Hennart (1988) argue that these difficulties make firms employ an internalised and hierarchical mode over the contractual arrangement for their international operations. According to Hill et al. (1990), firms prefer wholly-owned subsidiaries (WOS) over joint ventures, because they have a lower cost and dissemination risk mode than joint ventures and are less likely to make their proprietary asset intangible, nor tacit assets to be disseminated or dissipated by their local partner(s). By employing WOS, multinationals can transfer their firm-specific advantages to their affiliates (Kim and Gray, 2008), without undue exploitation by local partner(s) in the host country.

Moreover, Papyrina (2007) investigated the relationship between the joint effect of entry timing and entry mode with firms' survival rate, using a dataset based on annual surveys from 1988 to 1992. The findings suggest that in the beginning of institutional reforms, the survival rate of WOS was lower than that of joint ventures, while it was higher than joint ventures when the market was in the later stage of institutional reforms. An explanation for the result is that at the beginning of institutional reforms, WOS did not constitute an optimal choice, due to the 'high uncertainty in regulatory infrastructure which exacerbates the risk of unrecoverable cost associated with sole ownership' (Papyrina, 2007, p. 90). Meanwhile, with the help of local firms in partnership with multinationals, joint ventures can cushion the negative impact of a volatile environment and exceed the disadvantages of shared ownership. In the latter stages of institutional reforms, the market environment is stable and the benefits from local firms fall short of

the cost of joint ventures, rendering the joint ventures a less efficient entry mode. At the same time, contributions that relatively stabilise the regulatory framework provide enlarged benefits, related to sole ownership. The study conducted by Makino and Beamish (1998), Delios and Beamish (2004) and Li (1995), also support this result.

2.6 Firm size

Johnson and Tellis (2008), Krugman (1980) and Porter (1990), suggest that firm-specific advantages play a significant role in international trade. Even though small firms play an increasing role in the modern economic market (Cateora and Garman, 2006), larger firms are more likely and able to participate in the global market (Terpstra et al., 2006). The reason why larger firms perform better than small firms is multidimensional. First, a larger firm's resources, which it can recourse or commandeer, are greater (Bonaccorsi, 1992). As Ramaswami and Namakumari (2004), cited in Johnson and Tellis (2008, p.4) state, 'For example, Coke was able to purchase the leading cola brand in India, Thumbs up, to open its entry into India.' Second, the product-specific and market-specific knowledge held by small firms is relatively small, compared to large firms. Third, larger firms are more capable of sustaining negative performance upon entry into a host country (Luo, 1997). However, firm size does not guarantee success. Hitt et al. (2003) argued that due to the increase in bureaucracy, organizational flexibility decreases in large-size firms. Also, Chandy and Tellis (2000) suggest that this bureaucracy also impairs the innovation skill. Furthermore, Cooper

and Cooper and Kleinschmidt (1985) find that there is a negative relationship between firm size and export success in the high-tech electronics industry.

2.7 Cultural distance

While corporate and national culture has been frequently used to illustrate the poor performance of multinationals in host countries, findings regarding the role of cultural distance in the success of international operations are contradictory (Weber, 2011). Several studies (Chatterjee et al., 1992; Datta, 1991; Weber, 1996; Datta and Puia, 1995; Weber et al., 1996; Sarala, 2008) support the notion that cultural distance is detrimental to the success of multinationals. However, Larsson and Risberg (1998) and Morosini et al. (1998) argue that cultural distance may serve as a source of value creation, which in fact, enhances the performance of multinational enterprises (MNEs).

Cultural distance has garnered a large amount of interest in international business literature (Barkema et al., 1996; Kogut and Singh, 1988; Pothukuchi et al., 2002; Shenker, 2001). Among the studies related to cultural distance, several frameworks, such as Kluchkhohn and Strodtbeck (1961), Trompenaars (1993), Ronen and Shenkar (1985), Ghemawat (2001), Hofstede (1980, 2001), Schwartz (1992, 1994), and GLOBE (late 1990s), have been applied to measure the extent to which they are similar or different. Hofstede's framework has been one of the most influential and widely-used frameworks in international business studies. However, scholars have developed measures of cultural distance that represent a conceptual and empirical improvement over Hofstede's framework. Schwartz (1992, 1994) has proposed a

framework ‘which has the advantages of deriving the values from theory, offering a more comprehensive set of dimensions, being based on two matched samples of more diverse and representative populations (students and teachers), and being based on data collected more recently, from 1988 to 1992’ (Berry et al., 2010, p. 1462).

Drogendijk and Slangen (2006) confirmed the validity of Schwartz’s framework. The Global Leadership and Organizational Behaviour Effectiveness (GLOBE) study is more comprehensive and recent than Hofstede’s. Shenkar (2001) also argued that scholars have used cultural distance and its proxies in multiple areas, from strategy to organizational behaviour, to accounting and auditing, in both domestic and international contexts. Among all these areas, foreign investment represents the most popular area for the application of cultural distance. There are mainly three key points relating to cultural distance.

> ‘The first key point has been to explain the foreign market investment location and especially the sequence of such investment by multinational enterprises (MNEs). The second, to predict the choice of mode of entry into foreign markets. A third application has been to account for the variable success, failure and performance of MNE affiliates in international markets’ (Shenkar, 2001, p. 520).

In a study conducted by López-Duarte et al. (2016), they concluded that cultural difference does indeed affect several dimensions of multinationals’ operation, including internationalization decision and path, entry mode choices, performance of overseas subsidiaries, organizational design and development, human resources management and knowledge transfer. In this study, we focus mainly on the first three areas. Johanson

and Vahlne (2009) proposed an update and development of their seminal Uppsala Model. This model tries to illustrate how network development and relationship building moderates the role played by cultural distance in internationalization decisions. By applying this model, some researchers find that a firm's relational capital diminishes the negative impact of cultural distance on the internationalization decision, while the cost related to manage these networks hinders further international expansion to new areas in subsequent periods (Huztschenreuter et al., 2011; Pogrebnyakov and Maitland, 2011).

2.8 Country risk

As a factor of destabilization of subsidiaries of MNEs in a foreign country, the host country risk is frequently employed in the studies of MNEs (Wang and Larimo, 2019; Meschi and Riccio, 2008; Brouthers and Hennart, 2007; Zhao et al., 2004). This negative effect of country risk on the survival of MNEs is supported by the theories of the population ecology of organizations and industrial organization (Carroll & Delacroix, 1982; Porter, 1980; Scherer, 1980; Hannan & Freeman, 1977; Bain, 1956). Meschi and Riccio (2008) stated that country risk affects the performance of MNEs from two perspectives. Firstly, from an economic point of view, country risk (caused by government default on payments, a devaluation of the local currency and/or an increase in interest rate) has a negative impact on local demand and consumption, which will in turn affect the performance of MNEs. On the other hand, political uncertainty, which is related to the enforcement of regulatory restriction on FDI and/or government

instability, leads to a negative impact on profits, objectives and the bargaining power of MNEs.

Similarly, Wang and Larimo (2019), argue that the level of external uncertainty, caused by country risk, gives rise to the problem of adjusting and modifying agreements to the changing business environment. As a consequence, the transaction cost of MNEs has increased (Malhotra et al., 2018; Crook et al., 2013). Notwithstanding, country risk also has a negative impact on post-entry activities; for example, it will hinder the MNEs' effort on cooperating with local partners or firms (Tao et al., 2017).

2.9 Impact of foreign bank entry on domestic banks and market

As mentioned in section 2.2.3, the third empirical chapter uses the banking sector as an example to show the impact of foreign investment on domestic firms and market. This section is divided into two parts: the first part provides the evidence from countries other than China and the second is focused on the Chinese market.

Since the 1960s, due to increasing international trade flows and foreign direct investment activity, international banking activity has increased quickly. According to the IMF report (2000), the foreign bank control of the domestic financial market (measured as the ratio of assets of banks, where foreign investors owned more than 50% of total equity over the total assets of the entire banking sector) rose from 1.6% in 1994 to 6% in 1999 in south-east Asia, and from 7.5% in 1994 to 25% in 1999 in Latin America.

Thus, the increased presence of foreign banks in domestic markets raises a question regarding the impact of foreign bank entry on domestic market performance. Lensink and Hermes (2004) use bank level data for 48 countries, for the period 1990-1996, to investigate how the foreign bank presence affects domestic banks. Their results suggest that owing to the spill-over effect, foreign bank entry may have a strong positive effect on domestic banks, especially in the lower development market. They also argue that even though domestic banks need to increase costs for the implementation of modern techniques and practices brought in by foreign banks, they can increase interest rate margins and non-interest rate income, in order to pay for the investment made, which led to an increasing income. Claessens et al. (2001) used bank-level data for 80 developed and developing countries over the period 1988-1995, in order to examine the impact of foreign bank entry on domestic bank net interest margin, profitability, non-interest income, overall operating expense and loan-loss provisions. They find that the foreign bank presence improves the efficiency of the domestic banking system. In an earlier study, Terrel (1986) found that foreign banks entry brought lower gross interest margins, lower tax profits, and lower operation costs, by using bank-level data for 14 developed countries. After analysing data from Pakistan, Turkey and Korea, Bhattaharaya (1993) found that the amount of funds available for domestic projects increased with the presence of foreign banks. Meanwhile, Clarke et al. (1999) suggested that foreign bank presence instilled competition in domestic banks, by using a sample from Argentinian banks. Denizer (1999) found similar results by investigating Turkish banks. He found that foreign entry increased the banking sector's efficiency. However,

he also argued that the effect is stronger if the chosen country opens its capital account earlier. Turkey allowed foreign bank entry from 1980, whereas the capital account opened from 1989.

Moreover, Okuda and Rungsomboon (2004) examined the cost structure of foreign banks in Thailand and Thai domestic banks. They found that foreign banks and domestics banks can share their specialised market roles to achieve higher efficiency because foreign banks are good at the wholesale market while domestic banks are good at the retail market. Williams and Intarachote (2003) found that the profitability of domestic Thai banks decreased under the effect of foreign bank entry. A possible reason they provided is that domestic banks need to adopt a learning-by-doing process to achieve the superior management skills brought by foreign banks. As a result, the costs of domestic banks increase which in turn decreases their profitability. Saleh (2015) and Clarke et al. (2003) provide a more detailed explanation. Foreign banks' entry has led to the introduction of efficient banking management practices, latest banking technologies and financial innovation, which was previously unknown to domestic banks and the market. Domestic banks are learning and adopting those efficient banking management practices, latest banking technologies and financial innovations to improve their own operation. Bhaumik and Piesse (2004) suggested that the increasing presence of foreign banks in India gave rise to a steady improvement in the technical efficiency of domestic banks. However, Sensarma (2006) found that foreign banks' performance is poorer than state-owned banks in India, as far as cost efficiency and

productivity are concerned, which could be led by the high cost of operation of foreign banks in India.

Also, Unite and Sullivan (2003) support the notion that foreign competition improves domestic banks' efficiency by levelling the risk and making domestic banks less dependent on relationship-based banking practices in the Philippines. In the Philippines case, due to the high ownership concentration caused by corporate governance,[1] the corporate groups have significant ownership in the nation's large commercial banks. Thus, bank managers are often related to or appointed by the dominant ownership group (Unite and Sullivan, 2003). As foreign banks enter the Philippines, the increased competitive pressures and monitoring weaken the relationship-based banking practices. These results have also been supported by Manlagnit and Lamberte (2004). However, in the results, they argued that the improvement in domestic banks' profit and efficiency, due to the impact of foreign bank entry, was halted when the Asian financial crisis occurred. On the other side, Montinola and Moreno (2001), quoted in Manlagnit (2011, p.1184), found that:

> 'Banking efficiency in the production of deposits and intermediation of loans has been declining prior to the liberalization of foreign bank entry and there is no strong improvement in domestic bank efficiency in deposit or loan production even after

[1] Corporate governance is viewed as the relationship between corporate stakeholders and managers and how these participants determine the direction and performance of the corporation.

the liberalization, suggesting that foreign entry was too restrictive to generate a competitive environment to offset its adverse incentive effects.'

On the other hand, the evidence related to the impact of foreign banks' entry to the Chinese market is mixed. García-Herrero and Santabárbara (2008) have evaluated how Chinese domestic banks have benefited from foreign bank entry. By using panel data for 82 Chinese banks over the period 1999-2006, they performed a three-stage examination. The first stage shows that foreign banks' entry tends to improve the profitability of domestic banks, while only the strategic investors[2] seem to bring benefits to the whole banking system. In contrast, the impact of financial investors[3] is insignificant. The second and third stage examinations together show that foreign banks influence the profitability of domestic banks through three channels: efficiency, asset quality and capitalization.

Chen et al. (2005) examined the change in Chinese domestic banks' efficiency after the foreign banks' entry by using panel data of 43 Chinese banks over the period 1993 to 2005. They found that Chinese banks' efficiency improved after allowing foreign banks to enter the Chinese market. However, they also found that the impact of foreign bank entry on domestic banks' efficiency was higher in the early periods of openness to foreign investors than the late periods. Regarding bank size, they found

[2] Chinese regulation defines strategic investment as foreign stake bigger than 5%, a long-term commitment and transfer know-how to domestic partners.

[3] Financial investor is defined as an investor who has a stake below 5% or has announced no long-term commitment (García-Herrero and Santabárbara, 2008).

that, contrary to the U.S. experience that the average cost curve has a flat U-shape, large and small banks in China enjoy more benefits from the efficiency instigated by foreign banks' entry. Consistent with Zhao (2000), Chen et al. (2005) also found that state-owned banks enjoy higher efficiency than other types of bank.

However, after employing a sample of 48 Chinese banks over the period 1997 to 2007, Shen et al. (2009) found that at bank level, foreign bank entry affects neither profitability nor costs. The reason provided was that after allowing foreign investors to enter the Chinese banking sector, both the cost and revenues of local banks rose. Because local banks need to spend more on staff training or software and hardware investment to learn the technologies and management skills exemplified by foreign investors, these costs might offset the beneficial effect of foreign investment in the short run.

Laurenceson and Qin (2008) have used DEA test and TOBIT regression to gauge the impact of foreign investment on cost efficiency of the big four banks, ex-state-owned banks, a dozen or so national and regional joint-stock commercial banks and more than 50 city commercial banks in China covering the period 2001-2006. The results show that the relationship between foreign investment and cost efficiency is positive but insignificant. The reason provided for the insignificance is that foreign investors are restricted to minority-ownership stakes. They argue that the technology transfer or spill-over effect of foreign investment will be the strongest when they have a majority, or at least a controlling stake.

Yuan and Gunji (2010) employed a panel data of 19 banks covering the 1996 to 2004 period to examine the relationship between foreign banks' entry and domestic banks and the banking market. They found that when foreign banks were introduced to the Chinese market, it led to a rise in loans, non-performance loans and had a negative effect on domestic banks' profitability. In other words, as the market share of foreign banks rises, the performance of foreign banks themselves improves while domestic banks deteriorate. Meanwhile, there is still a spill-over effect of foreign banks on domestic banks' profitability, but not on cost.

2.10 Summary

Previous literature shows that there are both country-level factors and firm-level factors influencing the performance of foreign firms in China. It also illustrates the impact of foreign firms on Chinese domestic firms and the market. However, the results indicate that there is a conflict. For example, even though first movers enjoy the first-mover advantages, later-mover advantages will offset the advantages of first-mover. Moreover, while Saleh (2015), Chen et al. (2005) and Shen et al. (2009) find that foreign bank presence is positively related to domestic banks performance and domestic market development, Claessens et al. (2005) and Barajas et al. (2000) argue that the presence of foreign banks is still associated with a reduction in profitability and margins for domestic banks. We investigate all those issues in three empirical chapters.

The first empirical chapter investigates the firm-level factors that influence the performance of multinationals in China. Firstly, it explores the impact of factors such

as entry timing, entry mode, firm size and firm location on the performance of multinationals. Then the interaction effect of the above factors is examined. there are several questions which require an answer on the first empirical chapter: i) what are the effects of entry timing, entry mode, investment size, firm location, and advertising intensity on market-share performance and how do these factors affect the market-share performance of firms? ii)Are there any interaction effects among these four factors, and if so, how do they affect market-share performance? iii) What should early entrants do to achieve a better market performance? iv) What should the government do to balance the economic differences between various regions in China?

Other than the firm-level factors that have been investigated in the first empirical chapter, the second chapter wants to answer questions related to country-level factors, including country risk and cultural distance. As these are both related to the survival of multinationals in China, the second empirical chapter investigates the following questions: i) what are the effects of country risk, cultural distance and entry mode on foreign firm survival? ii) What is the joint effect of these factors on a firm's survival rate? iii) Which factor(s) will moderate these impacts?

However, it is not enough to simply mention the factors that influence foreign firms in China. Zhang et al. (2012) argue that "the size and depth of financial sector spur the economic growth. With the more use of the markets and banking sector, the openness and development of financial sector positively influence economic growth in China. Also, it is suggested that banking sector reform after China's accession to the World Trade Organization (WTO) are in the right direction." (p. 26). Also, as

highlighted before, the banking sector is a good example to show the effect of foreign investment on domestic firms and the market. Thus, in the third empirical chapter, the focus will be on the impact of foreign banks on domestic banks and financial sector. By using both aggregate measurements (the number of foreign banks operating in the host country and asset of foreign banks operating in the host country) and disaggregate measurements (foreign exposure index), the following questions are answered: i) whether opening up the bank sector positively influences the local banking industry; (ii) whether the percentage of shares held by foreign investors affects local bank performance; (iii) in terms of financial liberalization, whether the presence of foreign banks is actually in favour of the process.

In summary, the previous literature provides conflicting results on the effect of foreign investment in China. The three empirical chapters try to provide a clear picture about: i) how country-level and firm-level factors will affect the performance of multinationals in China, and ii) how the presence of foreign banks will affect domestic banks and the banking sector.

Chapter 3 IMPORTANT DETERMINANTS OF FOREIGN COMPANY PERFORMANCE IN CHINA

3.1 Introduction

Multinational firms are always faced with three questions when considering international expansion: which market to enter (entry location), how to enter it (entry mode), and when to enter it (entry timing). In previous studies, researchers have mainly focused on the first two questions, especially mode of entry (Anderson & Gatignon, 1986; Dikova & Van Witteloostuijn, 2007; Wei, Liu & Liu., 2005; Pan & David, 2000). Entry timing, on the other hand, also plays a significant role in the performance of multinational firms' overseas subsidiaries (Murray, Ju & Gao, 2012; Cui & Lui, 2005). In recent years, China has increasingly attracted worldwide attention. According to the Ministry of Commerce of People's Republic of China (MOFCOM) (2016), China has an FDI of $135.6 billion, second only to the US. China opened its market to the world in 1979; however, compared to the US, China is still considered an emerging market. Entry timing will have a more significant effect on the performance of foreign firms in China than it would for the same firms entering a developed market. Thus, the timing of entering the Chinese market is essential for multinational firms to consider (Isobe, Makino & Montgomery, 2000; Gaba, Pan & Ungson, 2002; Papyrina, 2007; Tan & Liu, 2007; Murray et al., 2012; Cui & Lui, 2005; Luo & Peng, 1998).

In this study, the factors affecting a foreign firm’s market share performance and profitability are examined. The following determinants (factors) are considered: the

point in time that a foreign firm enters a foreign market, the entry mode a foreign firm adopts to enter a foreign market (wholly owned subsidiaries, equity joint ventures, contractual joint ventures), the level of advertising intensity the firm adopts, location the firms decide to invest in as well as the investment size a firm undertakes when entering the foreign market (Pan, Li & Tse, 1999; Delios & Makino, 2003; Papyrina, 2007; Stalk & Hout, 1990; Vesey, 1991). This study aims to provide firms with a clear view of the critical factors involved when entering a foreign market by examining the effect of the previously noted determinants on firm performance.

Although a firm's competitiveness in a foreign market is largely based on the assets it owns, early market entry provides firms with an opportunity to attain first-mover advantages and thus, to sustain a leading position (Delios & Makino, 2003; Lieberman & Montgomery, 1998). Furthermore, in a foreign market, competition does not exist only between foreign firms, but also between foreign firms and domestic firms. Foreign firms are required to acknowledge and assimilate local market information to achieve competitiveness. Consequently, early entry provides firms with sufficient time for gaining this knowledge. In this study, we hypothesize that early entrants will achieve a higher market share performance than followers.

Early entry timing only is not a sufficient approach for firms to fully make use of first-mover advantages. Entry mode is another critical factor that affects a firm's performance. However, only a small number of research papers have examined this factor; furthermore, there is no agreement about which type of entry mode achieves higher market share performance (Woodcock, Beamish & Makino, 1994). In this study,

based on the database provided by State Statistical Bureau of China and made available to us, there are primarily three types of entry mode: equity joint ventures, contractual joint ventures, and wholly owned subsidiaries. We hypothesize that wholly owned subsidiaries will have higher market share performance than any other type of entry mode since using wholly owned subsidiaries as the preferred method for entering a foreign market provides foreign firms with a high level of ownership. This enables them to easily copy and apply to the host market what they have successfully affected in their home market.

There are also interaction effects between the above-discussed factors. Early entrants adopting different entry modes perform differently in foreign markets. Papyrina (2007) argues that entry timing and entry mode have a joint effect on a foreign firm's market share performance. Therefore, in this study, interaction effects are also examined. As such, early entrants with large investments entering the foreign market as wholly owned subsidiaries will achieve better performance. Additionally, a firm adopting a high level of advertising intensity will perform better in the market.

In this study, market share performance is examined. We hypothesize that early entrants will have higher market share performance than late entrants. Firm location, a significant factor that needs to be considered when investing aboard, is also examined in the research. We hypothesize that manufacturing and non-manufacturing firms intend to choose different regions in which to invest (Wei et al., 2005). Thus, the government should pay attention to developing all regions.

This study contributes to the existing literature in three ways. First, it tests the impact of entry timing on firms' foreign market performance using a larger database than Murray et al. (2012). The period of data Murray et al. (2012) used is from 1998 to 2002, but in this study, the data from ranges from 1998 to 2013. Since China joined World Trade Organization (WTO) in 2001, the policies and laws related to foreign investment has been changed significantly. For example, "Decision of the Ministry of Commerce on Amending the Provisions on the Merger or Acquisition of Domestic Enterprises by Foreign Investors", which took effect in 2006, makes the foreign merger and acquisition activities in China more stable. Also, "Catalogue of Industries for Guiding Foreign Investment", announced by Ministry of Commerce, has been amended in 2004, 2006, 2011. This catalogue shows that Chinese market are increasingly opened to foreign investor. Thus, it is essential to include the period after 2002 into the investigation. Secondly, this study observes entry mode, investment size, firm location, and advertising intensity as four critical factors that can affect the way in which a firm enters a foreign market. Furthermore, interaction effects among the above factors are examined. Finally this study contributes to strategic choice perspective information by including advertising intensity.

There are three main limitations to this study. Firstly, the data employed in this study ranges from 1998 to 2013, which is not the entire period since China opened its market to foreign investors in 1979. Secondly, the data is archival, and as such, we cannot draw out the motivations of foreign firms for investing in the Chinese market (Murray et al., 2012). The reason for this is that the motivation of foreign investment is

difficult to reflect using numeric data. Thirdly, the data used in this study pertains only to China and was taken from Chinese sources. Different countries have different conditions for foreign companies; thus, the results based on Chinese sources may not apply to all countries.

To summarise, this study aims to answer the following questions:

(1) What are the effects of entry timing, entry mode, investment size, firm location, and advertising intensity on market share performance, and how do these factors affect the market share performance of firms? Are there any interaction effects among these four factors, and if so, how do they affect market share performance?
(2) What should early entrants do to achieve better market performance?
(3) What should the government do to balance the economic differences between various regions in China?

3.2 Literature Review

3.2.1 The Impact of Foreign Investment on The Chinese Economy

Since the market reform began in 1978, China has grown tremendously. China's success is due to foreign investment among other factors (Zhang, 2001). There is evidence that FDI has reduced poverty in China by promoting economic growth (Zhang, 2006). Also, FDI has introduced advanced technology, management experience, and new industries. (Shen, 1998; Zhao & Zhang, 2007). According to the Ministry of

Commerce of People's Republic of China (MOFCOM) (2016), China has received FDI inflows of 136 billion dollars in 2016 which is the second largest in the world. The following numbers indicate the contribution and significance of FDI to the Chinese economy: FDI flows constituted nearly 5% of gross fixed capital formation; foreign-invested companies have produced 21.5% of total industrial output and count for 43% of China's exports in 2016 (China Statistical Yearbook, 2016; World Investment Report, 2016). The majority of FDI in China came from Hong-Kong and Taiwan and is primarily motivated by cheap labour, incentive policies and market access along with other operational advantages over other investors (Zhang, 2001). Tao (2004) also considers Macao to be a major investor in China.

