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Piotr Trąpczyński*

University of Economics in Poznań

Determinants of Foreign Direct Investment Performance – a Critical Literature Review**

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Abstract: *Foreign direct investment (FDI), its motives, modes and location choice constitute key subjects in theory and research in international business, due to their long-term consequences for firm competitiveness. The determinants of results achieved in foreign markets can therefore be described as a fundamental research area, which specifically includes studies on FDI performance. In spite of its long tradition and methodical advancement, extant research show numerous inconsistencies and ambiguous findings. In both international and Polish literature, no complex summary of extant knowledge on FDI performance determinants can be found, which would allow for the consolidation and evaluation of earlier findings. The aim of this paper is to present the findings of a structured review of 95 studies on performance of foreign subsidiaries. Within extant studies, four main research streams were identified, focusing on FDI mode choice, resource determinants on a firm and subsidiary level, host-country characteristics and corporate strategy.*

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* Contact: piotr.trapczynski@ue.poznan.pl, Uniwersytet Ekonomiczny w Poznaniu, Wydział Gospodarki Międzynarodowej, Katedra Konkurencyjności Międzynarodowej, al. Niepodległości 10, Collegium Altum, pok. 613, 60-967 Poznań

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Previous research has not adequately considered the role of expansion motives for evaluating FDI performance. Future studies should also to a greater extent account for a differentiated role of firm resources, particularly various types of international experience, as applied in host countries at different levels of economic and institutional development. Moreover, a more holistic FDI performance analysis requires a simultaneous consideration of financial and non-financial dimensions of a foreign subsidiary's competitive position. Based on the outcomes of the present review, areas for further studies have been proposed, especially as regards the context of outward FDI, increasingly undertaken by Polish companies, and its specific character.

Introduction

According to M. Peng (2004, p. 99), the reasons for failure or success in international markets should be a fundamental research question in the international business discipline. The issue of maximising performance in foreign markets lies, implicitly or explicitly, at the heart of foreign direct investment theories (Glaum, Oesterle 2007, p. 308). Indeed, economic sciences as such deal with the allocation of scarce resources among alternative uses and with the effectiveness of these choices (Robbins 2007, p. 23). While the multinationality-performance (M-P) relationship has occupied a prominent place in international business scholarship for the past decades, the related empirical studies have brought about heterogeneous outcomes (Li 2007, p. 117). As it has been argued, it is difficult to assume a general positive M-P relationship. This may be due to the fact that multinationality *per se* is not an independent, but rather a moderating variable. In order to benefit from international expansion, firms namely need to exploit certain resource advantages in different host countries (Matysiak, Bausch 2012). The performance of multinational corporations is comprised of contributions from a network of geographically dispersed entities, which exposes the firm to divergent characteristics of host countries (Verbeke, Li, Goerzen 2009, p. 158). Therefore, the question of the factors determining subsidiary performance in different foreign contexts is of both theoretical and practical interest, albeit it has generated inconsistent evidence.

Meanwhile, another current debate in international business (IB) focuses on the internationalisation of firms from developing countries and transition economies and the ability of extant IB theories to explain this phenomenon (Luo, Tung 2007). However, while several related studies have addressed the multinationality-performance relationship in general, little attention has been devoted to performance determinants of foreign subsidiaries. At the same time, while empirical studies have focused on Asian economies, FDI

from Central and East Europe (CEE) has received far less attention (Gorynia et al. 2012, p. 433). CEE studies have predominantly adopted a macroeconomic view, while the scarce firm-level research has mostly neglected FDI performance.

Thus, it is somewhat surprising that – in spite of the decades of theoretical development and empirical research on FDI mode choice – studies on the performance consequences of undertaking FDI remain relatively scarce, fragmented and incoherent in their outcomes. Furthermore, it is interesting to note that no comprehensive review of subsidiary performance determinants can be found in extant literature, both in Poland and abroad. Hence, in order to fill this gap in international business, the purpose of this paper is to critically review and consolidate the extant body of theoretical and empirical findings devoted to FDI performance. Thereby, the main theoretical streams, the related determinants of performance and their effects examined in empirical studies will be identified. Moreover, the use of previous performance measures is to be evaluated. Finally, based on the findings from the literature review, research gaps will be highlighted to provide suggestions for future research on foreign direct investment and internationalisation.

Methodology and Assumptions of the Literature Analysis

The purpose of the article is to present a possibly complete landscape of the existing theoretical and empirical research on FDI performance determinants. Therefore, a comprehensive search in all management, marketing, strategy and international business journals was performed with the help of EBSCOhost, ScienceDirect, Emerald, JSTOR and ProQuest databases. The triangulation of these sources was aimed at maximising search results, given the limited number of articles on this topic. The search was not confined to a specific publication period, all relevant articles irrespective of their publication dates being included instead.[1] The considered sources were restricted to peer-reviewed materials, including conference proceedings, but excluding working papers of unknown quality.