Zhang (2001, 2006) suggests that the impact of FDI on the Chinese economy is two-fold: first it is the undeniable effects of foreign investment on economic growth through direct effects (such as raising productivity and promoting export) and secondly the role of foreign investment in promoting transition to a market oriented economy and diffusing technology. Zhang (2006) calls this positive externality effects. This is briefly discussed at the end of this section. From an economic growth perspective, neoclassical theories point out that FDI is usually the power train of a host country's economy because 'i) inward FDI may enhance capital formation and employment augmentation; ii) FDI promotes manufacturing exports; iii) FDI brings into host economies special resources such as management know-how, the access of skilled labour to international production networks, and established brand names; and iv) FDI may result in technology transfers and spillover effects' (Markusen & Venables, 1999).

For example, as shown in Table 3.1, exports by foreign-invested firms in 2016 are ten times higher than the number in 1998, and it accounts for 43% of China's total exports. Thus, foreign-invested firms have boosted China's exports. Moreover, foreign-invested firms also produced the 21.5% of total industrial output in 2016 and offered 136.1 million employee positions. Undeniably, FDI has a significant positive effect on China's economy.

TABLE 3.1 The effect of FDI on the Chinese economy

	1998	2008	2016
Exports by foreign invested firms (billions of US dollars)	88.6	790.5	916.8
Share of exports of foreign invested firms in total exports (%)	44.1	55.27	43
Share of industrial output by foreign invested firms in total industrial output (%)	14.9	29.5	21.5
Number of employees in foreign invested firms (million persons)	18.0	94.3	136.1

Notwithstanding, Zhang (1993) argues that FDI seems to have a spillover effect on China's economic transition towards a market-oriented system in three ways: diversifying the ownership structure, establishing market-oriented institutions and

facilitating reforms of state-owned enterprises. Also, FDI in China has stimulated competition and helped China integrate with the world economy.

Given the effects that foreign investment has on the Chinese economy, it is important for both foreign investors and the Chinese administration to know which factors affect the performance of those companies as well as the specific location(s) that foreign companies would like to invest in. Shen (1998) discusses the case of Zhejiang a coastal province which strangely enough although a coastal area has fallen behind in attracting foreign investment in relation to other sister provinces and cities. Moreover, Shen (1998) states the gap in FDI between different provinces is tomorrow's gap in economic development. Bearing this in mind, the Chinese administration can take action to improve access for foreign investors and even direct investment to areas which are considered underdeveloped in order to achieve a harmonious growth all over the country. Zhang (2006) in his conclusion states 'Since poverty in China is concentrated in the rural inland areas, one policy implication of this study is that some preferential measures should be provided by the central government for the inland region to attract more FDI' (p. 88).

3.2.2Different Stages of Entry Timing Research

Literature regarding entry timing includes three developmental stages. In the first stage, scholars aim to explain the reasons for the decision of foreign market entry according to monopolistic or ownership advantages (Hymer, 1976; Knickerbocker, 1973). As different entry modes represent different managerial costs and capacities for competing

in the market, Buckley and Casson (1981) present the optimal period for firms regarding switching between entry modes. Based on these two theories, Dunning (1988) proposes a framework that combines "the ownership and internalization advantages of firms, and [the] locational advantages of countries" (Gaba et al., 2002, p.41). Agarwal and Ramaswami (1992) state that this framework can be used for examining the foreign market entry of firms.

In the second stage, as noted by Gaba et al. (2002, p.41, cited in Hill, Hwang & Kim, 1990), recent business strategists and marketing researchers "extend earlier classical works with multivariate frameworks that includes strategic variables (firm and industry) and competitive/environmental variables (country and industry)". Lambkin (1988), Lieberman and Montgomery (1998), and Mitchell (1991) found that entry timing affected firms regarding attaining a competitive position and helped firms to discover how to sustain this position.

Following the above stages, research concerning entry timing is conducted in the third stage. Before the mid-1990s, most studies focused primarily on the relationship between market entry timing and firm performance. These studies were based on domestic markets (Lee, Smith & Grimm, 2000; Li, 1995; Lilien & Yoon, 1990; Mitchell, 1991; Parry & Bass, 1990; Robinson, 1988; Suarez & Lanzolla, 2007; Varadarajan, Yadav & Shankar, 2008; Carpenter & Nakamoto, 1989; Lieberman & Montgomery, 1998). Following the mid-1990s, researchers switched to investigating the foreign market. A large body of literature established during this time, point out that

entry timing is a significant factor that can affect the decision for firms to invest in foreign markets.

3.2.3First-mover And Late-entrants Advantage Theory

The third stage includes many theories about entry timing. The first is the ‘first-mover advantage’ theory. Lieberman and Montgomery (1988, p.41) define first-mover advantages as "the ability of pioneering firms to earn positive economic profits." They contend that first-mover advantages arise from three primary sources: technological leadership, the pre-emption of assets, and the creation of buyer switching costs. Furthermore, as Pan et al. (1999) cited Decastro & Chirsman, (1995) and Mitchell Shaver & Yeung (1994) mention in their studies, first-mover advantages include four perspectives: economic, pre-emptive, technological, and behavioral. Moreover, Luo and Peng (1998) argue that first-mover advantages benefit early entrants in three ways: technological leadership, pre-emption of scarce assets, and the establishment of entry barriers for follower firms. By combining these three explanations, first-mover advantages can benefit foreign firms in three ways. Firstly, first-mover advantages make early entrants spend less on managerial costs and in this way enable firms to pre-empt assets. In the initial period, competition in the foreign market is not as intense as in later periods. Thus, early entrants do not need to exert as much effort on competition, which late entrants are always expected to do to gain access. This means that managerial costs are less for early entrants. Secondly, early entrants can set market standards that favor their profits and can, therefore, make full use of these standards to retain their

first-mover advantages. Finally, early entrants have higher customer preference and can use this advantage to establish barriers to late entrants.

First-mover advantage does not, however, guarantee higher performance. Entering a foreign market means the firm will suffer from the liability of foreignness, "i.e., the manifestation of additional costs and risks arising from a lack of complementary resources useful for understanding and operating in the host environment." (Stucchi, 2012, p.280). Isobe et al. (2000), Kerin, Varadarajan & Peterson (1992) and Lieberman and Montgomery (1998) state that it is debatable whether earlier entrants will have an overall higher performance than followers. Kerin et al. (1992) and Lilien and Yoon (1990), however, state that there is significant evidence to support that surviving first-movers will hold a higher market share than late entrants. Lambkin (1998) states that early entrants, early followers, and late entrants exhibit significantly different performances. Additionally, as Gaba et al. (2002) note in their study, early entrants tend to show better performance than early followers and late entrants. Thus, earlier entry timing provides an opportunity for attaining a leading position in a foreign market; however, first-mover advantages only are not sufficient for firms to attain and sustain higher performance as first-movers; this is because they face high levels of uncertainty, free-rider effects, and are exposed to additional risks (Lieberman & Montgomery, 1988).

In foreign markets, the risks and uncertainties are much higher than in domestic markets. Zaheer (1995) state that different cultures and institutional settings will also increase uncertainties and risks. In a foreign market, even when one firm enters a sector

in the host market early as a foreign firm, local firms may have operated in this sector for years, which will reduce the first-mover advantage. However, the political environment can have a positive effect on early entrants (Frynas, Mellahi & Pigman, 2006). Government always treat early entrants as instrumental for attracting additional foreign investment, which in turn will enhance first-mover advantages (Murray et al., 2012).

Recently, several researchers have conducted research that examines the first-mover advantage. Research conducted by Delios and Makino (2003) show that early entrants put forward larger investments. Magnusson, Westjohn & Boggs (2009) found a critical relationship between early entrants and market performance. These two studies and many others show that early entry timing has a positive effect on market performance. Mitchell (1991) also argues that early entry timing has a positive effect on market performance, but that early entry timing only is not sufficient for a firm to attain a high level of performance (Gaur & Lu, 2007; Golder & Tellis, 1993; Wang, Chen & Xie, 2010). To explain this, Mitchell, Shaver and Yeung (1994, p.56) examined the impact of entry timing on market share performance in a foreign market, and found the relationship between high market share performance and entry timing into a foreign market to be non-monotonic; the researchers conclude, “foreign entrants survive longer in product markets with a moderate number of foreign players”. Thus, examining the impact of entry timing and market performance using both market share performance is necessary.

Contrastingly, late entrants also have late-mover advantages. As Schnaars (1994) argues, first-movers have disadvantages that, in turn, become advantages that late entrants enjoy. Late entrants can benefit in three ways: (1) they have the opportunity to free-ride on first-mover investments; (2) they can use the experience of first-movers to solve technological problems and market uncertainties; (3) it is difficult for first-movers to change their structure or products in order to adapt to the new environment during the late period. "Late movers may be able to free ride on a first mover's investments in some areas such as R&D, customer education, and infrastructure development" (Frynas et al., 2006, p.340). First-movers face high levels of operational risk and market uncertainties. Once late entrants enter the market, they can use the solutions to these risks and uncertainties, thus enjoying free- riding on first-mover investments. Finally, in the initial period, the organizational structure and products of first-movers may be restricted to a fixed type. Late entrants can, therefore, use new structures and products to compete with early entrants in foreign markets. First-mover advantages can in this way be largely counteracted.

3.2.4 Investment Size And Entry Mode (strategic choice)

Despite the factors listed above, strategic choice is also an important factor when analyzing the impact of entry timing and market performance. Strategic choice is different from entry timing and is primarily concerned with what strategy a firm should adopt, for example, how much the firm will invest initially, or which entry mode should be used. Gaba et al. (2012) state that entry-timing performance relationships may be

contingent on other factors such as investment size, entry mode, firm location and advertising intensity (Cui & Lui, 2005; De Castro & Chrisman, 1995; Kerin et al., 1992; Szymanski, Troy & Bharadwaj, 1995). Hitter and Tyler (1991) point out that how a firm enters into, and how it performs in a foreign market, are not only determined by the industrial environment but also affected by the firm's strategic choices. More specifically, whether a firm can attain and maintain a leading position is significantly related to whether the firm's strategic choices match changing industrial environment conditions (Reger, Duhaime & Stimpert, 1992). Furthermore, a firm's market performance is also affected by how it is constructed and how it allocates its investments (Child, Chung & Davis., 2003). Child (1972, p.10) also argues that it is imperative to "recognize the exercise of choice by organizational decision makers. The boundaries between an organization and its environment are defined [to a] large degree by the [types] of relationships [that] its decision makers choose to enter [into]".

Cui and Lui (2005) and Pan et al. (1999) note that entry mode and investment size are potentially the most fundamental of strategic factors. Each entry mode and strategy has its benefits and risks, and as such, strategic choice plays a significant role in the decision-making of entering into a foreign market (Brouthers & Brouthers, 2000; Dikova & Van Witteloostuijn, 2007; Woodcock et al., 1994).

The impact of entry mode on a firm's performance can, however, be inconsistent (Gaur & Lu, 2007). Chowdhury (1992) and Delios and Beamish (2004), however, note that regarding a firm's market share performance, different entry modes do not have different impacts. Gaur and Lu (2007) note that this conflict occurs for two reasons.

Firstly, the difference between the host and home market varies from one firm to another. As such, wholly-owned subsidiaries are the reason why some firms succeed in foreign markets but may be the reason why other firms fail in the same context. Secondly, firms always learn how to perform well in the local market and become adept to the environment of the said foreign market. Thus, the level of ownership has less influence than is assumed.

Investment size can also affect the ability of a firm to make full use of first-mover advantages or the reduced risks of late followers. Investment size should, therefore, be a critical indicator of a firm's strategic choices (Murray et al., 2012).

3.2.5 Advertising Intensity

A significant body of literature has investigated the relationship between advertising expenditures and firms' financial metrics. Financial metrics include profits, market capitalization or value, and market-to-book ratio. The relationship between advertising expenditures and market performance has been proven positive in studies conducted by Binswanger, Ruttan and Ben-Zion (1978) and Conchar Crask & Zinkhan. (2005).

Cui and Lui (2005) point out that in many emerging markets, the amount of advertising expenditure has a significant effect on the organization's market share and profitability. Firstly, early entry firms that undertake intense advertising assist in increasing consumer awareness and enhance the possibility of superior performance (Szymanski et al., 1995). Japanese firms begin advertising their products in China

during the early stage of entry, as they believe that raising awareness about their products and brands will deliver significant sales.

Hirschey and Weygandt (1985) also posit a link between advertising and a firm's market performance, concluding that advertising systematically and positively influences the market performance of a firm. Chauvin and Hirschey (1993, p.129) state that "advertising constitutes a key determinant of the market value of the firm." O'Brien (2003) reports a significant positive relationship between advertising intensity and market-to-book ratio.

Furthermore, West et al. (2008) note that creativity in advertising is highly prized for its ability to gain consumer attention and bestow value to brands. These benefits induced by advertising, in turn, boost the sales and profits of firms (Kirmani & Wright 1989; Leone, 1995; Mela, Gupta & Lehmann, 1997; Osinga, Lefflang & Wieringa, 2010). In addition, Chemmanur and Yan (2009, p.41) state that "advertising can signal quality not only to the product market, thereby allowing consumers to price the firm's products correctly in equilibrium, but also to stock market investors on the true value of a firm's projects, thus allowing them to price the firm's equity correctly in equilibrium". Moreover, Chauvin and Hirschey (1993) point out that advertising expenditure can be treated as an investment in a firm's intangible assets, and that this investment has a predictably positive effect on the firm's performance.

William and Thomas (1967) also found a significant statistic and quantitative impact of advertising on profit rates. Chauvin and Hirschey (1993) highlight a similar result, stating that advertising has a significant, positive, and consistent influence on

the market value of a firm. In research conducted by Graham and Frankenberger (2000), it is shown that changes in advertising expenditure are highly associated with earnings. Srinivasan et al. (2008, p.14) states, “marketing activity such as advertising enables the company to charge high prices, attain greater market share, and sales (Boulding, Eunkyu & Staelin 1994), command consumer loyalty (Russell & Kamakura, 1994), and hence, ward off competitive initiatives”.

However, some empirical studies have challenged the relationship between advertising and a firm’s performance. Han and Manry (2004) studied the relationship between advertising expenditures and stock price using a sample of Korean firms. They found that advertising expenditures were negatively related to stock price. Additionally, Tai and Chan (2001) employed a portfolio approach in their investigation to examine the relationship between advertising expenditure and stock return. In their study, advertising expenditure was scaled by sales and the market value of equity, and amortized over five years. They conclude that advertising expenditure is not directly related to stock returns. Core, Guay and Van Buskirk (2003) also state that the relationship between advertising and a firm's performance is not significant. Furthermore, Connolly, Hirsch and Hirschey (1986) investigated whether advertising expenditure can be used as a measure of market value and found that advertising expenditure is insignificantly and negatively related to market value.

Moreover, advertising intensity is always associated with other factors like entry mode and investment size. As Anand and Delios (2002) illustrate, a firm will more likely choose wholly owned subsidiaries with a high level of advertising intensity

than other entry modes. Similarly, Chauvin and Hirschey (1993, p.137) state that the impact of advertising expenditure differs according to firm size and that "size advantage[s] are relevant in determining the valuation effects of advertising." Furthermore, Connolly and Hirschey (2005) found firm size was related to advertising intensity; the impact of advertising expenditure was more significant for large firms than small firms. Gomes-Casseres (1989) states that advertising intensity is associated with a preference for wholly owned subsidiaries and equity joint ventures. Tsang (2005) also found that a percentage of foreign equity is positively related to advertising intensity. Additionally, Gatigon and Andson (1988) indicate that a firm with a high level of percentage of equity tends to have a high level of advertising intensity. Thus, advertising intensity has a joint effect alongside entry mode and investment size.

3.2.6 Firm Location

Firm location, on the other hand, is another important factor influencing the market performance of a firm. There are three major regions in China. The first region is Eastern China, the second region is Northeastern, and Middle China and Western China is the third one. According to the Chinese Statistic Yearbook, Eastern China comprises only 36.5% of the population of the entire country, but contributes 55.3% of GDP, and has 87.3% of FDI. Thus, there is a significant imbalance among the four different regions. Therefore, when multinationals choose to invest in China, which specific region to invest in will be a crucial decision to consider. Hu and Chen (1996) state that in China, the location of a joint venture is significantly related to its performance.

Sridhar and Wan (2009) state that the choice of firm location affects investment, employment, and output.

Moreover, firm location is also related to entry mode. In Eastern China, foreign firms will more likely get what they want, compared to other parts of China (Pan, 1996). Additionally, a more developed area infers a lower level of risk, which in turn will encourage multinationals to choose wholly owned subsidiaries (Pan, 1996). Coughlin and Segev (2000) also found that coastal locations are a positive determinant for FDI location. Zhang (2006) concurs that FDI inflows are larger in the coastal region than in the inland regions.

Firm location is also related to entry timing. In 1984, China first declared five special economic zones (SEZ) and 14 open coastal cities. "In this region, a variety of measures are available to assist foreign investors and SEZs in particular, and [for enjoying] maximum freedom from the central government to experiment with market economies" (Chadee & Qiu, 2001, p.126). Thus, even when a firm is among the first-movers in other regions of China, compared to firms investing in SEZs and the 14 open coastal cities; it may not be able to enjoy the first-mover advantages. However, since the Chinese Government is working on narrowing the gap between different regions, cities other than the SEZs and the 14 open coastal cities have created more incentives to attract FDI (Wei, 2009). Therefore, even though a firm investing in other regions may be treated as a late-mover, it can still enjoy a more beneficial investment environment (Wei, 2009). There is a lot of discussion about SEZs, their effectiveness

and a number of legal issues have arisen (Peng & Fei, 2017) however their benefits are undeniable.

3.2.7 Differences Among Industries

Strategic choice and market performance are determined primarily by the industry (Mauri and Michaels, 1998). In a given industry, as the basic structural elements of industry are stable, its members can share competitive characteristics. In other words, successful firms can develop resources for producing competitive advantages, and other firms can imitate these resources to reduce the competitive gap. For example, in the technology industry, direct competitors can share the same opportunities for innovations (Klevorick, Levin, Nelson & Winter, 1995; Cohen and Klepper, 1992), and firms can use the same protection mechanism/s to protect their investment (Levin & Gaeth, 1988).

From a marketing expenditure perspective, different industries have their product differentiability, buyer characteristics, and product life-cycle or close rivalry (Comanor & Wilson, 1974; Kotler, 1994). Thus, the effect of marketing expenditure varies among industries.

Ho Keh & Ong (2005) hypothesize that advertising has a greater market performance impact for non-manufacturing firms than manufacturing firms. They used data covering more than 40 years and 15039 firm-years to test this hypothesis, and show their hypothesis to be supported by their subsequent results. Yasuda (2005) shows that

for Japanese manufacturing firms, advertising has a significantly positive impact on firm performance.

3.2.8 Firm location and Industry difference

There is a tendency for specific industries to choose specific areas. The ideal regions for manufacturing firms are Middle and Northeast China, while non-manufacturing firms tend to choose Eastern China. Multinationals will consider where and how to invest in China, based on their particular industry. As discussed in section 3.2.6, the Chinese government chose to help develop Eastern China firstly. Thus, the market in Eastern China is the most developed one among all regions in China (Wei, 2009). As a result, the Eastern China has become the richest region in China. Non-manufacturing industries, such as service firms, can enjoy a developed market. The cost of the labor force and price of raw materials is the main obstacle for the development of manufacturing firms (Wei, Luo & Zhou, 2010). Middle and northeast China, on the other hand, is less developed than Eastern China, but the labor and raw materials are much cheaper than Eastern China. Moreover, since the implementation of the Central Development Strategy in 2000, Middle and northeast offer a market with a low-cost labour force, cheap and rich raw materials, rapidly developing infrastructure and attractive investment policy. (Wei et al., 2010). Thus, Middle and northeast China has become an ideal region for manufacturing firms.

3.3 Hypotheses presentation, Development, and Discussion

In this section, we present the hypotheses and explain how they were developed. The hypotheses are divided into six groups.

The first group concerns the impact of entry timing and entry mode on market performance.

H1: early entrants to a foreign market have higher market shares than late entrants.

H2: wholly owned subsidiaries have higher market shares than contractual joint ventures and equity joint ventures.

H3: entry mode has a positive moderating effect on the entry timing-market share relationship, with early entrants as wholly owned subsidiaries having the highest market shares, followed by equity joint ventures, then contractual joint ventures.

The second group concerns the impact of investment size on market performance.

H4: foreign firms with a large investment size have higher market shares.

H5: investment size has a positive moderating effect on the entry timing-market share relationship.

The third group concerns advertising intensity.

H6: a higher level of advertising intensity will result in better market performance.

H7: advertising intensity has a positive moderating effect on the entry timing-market share relationship.

H8: the interaction effect of advertising intensity and investment size has a positive effect on market share performance.

H9: the interaction effect of advertising intensity and entry mode has a positive effect on market share performance – firms with a high level of advertising intensity and wholly owned subsidiaries having the highest market share, followed by equity joint ventures and contractual joint ventures.

The fourth group concerns firm location.

H10: early entrants in Eastern China have the best market performance.

H11: multinationals which invest in Eastern China with wholly owned subsidiaries achieve the best market performance.

The fifth group concerns advertising and industry differences.

H12: advertising intensity has a significantly positive effect for both manufacturing and non-manufacturing firms. Additionally, the impact is larger for early entrants than late entrants for both manufacturing and non-manufacturing firms.

The sixth group concerns firm location and different industry.

H13: non-manufacturing firms achieve better market performance in Eastern China than in other regions, while manufacturing firms achieve better market performance in Middle and Northeast China than in other regions.

Hypothesis 1 is concerned with the (dis)advantages of early/late entry. As discussed in the literature review, first-movers have a competitive advantage over late

entrants. First-movers can pre-empt natural and human resources more rapidly, compared to late entrants (Lieberman & Montgomery, 1988). Lilien and Yoon (1990, p.569) also support this opinion and state, "early entrants have more options on selecting geographic locations, suppliers, and business partners." Furthermore, Delios and Makino (2003) point out that early entrants have enough time and the required capacity to create obstacles for preventing late entrants from entering the host market.

From an informational point of view, early entrants also have advantages over late entrants. Host market conditions and local market knowledge are two critical aspects that foreign firms entering into a foreign market need to solve (Zaheer, 1995; Dikova & Van Witteloostuijn, 2007). This is because an early entrant firm has more time than a late entrant to become familiar with the host market's conditions, and to acquire local market knowledge (Li, 1995; Pan et al., 1999). Moreover, as discussed previously, Carpenter and Nakamoto (1989) state that customers have a stronger preference for early market entrants. Early entrants, therefore, have a stronger selling advantage, compared to late entrants.

We discussed in the literature review that first-mover advantages come with substantial costs and uncertainties. At the start of entering a foreign market, uncertainties are much more important than in any other stage of entering such a market (Luo, 1998). Cantwell Glac & Harding (2004) and Nerkar and Roberts (2004) state that it is important for foreign firms to learn local market knowledge and use it in conjunction with their resources to develop competitive advantages. However, as Chang (1995) states, local market information is not always easily accessible by foreign

firms entering a foreign market; furthermore, whether firms are familiar with the host market's structure determines the success of knowledge acquisition. Late entrants, however, can access this information from early entrants, thus protecting them from such uncertainties (Delios & Makino, 2003; Gao, Pan, Lu & Tao, 2008).

Developing and developed countries present different institutional uncertainties. Dikova and Van Witteloostuijn (2007) argue that local market institutions serve as a critical force affecting the performance of foreign firms. The market system in developing countries is different from the thorough market economy system in developed countries. In developing countries, the process of substituting old market regimes with market economy mechanisms remains ongoing; this forces firms to undergo "far-reaching institutional reforms" (Dikova & Van Witteloostuijn, 2007; Pan et al., 1999). As such, many firms prefer to wait and see how the first-movers cope, rather than being a first-mover themselves. As a result, late entrants may face less institutional uncertainties and risks than first-movers. Based on these two approaches, we formulated the first hypothesis (H1).

Hypothesis 2 concerns entry mode. According to the Rules for The Implementation of The Law of The People's Republic of China on Foreign-Capital Enterprises (1990), the entry mode a multinational can use to enter China is not restricted to any particular mode. However, Catalogue for Guidance of Foreign Investment (2017) has prescribed that several industries are not open for foreign firms and several industries are open for foreign firms with specific entry mode. Among all industries open to foreign firms, there are mainly three types of entry modes: equity

joint ventures, contractual joint ventures, and wholly owned subsidiaries. While equity joint ventures and wholly owned subsidiaries are equity entry modes, contractual joint ventures are classified according to the non-equity entry mode, where local companies and foreign firms effect contractual partnerships (Tallman & Shenkar, 1994). Hahn and Shaver (2005) point out that firms that wish to enter a foreign market using wholly owned subsidiaries will rely significantly on their resources in the home market; furthermore, with a high level of ownership of local firms, foreign firms entering a foreign market can easily copy what they have successfully achieved in their home market to the host market. Papyrina (2007), as cited in Murray et al. (2012, p.50), state that wholly owned subsidiary firms "incur lower new resource-based costs." Furthermore, a higher level of ownership supports a firm to perform better in foreign markets (Gaur & Lu, 2007). Compared to joint ventures, the operational costs associated with wholly owned subsidiaries are also likely to be less substantial, because foreign investors can avoid problems arising from divergent strategic viewpoints, dissimilar management philosophies, incompatible administrative routines, and different corporate and national cultures. Moreover, wholly owned subsidiaries ensure that foreign firms completely control foreign investments. As control power and direct management have been shown as increasingly important in the market operations of firms, wholly-owned subsidiaries are more powerful than other types of entry modes regarding market competition, and they will seize bigger market shares (Murray et al., 2012). Fung et al (2004) discuss the case of Whirlpool which formed a joint venture

with Beijing Snowflake Electric Appliance Group only to end the joint venture 2 years after it lost USD 30milion (p. 14).

As previously discussed, only early entrants have an opportunity to attain a leading position, and they should, therefore, attain more local knowledge to sustain this position (Kerin et al., 1992). To reiterate, joint ventures are non-equity mode ventures, where local companies and foreign firms make contractual partnerships (Tallman & Shenkar, 1994). Thus, contractual joint ventures make it more difficult for foreign firms to compete in a foreign market (Murray et al., 2012). Cui and Lui (2005) and Papyrina (2007) argue that in contrast to contractual joint ventures, wholly owned subsidiaries offer foreign firms a high level of managerial control, minimal conflicts of interests and [the] avoidance of partner opportunism. Thus, hypothesis H3 arises.

On the other hand, investment size also has a significant effect on firms' performance in a foreign market. As previously noted, foreign firms need to acquire local market knowledge to overcome the liability of foreignness and [to] compete with local firms (Dikova & Van Witteloostuijn, 2007; Zaheer, 1995). Cui and Lui (2005) and Isobe et al. (2000) suggest that foreign firms need their resources to use first-mover advantages. Furthermore, larger investments indicate larger firm size and capacity regarding market competition. Magnusson et al. (2009) argue that firms with a large investment size are more likely to succeed regarding dealing with high risk and uncertainties. Thus, hypothesis 4 arises.

Endogeneity is an issue that should be taken into account when examining the relationship between the factors previously discussed. Papyrina (2007) and Shaver

(1998) argue that foreign market entry factors affect this process jointly; therefore, it is necessary to test for endogeneity. In this study, endogeneity is examined using the interaction effect between entry timing, entry mode, investment size, and advertising intensity on a firm's market share performance. Papyrina (2007) also points out that entry timing and entry mode have a joint effect on a firm's market share performance. Furthermore, early entry alone is not sufficient for a firm to achieve a leading position in a foreign market; additionally, investment size also affects entry mode (Cui & Lui, 2005; Isobe et al., 2000; Luo, 1998). Thus, in this study, the interaction effects between entry timing, entry mode, and investment size are examined.

Hypothesis 5 applies to another interaction effect between entry timing and investment size. Investment size will likely have a positive effect on a firm's market share performance. With large investment size, firms can attain local market knowledge and use local resources more easily (Liberman & Montgomery, 1998). Therefore, early entrants with large investment sizes can attain more first-mover advantages than early entrants with smaller investments.

Advertising intensity is also an important factor that needs to be considered. In a market-oriented economy, the amount of advertising expenditure will have a significant effect on the firm's market share and profitability (Cui & Lui, 2005). Early entry timing, coupled with a high level of advertising intensity will give early entrants an opportunity to achieve high market performance (Szymanski et al., 1995). For late entrants, a good and effective advertising strategy will help them overcome late-entry

disadvantages and assist them in achieving good market performance (Lieberman & Montgomery, 1998). Thus, H6 and H7 arise.

Advertising intensity will not only affect market performance alone but will also affect interaction effects on investment size. Advertising expenditure can be treated as an investment. Connolly and Hirschey (2005) conclude the effect of advertising intensity on a firm's market share performance to be positively related to firm size. Keith and Mark (1993) also state firm size as being relevant for determining the effect of advertising on market performance. Thus, H8 arises. On the other hand, advertising intensity also has an interaction effect on entry mode. Regardless of the type of entry mode a firm chooses into a foreign market, advertising intensity is a strategic choice that a firm makes to boost its performance. However, in an emerging market, where the legal infrastructure is less developed, foreign firms with equity joint ventures will face the risk that their local partners will "[act] opportunistically" (Tsang, 2005, p.158), and this behavior will dilute the benefits brought on by advertising. However, wholly owned subsidiaries can use the benefit brought on by a high level of advertising intensity to their advantage. Thus, H9 arises.

As the firm location is a crucial factor when considering investing abroad, the interaction effect between firm location and entry mode, and firm location and entry timing should be included in the research. Coastal cities and SEZs are a prime location for FDI, as they have "well-developed infrastructure, [a] large population base, well-established financial and industrial sectors and are well equipped to handle business dealings with foreign firms" (Chadee & Qiu, 2001, p.126) Thus, in a good investment

environment, early entrants can make full use of their first-mover advantages to achieve better market performance. Thus, H10 arises. Based on research conducted by Chadee and Qiu (2001), multinationals prefer a higher level of ownership, such as wholly owned subsidiaries, or more than a 50% share of equity, in Eastern China. Thus, H11 arises.

Orr (1974) states that advertising can create a barrier for late entrants in the manufacturing industry and as such, the profit of early entrants will be higher than for late entrants. Similarly, Balaji (2009) also concludes that early entrants have an opportunity for achieving a positional advantage and market share dominance. Ho et al. (2005) conclude in their study that the impact of advertising on a firm's value is larger for non-manufacturing firms than manufacturing firms. Additionally, the impact of advertising expenditure on a firm's performance is proven to be significantly positive for early entrants, compared to late entrants (Balaji, 2009). Thus, H12 arises.

Wei Yao and Liu (2009) state that manufacturing industries are moving from Eastern China to Middle and Northeast China, and that the profits of manufacturing firms in Middle and Northeast China are higher than in Eastern China. Furthermore, Middle and Northeast China are becoming centers of manufacturing industries. In contrast, non-manufacturing firms still achieve higher market performance in Eastern China (Wei et al., 2009; Wei, 2009). Thus, H13 arises.

3.4 Methodology and Data

3.4.1 Data selection

The dataset used in this study represents the Chinese industrial census ranging from 1998 to 2013 and is conducted by the State Statistical Bureau of China. As the State Statistical Bureau of China has not released new data from 2014 till now, the time period of data used in this study is restricted to 2013. The dataset includes all manufacturing and non-manufacturing firms. The dataset contains geographic location, industry code, firm type, age, number of employees, and accounting information. The limitations of this dataset are discussed in the introduction. Data description is presented in Table 3.2. Table 3.3 presents the correlation matrix. Furthermore, the database included in this study covers a longer period compared to that in Murray et al. (2012). Regarding to the firm numbers in China, the details are as follows. The total number of firms included in the database is 165118, 162033, 162885, 166361, 176514, 157641, 187984, 192481, 201961, 176768, 186113, 214364, 202872, 225609, and 233769, from 1998 to 2013 respectively. The number of foreign firms are 26442, 26837, 28445, 31423, 34466, 49386, 51246, 106165, 60872, 67456, 77847, 75375, 74045, 57216 and 56908, from 1998 to 2013 respectively.

Table 3.2 Variable Description

	Early Entrants	Lag time	Equity joint ventures	Wholly owned subsidiaries	Investment size	Advertising intensity	Industry growth	Firm location	Market share	Industry Concentration
Mean	0.08	1.82	0.42	0.29	10.18	0.07	0.29	0.75	0.02	0.10
Std.Dev	0.15	0.68	0.53	0.38	1.44	0.05	0.16	0.43	0.07	0.03
Min	0	0	0	0	7.53	0	0.13	0	0	0.06
Max	1	2.71	1	1	18.03	0.16	0.38	1	0.09	0.16

TABLE 3.3 Correlations matrix

	Early entrants	lag time	Equity joint ventures	Wholly owned subsidiaries	Investment size	Advertising intensity	Industry growth	Firm location	Market share	Industry Concentration
Early Entrants	1									
Lag time	-0.67*	1								
Equity joint ventures	0.05*	-0.10*	1							
Wholly owned subsidiaries	-0.08*	0.14*	-0.84*	1						
Investment size	0.07*	-0.09*	0.05*	-0.25*	1					
Advertising intensity	0.09*	0.08*	0.26*	-0.31*	0.27*	1				

Industry growth	-0.07*	0.19*	-0.32*	0.18*	-0.14*	0.28*	1			
Firm location	-0.50*	0.08*	-0.21*	0.09*	-0.07*	0.14*	0.11*	1		
Market Share	0.18*	-0.21*	0.02	0.13*	0.19*	0.13*	-0.06	0.02*	1	
Industry Concentration	0.12*	-0.18*	0.02*	-0.01*	0.05*	-0.09*	-0.05*	-0.03*	0.21*	1

Notes: * means significance at 0.05

3.4.2 Dependent variables

Market share: market share is captured by the percentage of a foreign firm's sales to total sales in China within the same product sector. A firm's market share varies from one year to the next and as such, it is not possible to use a specific year to represent the firm's market performance. Thus, to compare the overall difference in market performance of early entrants and late entrants, respectively, we used the average market share. The average market share was computed as the average market share of a firm during the entire period. "If a firm exited during the period, we measured the average market share for years of operation" (Murray et al., 2012, p.57).

3.4.3 Independent variables

Entry timing: entry timing is measured as the timing of a firm when it first enters the Chinese market. An early entrant is captured by a dummy variable, which takes the value of 1 if the firm is a first-mover and 0 if otherwise. Moreover, lag time measures followers' delay in natural logarithm of years after early entrants making the first move (Murray et al., 2012).

Entry mode: there are mainly three types of entry mode: contractual joint ventures, equity joint ventures, and wholly owned subsidiaries. In this study, there are two dummy variables (equity joint ventures and wholly owned subsidiaries). We used contractual joint ventures as the baseline in the analysis.

Investment size: investment size is measured as the initial investment when the firm first entered the Chinese market. In the study, the natural logarithm has been applied.

Advertising intensity: advertising intensity is measured as marketing expenditures of the firm as a percentage of total sales of the firm.

Firm location: there are three primary regions in China. The first region is Eastern China (Location 1), the second one is Western China (Location 2), and the third one is Middle and Northeast China (Location 3). In this research, there were two dummy variables (Location 1, Location 3). Location 2 (Western China) is used as a baseline in the analysis.

Industry: a dummy variable is coded as 1 if the firm is in manufacturing industry and 0 if the firm is in non-manufacturing industry.

3.4.4 Control variables

Murray et al. (2012) employed three control variables: industry concentration, industry growth, and firm location. Firm location was therefore used as an independent variable in this study. Thus, in this study, there is only two control variables: industry growth and industry concentration. Industry growth was obtained from the China Statistical Yearbook. Industry concentration is measured as Herfindahl–Hirschman Index.

3.4.5 Models

Multiple linear regression was employed to examine market share performance. The method of variance inflation factor (VIF) was used to identify the presence of multicollinearity. VIF quantifies the severity of multicollinearity in and linear regression analysis. The rule of thumb is that if VIF is not great than 10 indicates that multicollinearity is low (Kutner et al., 2004). The VIF was lower than 10; thus, multicollinearity was not a serious problem in the regression. Based on Murray et al. (2012), there are three models in this study. Model 1 examines the impact of early entrants according to entry mode and investment size on market share performance. Model 2 uses lag time as opposed to early entrants to examine the delayed effects on market share performance. Model 3 uses all independent variables as indicators.

Model 1:

$$Market\ Share = \alpha + \beta Early\ Entrants + \gamma EJVs + \mu WOSs + \rho Investment\ size + \tau Advertising + \varphi Industry\ Growth + \varepsilon$$

Model 2:

$$Market\ Share = \alpha + \beta Lag\ time + \gamma EJVs + \mu WOSs + \rho Investment\ size + \tau Advertising + \varphi Industry\ Growth + \varepsilon$$

Model 3:

$$Market\ Share = \alpha + \beta Early\ Entrants + \gamma EEJVs + \mu WOSs + \rho Investment\ size + \tau Advertising + \varphi Industry\ Growth + \pi Interaction\ effects + \varepsilon$$

Where α is intercept, $\beta, \gamma, \mu, \rho, \tau, \varphi, \pi$ are coefficients, and ε is error term. $EJVs$ stands for equity joint ventures, $WOSs$ stands for wholly owned

subsidiaries, $Advertising$ stands for advertising intensity, and $Interaction\ effects$ stands for interaction effect includes early entrants*investment size, early entrants*EJVs, early entrants*WOSs, early entrants*advertising intensity, lag time *advertising intensity, advertising intensity*investment size, advertising intensity*WOSs, Advertising intensity*EJVs, Location 3*Early Entrants, Location 3*Lag time, Location 1*Early Entrants, Location 1*lag time, Location 3*WOSs, Location 3*EJVs, Location 1*WOSs, Location 1*EJVs, Location 1*Industry and Location 3*Industry.

3.5 Results

Tables 3.4, 3.5, 3.6 and 3.7 show the estimated influence of entry timing, entry mode, investment size, firm location, advertising intensity and interaction effects on a firm's market share performance for all industries, manufacturing industries, and non-manufacturing industries, respectively. The coefficients in Table 3.5 show the influence of each factor on the firm's market share performance, Tables 3.6 and 3.7 show the influence of each factor on the firm's market share performance, based on the specific industry. More specifically, the positive coefficient means that the factor has a positive effect on the firm's market share performance.

Hypothesis 1 states that early entrants into a foreign market will have a higher market share performance. The findings in Table 3.5 show that the coefficient of early entrants is positive, which means it is positively related to market share performance. In model 2 (M2), lag time has a negative coefficient of market share performance Therefore, late entrants have a lower market share performance. This result supports

H1. Furthermore, Table 3.4 presents the average market share of foreign firms. Early entrants have an average market share of 2.1%, while late entrants have a market share of 0.5%. These figures also support the hypothesis that early entrants perform better than late entrants.

Table 3.4 Average market share of foreign companies

Entry Timing	Average Market Share
Early Entrants	2.1%
Late Entrants	0.5%

TABLE 3.5 Result in all industries

Dependent Variable: Market Share				
	Model 1	Model 2	Model 3	VIF
Independent Variables				
Intercept	-2.218*	-2.052*	-2.584*	
Early entrants	1.127*		1.519*	6.73
Lag time		-0.318*		1.12
Equity joint ventures (EJVs)	0.79	0.85	0.62	6.48
Wholly owned subsidiaries (WOSs)	0.208*	0.327*	0.244*	7.52
Investment size	0.463*	0.538*	0.406*	4.73
Advertising intensity	0.349*	0.441*	0.276*	1.76
Interaction effects				

Early entrants*investment size			0.655*	
Early entrants* EJVs			-0.536	
Early entrants *WOSs			3.184*	
Early entrants*advertising intensity			0.127*	
Lag time*advertising intensity			0.087*	
Advertising intensity*investment size			0.175*	
Advertising intensity*WOSs			0.132*	
Advertising intensity*EJVs			0.084*	
Location 3*Early Entrants			0.636*	
Location 1*Early Entrants			1.872*	
Location 3*Lag time			-0.358*	
Location 1*Lag time			-0.539*	
Location 1*WOSs			1.722*	
Location 1*EJVs			1.018	
Location 3*WOSs			1.242*	
Location 3*EJVs			-0.351	
Location 1*Industry			0.901	
Location 3*Industry			1.347*	
Control Variables				

Industry growth	0.016*	0.019*	0.023*	1.43
Industry Concentration	0.06*	0.005*	0.006*	1.39
Model indexes				
N	153,415	153,347	153,347	
R^2	0.168	0.224	0.209	
Adjusted R^2	0.1680	0.2240	0.2089	

Notes: * means significance at 0.05

Hypothesis 2 states that wholly owned subsidiaries have higher market share performance than equity joint ventures, followed by contractual joint ventures. Findings in Table 3.5 show that wholly owned subsidiaries performed better than contractual joint ventures. However, the coefficients of equity joint ventures are insignificant; thus, equity joint ventures are not significantly different from contractual joint ventures. Therefore, H2 is only partially supported. An explanation for the insignificance is that both equity joint ventures and contractual joint ventures are forms of cooperation between a foreign and a local firm. Cui and Lui (2005) state that joint ventures suffer from high cooperation cost and a low level of managerial control. Thus, the difference between two joint ventures is not significant.

Hypothesis 3 states that entry mode has a positive moderating effect on entry timing–market share relationship, as wholly owned subsidiaries, have the highest market shares. The results of model 3 (M3) show that the coefficient capturing the interaction of entry timing and wholly owned subsidiaries is positive and significant, and the coefficient capturing the interaction of entry timing and equity joint ventures are negative and insignificant. These results mean that early entrants in the wholly owned subsidiaries mode achieve a better market share performance than early entrants adopting the contractual joint ventures mode. However, early entrants employing the equity joint ventures mode are not significantly different from those employing contractual joint ventures. Thus, H3 is partially supported.

Hypothesis 4 states that foreign firms with larger investment sizes have higher market share performance than firms with a smaller investment size. Results in Table

3.5 (M3) show that the coefficients of investment size for both these models on market share performance are positive. This means that foreign firms with large investment size enjoy higher market share performance. Thus, H4 is supported.

Hypothesis 5 states that investment size has a moderating effect on entry timing-market share performance. The coefficient in M3 capturing the interaction of investment size and entry timing on market share performance is positive, meaning that early entrants with larger investment size will have better market share performance.

Based on the regression results, advertising intensity is positively related to a firm's performance. This means that a firm that adopts an effective advertising strategy will attain a higher level of market performance than those who do not. Thus, H6 is supported. However, advertising intensity can be both positive to early and late entrants, which means that even though advertising can boost the market performance of early entrants, late entrants can also adopt an intensive advertising strategy to achieve good market performance. Therefore, H7 is not supported, as advertising intensity has a positive effect on market share performance for both early and late stage market entry.

Hypothesis 8 states that the interaction effect of advertising intensity and investment size will positively affect a firm's market performance. The results in Table 3.5 show that the coefficient of the interaction effect is positive and significant. Thus, H8 is supported. However, based on the results, the coefficient of the interaction effect of entry model is significant. Additionally, the coefficient of the joint effect of advertising intensity and wholly owned subsidiaries is larger than the coefficient of the joint effect of advertising intensity and equity joint ventures. This means that wholly

owned subsidiaries with a high level of advertising intensity will have the best market share performance, followed by equity joint ventures, then contractual joint ventures. Thus, H9 is supported.

As shown in Table 3.5, the interaction effect between early entrant and Location 1 (Eastern China) yields the highest significantly positive coefficient. Thus, H10 is supported.

The interaction variables of Location1 and entry mode, Location 3 and entry mode indicate the combination effect of firm location and entry mode. The coefficient of Location 1 (Eastern China) and wholly-owned subsidiaries is the highest. Thus, H11 is supported.

As shown in Tables 3.6 and 3.7, the coefficient of advertising intensity is significantly positive for both manufacturing and non-manufacturing firms. Additionally, the interaction effect between advertising intensity and entry-timing is also indicated in Tables 3.4 and 3.5. Regardless of manufacturing or non-manufacturing firms, the interaction effect of early entrants and advertising intensity is significantly positive, while the interaction effect of the late entrant and advertising intensity is also significant with a lower value. Thus, H12 is supported.

TABLE 3.6 Results in manufacturing industry

Dependent Variable: Market Share (Manufacturing Industry)				
	Model 1	Model 2	Model 3	VIF
Independent Variables				
Intercept	-1.896*	-2.104*	-2.368*	
Early entrants	1.065*		1.358*	5.32
Lag time		-0.371*		0.98
Advertising intensity	0.247*	0.497*	0.185*	1.63
Location 1			0.935*	
Location 3			2.037*	
Interaction effects				
Early entrants*advertising intensity			0.38*	
Lag time*advertising intensity			0.36*	
Control Variables				
Industry growth	0.005*	0.009*	0.014*	1.08
Model indexes				
N	67,253	67,148	67,148	
R^2	0.133	0.145	0.142	
Adjusted R^2	0.1329	0.1450	0.1419	

Notes: * means significance at 0.05

TABLE 3.7 Results in non-manufacturing industry

Dependent Variable: Market Share (Nonmanufacturing Industry)				
	Model 1	Model 2	Model 3	VIF
Independent Variables				
Intercept	-1.265*	-2.015*	-2.153*	
Early entrants	1.428*		1.362*	4.27
Lag time		-0.309*		1.32
Advertising intensity	0.573*	0.498*	0.201*	1.07
Location 1			1.863*	
Location 3			1.328*	
Interaction effects				
Early entrants*advertising intensity			1.037*	
Lag time*advertising intensity			0.802*	
Control Variables				
Industry growth	0.013*	0.021*	0.014*	1.35
Model indexes				
N	86,162	86,199	86,199	
R^2	0.140	0.149	0.167	
Adjusted R^2	0.1399	0.1450	0.1669	

Notes: * means significance at 0.05

As shown in Table 3.5, the interaction effect of Location 1*industry is not significant while Location 3* industry is significant. The result suggests that

manufacturing firms perform better in Middle and Northeast China while nonmanufacturing firms perform better in Eastern China. Thus, H13 is supported.

3.6 Discussion

In this study, we examine the effect of entry timing, entry mode, investment size, firm location, advertising intensity, and their joint effect on the market share performance of foreign firms. First, we examine the impact of entry timing on market share performance. The results suggest that early entrants have higher market share performance. This finding is consistent with the first-mover advantages that are discussed in the literature review section, where early entrants are shown to have first-mover advantages. On the other hand, the most important issue this study deals with is the strategies that foreign firms can use to maximize their profit. “The key to the first-mover advantage–early-entrant survival disadvantage dilemma lies in certain strategic choices that can help early market entrants maintain higher market shares” (Murray et al., 2012, p.61). In this study, we use entry mode, investment size, firm location, and advertising intensity as determining factors for dealing with market share performance. Based on our results, the term of early entrants with wholly owned subsidiaries is positively related to market share performance. Thus, early entrants with wholly-owned subsidiaries have a higher market share performance than equity joint ventures and contractual joint ventures. On the other hand, investment size is another critical factor that affects the firm's market share performance. Based on the results of this study, the interaction effect between investment size and entry timing has a significant positive

effect on a firm's market share performance. Therefore, it is suggested that early entrants with large investment size can make full use of first-mover advantages, and thereby perform better in a foreign market. In other words, if a firm has the willingness to spend a larger initial investment in a foreign market, it will achieve a higher level of market performance.

Another strategy a firm can adopt in a foreign market is advertising. Advertising has proven that it can positively affect a firm's market performance. In this study, there is a significantly positive relation between advertising intensity and market share performance. Thus, it is suggested that early entrants should adopt a high-intensity advertising strategy. However, the interaction effect between advertising intensity and both early and late entrants are both significantly positive. This means that regardless of whether a firm is an early or a late entrant, advertising can boost its market share performance. Moreover, as advertising intensity is positively related to market share performance, regardless of the adopted entry mode of the firm, wholly owned subsidiaries will benefit more from a high level of advertising intensity than joint ventures. It is therefore suggested that a firm invests more in advertising, particularly wholly owned subsidiaries. Moreover, advertising intensity has a more positive effect for non-manufacturing firms.

Firm location is also considered in the study. As Eastern China has been the first region that opened its doors to foreign investment since 1976, early entrants into Eastern China perform better than in other regions. Additionally, wholly-owned subsidiaries are identified as the best entry mode a firm should adopt for investing in Eastern China.

3.7 Conclusion

In conclusion, this study attempts to answer three questions: i) what are the effects of entry timing, entry mode, investment size, firm location, and advertising intensity on market share performance, and what are the joint effects of these factors? ii) Are the effects of these factors the same for all industries? iii) What strategy should multinationals adopt to perform better, and what should government contribute to making the economy perform better?

Firstly, entry timing is a significant factor that a firm should consider when thinking about expanding into a foreign market. However, the performance of a firm in a foreign market is not only determined by entry timing. In this study, entry mode, investment size, firm location, and advertising intensity were tested, with results showing that these four factors are also positively related to market share performance. Joint effects between entry timing, entry mode, investment size, firm location, and advertising intensity were shown to exist. The interaction effect of entry mode and entry timing suggest that early entrants adopting the wholly owned subsidiary model are likely to achieve the highest market share. A large initial investment in the early stage of foreign market entry was shown to have a positive effect on a firm's market share performance. Firm location, alongside entry timing and entry mode, appears to suggest that multinationals consider not only when and how to invest in China, but also where to invest.

Secondly, this study suggests that managers require an in-depth understanding of the effects of entry timing, as well as other factors. A firm needs to consider all factors together to achieve better market share performance. The government should establish a good understanding of regional differences for different industries and should introduce new policies for foreign investors, based on the specific region they wish to invest in.

Chapter 4 FIRM SURVIVAL ANALYSIS: CULTURAL DISTANCE, COUNTRY RISK AND ENTRY MODE

4.1 Introduction

Despite often repeated assertions about the death of the nation state and the birth of the "global village," differences across nations continue to persist in terms of market preferences, economic growth rates, management and governance systems, and choice of organizational goals and strategies. All countries, either developed or developing, attract an enormous flow of inward investments. According to Click (2005), all investment decisions, individual or corporate, are driven by two fundamental factors: expectations about return and assessment of risk. International expansion is facing additional dimensions of risk, which are not applicable to domestic investment, although the same plan with the same rate of return and commercial risk may entail different risks for different countries (Vijayakumar et al., 2009). This component of risk is termed as the so-called "country risk". Therefore, understanding what risks are faced by foreign firms when expanding to other countries, and how these risks affect their performance and survival in the host countries, will help multinationals gain a clear view of the obstacles they will face in the future. The country risks faced by multinationals in terms of international investment can be classified as follows: economic, political, and financial. There are various institutions that measure country risk. In this study, we use the country risk measures which comply with the International Country Risk Guide (ICRG).

Cultural distance is also a factor that needs to be taken into account when considering international expansion. Cultural distance has been used as a key variable in strategy, management, and organization behaviour research. The construct has been applied to a multitude of research questions, ranging from innovation and organizational transformation to foreign expansion and technology transfer (Gomez-Mejia & Palich, 1997) and from affiliate performance to expatriate adjustment (Black et al., 1991). It is in the area of foreign direct investment (FDI), however, that the construct has had its greatest impact. Makino and Neupert (2000) state the importance of cultural distance on the survival of foreign firms.

Despite country risk and cultural distance, entry mode, too, plays a significant role in the survival rate of multinationals. However, there is no agreement about which type of entry mode is the best choice for multinationals (Woodcock et al., 1994). In this study, there are three type of entry modes: wholly owned subsidiaries, contractual joint ventures, and equity joint ventures. We hypothesize that wholly owned subsidiaries have the highest survival rate among the entry modes mentioned above. Parent firms have complete control through wholly owned subsidiaries, which means they can reduce transaction costs and handle uncertainty better than joint ventures.

However, when evaluating the long-term potential of multinational's business, many researchers tend to examine market share performance. Firm survival, on the other hand, is more and more widely recognized as a significant indicator of business performance because exit from a foreign market usually indicates a failure of the management's original goal for the business (Bane and Neubauer, 1981). Thus, other

than market share performance, firm survival is also a critical indicator that needs to be tested. The impact of country risk, cultural distance and entry mode on the survival of foreign firms has only been examined individually and not in a combined fashion. The objective of this study is to find the relationship between these factors and the survival of foreign firms, at both individual and combined levels.

To summarize, previous literature has solely focused on country-level factors or firm-level factors that have influenced the survival of multinationals in China, such as entry-timing (Murray et al., 2012), cultural distance (Gong, 2003; Meschi and Riccio, 2008; Harzing, 2003) and country risk (Fung et al., 2004; Zhang, 2015; Yap and Sufian, 2018). The motivation of this study can be summarized as follows. Given the fact that country-level factors such as country risk and cultural distance are important factors to be considered by multinationals, why do multinationals tend to invest in China (particularly if China is considered to be a risky country both politically and economically and its culture is quite distant from the US, Europe, Latin America, Africa, etc)? Specifically, if the country-level factors mentioned above (high risk, distant culture) have a negative effect on multinationals' survival, what are those other factors that can moderate those negative effects that have made China an attractive destination for FDI? For example, is the sheer size of the Chinese market (in absolute terms) and its huge growth potential a mitigating factor that compensates for risk and/or cultural differences? Could it be that the sheer size of the Chinese market allows other modes of entry such as equity joint ventures which were deemed more troublesome to actually achieve a higher success rate when investing in China? This study tries to fill this gap

by analysing not only country risk, cultural distance and entry mode but also market size, firm age, location and the combined influence of these factors on multinationals' survival in China. This study also aims at identifying factors that can have a moderating effect on previously established negative relationships. In summary, this study aims at providing a convincing answer to the following questions:

(1) What are the effects of country risk, cultural distance, entry mode, market size, firm age and location on foreign firm survival?
(2) What is the joint effect of these factors on firm survival?
(3) Which factor(s) have a moderating impact?

4.2 Literature Review and Research Hypotheses formulation

4.2.1 Cultural distance

Culture is defined by Hofstede (1998, 2001) as "collective mental programs" shared by a group of people. These programs differ from one group to another. Thus, culture is the factor that distinguishes one group from another. The cultural distance is embodied in the existing differences between two nations in terms of certain values, norms and behaviour rules (Shenkar, 2001).

Williamson (1985) states that there are three primary dimensions of cultural distance. The first one explains the location choice of foreign market investment. A theory of familiarity emerged, which argued that firms were less likely to invest in a culturally distant market country (Shenkar, 2012). Yoshino (1976) and Ozawa (1979)

state that the cultural distance of Japan from Western countries is a constraint for Japanese FDI in foreign countries. Davidson (1980) also found similar results pertaining to firms from Western countries. However, Dunning (1988) argues that large cultural distance is an encouragement for foreign firms to overcome the transactional and market failure.

The second dimension predicts the entry mode of multinationals. The results of the impact of cultural distance on entry mode is mixed. Erramilli and Rao (1993), Pan (1996) and Boyacigiller (1990) found that the cultural distance is positively related to control. In other words, the greater the cultural distance, the greater the control multinationals want to have. However, Kim and Hwang (1992) and Kogut and Singh (1988) established a relationship between low control level and high cultural distance.

In this study, we only consider the third dimension of cultural distance, which analyses the success, failure and the performance of multinationals in the international market. According to Chang (1995), cultural distance limits the ability of a MNE to generate rent when entering new domains. Li and Guisinger (1991) found that US affiliates whose foreign partners hailed from culturally dissimilar countries were more likely to fail. Barkema et al. (1997) found that firms which have gradually ventured into more culturally distant locations were less likely to have their affiliates terminated prematurely. The more culturally distant two firms are, the greater the differences in their organizational and administrative practices, employee expectations, and interpretation of and response to strategic issues (Kogut & Singh, 1988; Schneider & De Meyer, 1991). Therefore, communication between culturally distant partners can be

difficult, compounding the coordination problems that exist in any partnership, and leaving such joint ventures vulnerable to managerial conflicts and early dissolution (Camerer & Vepsalainen, 1988; Lane & Beamish, 1990). Moreover, environmental uncertainty aggravates the transactional difficulties in cross-border joint ventures (Kogut & Singh, 1988). Poor communication and mutual distrust can make the transfer of management practices and technologies very expensive (Clegg, 1990; Perlmutter & Hennan, 1986).

Moreover, Gong (2003, p. 729) states that 'as cultural distance increases, complete and accurate information about subsidiary actions and performance becomes more difficult and expensive to obtain, and subsidiary activities thus become harder to interpret, making behavioural and outcome controls by the headquarters difficult.' In addition, cultural distance has been recognized as a crucial factor in the management of transaction costs of subsidiaries (Buckley and Casson 2016; Gatignon and Anderson 1988; Harzing 2003). Cultural distance increases the uncertainty, risk and information asymmetry between the home country and the host country, thereby increasing the transaction costs of operating in that environment (Coase 1937; Buckley and Casson 2016).

4.2.3 Country Risk

Country risk, on the other hand, is a factor relating to foreign firm destabilization. The overall country risk in an international market is considered to be a composite of political and economic risks. These risk factors are the most salient in a firm's decision

to enter a specific international market (Cosset & Roy, 1991). As part of the political environment of a country, legal effectiveness is related to contract enforcement and dispute settlement which is associated with a healthier market for foreign investment (Ju et al., 2013) Also, Zhang (2015) argues that government policy, which is related to the political risk of a country, is significantly related to the performance of firms in China. Similarly, Fung et al. (2004) argue that the precarious nature of Chinese government policy requires foreign firms to maintain flexibility and change their strategy. Furthermore, a country's political risk indicates the likelihood that political forces, often a reflection of underlying societal tension and unrest, may cause drastic changes in a country's business environment that, in turn, may prove detrimental to foreign business interests. At the extreme, such changes in the business climate can lead to the expropriation of foreign assets, like the ones experienced by US firms after the Iranian revolution in 1979. Similarly, an economic collapse in the host country, much like what occurred during the civil war following the breakup of the former Yugoslavia, can render a foreign firm's assets worthless. In less extreme cases, changes in a country's political regime may result in taxes increasing, limiting or prohibiting the repatriation of firm profits to the home country, or imposing exchange rate controls and restrictive technology licensing practices. All of these factors make a country less attractive with regard to international market entry. In a similar fashion, a country's economic risk points to economic forces that may cause drastic changes in the business environment, which are detrimental to business interests. Here, economic mismanagement and corruption are chief among the causes of increased economic risk,

often resulting in high inflation, capital flight, and debt defaulting.

When the time comes to reflect on the possibility of entering a foreign country, the firm must take into account that country's social, legal, economic and political framework. In this context, we found target country risk to be one of the most influential variables affecting internationalisation decisions. In a broad sense, this risk can include various types of specific interrelated risks: those derived from uncertainty about the demand, competitors, costs, and other market conditions; those which jeopardize the country's actual financial solvency; and the political risk (Quer et al., 2007). Yap and Sufian (2018) has investigated the effect of the level of fiscal freedom, monetary freedom and trade freedom on the banks' profit efficiency by employing a sample including both domestic banks and foreign banks in China covering the period from 2007 to 2013. They conclude that these three types of freedom are all significantly related to the banks' profit efficiency. Notwithstanding, if the country risk deteriorates, then foreign firms face increasing environmental uncertainty that can alter the subtle, often precarious balance of contributions, roles and benefits of the local and foreign partners. Similarly, Conklin (2002) states that country risk is a crucial factor that should be taken into account when choosing to expand to a foreign market. Oetzel et al. (2001) also points out the effectiveness of country risk measures. After testing the relationship between country risk and return on capital of US FDI, Click (2005) concluded that economic risk played a significant role in their relationship. Erb et al. (1996) also reported that country risk is related to the performance of multinationals. Diamonte et al. (1996) showed that the return of multinationals in a declining political risk emerging

market is higher than those in increasing political risk emerging market. Habib and Zurawicki (2002) also, opined that there was a negative impact of political risk on FDI. In the end, the IJV's very survival could be affected (Meschi and Riccio, 2008).

Thus, considering the literature on both cultural distance and country risk we set up the following two hypotheses:

H1: Survival rate is negatively related to country risk and cultural distance.

H2: Deterioration of country risk amplifies the negative impact of cultural distance on survival rate.

4.2.4 Entry Mode

Multinationals can choose from a variety of entry modes when entering a foreign market, but there are mainly three entry modes: wholly owned subsidiaries, equity joint ventures and contractual joint ventures. Wholly owned subsidiaries and equity joint ventures consist of equity entry modes (Kumar and Subramaniam, 1997), while contractual joint ventures comprize non-equity entry modes in which local partner and multinationals enter a contractual partnership (Tallman and Shenkar, 1994). However, the performance, more specifically, the survival of foreign firms is dependent on the entry modes. Among these three entry modes, wholly owned subsidiaries enjoy the highest survival rate in comparison with the two other modes (Muarry et al., 2012). Also, Wang and Giouvris (2019) state that wholly-owned subsidiaries are the reason that some firms succeed in foreign market while others failed in the same context. First, wholly owned subsidiaries rely on the existing capabilities of their home market and

simply copy and transfer what they have carried out successfully in other overseas markets (Penner-Hahn and Shaver, 2005). Equity joint ventures and contractual joint ventures, on the other hand, are faced with higher transaction costs in the hosting countries compared with wholly owned subsidiaries. Nitsch et al. (1996) states that wholly owned subsidiaries can avoid the costs involved in looking for a suitable partner. Second, wholly owned subsidiaries have complete control of the subsidiaries. Thus, the parent firm can fully control the system, method and decision of subsidiaries in foreign markets (Anderson and Gatignon, 1986). Furthermore, complete control can lead to less conflict and faster and more efficient decision-making (Anderson & Gatignon, 1986; Gomes-Casseres, 1990; Hennart, 1991). Killing (1983) also points out that complete control reduces the transaction cost arising from coordination problems. This reduction in coordination cost will, in turn, enhance the survival rate of foreign firms. Taken together, wholly owned subsidiaries are likely to possess a higher survival rate than the two other entry modes. Therefore, we set up the following hypothesis.

H3: Wholly owned subsidiaries have a higher survival rate than equity joint ventures and contractual ventures.

4.2.5 Market Size and Firm Age

Market size mitigates the negative effect of country risk and cultural distance on the survival of foreign firms (Rothaermel et al., 2006). Zhao (2006) quoted in Ju et al. (2013) states that market size and development can reduce the negative effect of government intervention on business operations. Also, Zhang (2015) concludes that the huge and

growing domestic market of China is an advantage for firms' performance in China. Managers of multinationals are more willing to accept uncertainty stemming from country risk and cultural distance in larger markets than small markets. Larger markets offer more opportunities and, therefore, more incentives for firms to invest. Moreover, larger markets generally provide a more open environment that allows more companies to coexist (Dollinger & Golden, 1992). Computer and telecommunications company, Motorola, chose to enter China in 1991 by establishing a wholly owned subsidiary. Clearly, the opportunities available in China, including low labour costs for a skilled workforce and the size of the potential market (i.e. a large emerging middle class with sufficient purchasing power), outweighed the costs inherent in the uncertainty stemming from country risk and cultural distance when Motorola's managers made this strategic entry decision.

However, firm age also has an effect on the relationship between firm survival and cultural distance and country risk. Stinchcombe (1965) underlines the role of firm age. He identified "four aspects of new organizations that make them more prone to failure than older, more established organizations: (a) new organizations must get by with general knowledge until members learn new, specific roles, and functions; (b) during the role identification and formation process, there may be conflict, worry, and inefficiency; (c) relations with outside individuals and organizations must be forged, and an initial lack of trust may be a liability; and (d) new organizations lack stable ties with the customers they wish to serve" (Stinchcombe,1965, p.148). Furthermore, Fichman and Levinthal (1991) point out that there is an initial "honeymoon" period

when the initial assets buffer the new organization. As noted by Aldrich and Auster, "the major problem facing smaller and younger organizations is survival, whereas larger and older organizations face the problem of strategic transformation" (1986, p. 193). Thornhill and Amit (2003) also state that firm age plays a significant role in the performance and survival of a foreign firm in a host country. Therefore, we set up the following hypotheses:

H4: Firm age and the growth of market size moderate the relationship between survival rate and entry mode.

H5: Firm age and the growth of market size moderate the negative effect of cultural distance and country risk on survival.

4.2.6 Firm location and the impact of cultural distance and risk on different industries

After 1979, China decided to open its market to investors coming from all over the world. The opening-up policy had its own process. Firstly, the Chinese government chose to develop Eastern China (Wang and Giouvris, 2019). From 1979 to 1992, the greatest number of parts of the country, which were opened to foreign firms, were located in eastern China. More specifically, special economic zones were set up in 1979, coastal open cities and Economic & Technological Development Zones were set up in 1984, Shanghai Pudong in 1990, and tax-protected zones in 1991. After 1992, the opening-up policy included inner China. Thus, FDI in China first took place in the eastern part of the country and then expanded to other regions (Jiang, 2002). Zhang

(2008) states that the total amount of FDI in eastern China accounted for 70.73% of total FDI in China. In summary, Eastern China is a pioneer in reform and opening-up has allowed Eastern China to enjoy extensive economic growth (Wang et al, 2016). Therefore, the huge gap between different regions in China could have a crucial impact on the survival rate of foreign firms. However, in 2000, the Central Development Strategy has been implemented. Middle and northeast China started to offer low-cost labour force, cheap and rich raw materials, rapidly developing infrastructure and attractive investment policy to foreign firms (Wang and Giouvris, 2019). Thus, the degree of development of the market will affect the survival rate of the firms in different regions.

On the other hand, different industries have their own characteristics. The impact of cultural distance and country risk on foreign firms will vary in relation to the industries (manufacturing vs non-manufacturing) those firms belong to. Drogendijk and Slangen (2006) conclude that cultural distance and country risk has a lesser impact on manufacturing firms than non-manufacturing firms. Tihanyi et al. (2005) also argue that non-manufacturing firms are more sensitive to cultural distance and country risk when compared to manufacturing firms. Thus, we set up the following hypotheses:

H6: The negative impact of cultural distance on survival rate is lesser in eastern China than other parts of China.

H7: The negative impact of cultural distance and country risk on survival rate is lesser among manufacturing industries than non-manufacturing industries.

4.3 Hypotheses grouping

The first two hypotheses (H1 and H2) form their own group which is concerned with the impact of cultural distance, country risk and their interaction on survival. H3 is concerned with entry modes and survival. H4 and H5 form another group and are concerned with moderating effects of firm age and growth of market size on entry mode, cultural distance and risk in relation to survival. H6 looks at location effects interacting with cultural distance and H7 looks at types of industries (manufacturing vs non-manufacturing) and how they are affected by cultural distance and country risk. Analytically:

H1: Survival rate is negatively related to country risk and cultural distance.

H2: Deterioration of country risk amplifies the negative impact of cultural distance on survival rate.

H3: Wholly owned subsidiaries have a higher survival rate than equity joint ventures and contractual ventures.

H4: Firm age and the growth of market size moderate the relationship between survival rate and entry mode.

H5: Firm age and the growth of market size moderate the negative effect of cultural distance and country risk on survival.

H6: The negative impact of cultural distance on survival rate is lesser in eastern China than other parts of China.

H7: The negative impact of cultural distance and country risk on survival rate is lesser among manufacturing industries than non-manufacturing industries.

4.4 Methodology

4.4.1 Data

Data is obtained from different sources. Country risk data is obtained from Political Risk Services (PRS) and is available from 1984 to 2016. Culture distance can be calculated using the Hofstede index and GLOBE index. GNP per capita can be obtained from China Statistical Yearbook, which is published by the State Statistical Bureau of China. To avoid collinearity, Variance Inflation Factor (VIF) tests are used. The VIF result of each independent variable and control variable is less than 10. Thus, multi-collinearity is not a problem. Table 4.1 presents the correlation matrix and Table 4.2 presents the data description.

Table 4.1 Correlation Table

Variables	Survival rate	Firm age	Wholly Owned subsidiaries	Equity Joint Ventures	Hofstede's cultural distance	GLOBE's cultural distance	Economic risk	Political risk	Variation in economic risk	Variation in political risk	Variation in Market Size	Investment Size	Firm Location
Survival rate	1												
Firm age	-0.18* (0.007)	1											
Wholly owned subsidiaries	0.15* (0.003)	-0.23* (0.006)	1										
Equity Joint Ventures	-0.08* (0.001)	0.27 (0.012)	0.03 (0.017)	1									
Hofstede's cultural distance	-0.21* (0.006)	0.01* (0.001)	0.31 (0.014)	0.13 (0.019)	1								
GLOBE's cultural distance	-0.16* (0.005)	0.12* (0.009)	0.02 (0.011)	0.09 (0.016)	0.47* (0.002)	1							

Economic risk	-0.38* (0.002)	-0.3* (0.007)	-0.21* (0.005)	0.11* (0.002)	-0.03 (0.013)	-0.09* (0.002)	1						
Political risk	-0.26* (0.009)	-0.06* (0.002)	-0.12* (0.003)	0.08 (0.021)	-0.08 (0.017)	0.02* (0.007)	0.29* (0.002)	1					
Variation in economic risk	0.23 (0.012)	-0.05 (0.018)	0.02 (0.017)	0.04(0.012)	0.2 (0.013)	0.19 (0.014)	0.16 (0.011)	-0.07 (0.019)	1				
Variation in political risk	0.14 (0.013)	-0.08 (0.014)	0.01 (0.013)	0.03 (0.011)	0.12 (0.011)	0.14* (0.004)	-0.01 (0.012)	0.23 (0.013)	0.41 (0.016)	1			
Variation in Market Size	0.37* (0.004)	0.24 (0.016)	0.13 (0.013)	0.21 (0.013)	0.16 (0.012)	0.08 (0.018)	-0.17 (0.019)	0.21 (0.017)	0.18* (0.005)	0.19* (0.002)	1		
Investment size	-0.13* (0.005)	0.14 (0.017)	0.17 (0.012)	0.09* (0.007)	0.12* (0.008)	0.13* (0.009)	0.24 (0.012)	0.08 (0.021)	0.02* (0.007)	0.07* (0.006)	0.12 (0.018)	1	
Firm location	0.08* (0.007)	0.03 (0.011)	0.15 (0.011)	0.27 (0.017)	0.09* (0.006)	0.17* (0.002)	0.26 (0.019)	0.31 (0.027)	0.16 (0.017)	0.09 (0.016)	0.11 (0.014)	0.10 (0.01)	1

Notes: 1. p-value in brackets. 2. * indicates significance at level 0.01.

Table 4.2 Data Description Table

	Political Risk	Ecnonmic Risk	Variation in political risk	Variation in economic risk	Variation in Market size	Hofstede's cultural distance	Globe's cultural distance	Wholly owned subsidiaries	Equity Joint Ventures	Survival	Firm age	Investment size	Firm location
Mean	0.79	0.7	0.01	0.01	0.12	3.88	4.23	0.45	0.36	0.56	16.81	9.75	0.79
Std.Dev	0.07	0.13	0.04	0.05	0.06	1.74	1.68	0.51	0.48	0.09	1.41	1.32	0.06
Min	0.64	0.45	-0.06	-0.09	-0.03	0.51	0.42	0	0	0	1	6.82	0
Max	0.91	0.83	0.1	0.11	0.24	7.88	8.09	1	1	1	33	18.03	1

4.4.2 Dependent Variables

Firm survival is measured with the help of binary coding (0,1). Firms that are still active at the end of period are assigned the value 0, while firms that are delisted are assigned the value 1.

4.4.3 Independent Variables

There are three types of entry modes: wholly owned subsidiaries, equity joint ventures and contractual joint ventures. In this study, there are two dummy variables (wholly owned subsidiaries (WOSs) and equity joint ventures (EJVs)). Contractual joint ventures are used as baseline in the analysis.

Country risk is measured with the help of scores of economic risk (ER) and political risk (PR) obtained from Political Risk Services. In practice, economic risk score is measured on a scale of 0 to 100%, while political risk score is measured on a scale of 0 to 100. In this study, both the scores have been modified to a single scale, ranging from 0 (no risk) to 1 (maximum risk). Economic risk score corresponds to a weighted average of five main dimensions (GDP per head, real GDP growth, inflation rate, budget balance as a percentage of GDP, and current account as a percentage of GDP). Political risk score is correlated to the weighted average of four main dimensions (government and institutional stability, the socio-economic situation, the level of internal and external conflict and investment profile).

Culture distance is calculated using the Hofstede index (Hof) and GLOBE index (Glo). Hofstede index uses four dimensions of national culture: power distance, uncertainty avoidance, masculinity/femininity, and individualism. GLOBE index includes nine dimensions: assertiveness, institutional collectivism, in-group collectivism, future orientation, gender egalitarianism, human orientation, performance orientation, power distance and uncertainty avoidance. Culture distance can be calculated as follows:

$$CD(Hofstede)_j = \sum_{i=1}^{4} \frac{\{(I_{ij} - I_{ib})^2 / V_i\}}{4}$$

$$CD(GLOBE)_j = \sum_{i=1}^{9} \frac{\{(I_{ij} - I_{ib})^2 / V_i\}}{9}$$

Where I_{ij} is the distance index for ith cultural dimension and jth country, V_j is the variance of the index of ith cultural dimension, b stands for China, CD_j is the cultural distance between jth country and China. Both Hofstede and GLOBE indices provide the calculated culture distance on their respective websites.

Market size is measured as Gross National Income (GNP) per capita. To test the moderating effect of market size growth, the annual variation of market size is used.

Firm age is measured as the number of years between the date of establishment of a firm and the end of the dataset period.

Firm location: There are three primary regions in China. The first region is eastern China (Location 1), the second is western China (Location 2), and the third is middle and northeast China (Location 3). In this research, there are two dummy

variables (Location 1 and Location 3). Location 2 (western China) is used as baseline in the analysis.

Industry: a dummy variable is coded as 1 if the firm is in manufacturing industry and 0 if it is in non-manufacturing industry.

4.4.4 Control Variable

Investment size has been used as the control variable and is also considered as the initial investment at the time of establishment of a firm. In the study, the natural logarithm has been applied.

4.4.5 Model

A simple survival function, such as the one mentioned below (without specifying its parametric form), will be used to estimate the hazard rate. (Allison, 1984; Kalbfleisch and Prentice, 1980)

$h(t)=\lambda_t$, where t=1, 2, 3,….., T and $0<\lambda_t<1$

Where λ_t is the hazard rate for time interval t within the period of risk. Hazard rate is the converse of survival rate. Hazard rate is defined as ‘‘the probability that an individual would experience an event in an interval from time t to t + s, given that the individual is at risk from time t” (Allison, 1984, p. 23)

The impact of the independent variables and the control variable on survival rate will be tested using the Cox regression.

Models 1 to 5 present 5 Cox regressions associating distance variables, entry mode variables and the control variable with the hazard rate. Models 6 to 10 present 5 Cox regressions associating country risk, cultural distance and the control variable with the hazard rate.

Model 1:

$$h(t)=b_1 Hof+b_2 WOSs+b_3 EJVs+b_4 Location1 * Hof+b_5 Location3 * Hof+b_6 Investment\ size$$

Model 2:

$$h(t)=b_1 Hof+b_2 WOSs+b_3 EJVs+b_4 Hof * firm\ age+b_5 Hof * market\ size+b_6 Investment\ size$$

Model 3:

$$h(t)=b_1 Glo+b_2 WOSs+b_3 EJVs+b_4 Location1 * Glo+b_5 Location3 * Glo+b_6 Investment\ size$$

Model 4:

$$h(t)=b_1 Glo+b_2 WOSs+b_3 EJVs+b_4 Glo * firm\ age+b_5 Glo * market\ size+b_6 Investment\ size$$

Model 5:

h(t)=$b_1 WOSs + b_2 EJVs + b_3 WOS * Market\ size + b_4 EJVs * Market\ size + b_5 WOSs * firm\ age + b_6 EJVs * frim\ age + b_7 Investment\ size$

Model6:

h(t)=$b_1 ER + b_2 PR + b_3 VariER + b_4 VariPR + b_5 WOSs + b_6 EJVs + b_7 ER * Market\ size + b_8 PR * Market\ size + b_9 ER * Industry + b_{10} PR * Industry + b_{11} Investment\ size$

Model 7:

h(t)=$b_1 Hof + b_2 ER + b_3 PR + b_4 VariER + b_5 VariPR + b_6 WOSs + b_7 EJVs + b_8 Hof * Industry + b_9 Investment\ size$

Model 8:

h(t)=$b_1 Hof + b_2 ER + b_3 PR + b_4 VariER + b_5 VariPR + b_6 WOSs + b_8 EJVs + b_9 VariER * Hof + b_{10} VariPR * Hof + b_{11} VariER * Market\ size + b_{12} VariPR * Market\ Size + b_{13} Investment\ size$

Model 9:

h(t)=$b_1 Glo + b_2 ER + b_3 PR + b_4 VariER + b_5 VariPR + b_6 WOSs + b_7 EJVs + b_8 Glo * Industry + b_9 Investment\ size$

Model 10:

$$h(t)=b_1 Glo + b_2 ER + b_3 PR + b_4 VariER + b_5 VariPR + b_6 WOSs + b_8 EJVs + b_9 VariER * Glo + b_{10} VariPR * Glo + b_{11} VariER * Market\ size + b_{12} VariPR * Market\ Size + b_{13} Investment\ size$$

4.5 Model expectations

Models 1 and 3 test the impact of culture distance and entry mode on hazard rate. We expect wholly owned subsidiaries to have a significant negative effect on hazard rate. We also expect that there will be a significant positive effect on hazard rate due to culture distance and equity joint ventures mode. The impact of firm location and industries difference on the relationship between hazard and cultural distance are also tested in Model 1 and 3. It is expected that the impact of cultural distance on hazard rate in Location 1 will be greater than the hazard rate in Location 3.

Models 2 and 4 consider the interaction effect of culture distance, firm age and market size. Significant negative coefficients of interaction variables are expected to be found in Models 2 and 4.

Model 5 tests how entry mode, interaction effects of entry mode with firm age, and market size affect the hazard rate. The impact of entry mode is expected to be similar to the results of Models 1-4, while firm age and market size are expected to moderate the relationship between entry mode and hazard rate. The interaction effect of firm age with entry mode and market size with entry mode are expected to be significant.

Model 6 tests the impact of country risk on hazard rate. The coefficient of country risk is expected to be significantly positive, and the coefficient of 'variation of country risk' is expected to be significantly negative.

Models 7 and 9 test the impact of country risk, variation of country risk and cultural distance on hazard rate. The coefficients of all variables are expected to be significantly positive.

Models 8 and 10 consider the interaction variables of variation of country risk and cultural distance and the interaction variables of variation of country risk and market size. The results of interaction variables are expected to be significantly negative.

4.6 Results

In the model, we use the hazard rate to test our hypotheses. The hazard rate is the converse of survival rate. If the p-value of the variable is less than 0.01, then the effect of this variable is significant.

H1 states that the survival rate is negatively related to cultural distance and country risk. Models 1 and 3 (Table 4.2) indicate a significant and positive impact on hazard rate due to cultural distance. Thus, the survival rate of a foreign firm with a high level of cultural distance from the host country will be lower than that of a firm with a low level of cultural distance.

The result of Model 6 (Table 4.2) indicates that economic risk has a significant and positive impact on hazard rate, while political risk does not have a significant

impact. In other words, survival rate is negatively related to economic risk. Thus, H1 is only partially supported.

However, the coefficient of variation in country risk and interactions with cultural distance, market size growth and firm age through Models 7 to 10 are not significant. Thus, high- or low-level of country risk, as well as positive or negative variation of country risk, do not affect the survival rate of firms. Therefore, hypothesis 2 is not supported.

The results of Model 5 (Table 4.2) illustrate the relationship between survival rate and entry mode. The coefficient of wholly owned subsidiaries is significantly negative, while the coefficient of equity joint ventures is significantly positive. Therefore, the survival rate of wholly owned subsidiaries is higher than equity joint ventures and contractual joint ventures. Hypothesis 3 is thus supported.

In Model 5, the interaction effects of 'entry mode and market size' and 'entry mode and firm age' are tested. The results indicate that the coefficient of wholly owned subsidiaries and market size growth is not significant, and the coefficient of equity joint ventures and market size growth is significantly negative. Similarly, the interaction effect of firm age and wholly owned subsidiaries is not significant, while the interaction effect of firm age and equity joint ventures is significantly negative. In other words, as market size grows, the survival rate of equity joint ventures rises, while the survival rate of wholly owned subsidiaries is not affected. As the firm grows older, the survival rate of equity joint ventures increases, while that of wholly owned subsidiaries is not affected by the firm's age. Moreover, Figures 4.1 and 4.2 show the relationship between

survival rate and firm age. These figures show that the negative impact of cultural distance does not become functional immediately. After about 18 years, the survival rate turns constant. Thus, H4 is partially supported.

Figure 4.1 Survival rate according to level of Hofstede's index

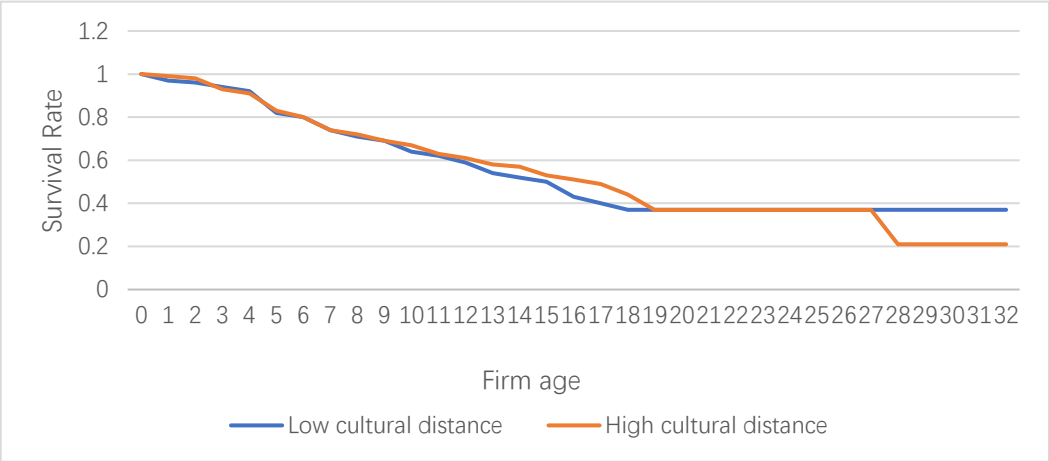
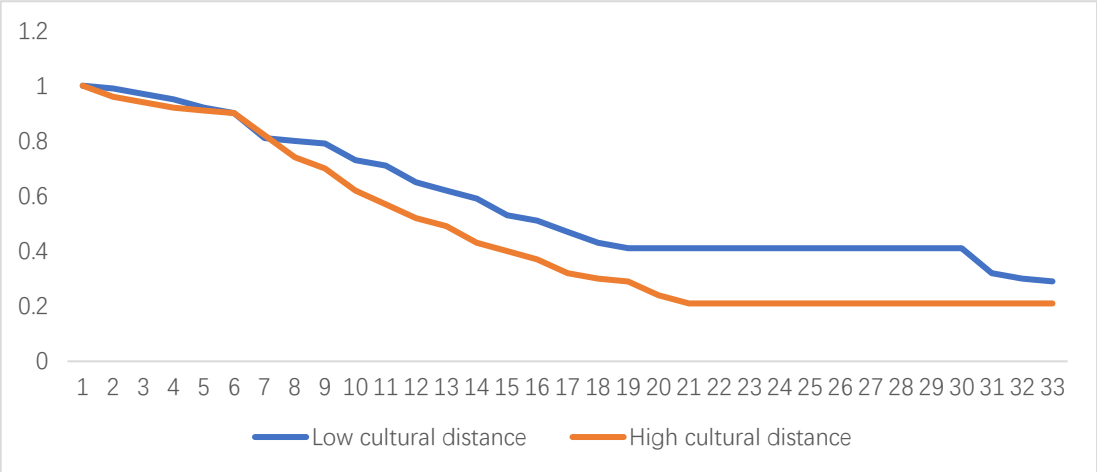


Figure 4.2 Survival rate according to level of GLOBE's index



In Models 2 and 4, the coefficients of the interaction effect of firm age and cultural distance and the interaction effect of market size growth and cultural distance are significantly negative. This result highlights that firm age and growth of market size moderate the impact of cultural distance on survival rate. The greater the age of the firms and the larger the market size, it is less likely that firms will be affected and

destabilized by cultural distance. The interaction effect of growth of market size and country risk is tested in Model 6. The results show that for both political risk and economic risk, the interaction effects are not significant. Thus, H5 is partially supported.

In Models 1 and 3, the coefficient of interaction effect of firm location with cultural distance is significantly positive. More specifically, the coefficient of Location 1 with cultural distance is lower than that of Location 3 with cultural distance. In other words, the impact of cultural distance on survival rate of multinationals in Location 1 (eastern China) is lower than that of Location 3 (middle and north-eastern China). Thus, H6 is supported.

Table 4.3 Cox Regression Results

Independent Variables	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7	Model 8	Model 9	Model 10
Hofstede's cultural distance	0.24⋆ (0.003)	1.4⋆ (0.002)					0.25⋆ (0.001)	0.27⋆ (0.009)		
GLOBE's cultural distance			0.18⋆ (0.002)	1.85⋆ (0.000)					0.19⋆ (0.006)	0.26⋆ (0.006) ⋆
Economic risk						0.02⋆ (0.003)	0.04⋆ (0.002)	0.03⋆ (0.007)	0.05⋆ (0.007)	0.03⋆ (0.009)
Political risk						0.25 (0.14)	0.32 (0.11)	0.45 (0.31)	0.42 (0.23)	0.44 (0.009)
Variation in economic risk						0.03 (0.15)	0.05 (0.12)	-0.12 (0.007)	0.04 (0.005)	0.02 (0.015)
Variation in political risk						0.12 (0.002)	0.09 (0.151)	-0.18 (0.16)	0.05 (0.45)	-0.16 (0.28)
Wholly owned subsidiaries	-0.13⋆ (0.005)	-0.15⋆ (0.000)	-0.16⋆ (0.0002)	-0.12⋆ (0.009)	-0.19⋆ (0.007)	-0.11⋆ (0.004)	-0.12⋆ (0.002)	-0.11⋆ (0.009)	-0.18⋆ (0.001)	-0.14⋆ (0.000)
Equity joint ventures	0.92⋆ (0.007)	0.87⋆ (0.002)	1.03⋆ (0.008)	-0.75⋆ (0.000)	0.23⋆ (0.007)	0.30⋆ (0.000)	0.75⋆ (0.001)	0.68⋆ (0.005)	0.92⋆ (0.003)	0.82⋆ (0.002)
Interaction effects										
Hofstede's cultural distance*firm age		-0.34⋆ (0.001)								
Hofstede's cultural distance*market size		-0.12⋆ (0.009)								

Independent Variables	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7	Model 8	Model 9	Model 10
GLOBE's cultural distance *firm age				-0.52* (0.000)						
GLOBE's cultural distance*market size				-0.25* (0.001)						
Economic risk*Variation in Market size						0.24 (0.014)				
Hofstede's cultural distance*Industry							0.17* (0.008)			
GLOBE cultural distance*Industry									0.18* (0.007)	
Political risk*Variation in Market size						0.17 (0.014)				
Variation in economic risk*Hofstede's cultural distance								0.09 (0.09)		
Variation in economic risk*GLOBE's cultural distance										-0.05 (0.17)
Variation in economic risk*Variation in Market size								0.12 (0.08)		0.11 (0.09)
Variation in political risk*Hofstede's cultural distance								0.17 (0.09)		
Variation in political risk*GLOBE's cultural distance										0.13 (0.15)
Variation in political risk*Variation in Market size								0.05 (0.18)		0.07 (0.27)
Wholly owned subsidiaries*Variation in Market size					0.15 (0.17)					
Equity Joint Ventures*Variation in market size					-0.12* (0.004)					
Wholly owned subsidiaries*firm age					0.03 (0.11)					

Independent Variables	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7	Model 8	Model 9	Model 10
Equity joint Ventures*firm age					-0.08* (0.002)					
Hofstede's cultural distance*Industry										
GLOBE cultural distance*Industry										
Political risk*Industry					0.12* (0.001)					
Economic risk*Industry					0.11* (0.007)					
Location 1* Hofstede's cultural distance	0.18* (0.001)									
Location 3* Hofstede's cultural distance	0.25* (0.001)									
Location 1* GLOBE's cultural distance			0.13* (0.003)							
Location 3* GLOBE's cultural distance			0.19* (0.001)							
Control Variable										
Investment size	0.13 (0.12)	0.15 (0.22)	0.09 (0.07)	0.12 (0.18)	0.11 (0.27)	0.71 (0.13)	0.86 (0.11)	0.87 (0.21)	0.81 (0.31)	0.82 (0.35)
Model Indices										
Log-likelihood	-567.65	-503.24	-382.17	-310.24	-254.31	-570.35	-568.51	-584.21	-563.44	-562.38
Model Chi-square	9.24	236.27	10.35	210.38	13.554	9.35	10.29	11.38	11.28	13.68

Note: p-values in parentheses, *Significance level at 0.01

Coefficient of Hof*Industry and Glo*Industry show results of the impact of cultural distance in different industries. The both the coefficient is significant, which shows that the impact of cultural distance is lower among manufacturing industries than non-manufacturing industries. That means, the impact of cultural distance on the survival rate of manufacturing firms is lower than that of non-manufacturing firms. Similarly, the impact of country risk on the survival rate of manufacturing firms is lower

than that of non-manufacturing firms (as suggested by the coefficient of Economic risk*Industry and Political risk*Industry). Thus, H7 is supported.

4.7 Discussion

As mentioned in the methodology section, Models 1 and 3 were expected to demonstrate a significant effect of cultural distance on hazard rate. The results supported the expectations. In forming a foreign subsidiary, whether a joint venture or a wholly owned subsidiary, the parent company will transfer financial, technological and commercial resources to it. In addition, other intangible contributions, such as national habits, beliefs and values, will be instilled in the foreign subsidiary. These national habits, beliefs and values constitute the software of the mind (Hofstede, 1980) and the "invisible force behind the tangible and observable in any organization" (Kilmann et al, 1985, p. 2). Therefore, any foreign subsidiary is made up of "national cultural differences whose intensity depends on the degree of congruence or divergence between the partners' national cultures" (Meschi & Riccio, 2008, p. 253). Depending on whether the national culture involved in the operation of the foreign subsidiary is congruent, different levels of cultural collision will result, which may be detrimental to the foreign subsidiary. In other words, the survival of a foreign subsidiary is highly associated with the intensity of cultural distance (Buono & Bowditch, 1989; Nahavandi &Malekzadeh, 1988; Slangen, 2006; Barkema &Vermeulen, 1997; Fey & Beamish, 2001; Hennart & Zeng, 2002; Li & Guisinger, 1991; Meschi, 1997; Park & Ungson, 1997; Pothukuchi et al., 2002). Thus, the results are supported by the earlier results as

well as the literature.

Models 2 and 4 consider the impact of firm age and market size growth on survival rate. The results also support the fact that firm age and market size growth moderate the negative effect of cultural distance on survival rate. This is mainly caused by the theory of liability of newness (Carroll & Delacroix, 1982; Freeman et al., 1983; Hannan and Freeman, 1977). The theory argues that the survival rate of a foreign subsidiary is high immediately after its creation and then decreases over time. Furthermore, when large cultural distance is combined with the liability of newness, young subsidiaries are even more unstable. During its early years, a firm will face the lack of ready-made procedures and routines for resolving culture conflicts. When the firm grows older, it will have a complete set of procedures and routines to deal with cultural conflicts. Thus, as the firm grows older, the likelihood of negative impact of culture distance decreases. However, as shown in Figures 1 and 2, the survival rate of young foreign subsidiaries in the first 5 years is high. This is mainly because of the honeymoon effect, which is defined by Park and Russo (1996) and Hennart et al (1998). This compensates for the negative effect of cultural distance on survival rate.

This study also seeks to test how entry mode affects the survival rate. The results match the expectations of Model 5, with a significant effect of entry mode being detected. More specifically, wholly owned subsidiaries achieve a higher survival rate than equity joint ventures and contractual joint ventures. There are several reasons for this result. First, to set up wholly owned subsidiaries, foreign firms tend to rely on their home market experience and copy and transfer what they have successfully carried out

in the home market to the host market (Penner-Hahn & Shaver, 2005). Further, as per Papyrina (2007) cited in Murray (2012), the problems caused by divergent strategic viewpoints, dissimilar management philosophies, incompatible administrative routines, and different corporate philosophies can be avoided by choosing the wholly owned subsidiaries mode. Thus, wholly owned subsidiaries will achieve a higher survival rate compared with joint ventures. However, the results also suggest that firm age and market size have a moderating effect on the relationship between entry mode and survival rate. This can be explained using a similar reason, which illustrates the moderating effect of firm age and market size on the relationship between culture distance and survival rate. As the firm grows older, it learns to deal with the problems of divergent strategic viewpoints, dissimilar management philosophies, incompatible administrative routines, and different corporate philosophies. Thus, the gap between different modes of entry will decrease.

A previous study conducted by Meschi and Riccio (2008), which investigates the survival rate of international joint ventures in Brazil, found that neither high- or low-level of country risk nor positive or negative variation of the same risk affects the survival rate of international joint ventures in the country. However, in the current study, the results suggest that country risk has a significant effect on the survival rate of foreign firms, while the variation of country risk does not. From an economic point of view, China is the second largest market in the world, which offers foreign investors a great opportunity to make a fortune. Therefore, any environmental uncertainty caused by government default on payments, devaluation of the local currency, and/or an

increase in interest rates will have a negative impact on local demand and consumption, which, in turn, will determine the outcome of a foreign firm (Meschi and Riccio, 2008). In other words, the economic risk will significantly influence the survival rate of multinationals in China, as opposed to political risk. Even though several indicators of political risk such as government stability, law and order, quality of the bureaucracy, investment profile, internal and external conflict, ethnic tensions, and democratic accountability have been found to be closely associated with a foreign firm's survival (Busse and Hefeker, 2005), since the Chinese government has published the "Law of the People's Republic of China on Foreign-Capital Enterprises" in 1986, the Chinese government keeps working on perfecting the Chinese market with regard to the political dimension. After joining the WTO in 2001, the Chinese government has published and revised a series of laws and policies to keep the political risk for multinationals at a low level. For example, foreign-funded enterprises enjoy preferential tax policy in house property tax, urban maintenance and construction taxes, and stamp tax. Thus, the political risk, when compared with economic risk, is not a primary one, should a multinational be concerned about it when investing in China.

In 1979, the Chinese government set up five economic special areas as part of the opening-up policy. These five, special economic areas are all in eastern China. In other words, eastern China is the first region which opened its doors to investors from all over the world. As a result, cultures from other countries first influenced the customers of eastern China, and the market in Eastern China was the first to face the cultural shock. Thus, nearly 30 years since 1979, the market in eastern China has

developed into the most mature in the country. The cultural distance between eastern China and foreign countries will be less compared to the distance between other parts of China and foreign countries. In a good investment environment, such as Eastern China, multinationals could make full use of the resources available to them to achieve better performance, and the better performance will in turn increase the survival rate of multinationals (Wang and Giouvris, 2019). Therefore, the negative impact of cultural distance on the survival rate will be lesser in eastern China than any other part of China.

4.8 Conclusion

The main objective of this study is to answer three questions: i) what are the effects of country risk, cultural distance, entry mode, market size, firm age and location on foreign firm survival? ii) what is the joint effect of these factors on firm survival rate? iii) which factor(s) have a moderating impact? This study provides evidence that cultural distance is significantly negatively related to the survival of multinationals in China. In terms of country risk, economic risk has a significant downward influence on multinationals' survival. Facing these negative pressures (distant culture and economic risk), foreign firms can make decisions with reference to entry mode and investment location, to counterbalance the negative effect of these obstacles. Furthermore, the size of the Chinese market moderates the negative effects brought about by cultural distance.

This study provides suggestions for both multinationals' managers and policymakers. For the multinationals' managers, the results show that by entering the Chinese market as 'wholly owned subsidiaries' and investing in Eastern China would

help their companies to overcome the obstacles of cultural distance and country risk. In addition, multinationals should not dwell on the negative effect of cultural distance because the size and fast growth of the Chinese market does have a moderating effect. In addition, the size of the Chinese market allows other forms of entry such as equity joint ventures which are considered troublesome to achieve high success rates which may not be the case in other countries. This in itself provides more flexibility to multinationals as far as entry mode is concerned and makes the Chinese market more attractive to FDI. From the policy-makers perspective, this study suggests that the Chinese government should do their best the minimize the economic risk in the market in order to build up a stable economic environment for foreign investors. Also, the Chinese government needs to seriously consider the present imbalance between different areas in the country to attract investment. They need to use their political and economic power to close the gap identified by this study.

There are also limitations in this study. The exit types of multinationals could not be inferred from numerical data. For example, firm closure and capital divestiture, are not distinguished. Also, every emerging country is different, and the results obtained from China cannot be easily generalized to other countries. Future research could employ a dataset (if available) that makes a distinction between exit types and includes more countries so that universal conclusions can be reached.

Chapter 5 THE IMPACT OF FOREIGN BANK ENTRY ON CHINESE BANKS AND FINANCIAL LIBERALIZATION. RECENT EVIDENCE

5.1 Introduction

The opening up of financial services and the structural reforms of the domestic financial sector are two interwoven processes, but both aim at developing an efficient and competitive financial system to facilitate economic growth. Along with the expanded participation in The General Agreement on Trade and Services (GATS), policymakers have come to realize that the presence of foreign financial service providers can benefit the consumers, the financial industry through learning-by-doing, and the economy through efficiency gains. Thus, determining how exactly the presence of foreign banks affects the Chinese Banking system is a topic worth investigating.

Experiences from other countries seem to suggest that the presence of foreign investors in the local banking system can facilitate increased competition, improve allocation of credit, and aid easier access to international capital markets (Lee, 2002). But there are also costs associated with foreign investment. For example, if foreign banks attract the most profitable portion of domestic markets, it may lead to pressure on domestic banks, providing them an incentive for more risk taking. The evidence on the role of foreign banks in growth and stability is mixed (Jordan and Qi, 2006). The mixed evidence in the literature is an excellent motivation for us to provide a definitive answer regarding the role of foreign banks in growth and stability using the most recent data available to us. In 2003, the China Banking Regulatory Commission (CBRC)

stipulated a 20–25 percent principle, whereby each foreign bank could hold a maximum of 20 percent in the stock of a local bank, and the total holdings of foreign banks in any local bank must not exceed 25 percent.

This study is focused on the effect of foreign bank presence on Chinese bank performance. There are two policy questions this study tries to answer. The first question is whether opening up the bank sector positively influences the local banking industry. There exist some positive effects such as technology transfers, product innovation, and the enhancement of competition within the industry. These effects can help local bank enhance their efficiency and profitability (Claessens et al, 1998). However, foreign bank presence may also lead to financial instability (Shen et al, 2009). The other question is whether the percentage of shares held by foreign bank affect local bank performance. To answer these questions, this study employed three different measurements: MacroFP, MicroFP and foreign exposure index.

Claessens et al (2001) and Lensink & Hermes (2004) defined MacroFP as the percentage of foreign banks in the total number of banks in a country, which captures the overall scale of foreign presence in the host country over a period of time and is therefore useful in a cross-country analysis. But in this study, a different definition of MacroFP has been used. In this study, MacroFP is measured as the ratio of Chinese Banks with foreign bank investment to the total number of Chinese banks (Shen et al., 2009) Therefore, MacroFP can be used to answer the question regarding the opening up of the Chinese banking market. This st udy also employed another two bank-level measures of foreign presence for Chinese banks (Foreign exposure Index and MicroFP).

The Foreign exposure Index uses the number of foreign bank branches operating in the city where a specific Chinese bank is located to capture foreign presence while MicroFP is the percentage shareholding of foreign investors in a Chinese bank and acts as a proxy for foreign bank influence. These measurements provide a more accurate measurement of foreign presence at the bank level and local level where the actual influence is felt.

By using all these measurements, this study provides more accurate results. Specifically, results from aggregate measurements which include the number of foreign banks operating in the host country and asset of foreign banks operating in the host country suggest that foreign bank presence boosts the performance of the Chinese banking sector (Shen et al., 2009). Therefore, the opening up policy of China has clearly been effective in terms of increasing profits following the introduction of foreign investment. By using the foreign exposure index, the results also suggest that increased foreign presence in China is associated with a competitive and developed banking sector. However, the findings of this study indicate that the influence of MicroFP on the performance of domestic bank is insignificant, which means that for those banks that have already introduced foreign investment, releasing more shares to foreign investors might not increase profits. It is important to note that, this insignificant impact of MicroFP on domestic bank performance is unrelated to the impact of MicroFP on domestic financial liberalization.

Notwithstanding the conventional view of the positive role of finance for growth, a good financial system with a well-functioning competitive market as well as, a well-supporting financial institution are essential ingredients for sustainable economic

growth (Lee, 2002). In the wake of internationalization of the financial sector, internationalization of the banking sector through increased foreign bank presence has been more important than ever. It has also been observed that as a result of financial liberalization, globalization of financial markets has gained additional momentum. Thus, investigating the importance of foreign bank presence on financial liberalization is essential. In this study, apart from examining the effect of foreign bank entry on domestic bank performance, the relationship between foreign bank entry and domestic financial market liberalization is also examined.

Overall, this study contributes to the literature in following ways. Firstly, the data used in the paper is the most up-to-date dataset available and covers the period from 2009 to 2016, including Bankscope, Almanac of China's Finance and Banking and the Annual report of China's Banking Regulatory Commission. The time period covered by the most recent study is limited to 2013 (Li et.al, 2015). There several policies have been announced during the period from 2013 to 2016. In 2014, State Council published the "Decision of the State Council on Amending the Regulation of the People's Republic of China on the Administration of Foreign-Funded Banks". The new regulation has cancelled the requirement of setting up representative office before setting up new branch. Also, the restriction for foreign banks to apply for Renminbi business has been lifted. More specifically, before the new regulation, foreign banks need to operate at least three years to apply for Renminbi business, this period has been reduced to one year. Moreover, the operation capital requirement of foreign banks has been cancelled. These new regulations make the Chinese banking sector more open

than before; therefore, it is essential to include the time period after 2013. However, Li et.al (2015) only investigate the impact of foreign bank entry on financial markets. This study not only does it use a more recent data sample (from 2009 to 2016), but it also analyses the impact of foreign bank entry on domestic firms (banks) as well. Secondly, in relation to existing literature (Shen et al., 2009; Bayraktar and Wang, 2004; Huang et al., 2014; Lee, 2002), this study not only use aggregate measurements but also employs MicroFP and foreign exposure index. These measurements together guarantee a more accurate result. Thirdly, previous literature concentrates on assessing the relationship between foreign bank presence and domestic bank performance (Hermes & Lensink, 2004; Shen et al., 2009; Lee, 2002; Xu, 2011; Gormley, 2010; Jeon et al, 2011) but they place little importance on how foreign bank presence affects financial liberalization[4]. In this study, both aggregate measurements (the number of foreign banks operating in the host country and asset of foreign banks operating in the host country) and disaggregate measurements (foreign exposure index) are employed to estimate the degree of the impact of foreign bank presence on financial liberalization and domestic bank performance. Even though aggregate measurements, especially the MicroFP, yields an insignificant result regarding the impact of foreign bank presence on domestic bank and market, the results of three performance indicators (net interest margin, noninterest income and cost) and one financial liberalization indicator (bank

[4] Financial liberalization is a process where the control of financial institutions is released from the central government. As a result, financial institutions are more market-driven rather than government-driven. (Yi and Ding, 2007).

privatization rate) using more accurate disaggregate measurement show that foreign bank presence in China is highly and significantly associated with a competitive and developed banking sector and financial market.

To summarize our motivation for this study is to provide a convincing answer regarding the role of foreign banks in growth, stability and financial liberalization in China (given the mixed evidence in the literature) using the most recent data available to us and employing both aggregate and disaggregate measures (MicroFP and foreign exposure index) which together guarantee a more accurate result.

This paper is organized as follows: Section 2 will discuss the existing literature. The hypotheses to be tested, are listed in Section 3. Section 4 and 5 will provide details about the dataset and the method(s) used for analysis. Section 6 will summarize the results and section 7 will discuss the results and provide ideas for further research.

5.2 Literature Review

5.2.1 China's Banking System

There are four types of commercial banks in China: state-owned banks, joint-stock banks, city banks and rural banks. State-owned banks are directly controlled by the government while joint-stock banks are governed by stockholders which are not limited to the government. City banks and rural banks are mainly controlled by the government but there is also a small amount of private control present. Each type has its own distinctive features on size and geographic branch coverage. State-own banks are the

largest banks in China. All five state-owned banks contributed 36.8% to the total commercial bank assets in 2016. Also, these five banks have nation-wide branch coverage and cover nearly all large cities in China. There are twelve joint-stock banks in China, together they make up 19.1% of total commercial bank assets in 2016. These banks started building up branches in particular regions and now they have rapidly expanded to achieve national coverage. Unlike state-owned banks and joint-stock banks, rural banks and city banks are small in size but have the largest number of branches. They are city or town-based and they offer limited and area-specific banking services (Xu, 2011; Chen and Xiao, 2007; Chuan, 2001).

China has one of the largest banking sectors in the world. At the end of 2016, the total assets of the banking sector were 212 trillion RMB which is equal to 316% of GDP (China Banking Regulatory Commission (CBRC), 2016). However, in early years, China's banking system is far from being a developed and efficient system. In 2003, the ratio of non-performing loans to total loans was over 20% while the ratio is 3.1% on average in Europe. To address the high ratio of non-performing loans and low efficiency in the banking sector, the Chinese government has launched a banking reform which has taken two forms: banking restructure and financial liberalization (Xu, 2011). Banking restructure is characterised by capital injections from central bank and non-performing loans disposal. The results were amazing, the ratio of non-performing loans to total loans is 1.53% in 2018 while the ratio is 3.6% in Europe, 1% for US and Japan (Magnus et al., 2018). Meanwhile, financial liberalization includes the removal of credit plan, gradual liberalization of interest rates, and opening up to foreign

competition (Huang and Qin, 2009; Liu, 2008). Before 1978, China's banking system was operating under a nonbank financial system (Zhang and Daly, 2014). In 1979, the Chinese government started to apply the credit plan, which means that the gap between loans and deposits are controlled by the central bank, loans are limited to local bank's own deposits. In 1985, the central bank releases control on interbank lending. The amount of loans the local bank can approve is not only limited to its deposit size. In 1998, the credit plan is removed, the central bank no longer controls loans and deposits.

Traditionally, foreign entry in the banking sector in China has been highly regulated and subject to strict entry requirements which include minimum entry capital requirements, previous presence in China and minimum total assets. Moreover, consumer type, location and range of business such as currency denomination are also regulated for foreign banks. For example, in 1985, foreign banks can only operate in Shanghai, customers are limited to foreign firms and individuals, and the currency denomination is foreign currency only. However, after China was acceded to WTO at the end of 2001, those restrictions were gradually lifted. Especially after December 2006, there are no discriminatory restrictions on foreign bank entry and banking business in China. Foreign banks enjoy the same treatment as local banks. The number of foreign bank entities in China was 192 in 2003, 211 in 2004, 254 in 2005, 312 in 2006, 440 in 2007 and in 2017 this number has increased to 1013. The total assets of foreign bank entities have increased from 300 billion RMB in 2001 to 3.24 trillion RMB

in 2017 (China Banking Regulatory Commission (CBRC), 2003, 2004, 2005, 2006, 2007, 2017).

5.2.2 Foreign spillover theory

The foreign spillover theory points out that multinationals must possess some firm-specific advantages to overcome the disadvantages of operating overseas such as culture, language barriers, and local business practice (Hymer, 1960; Caves, 1974; Dunning 1980,1983). Blomstrom and Kokko (1988) concluded in their study that firm-specific advantages usually include superior production technologies and advanced management skills. Dunning (1983) also counted intangible advantages such as brand names, trademark, or reputation for quality as firm-specific advantages. Meanwhile, multinationals which operate in a foreign country could generally produce "spillovers" through channels such as demonstration, personnel training, and competition (Blomstrom and Kokko, 1988).

Even though related research focuses more on the manufacturing industries, Dunning (1989) suggested that the FDI spillover theory is well-positioned and could be readily applied to the services sector, as Glodberg (2004) has applied the theory in the financial sector. There exist some close counterparts of technology transfer and productivity in financial sector FDI literature. Also, Glodberg (2004) noted that efficiency improvement is a result of foreign entry to the hosting country's financial or bank sector.

Levine (1996) said there are two channels where foreign bank presence may positively influence domestic bank efficiency. The first channel is through technology transfer. “Foreign bank may directly bring new and better skills, management techniques, training procedures, technology, and products to the domestic market” (Levine, 1996, p.91). The other channel is competition. Levine (1996) concluded that stimulating competition in domestic financial sector will place downwards pressure on profits and overheads expense and, in turn, enhance domestic bank efficiency.

5.2.3 Foreign bank entry in the domestic banking sector

In 1979, foreign banks are first allowed to establish representative offices in China and to open up branches in special economic zones in 1982. In 1996, the government has relaxed the geographic restriction to 23 cities in China. However, the licence foreign banks have been granted is limited, the business they are allowed to do is foreign currency deposits and loans while the clients are limited to foreign firms and individuals. In 2006, 5 years after China joined the WTO, the geographic, client and business restrictions were lifted, and most foreign bank received the same treatment as local banks.

However, as Chan et. al (2014) state in their study, there are still several challenges faced by foreign banks. Firstly, foreign banks faced a plethora of rules and regulations. For example, some foreign banks need to file 6300 different reports annually, its parents bank only need to file 400 reports in the home regulator. Secondly, even though China has opened its market to foreign banks, foreign banks still have

limited access to China's bond market, which is the fourth largest in the world. The third challenge is the capital and liquidity constraints. Furthermore, there are two operation challenges: attracting and retaining well-qualified and skilled personnel, and the legal environment (Chan et.al, 2014).

The ratio of foreign banks assets over total assets in the banking sector has dropped to 1.3% at the end of 2017. But the assets of foreign banks have increased from 300 billion RMB in 2001 to 3.24 trillion RMB in 2017 (China Banking Regulatory Commission (CBRC), 2017). There are several reasons for this situation. Firstly, the fast economic growth of China "contributes to enormous accumulation of assets in domestic banks, which outpaced the growth of assets in foreign banks (Xu, 2011, p.888). Secondly, foreign banks activities are concentrated in a few cities. For example, the ratio of foreign banks asset over total assets in the banking sector in Shanghai is 10.2%, while the national ratio is 1.3% in 2017. Thus, the national aggregate ratio is not reflective of actual foreign bank presence and the impact level.

Notwithstanding, there are a few things which the Chinese government and the local banks can learn from foreign bank presence. Apart from the traditional banking business, such as deposits and loans, the foreign bank's main focus is always on the niche markets and fee-based banking business (Xu, 2011). By 2004, foreign banks have introduced over 100 financial products to the market which is three times higher than the local banks can provide. Experience and expertise in niche markets and fee-based products promise benefits for the Chinese banks which are relatively inexperienced in these areas. Secondly, foreign bank presence also boosts the efficiency of the banking

sector and the firm's productivity in China. Li et al. (2015), using an unbalanced panel dataset covering 75 commercial banks from 2009 to 2013, find that foreign bank entry is significantly associated with increased competition in the banking sector and bank efficiency. Moreover, Li and Huang (2015) suggest that the presence of foreign banks significantly affects industrial productivity. Also, Chan et. al (2014) also point out that as China is in the process of opening up its market to the world and undergoing the internationalization of RMB, foreign banks will have more opportunities than ever before and foreign banks will play an important role in the opening-up of the market and a rebalancing of the Chinese economy.

The benefits and cost of foreign bank entry are investigated extensively in literature. The World Bank (2002) summarized the benefits which foreign bank entry may bring. Those are as follows: i) foreign bank entry increases the efficiency and competition of domestic banking sector which tends to reduce the cost and increase profits (World Bank, 2001; Claessens et. al, 1998); ii) as the evaluation and pricing of credit risks are expected to be more sophisticated, the allocation of credit to private sector may improve (Clarke et. al, 2001; Barth et. al, 2001); iii) foreign bank entry helps build a domestic banking supervisory and legal framework and enhances the overall transparency (Bayraktar and Wang, 2004); iv) "it is expected that foreign banks will provide more stable sources of credit since they may refer to their parents for additional funding and they have easier access to international markets. Thus, domestic financial markets will be less vulnerable to domestic shocks" (Bayraktar and Wang, 2004, p.4); v) foreign banks may reduce the cost associated with recapitalization and restructuring

banks in the post-crisis period. Also, as Garcia-Herrero and Santabarbara (2008) cited in Zhang and Daly (2014) state, 'the Chinese banking sector has benefited from foreign bank presence through higher profitability and increased efficiency.'

However, there are also costs pertaining to the presence of foreign banks. As Hellmann et al, (2000) stated, domestic banks may possess an incentive to take more risk when the franchise value of the domestic bank decreases with foreign bank entry. When foreign banks enter into the domestic market, competition increases, and the deposit-rate is either eliminated or reduced, thus the franchise value of domestic bank is decreased. In addition, domestic banks are not the only ones offering banking services, thus the franchise value could be even lower. Bayraktar and Wang (2004) also pointed out that the presence of foreign banks may increase the financial instability which, in turn, may lead to access to credit becoming impaired for some sectors of the economy.

Denizer (2000) concluded that net interest margin, overhead expenses, and returns on assets are related to foreign ownership in Turkey. His study also showed that foreign bank entry has a strong competitive effect on the domestic market. Hasan and Marton (2000) argued in their study based on Hungary that the presence of foreign banks is associated with higher efficiency in the domestic bank sector. Moreover, Goldberg et al (2000) uncovered that diversity of ownership tends to contribute to greater stability of credit in times of crisis and domestic financial system weakness in Mexico and Argentina.

Claessens et al (1998) investigated the effect of foreign bank entry on the domestic banking sector by using data covering the period between 1988–1995. Their

sample includes all OECD countries and many developing countries. Even though the dataset they employed included China, the total number of banks in China in their dataset is only 5. They concluded that with the presence of foreign bank profitability, overheads of domestic banks move downwards.

Meanwhile, Demirguc-Kunt and Huizinga (1999) showed that in developing countries, foreign banks generally record higher profits and margins compared to domestic banks. Demirguc-Kunt et al (1998) also pointed out that foreign bank entry lowers the profits and overheads costs of domestic banks while raising the efficiency of domestic banks. Again, in both of these two studies, the number of banks in China included in the dataset is extremely low, 5 and 6 respectively.

Also, Zhang and Daly (2015) investigate the impact of opening up, on domestic bank performance using data covering the period from 2004 to 2010. All the three variables (economic globalization, social globalization and political globalization) which they use to measure the openness of domestic market are found to be significantly positively related to domestic bank performance. They conclude that: i) China's banking sector development is stimulated by the expansion of international trade and investment, ii) even though foreign bank presence has levelled up the competition in the banking sector, domestic banks' performance is improving, iii) the opening up of the domestic market boosts cultural mixing and information globalization which decrease transaction costs and iv) political globalization also supports bank performance although the effect is lower than economic and social globalization.

Generally speaking, existing literature on the relationship between foreign bank presence and domestic bank performance in China is limited. Even though there are some studies which have included China in their sample, the sample is too small to capture the whole Chinese Market. In addition, the time period of dataset employed by other studies conducted by Xu (2011), Shen et al (2009), Bayraktar and Wang (2004) are from 1999-2006, 1997-2007, and 1995-2002 respectively, which is considered outdated by today's standards. As China Banking Regulatory Commission (CBRC) has not released the annual report after 2016, this study provides more recent results by employing the most up to date dataset (from 2008 till 2016) and focuses only on the Chinese banking sector.

5.2.4 Financial liberalization

In many developing countries, financial sector reforms have been generally pursued as part of broader structural adjustment programs, bringing about a significant economic benefit through a more effective mobilization of domestic savings and more allocation of resources. As shown by Qian (2000) and Sorsa (1997), lower income countries tend to have more restrictive entry regimes. In terms of the factors that determine differences in commitments, it appears that a country's income level, the openness of its economy to trade in goods, and the depth and competitiveness of its financial sector are positively associated with a country's interest in opening up (Lee, 2002). Thus, countries with less-developed financial systems considered the gains from internationalization so large that they wanted to open up entirely. Notwithstanding the investigation of the financial

liberalization process in MENA countries, Lee (2002) argued that a more liberalized financial sector can be implicitly protected by a safeguard scheme of regulation on banking ownership.

It has been long argued that financial liberalization yielded greater financial depth and increased allocation efficiency of investment. Since financial liberalization generally increases the likelihood that markets operate effectively, banks operating in developed financial markets will become efficient (Bekaert et al, 2001). Reinhart and Tokatlidis (2002) stated that financial liberalization always boosts the real interest rate which is likely to encourage saving and expand the supply of credit available to domestic investors. Thus, although financial liberalization would promote the development of the financial market, it would also bring the risk of financial crisis to the market (Williamson and Mahar, 1998). When an economy includes strong institutions, the impact of financial liberalization on the fragility of the banking system will be mitigated through changes in those institutions, supporting a better functioning of the financial market (Demirgüç-Kunt and Detragiache, 1998; Kaminsky and Schmukler, 2002). Furthermore, Sorsa (1997) stated that financial liberalization has little correlation with the level of financial sector development, especially in the developing countries members of General Agreement on Trade in Services (GATS). Moreover, financial liberalization is associated with lower concentration ratios, an increased presence of foreign banks, and higher capitalization (Vives, 2000) Meanwhile, Li (2014) argues that liberalizing China's financial market is a component of economic

reform and of opening up to the global market. In other words, foreign bank presence is connected to the China's financial market liberalization.

China has been experiencing fast economic growth and increased financial liberalization in the last thirty years. As the largest emerging market with many years of uninterrupted fast growth, China is an interesting case for further study. Financial liberalization in China is characterised by a gradual decline in state sector and a growing importance of collective, individual and foreign enterprises. China's financial liberalization occurred in two dimensions: the internal dimension and external dimension. Internally, China's financial liberalization starts with marketization and privatization (Cheng, 1997; Byrd, 1983; Li, 1994; Yi, 1994; Dipchand et al., 1994; Tang and Li, 1997). External financial liberalization is concerned with the inflow of foreign direct investment, loans from foreign governments and international organizations (Li and Liu, 2001). Thus, foreign bank entry is connected to China's financial liberalization.

However, China is opening its financial market to foreign banks. As foreign banks are more skilled and adapted to the liberalized market, the process of financial liberalization in the Chinese market will allow them to better "differentiate products on both price and risk" (Chan et al, 2014, p. 10). But Chan et. al (2014) also state that given that the financial market is more liberalized, domestic banks can now determine their own interest and deposit rate, they can choose a lower rate and ease the burden of SOEs. Sara (2019) states that the interest rates liberalization, helped to lift the interest rate ceiling in 2015. This will significantly benefit the large domestic banks which will help them to have a stronger market position than all other types of banks in China.

5.3 Hypotheses to be tested

5.3.1 Net Interest Margin and hypothesis 1

Jia (2016) states that the opening up of the domestic market is positively related to improvements and cost efficiency at domestic banks. Improvements in competitiveness and cost efficiencies can be captured by Net Interest Margin. Net Interest Margin is the interest income minus interest expense divided by total earning asset. Foreign banks' entry increases the market competition which, in turn, increases the pressure the domestic banks face. Domestic banks need to increase deposit interest rate or lower the lending rate to retain their market share. These two methods will both narrow the interest margins and improve the competitiveness of the local bank industry.

Hypothesis 1: Foreign bank entry will result in lower net interest margin of domestic banks.

5.3.2 Noninterest income and hypothesis 2

Noninterest incomes are income generated from non-lending operations, including investment banking and brokerage services. According to a PricewaterhouseCoopers survey (PricewaterCoopers, 2007) and the annual report of China's Banking Regulatory Commission (2008), foreign banks in China focus on noninterest niche markets such as credit card, fund management, securities trading, and trade finance. Chinese banks admitted that they are lacking experience in noninterest bank business which reduces

their profitability but are willing to catch-up. Also, Zhang and Daly (2015) argue that the presence of foreign banks triggers more trade and capital flow in the banking sector, which in turn increases the profitability of domestic banks.

Hypothesis 2: Foreign banks' entry will boost the noninterest income of domestic banks.

5.3.3 Cost and hypothesis 3

The FDI spillover theory suggested that foreign banks' entry increases the competition in the local industry, thereby inducing efforts of cost reduction by local banks. But the cost reduction only happens in the long run; in the short run, the cost will increase (Lensink and Hermes, 2004). In the short run, domestic banks often spend more on new facilities and technologies to upgrade their service, implement new services, and also, they are likely to increase salaries to attract skilled personnel. Before China opened its doors to foreign banks, domestic banks lacked motivation to develop new products or instruments to stimulate their profits' growth under the monopolistic nature of China's bank-based economy. However, after the restrictions regarding foreign banks' entry were gradually lifted, domestic banks were forced to spend more on products or instruments to catch up with foreign banks which increased their costs (Ding, 2015).

Hypothesis 3: Foreign banks' entry will increase the cost of domestic banks.

5.3.4 Financial sector liberalization and hypothesis 4

Foreign bank entry is believed to be connected to the financial liberalization in the host

country. Foreign banks may introduce modern and more efficient techniques which are new to domestic banks. Also, foreign banks' presence leads to improvement of bank regulation and supervision because foreign banks may demand an improved system of regulation and supervision from regulatory authorities in the domestic market (Chen and Xiao, 2007). As a result, there will be a reduced influence of the government on the domestic financial sector, which in turn may reduce financial repression policies such as interest rate control, direct credit policies, etc (Huang and Qi, 2009). Thus, by reducing government control in the domestic financial market, foreign bank presence contributes to the liberalization of the financial sector (Jiao 2008). However, the number of studies focusing on testing the relationship between foreign bank entry and financial liberalization in China is very limited. Moreover, empirical results from Barajas et al, (2000) in Colombia, Claessen et al, (2001) in 80 countries, which includes China but the sample size related to China is only 5 banks, and Clarke et al (1999) in Argentina also support the point that foreign bank entry is associated with financial liberalization. Li and Ma (2004) investigate the relationship between the opening-up of the banking sector with the liberalization of financial markets in China. They find that allowing foreign banks to enter the domestic market can effectively deepen the banking reform process of the Chinese financial markets. This allows us to set up the hypothesis below:

Hypothesis 4: Financial sector liberalization is positively associated with foreign bank entry.

Moreover, the FDI spillover theory suggested a decrease in account profits due to the competitiveness. However, account profit is the net interest margins plus noninterest income minus cost and loan loss provisions. As the foreign banks' entry is expected to have a positive effect on noninterest incomes and a negative effect on net interest margin, the effect of foreign banks entry on account profits is ambiguous. In other words, the account profits of domestic banks will either increase or decrease after foreign bank's investment enters the market.

5.4 Methodology

In this study, the following models/equations have been employed to investigate the effect of foreign bank presence on domestic bank performance and financial liberalization. Analysis takes place at three different stages and each model/equation corresponds to a different stage:

$$Equation 1$$

$$: Indicator \ = \alpha + \beta X_{it} + + \theta FEI_{it} + \nu MicroFP_{it} + \delta MacroFP_{it} + \lambda_t + \varepsilon_{i,t}$$

$$Equation\ 2:$$

$$Indicator = \alpha + \beta X_{it} + \theta FEI_{it} + \gamma_1 Indicator_{it-1} + \gamma_2 Indicator_{it-2}$$
$$+ (\theta FEI_{it} \times Year\ Dummies) + \lambda_t + \varepsilon_{i,t}$$

$$Equation\ 3:$$

$$Indicator = \alpha + \beta X_{it} + \theta FEI_{it} + CT_{it} + \lambda_t + \varepsilon_{i,t}$$

Where $Indicator$ is the dependent variable (Y). The indicator measures bank performance and bank privatization rate. Bank performance in turn is captured by 'net interest margin', 'noninterest income', 'costs' and 'accounting profit' for domestic bank *i* and time *t* as presented above and bank privatization is captured by 'bank privatization rate' which is equal to (1 – number-based share of state-owned banks); FEI_{it} is the bank-level foreign exposure index; $MacroFP_{it}$ is the country level percentage of foreign banks out of the total number of banks in China; $MicroFP_{it}$ is percentage shareholding of foreign investors in a bank; λ_t is a vector of year dummies, capturing all effects that change over time such as regulatory reforms and other external shocks; CT_{it}, is city variables which include real GDP growth and openness proxied by real foreign direct investment to GDP ratio in city i at time t. α is a constant, and $\beta, \theta, \nu, \delta, \gamma_1, \gamma_2$ are coefficients. $\varepsilon_{i,t}$ is the error term. X_{it} is the vector of bank specific variables (which control for factors affecting cross-bank variation in performance according to Claessens et al. (2001)) and includes 'equity', 'non-interest earning asset' and 'customer and short term funding'.

Specifically, equity for a bank is a cushion again decline in assets and it measures the degree of protection available to a bank. Berger (1995) identified in his study that there is a positive relationship between bank performance and equity. Non-interest income mainly consists of cash and non-interest earning deposits at other banks, so the non-interest income may have a downward effect on the net interest margin. Moreover,

customer and short-term funding includes demand deposits and fixed deposits[5]. These types of customer funding offer low interest but require branching network which is connected to bank performance (Xu, 2011). The first stage of analysis is undertaken by using equation 1. Notwithstanding, comparing to existing literature which uses macro variables such as GDP growth, real interest rate and inflation rate to analyse the impact of foreign bank presence on domestic market, this study uses year dummies as a replacement. Year dummies help to neutralize the time-specific effect which is related to bank performance and financial liberalization but not related to the focus of this study (the impact of foreign bank presence).

Bank variables such as 'equity', 'non-interest earning asset', and 'customer and short-term funding' may be endogenously determined in the model as the dependent variables can influence their level. Given the presence of endogeneity, Difference Generalised Methods of Moments is adopted in the second stage by using equation 2. Furthermore, as FEI is assumed to be homogenous across years, we use interaction year dummies with FEI to relax the homogeneity assumption.

However, as FEI is essentially a city-level indicator, it might proxy for city factors that are correlated with bank performance. For example, economic growth or openness of the economy will affect bank performance in general. Thus, in the third stage, city variables CT_{it} (which include real GDP growth and openness proxied by

[5]Demand deposits are checking accounts. With proper ID you can go to the bank it's drawn on and "demand" that they cash it immediately. Fixed deposits are deposits which are kept for a specific period and have got a maturity date.

real foreign direct investment to GDP ratio in city i at time t) have been included. For this reason, we use equation 3. However, as the national and regional banks cover multiple cities and are difficult to reflect in the reduced sample in the third stage, the test is conducted on city-bank sample.

5.5 Data

Panel data is employed in this study, expanding from 2008 to 2016. Specifically, the panel includes 6 state-owned banks, 12 joint-stock banks, 90 city banks, 14 rural banks and rural credit cooperatives.

Unfortunately, information is not provided for every single bank in every single year, making the dataset unbalanced. Also, some observations have been dropped because of missing important variables.

The main data source is Bankscope which provided the bank-level data. Macroeconomic data such as GDP growth rates, inflation rates, and real interest rate, are collected from World Bank's World Development Indicator database. The data concerning the total number of foreign banks and total assets of foreign funded banks are collected from the Almanac of China's Finance and Banking 2008–2016 and the Annual report of China's Banking Regulatory Commission 2008–2016. As the annual report of China's Banking Regulatory Commission after 2016 has not been released, the dataset used in this study is limited to 2016.

5.5.1 Foreign Exposure Index

In this study, in order to reach a more accurate result, the foreign exposure index, developed by Ying Xu (2011), is employed. This index measures the degree of foreign exposure at the bank level. As city is a natural boundary of foreign bank influence, this index uses the number of foreign bank branches operating in the same city where Chinese banks operate to determine the degree of foreign exposure for the banks in question.

This index can capture the degree of foreign exposure each domestic bank faces compared to its peers. As the cross-sectional maxima vary over time, the benchmark of this index is set as the panel maximum. In other words, the maximum number of foreign bank branches present in a city over the whole observation period.

There are mainly four types of banks in China: rural bank, city bank, joint-stock bank, and state-owned bank. Across the observation period, the number of foreign bank branches in rural areas in China is equal to zero, so the FEI of rural bank is equal to zero. Also, as the activities of city banks are always limited to the city they are located in, the FEI of a city bank is equal to the FEI in that city. So, the FEI for a city bank *i*, which operates in city *m* in year *t* is:

$$FEI_{i,m,t}^{CB} = \frac{N_{m,t}}{Max_N}$$

Where $N_{m,t}/Max_N$ is the ratio of the number (N) of foreign bank branches in city *m* in year *t* over the panel maximum N.

City banks, state-owned banks, and joint-stock banks set up different branches in different cities, and each city has a different level of foreign exposure. Thus, it is not obvious as to which level represents the bank's overall level of foreign exposure. Therefore, the FEI of state-owned bank or joint-stock bank *i* with a set of branches in cities *m*, (*m=1, 2,…,k)* in year *t* is measured as follows:

$$FEI_{i,m,t}^{Joint\ stock\ B,State\ Bank} = \frac{Max\ N_t^M}{Max\ N}$$

Where Max $N^M{}_t$/Max N is the ratio of maximum number of foreign bank branches among *m* cities where a state-owned bank or a joint-stock bank has branches in year *t* to the panel maximum.

However, by using these two formulas, an implicit assumption is made which is 'the homogeneity of foreign bank branches'. In other words, each foreign bank branch is treated equally and is seen to impose the same level of influence on local domestic banks across cities and time. There are two factors that justify this assumption. Firstly, when thinking of adding 'weights' to relax the homogeneity assumption, it is found that the number of foreign banks branches is already weighted in China. The greater the number of branches a foreign bank has, the greater the influence it has on domestic banks. Foreign banks have a greater number of branches in developed cities such as Beijing and Shanghai than other cities. Therefore, adding 'weights' would offer limited help (Lin, 2011). Secondly, due to data limitations, other data such as 'total asset' or 'volume of transactions' of foreign branches in each city are not available. The only readily available data is the number of branches. Nevertheless, Claessens et al.

(2001) state that compared to ‘the assets of foreign bank entities’, ‘the number of foreign bank entities’ is more important as far as their impact on domestic banks is concerned. Thus, as the homogenous nature of FEI is present, it is necessary to neutralize it. This is achieved by adding interaction terms of FEI with time (t) in the model.

5.5.2 Dependent variables

Net Interest Margin (NIM) is calculated as interest income minus interest expense over total earning assets.

Cost (COST) is the overheads over total earning assets.

Non-interest Income (NII) is calculated as the other operation income over total earning assets.

Bank privatization rate (BPR): 1-share of state-owned banks

5.5.3 Explanatory

Foreign Banks Numbers (fb_nb) is the number of foreign banks branches.

Foreign Banks asset share (fb_as) measures the share of total asset of foreign funded banks over total banking assets.

MacroFP = the number of Chinese banks where foreign banks have invested/the total number of Chinese banks;

MicroFP = the shares held by foreign banks in a domestic bank/the total shares in a domestic bank;

5.5.4 Bank specific indicators

Equity (EQT) is measured as book value of equity over total earning assets.

Non-interest earning assets (NIA) is calculated as the cash, non-interest earning deposits at other banks, and other NIAs over total earning assets.

Customer and Short-term Funding (CSF) is measured as all short-term and long-term deposits plus other non-deposit short term funding over total earning assets.

5.5.5 Macroeconomic variables

Real GDP growth (Real GDP growth_ct) is the real GDP growth in city i.

Openness (Openness_ct) is the ratio of Foreign Direct Investment over GDP in city i.

Table below is the description statistic table.

Table 5.1 Description Statistic Table

	NIM	COST	NII	BPR	FEI	EQT	NIA	CSF
State-owned bnaks								
Mean	2.5712	0.0094	0.0029	0.4315	0.8591	0.0415	0.4962	0.9852
Std. Dev								
Min	1.0357	0.0087	-0.0002	0.4015	0.7148	0.0459	0.4158	0.8178
Max	2.9124	0.0192	0.0097	0.4934	1.0000	0.1024	0.5782	1.1127
N	42	42	42	42	42	42	42	42
Joint-stock banks								
Mean	2.6715	0.0115	0.0017	0.4562	0.7598	0.0325	0.5076	0.9924
Std. Dev								
Min	1.3841	0.0083	-0.0009	0.4087	0.0185	0.0009	0.2981	0.8077

Max	3.1985	0.0195	0.0069	0.6781	1.0000	0.3027	0.6752	1.1969
N	104	104	104	104	104	104	104	104
City banks								
Mean	2.3948	0.0125	0.0035	0.5482	0.0782	0.0439	0.4823	1.0152
Std. Dev								
Min	0.5986	0.0039	-0.0005	0.4965	0.0000	0.0001	0.1984	0.6524
Max	4.3584	0.0315	0.0107	0.6745	1.0000	0.1105	0.7851	1.5821
N	324	324	335	340	344	327	327	327
Rural banks								
Mean	2.4012	0.0139	0.0049	0.9244	0.0000	0.0395	0.6025	0.9884
Std. Dev					0.0000			
Min	1.0152	0.0064	-0.0001	0.9053	0.0000	0.0048	0.4159	0.8527
Max	4.9528	0.0212	0.0074	0.9863	0.0000	0.0657	0.7911	1.2958
N	37	36	35	35	37	36	36	36

5.6 Results and discussion

The main objective of this study is to use a more accurate measure of foreign bank presence to assess the impact of foreign bank presence on domestic bank performance as well as the domestic financial liberalization. Three performance indicators namely net interest margin, noninterest income and cost are used. Financial liberalization captured by bank privatization rate, is also examined in this study and the results are presented in Table 5.2-5.6. In each table, the estimators in models 1-5 are fixed effects model estimators and the estimators in model 6-7 are Difference Generalised Methods of Moments (GMM) estimators.

There are three steps of analysis for each indicator in this study. In the first step, the baseline models are examined (models 1-4) using the aggregate measures (foreign banks numbers, foreign banks asset share, and MacroFP) as well as bank specific variables and year dummies, which are used as conventional model specification in

previous studies, for example Shen et al. (2009). The second step is to examine the same model as in the first step but to replace the aggregate measures with disaggregate measure: FEI (model 5). By comparing the results from these two steps, it is possible to identify how FEI changes results while all other variables remain the same. Results of all four tables shows that the FEI has a larger coefficient and a smaller F-value compared to other measures. Thus, in models 6 and 7, the Difference GMM estimators address the endogeneity issue and the interaction terms of FEI and year dummies relax the homogeneity of FEI over the years. In this way, we test the accuracy of FEI.

5.6.1 Net Interest Margin

Table 5.2 reports results associated with net interest margin. The baseline model (models l-3) using the aggregate measures (foreign banks numbers, foreign banks asset share, MacroFP) finds a highly significant and positive relationship between foreign bank presence and domestic bank's interest margin. This reproduces the results of previous studies, such as Chen and Xiao (2007), Jiao (2008), Shen et al. (2009) and Huang and Qin (2009). But there are few convincing arguments which can link the presence of foreign banks to a rising interest margin. Huang and Qin (2009) offer a limited explanation to this phenomenon. In their study, they attribute their results to the fact that in China the deposit rate and loan rate are partly controlled by the central bank. In their sample (1999-2005), control is released for several times to allow banks to gain higher margin. For example, in 2000, the central bank unified the policy on interest rate on foreign currency for domestic and foreign bank entities. On 1st January 2004, the

central bank extends the highest loan rate that commercial banks can set to 1.7 times the base loan rate. And in October 2004, the restriction on the highest loan rate of commercial banks has been removed, only the lowest loan rate is restricted. This may explain why the margin is increased. But as mentioned above, their study did not provide convincing evidence which links the presence of foreign banks to the higher margin. However, in this study, the significant and positive coefficients of foreign banks number (fb_nb) and foreign banks asset share (fb_as) provide convincing evidence that the relationship between foreign banks presence and higher margin is significant.

Table 5.2 The effect of foreign bank presence on Chinese Banks' net interest margin

							GMM Method	
	1	2	3	4	5		6	7
Log Net Interest Margin							0.302**	0.358**
							(0.003)	(0.007)
Log2 Net Interest Margin							-0.0152	-0.0235
							(0.062)	(0.051)
Bank Specific Variables								
Equity	-0.1734	-0.1954	-2.782**	-1.6217	-1.026		-3.0528	-3.9625
	(0.065)	(0.074)	(0.043)	(0.103)	(0.081)		(1.021)	(0.907)
Non-interest earning assets	-0.321	-0.4952	-0.4037	-0.2102	-0.284		-0.982**	-1.301**
	(0.074)	(0.071)	(0.051)	(0.671)	(0.051)		(0.012)	(0.009)
Customer and short-term funding	0.0624	0.3154	0.2134	0.1982	0.1705		0.0400	-0.1024
	(0.074)	(0.071)	(0.051)	(0.057)	(0.073)		(0.102)	(0.105)
Cost	59.61**	48.97**	51.17**	59.24**	62.31**		22.7821	40.0***
	(0.004)	(0.013)	(0.011)	(0.011)	(0.005)		(0.056)	(0.0009)

Aggregate Measures								
Macro FP	0.018**							
	(0.023)							
Foreign Banks Number		0.015**						
		(0.014)						
Foreign Banks Asset Share			0.504**					
			(0.005)					
Disaggregate Measures								
Micro FP				0.009				
				(0.055)				
FEI					-3.826**		-1.742**	
					(0.007)		(0.003)	
Year Dummies								
FEI*Year 2008								-0.2841
								(0.064)
FEI*Year 2009								0.0002
								(0.074)
FEI*Year 2010								0.0014
								(0.065)
FEI*Year 2011								0.0012
								(0.083)
FEI*Year 2012								0.003**
								(0.041)
FEI*Year 2013								0.010**
								(0.028)
FEI*Year 2014								0.020**
								(0.027)
FEI*Year 2015								0.022**
								(0.017)
FEI*Year 2016								0.019**
								(0.011)
Year 2008	0.312	0.204	0.1785	0.4275	0.0462		-1.012	-0.0785
	(0.104)	(0.067)	(0.074)	(0.069)	(0.052)		(0.05)	(0.054)
Year 2009	0.0124	0.0173	0.1754	0.6624	0.0027		0.0014	0.0011
	(0.057)	(0.067)	(0.053)	(0.074)	(0.061)		(0.051)	(0.051)
Year 2010	0.2754	0.3012	0.0154	0.01127	0.0235		0.0152	0.0112
	(0.064)	(0.073)	(0.085)	(0.094)	(0.078)		(0.081)	(0.063)
Year 2011	0.1789	0.8527	1.2013	0.975	0.1275		0.0931	0.0202

	(0.058)	(0.082)	(0.094)	(0.065)	(0.075)		(0.082)	(0.063)
Year 2012	0.157**	0.174**	0.853**	0.687**	0.146**		0.165**	0.152**
	(0.003)	(0.041)	(0.038)	(0.014)	(0.038)		(0.0270	(0.004)
Year 2013	0.017**	0.065**	0.075**	0.085**	0.180**		0.213**	0.162**
	(0.004)	(0.017)	(0.038)	(0.029)	(0.044)		(0.031)	(0.029)
Year 2014	0.205**	0.187**	0.954**	1.235**	0.425**		0.306**	0.299**
	(0.049)	(0.042)	(0.035)	(0.009)	(0.017)		(0.016)	(0.009)
Year 2015	0.064**	0.174**	0.363**	0.317**	0.982**		0.495**	0.365**
	(0.048)	(0.014)	(0.008)	(0.027)	(0.008)		(0.014)	(0.012)
Year 2016	1.095**	0.998**	0.973**	1.001**	1.132**		0.648**	0.491**
	(0.014)	(0.003)	(0.001)	(0.007)	(0.005)		(0.015)	(0.037)
_cons	-0.892**	-1.10**	-1.99**	-1.03**	1.954**		2.018**	2.11.**
	(0.042)	(0.007)	(0.004)	(0.025)	(0.039)		(0.017)	(0.029)
N	379	379	379	379	379	N	140	140
R squared	0.192	0.144	0.209	0.312	0.164	M2	0.6871	0.8512
F	4.4898	3.1786	4.9924	8.5685	3.7066	Sargan	120.82	119.41

Note: (1) Models 1-5 use equation 1 and models 6-7 use equation 2. (2) p-values in parentheses, ** Significance level at 0.05, ***Significance level at 0.001

However, the results of aggregate models (models 1-3), have exposed an intrinsic problem. The aggregate measures of foreign presence are annual data and vary only by year. So, it is hard to distinguish the effect of foreign presence from other regulatory effects such as interest-rate policy which may have a larger effect on interest margin than foreign bank entry.

Thus, after including FEI in model 5, results change completely. The coefficient of FEI is significantly negative which means that foreign bank presence relates to a lower margin, in other words, a more competitive and efficient domestic bank system. There is other evidence supporting this result. Although interest rates are regulated by the central bank in China, liberalization is underway and advancing rapidly. Domestic banks in China already try to make more income by adjusting their interest rates to the

situation they meet in the market. People's Bank of China (2003) has argued that financial institutions have not raised the interest rate on all loans to the upper limit even though the government is continuously widening the band that the interest rate can float. This can be the evidence that under the pressure of foreign bank entry, local banks have consciously kept their interest rate at a competitive level.

In model 4, MicroFP yields an insignificant result while MacroFP has a significant effect in model 1. Year dummies control for other policy effects including those that facilitate banks to earn more interest such as the widening band, unaccounted for by the identified macroeconomic factors. After the Vice President Xi Jinping took over control in 2012, the opening up of the banking sector has speeded up. The number of foreign bank entities has increased from 387 in 2011 to 1013 in 2017. This provides an explanation for the significance of year dummies from 2012 to 2016 and the insignificance of year dummies from 2008 to 2011. Thus, in model 5, the significant coefficient of FEI is more accurate and equal to -3.83. Difference GMM estimators in model 6 correct for endogeneity and provide significant results with the same sign. The interaction term of FEI and year dummies in model 7 accounts for variation of FEI over time. The results in model 7 suggest that the impact of FEI on domestic bank's margin is significant after year 2012. However, the sign of 'Customer and short-term funding' is expected to be positive in all models because it offers a lower interest for customers compared to other deposit products, which should have a positive effect on net interest margin. But in the last model (model 7), the sign is found to be negative. This could be

a result of the introduction of interaction effects between FEI and year dummies. Results for models 1 to 6 match our expectations, so our models are well specified.

In summary, there is a significantly negative relationship between foreign bank entry and domestic bank margin. This means a more open banking market is strongly associated to a more competitive one.

5.6.2 Noninterest Income

Table 5.3 presents results of the relationship between noninterest income and foreign presence. The baseline model (l-3) shows there is a non-significant effect of fb_nb, fb_ns and MacroFP on domestic bank's noninterest income. However, when FEI is introduced, model 5 reports a significantly positive effect. This means that the enhanced measure of foreign presence suggests that foreign bank entry is associated with an increased noninterest income for domestic banks. The sign of Customer and short-term funding changed from positive in models 1-4 to negative in model 5. As illustrated in section 4, customer and short-term funding should be negatively related to the banks' noninterest income. Therefore, the inclusion of FEI has helped to achieve more reliable results by providing a negative sign through models 5 to 7. Similar to net interest margin, the coefficient of MicroFP remains insignificant in model 4. Including year dummies (Y2008….Y2016) did not produce a different result for net interest margin. After controlling for endogeneity, the signs of 'Equity' and 'Non-interest earning asset' turn from negative in model 5 to positive in models 6 and 7. This happens because GMM neutralises the impact of endogeneity and results become more reliable. Equity and non-

interest earning assets should be positively related to the non-interest income.

Table 5.3 The effect of foreign bank presence on Chinese Banks' non-interest income

							GMM Method	
	1	2	3	4	5		6	7
Log Non-interest Income							0.2064**	0.2101**
							(0.006)	(0.003)
Log2 Non-interest Income							-0.0874	-0.103
							(0.081)	(0.097)
Bank Specific Variables								
Equity	0.0001	0.0092	0.0101	0.0001	-0.0203		0.0012	0.0004
	(0.058)	(0.096)	(0.054)	(0.072)	(0.070)		(0.097)	(0.091)
Non-interest earning assets	0.051	0.0184	0.2151	0.1987	-0.0028		0.0032**	0.0041**
	(0.069)	(0.064)	(0.057)	(0.077)	(0.104)		(0.047)	(0.035)
Customer and short-term funding	0.024	0.0974	0.1345	0.0074	-0.0012		-0.014	-0.002
	(0.051)	(0.097)	(0.065)	(0.071)	(0.075)		(0.064)	(0.092)
Cost	0.537**	0.499**	0.604**	0.553**	0.465**		0.3617	0.2142**
	(0.007)	(0.021)	(0.027)	(0.014)	(0.042)		(0.051)	(0.007)
Aggregate Measures								
Macro FP	0.003**							
	(0.014)							
Foreign Banks Number		0.001**						
		(0.001)						
Foreign Banks Asset Share			0.004**					
			(0.005)					
Disaggregate Measures								
Micro FP				0.194				
				(0.052)				
FEI					0.01***		0.0145**	
					(0.000)		(0.007)	
Year Dummies								

FEI*Year 2008								0.0014
								(0.059)
FEI*Year 2009								0.0025
								(0.073)
FEI*Year 2010								0.0043
								(0.082)
FEI*Year 2011								0.0078
								(0.091)
FEI*Year 2012								0.01**
								(0.003)
FEI*Year 2013								0.01**
								(0.001)
FEI*Year 2014								0.02**
								(0.007)
FEI*Year 2015								0.03**
								(0.024)
FEI*Year 2016								0.0**
								(0.041)
Year 2008	-0.012	-0.0081	-0.0143	-0.003	-0.0002		-0.0011	-0.001
	(0.084)	(0.064)	(0.057)	(0.055)	(0.072)		(0.068)	(0.097)
Year 2009	-0.004	-0.0034	-0.0012	-0.0107	-0.0003		-0.0007	-0.001
	(0.075)	(0.062)	(0.059)	(0.067)	(0.14)		(0.103)	(0.097)
Year 2010	-0.001	-0.041	-0.095	-0.084	-0.0012		-0.0002	-0.003
	(0.063)	(0.079)	(0.071)	(0.053)	(0.082)		(0.092)	(0.097)
Year 2011	-0.006	0.0012	0.001	-0.0001	-0.0014		0.0001	-0.003
	(0.053)	(0.062)	(0.055)	(0.061)	(0.079)		(0.088)	(0.102)
Year 2012	-0.00**	-0.00**	-0.00**	-0.10**	-0.01**		-0.000**	-0.00**
	(0.001)	(0.017)	(0.012)	(0.032)	(0.009)		(0.021)	(0.025)
Year 2013	-0.01**	-0.00**	-0.00**	-0.01**	-0.00**		-0.004**	0.01**
	(0.008)	(0.031)	(0.049)	(0.026)	(0.033)		(0.041)	(0.015)
Year 2014	-0.01**	-0.01**	-0.00**	-0.00**	-0.00**		-0.001**	-0.00**
	(0.007)	(0.014)	(0.037)	(0.004)	(0.007)		(0.004)	(0.048)
Year 2015	-0.01**	-0.05**	-0.00**	-0.00**	-0.01**		-0.001**	-0.00**
	(0.004)	(0.049)	(0.041)	(0.032)	(0.006)		(0.017)	(0.035)
Year 2016	-0.01**	-0.00**	-0.00**	-0.00**	-0.01**		-0.003**	-0.01**
	(0.001)	(0.017)	(0.004)	(0.028)	(0.046)		(0.007)	(0.008)
_cons	0.012**	0.030**	0.029**	0.103**	0.01**		2.0178**	2.11**
	(0.041)	(0.005)	(0.001)	(0.021)	(0.027)		(0.018)	(0.027)
N	382	382	382	382	382	N	140	140
R squared	0.221	0.2245	0.2012	0.2134	0.138	M2	0.7015	0.6618
F	5.3603	5.5155	4.7989	5.1689	3.0249	Sargan	122.64	111.28

Note: (1) Models 1-5 use equation 1 and models 6-7 use equation 2. (2) p-values in parentheses, ** Significance level at 0.05, ***Significance level at 0.001

5.6.3 Cost

Results in Table 5.4 show that the coefficient of both aggregate measurements (fb_nb, fb_ns and MarcoFP) and FEI are significantly positive, which means that the presence of foreign banks is linked to a raise in cost of domestic banks. This is in line with Lensink and Hermes (2004) observation that costs are likely to rise following foreign entry in the short run, because domestic banks spend more to offer new services or improve the quality of existing services to defend their market share

Table 5.4 The effect of foreign bank presence on Chinese Banks' cost

							GMM Method	
	1	2	3	4	5		6	7
Log Cost							0.2001**	0.2357**
							(0.003)	(0.009)
Log2 Cost							0.0358	0.0004
							(0.052)	(0.067)
Bank Specific Variables								
Equity	0.215**	0.085**	0.044**	0.031**	0.027**		0.0185**	0.0201**
	(0.006)	(0.002)	(0.014)	(0.012)	(0.178)		(0.026)	(0.002)
Non-interest earning assets	-0.0024	-0.0028	-0.0031	-0.0034	-0.002		-0.001	-0.002
	(0.083)	(0.072)	(0.067)	(0.055)	(0.059)		(0.0051)	(0.054)
Customer and short-term funding	0.008	0.0099	0.0054	0.0081	0.0049		0.0099	0.011***
	(0.053)	(0.054)	(0.087)	(0.079)	(0.051)		(0.063)	(0.0009)
Aggregate Measures								

Macro FP	0.006**							
	(0.003)							
Foreign Banks Number		0.0001						
		(0.082)						
Foreign Banks Asset Share			0.002**					
			(0.007)					
Disaggregate Measures								
Micro FP				0.006**				
				(0.003)				
FEI					0.0001		0.0052**	
					(0.082)		(0.008)	
Year Dummies								
FEI*Year 2008								0.0014
								(0.124)
FEI*Year 2009								0.0022
								(0.093)
FEI*Year 2010								0.0023
								(0.085)
FEI*Year 2011								0.0032
								(0.097)
FEI*Year 2012								0.0041**
								(0.003)
FEI*Year 2013								0.0057**
								(0.007)
FEI*Year 2014								0.0061**
								(0.003)
FEI*Year 2015								0.0077**
								(0.009)
FEI*Year 2016								0.0095**
								(0.024)
Year 2008	0.001	0.0014	0.0041	0.0015	0.0021		0.0008	0.0012
	(0.062)	(0.051)	(0.059)	(0.065)	(0.087)		(0.074)	(0.084)
Year 2009	0.0014	0.0054	0.0021	0.0035	0.0012		0.0002	0.0001
	(0.054)	(0.052)	(0.095)	(0.084)	(0.041)		(0.054)	(0.095)
Year 2010	0.001	0.0042	0.0021	0.0015	-0.002		0.0002	0.003
	(0.051)	(0.062)	(0.052)	(0.056)	(0.001)		(0.052)	(0.067)
Year 2011	-0.001	-0.005	-0.004	-0.004	-0.003		-0.000	0.0041
	(0.054)	(0.067)	(0.061)	(0.072)	(0.071)		(0.057)	(0.095)

Year 2012	-0.01**	-0.01**	-0.00**	-0.00**	-0.00**		-0.002**	-0.001**
	(0.014)	(0.009)	(0.005)	(0.029)	(0.027)		(0.041)	(0.006)
Year 2013	-0.00**	-0.00**	-0.01**	-0.01**	-0.01**		-0.001**	-0.003**
	(0.005)	(0.001)	(0.007)	(0.011)	(0.029)		(0.001)	(0.017)
Year 2014	-0.01**	-0.01**	-0.00**	-0.01**	-0.01**		-0.002**	-0.001**
	(0.049)	(0.041)	(0.039)	(0.035)	(0.028)		(0.009)	(0.016)
Year 2015	-0.00**	-0.00**	-0.00**	-0.00**	-0.01**		-0.002**	-0.000**
	(0.015)	(0.019)	(0.024)	(0.035)	(0.038)		(0.027)	(0.018)
Year 2016	-0.01**	-0.01**	-0.01**	-0.01**	-0.01**		-0.002**	-0.000**
	(0.014)	(0.025)	(0.014)	(0.011)	(0.007)		(0.003)	(0.045)
_cons	0.413**	0.016**	0.009**	0.018**	0.003**		2.0178**	2.1128**
	(0.034)	(0.009)	(0.011)	(0.044)	(0.029)		(0.001)	(0.003)
N	382	382	382	382	382	N	140	140
R squared	0.207	0.215	0.301	0.194	0.199	M2	0.6214	0.3652
F	5.0007	5.2182	8.2044	4.5859	4.7334	Sargan	101.24	100.95

Note: (1) Models 1-5 use equation 1 and models 6-7 use equation 2. (2) p-values in parentheses, ** Significance level at 0.05, ***Significance level at 0.001

5.6.4 Financial liberalization

Table 5.5 shows the estimation results of the impact of foreign bank presence on domestic financial liberalization. The baseline model 1-3 shows that fb_nb, fb_as and MacroFP yields an insignificant effect on financial liberalization. However, after taking FEI into account, the effect becomes significantly positive. Year dummies capture all the effects that change over time, such as regulatory reforms and other external shocks that can affect the banking system. Year dummies help to control for time-specific factors that affect bank performance. In model 6 and 7, after controlling for endogeneity, the results keep unchanged. Thus, the results show that foreign bank presence has a

significant positive effect on the domestic financial market liberalization. The results provide convincing evidence to explain the rapidly liberalized financial market in China. From March 2002, the People's Bank of China began issuing licenses to allow banks to extend foreign exchange services to domestic companies and individuals. "Citibank Shanghai received the first license for a fully owned foreign bank. Xiamen International Bank, a bank which is 25% owned by Japan's Shinsei Bank, then Asian Development Bank and the Sino-Finance Group, won approval to provide foreign exchange services in Xiamen later. HSBC, the Bank of East Asia, Hang Seng Bank and Standard Chartered have also received licenses (Oxford Analytica 21 June 2002). PBC originally set a maximum 15% stake limit to be bought by foreign investors. HSBC was the first foreign bank to take advantage of this rule when it took an 8% stake in the Bank of Shanghai in December 2001, followed by Citibank and IFC" (Bayraktar and Wang, 2004, p19). In December 2003, the ceiling on foreign ownership in local banks was raised from 15% to 20% for single shareholders and 25% overall. After several years, steps towards opening up the bank sector to foreign banks and investors, China's process of liberalization of financial market is speeding up (Bayraktar and Wang, 2004; Xu, 2003; Laurenceson and Qin, 2008; Mao, 2006; Podpiera, 2006; Ma, 2007).

Table 5.5 The effect of foreign bank presence on bank privatization rate

							GMM Method	
	1	2	3	4	5		6	7
Log Privatization Rate							0.0128**	0.0265**
							(0.003)	(0.019)
Log2 Privatization Rate							0.0015	0.0004
							(0.052)	(0.067)
Bank Specific Variables								
Equity	0.0014	0.0021	0.0027	0.0243	0.0025		0.0221	0.0018
	(0.085)	(0.064)	(0.075)	(0.066)	(0.082)		(0.085)	(0.079)
Non-interest earning assets	0.0027	0.0029	0.0123	0.0019**	0.0036		0.0008	0.0014
	(0.059)	(0.108)	(0.093)	(0.038)	(0.088)		(0.201)	(0.13)
Customer and short-term funding	0.0012**	0.0045**	0.0014**	0.0039**	0.0011**		0.0001	0.0005
	(0.025)	(0.016)	(0.017)	(0.008)	(0.058)		(0.062)	(0.063)
Cost	0.1405**	0.1924**	0.1352**	0.2142	0.2236		0.0752**	0.1124**
	(0.028)	(0.014)	(0.011)	(0.068)	(0.078)		(0.215)	(0.302)
Aggregate Measures								
Macro FP	0.0014							
	(0.099)							
Foreign Banks Number		0.0008**						
		(0.08)						
Foreign Banks Asset Share			0.0028					
			(0.071)					
Disaggregate Measures								
Micro FP				0.00001				
				(0.081)				
FEI					0.0254**		0.0072**	
					(0.001)		(0.006)	
Year Dummies								
FEI*Year 2008								0.0011
								(0.062)
FEI*Year 2009								0.0012

								(0.074)
FEI*Year 2010								0.0185
								(0.078)
FEI*Year 2011								0.019
								(0.077)
FEI*Year 2012								0.0024**
								(0.012)
FEI*Year 2013								0.0032**
								(0.039)
FEI*Year 2014								0.0033**
								(0.044)
FEI*Year 2015								0.0048**
								(0.035)
FEI*Year 2016								0.0061**
								(0.018)
Year 2008	0.0015	0.0005	0.0009	0.0012	0.0024		0.0001	0.0000
	(0.051)	(0.064)	(0.097)	(0.099)	(0.072)		(0.085)	(0.093)
Year 2009	0.0014	0.0015	0.0031	0.001	0.0023		0.0007	0.0001
	(0.062)	(0.072)	(0.084)	(0.081)	(0.073)		(0.097)	(0.061)
Year 2010	0.001	0.003	0.0003	0.0001	0.0019		0.0002	0.0002
	(0.055)	(0.063)	(0.074)	(0.057)	(0.003)		(0.07)2	(0.083)
Year 2011	0.0001	0.0013	0.0002	0.0004	0.0025		0.0003	0.0002
	(0.054)	(0.066)	(0.059)	(0.0501)	(0.031)		(0.072)	(0.068)
Year 2012	0.0005**	0.0011**	0.0009**	0.0014**	0.0031**		0.0012**	0.0009**
	(0.003)	(0.048)	(0.041)	(0.038)	(0.003)		(0.029)	(0.049)
Year 2013	0.0015**	0.0001**	0.0017**	0.0024**	0.0044**		0.0021**	0.0011**
	(0.015)	(0.035)	(0.041)	(0.048)	(0.018)		(0.009)	(0.005)
Year 2014	0.0015**	0.0024**	0.0038**	0.0049**	0.0046**		0.0035**	0.001**
	(0.001)	(0.042)	(0.037)	(0.024)	(0.008)		(0.007)	(0.034)
Year 2015	0.0041**	0.0024**	0.0019**	0.0049**	0.005**		0.0044**	0.0024**
	(0.015)	(0.042)	(0.047)	(0.031)	(0.025)		(0.017)	(0.048)
Year 2016	0.0014**	0.0041**	0.0051**	0.0035**	0.0053**		0.0045**	0.0023**
	(0.012)	(0.036)	(0.031)	(0.018)	(0.052)		(0.019)	(0.021)
_cons	1.1248**	0.9054**	0.9971**	1.0012**	0.0022**		2.0178**	2.1128**
	(0.041)	(0.023)	(0.001)	(0.022)	(0.018)		(0.003)	(0.009)
N	382	382	382	382	382	N	140	140
R squared	0.205	0.213	0.231	0.211	0.207	M2	0.5742	0.2981
F	4.9129	5.1564	5.7232	5.0951	4.9733	Sargan	112.47	101.27

Note: (1) Models 1-5 use equation 1 and models 6-7 use equation 2. (2) p-values in parentheses, ** Significance level at 0.05, ***Significance level at 0.001

5.6.5 City-bank sample

Table 5.6 presents the results from models that include the city dimension. In these models, the real GDP growth in city i and the ratio of foreign direct investment over GDP in city i are controlled. As the sample size compared to the previous models is extensively reduced, the coefficient of FEI of noninterest income, cost and bank privatization rate are no longer significant, but a significant negative coefficient is present for FEI on net interest margin. The results of net interest margin in city dimension is in line with previous results.

Table 5.6 The city bank sample

	Net Interest Margin	Noninterest Income	Cost	Bank Privatization Rate
	1	2	3	4
Log Equity	2.9257	-0.0148	0.0113	0.0236
	(0.055)	(0.052)	(0.060)	(0.077)
Log non-interest Earning Asset	0.1351	-0.0019	0.0025	0.0009
	(0.075)	(0.066)	(0.050)	(0.151)
Log Customer and Short-term Funding	-0.6105	0.0018	0.0036	0.0002
	(0.069)	(0.158)	(0.059)	(0.249)
Log Cost	36.1325	0.0168		0.0008
	(0.074)	(0.094)		(0.090)
Real GDP Growth_ct	6.9124**	-0.0101**	-0.0034**	0.0011**
	(0.002)	(0.001)	(0.004)	(0.001)
Openness_ct	0.5029	-0.0019**	-0.0015	0.0003
	(0.077)	(0.176)	(0.052)	(0.051)
FEI	-2.1507**	0.0049	0.0015	0.0013
	(0.001)	(0.050)	(0.051)	(0.050)
Year 2008	0.0013	0.0004	0.0006	0.0014
	(0.051)	(0.063)	(0.095)	(0.098)

Year 2009	0.0012	0.0014	0.0029	0.0015
	(0.061)	(0.074)	(0.083)	(0.079)
Year 2010	0.001	0.003	0.0002	0.0001
	(0.057)	(0.061)	(0.071)	(0.056)
Year 2011	0.0001	0.0012	0.0002	0.0004
	(0.052)	(0.064)	(0.057)	(0.050)
Year 2012	0.0004**	0.0011**	0.0009**	0.0013**
	(0.003)	(0.047)	(0.041)	(0.036)
Year 2013	0.0014**	0.0000**	0.0015**	0.0022**
	(0.011)	(0.034)	(0.041)	(0.039)
Year 2014	0.0015**	0.0023**	0.0035**	0.0048**
	(0.001)	(0.041)	(0.037)	(0.023)
Year 2015	0.0039**	0.0023**	0.0017**	0.0045**
	(0.013)	(0.040)	(0.040)	(0.034)
Year 2016	0.0012**	0.0035**	0.0047**	0.0032**
	(0.011)	(0.035)	(0.030)	(0.015)
_cons	0.9052	0.0078	0.0035	0.0038
	(0.057)	(0.069)	(0.081)	(0.091)
N	132	132	140	132
R Square	0.2942	0.3205	0.3321	0.2619
F	4.1523	6.6305	7.0187	4.8902

Note: (1) In this table we use equation 3. (2) p-values in parentheses, ** Significance level at 0.05, ***Significance level at 0.001

5.7 Conclusion

The main objective of this study is to use an enhanced measure of foreign bank entry (FEI) to answer three policy questions: (i) whether opening up the bank sector positively influences the local banking industry; (ii) whether the percentage of shares held by foreign investors affect local bank performance; (iii) in terms of financial liberalization, whether the presence of foreign banks actually is in favour of the process. In the study, four performance indicators – net interest margin, noninterest income, costs and accounting profits – as well as the financial liberalization indicator captured

by bank privatization rate – are examined.

There are mainly two advantages for using FEI as a measure of foreign bank entry. The first one, which is a direct advantage, is that it provides a more accurate measure of foreign bank presence which results in an accurate assessment of the relationship between foreign bank entry and domestic bank performance. The indirect advantage is that FEI allows researchers to include year dummies in analysis and thereby isolate the effect of foreign entry from other macroeconomic influences (Xu, 2011). Previous literature provides confusing results using aggregate measures (fb_ns, fb_nas and MacroFP). In this study, after using the FEI measurement, the results strongly support that foreign bank entry is positively related to a more competitive and efficient domestic banking sector in China.

There are two opposing views regarding the opening-up policy in financial markets. The first one argues that foreign bank entry is in favour of enhancing efficiency of the domestic banking sector. The other one suggests that "the inefficient domestic banking industry will 'lose' under intensified foreign competition and become vulnerable to foreign takeover" (Xu, 2011, p.29). The results of this study provide empirical support for the first one. This is an important policy implication of this study.

Finally, due to limited data, we can only use the number of foreign bank branches in a city to measure the influence of foreign presence. The FEI measurement is expected to be further expanded when data on foreign banks assets and information on foreign bank balance sheet are accessible at city level.

Chapter 6 CONCLUSION

The literature discusses the importance of foreign investment in China and the important factors that influence the performance of foreign investment. However, over the past decade, the evaluation of multinationals' performance, has mainly focused on developed countries and uses individual factors as explanatory variables rather than looking at interactions. Moreover, researchers tended to use aggregate measures to examine the effect of foreign investment, especially when investigating the effect of the banking sector on domestic firms and markets. We suggest that, not only should separate factors be considered, but also the interaction effect of these factors and disaggregate measures, in addition to aggregate measures, to be taken into account.

Chapter one is the introduction and it provides an overview of this thesis and a summary of the aims of this thesis. The second chapter is the literature review, which provides a review of relevant literature and indicates the direction of this thesis. The third chapter is the first empirical chapter of the thesis. We examine the relationship of several strategic choices that multinationals can make and how this affects their performance in China. The fourth chapter is the second empirical chapter, which investigates the effect of country-level factors on multinationals' survival rate in China. Chapter five is the third empirical chapter, which aims at investigating how foreign bank presence has influenced domestic bank performance and financial liberalization.

In chapter three, the results show that the performance of multinationals is significantly affected by the strategic choice that they have made. Specifically, entry

timing is positively related to multinationals' performance. In other words, a decision to enter the foreign market in the early period, is better than a 'wait-and-see' decision. Moreover, compared to the joint venture entry mode, the 'wholly owned subsidiary' achieves a much larger market share. A large investment size, a high level of advertising intensity and investing in Eastern China, both have a positive effect on performance. However, industry differences, suggest that the degree of the effect varies from manufacturing industries to non-manufacturing industries.

The interaction effects which have been examined in chapter three, also appear to be significant. The results show that an early entrant adopting the 'wholly owned subsidiary' model is more likely to perform better. A large initial investment in the early period of the foreign market, was shown to be positively related to a good performance.

Chapter four, investigates the relationship between country-level factors and the multinationals' survival. The results in chapter four, show that country risk and cultural distance, both play a negative significant role in multinationals' survival. However, the findings also suggest that the large market size of China and longer firm age will moderate these negative effects. Notwithstanding, different industries suffer from different levels of influence of country risk and cultural distance. These two negative effects are lower in manufacturing industries than non-manufacturing industries.

Chapter five, moves the focus to the influence of foreign bank investment on domestic banks and markets. Previous literature mostly uses aggregate measures such as foreign bank numbers and foreign bank shares, to examine the level of the effect of foreign bank presence in domestic banks and markets. Given the fact that foreign banks

are geographical concentrated in large cities such as Beijing, Shanghai, Guangzhou and Shenzhen; using aggregate measures is now suitable to represent the accurate level of foreign banks' influence. In this thesis, we adopt a new disaggregate measure: foreign exposure index, to measure the accurate effect of foreign banks presence. The results show that after the Chinese government lifted the restrictions of foreign investment in the banking sector, with the competition of foreign banks, domestics banks have become more efficient and the liberalization of financial markets has been sped up. Also, with the use of foreign exposure index, we can isolate the effect of foreign entry from other macroeconomic influences, by including year dummies in the analysis. However, the results also indicate that even though the efficiency of domestic banks has risen after the entry of foreign banks, the profitability of domestic banks is negatively associated with the presence of foreign banks.

To summarise the main findings of this thesis, it can be stated that:

- Firstly, the evidence of this thesis suggests that entry timing, entry mode, investment size, advertising intensity, firm location and industry difference has significantly affected the multinationals' performance.
- Secondly, the joint effect of the above factors, shows that these factors do not perform by themselves alone, so the joint effect does exist. Multinationals should consider different factors together, in order to achieve a better performance.

- Thirdly, countries risk and cultural distance are two important factors affecting the survival of multinationals in China. Both of these factors are negatively related to the survival rate. However, these negative effects can be moderated by the large size of the Chinese market and the longer age of multinationals. In addition, wholly owned subsidiaries survival rate is better than that of other joint venters.
- Fourthly, different from aggregate measures, disaggregate measures foreign exposure index, provides convincing evidence that foreign bank presence is positively related to domestic banks' performance. Moreover, allowing foreign banks to enter the Chinese banking sector, is truly boosted by the process of financial liberalization in the Chinese market. The opening-up policy is in the right direction.

There are also limitations to this study, which provides direction for further research. Firstly, the first empirical is based on archival data, and as a result, we could not examine the motivation of foreign investment. Multinationals' motivation varied from resource seeking to local market seeking. These motivations also have a significant impact, on whether and how they can make full use of the first-mover advantages. Thus, further research could extend the current scope, by including the motivation of foreign investment. Secondly, for the second empirical chapter, with respect to firm survival, we could not differentiate between exit types. For example, firm closure and capital divestiture, are not always indicated by the failure of

multinationals. Future studies should incorporate different types of exits. Thirdly, the data used in third empirical chapter is limited. We can only use the number of foreign banks branches in a city, to measure the influence of foreign presence. Further studies could include foreign bank assets at the city level, if possible. Finally, the thesis has only focused on one developing country (China), future research can investigate whether the findings can be generalised to other developing countries

The findings of this thesis also have some implications for regulators, policymakers and multinationals' managers.

The first empirical chapter suggests that to be successful in a foreign market, managers should gain a clear in-depth understanding of the overall impact of entry timing, as well as other strategic choices on performance. Even though early entrants face the disadvantage of having a higher uncertainty than late entrants, the manager should understand that opportunities do exist for them to enjoy early mover advantages and can amplify such advantages, by speeding up their sequential entry pace. From the government's perspective, policymakers and regulators should understand that the difference between different regions of China and industries do exist. They need to change the policy depending on the different situations, and as a result, they can balance the gap and attract foreign investment more efficiently.

Given the fact that country risk significantly influences the survival of multinationals in China, the Chinese government should realise that they need to do more work to lower the risk in China. On the other hand, foreign investors should notice that the law of foreign capital enterprise has been published in 1986 and after joining

the WTO (World Trade Organization) in 2001, a series of laws and policies have been published and revised. These actions have kept the country's risk at a low level. Thus, with the help of the Chinese government, the negative effect will be increasingly smaller in the future, the country risk is not the primary concern when investing in China.

The third chapter provides strong evidence supporting the opening-up policy. Since the reform in 1978, a pessimistic view exists that an inefficient domestic banking sector will lose to foreign banks and become vulnerable to a foreign takeover. The findings of chapter five, provide convincing evidence that foreign bank presence, enhances the domestic banks' efficiency and promotes the liberalization process. Thus, China's policy of opening up the banking sector to foreign investors is beneficial to domestic banks and the market.

In conclusion, the findings of this thesis can be used by i) managers to decide when, where and how they should enter the Chinese market and ii) by regulators and policymakers, to decide how they can attract more investors and how to make full use of foreign investment. All of the explanatory factors used in this thesis, namely entry timing, entry mode, investment size, advertising intensity, firm location, country risk, cultural distance, and foreign exposure index; show their importance in explaining the performance of multinationals and the importance of foreign investment in the Chinese economy.

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