In order to be qualified for the analysis, a paper's title or abstract needed to include at least one term belonging to each of the groups specified below:

– subsidiar, affiliat, foreign direct invest/FDI, entry mode,
– internatio, multinatio, transnation;

[1] The reference date of the search is November 1, 2012.

– performance, effect, outcome, result, profit, survival, efficien.

The purpose of keywords from group 1 was to consider different terms expressing FDI and its visible organisational results, such as the establishment of a subsidiary of the choice of an entry mode. The inclusion of the second group of search terms was meant to exclude domestic investments (for other search terms than "FDI"). The aim of the third group of search terms was to retain only studies analysing performance, expressed in several synonyms identified in a preliminary literature review. Asterisks (*) were added to account for American and British English spellings and different grammatical forms. After the collection of literature, abstracts of all resulting articles were screened to ensure the coherence of their contents with the review objectives. Accordingly, a shortlist of 95 articles was retained for further analysis.

Previous literature analyses in management research have used various qualitative and quantitative methodical designs, depending on the purpose and contents of literature analysis (for an overview see Schmid, Kotulla 2009, pp. 317-319). As the objective of this review is to identify different theoretical approaches, as well as empirical determinants of subsidiary performance, the adopted methodology is a qualitative one, focusing on the theoretical foundations, research methods and findings of previous studies. In this descriptive literature critique, the collected material was coded and analysed along the following dimensions:

– *Theoretical background:* main theory used, the resulting research questions and performance determinants;
– *Research methodology:* research design, operationalisation of independent and dependent variables, study sample, analytical methods,
– *Research outcomes:* direction and significance of effects on subsidiary performance, possible interactions between variables, results variations depending on performance measures.

The literature review includes studies accounting for different modes of foreign direct investment (acquisitions, joint ventures, greenfield) and their performance implications. The author did not integrate the findings from the vast and insightful research on international joint venture performance and the antecedents of foreign acquisition success, as it was assumed that these two areas constitute detailed research topics in themselves and as such deal with specific determinants. Another assumption refers to the term of performance, whose understanding has remained heterogeneous in previous studies. Here, a holistic and multidimensional conceptualisation of FDI performance is assumed. The author draws on the competitiveness concept of Gorynia (2002, pp. 74-75), one of its dimensions being the competitive position. It can be understood as the result of the evaluation of

a firm's offering by the market, thus including both financial (relative profitability) and non-financial measures (such as market share, product competitiveness and advancement; see Gorynia et al. 2012, p. 436).

FDI Performance: Results of Extant Research

The review of literature on FDI performance, carried out according to the methodology described in the above section, allowed to identify four major research streams, based on distinct theoretical foundations and methodological premises, and therefore placing emphasis on particular antecedents of FDI performance. These research streams are discussed in the subsequent section.[2]

FDI Mode Choice and FDI Performance

Early research on FDI performance, drawing mainly on the transaction cost theory (Anderson, Gatignon 1986), has posited different performance outcomes for given FDI modes. A higher performance of greenfield than joint ventures (Larimo 1993) acquisitions was observed (Woodcock, Beamish, Makino 1994; Nitsch, Beamish, Makino 1996). The related theoretical argumentation was based on the differences between the FDI modes in terms of costs of resource acquisition and of subsidiary governance. However, other studies found no significant performance differences between the FDI modes (Chan 1995). Shaver (1998, p. 571) argued that conceptual and empirical models have to account for self-selection of entry modes, i.e. the performance of given FDI modes can be contingent on contextual external and internal factors. It was found that entry modes selected according to the predictions of transaction cost theory, extended with institutional and cultural factors, showed superior performance (Brouthers 2002; Brouthers, Brouthers, Werner 2000, 2003). However, this was contradicted by the findings of Kim and Gray (2008) that entry modes chosen on the base of transaction-cost minimisation were related to worse financial and comparable non-financial results, suggesting the effects of some other moderating variables, such as firm resources and capabilities, including learning through experience.

[2] For clarity reasons, not all reviewed studies are individually presented in the paper.

Accordingly, the studies comparing the performance of ownership modes (wholly-owned subsidiaries vs. joint ventures) with a simultaneous consideration of firm- and host-country determinants, pointed to a lower performance of wholly-owned subsidiaries than joint ventures in host countries with higher legal restrictions (Makino, Beamish 1998; Ogasavara, Hoshino 2007) or higher cultural distance (Mulok, Azimah, Ainuddin 2010). On the other, wholly-owned subsidiaries were also – surprisingly – found to outperform joint ventures in countries with higher regulative and normative institutional distance (Gaur, Lu 2007)[3] or for firms possessing higher firm-specific advantages (Siripaisalpitat, Hoshino 2000). Studies comparing the performance of establishment modes (acquisition vs. greenfield) have, *inter alia*, underlined the role of subsidiary integration (Slangen, Hennart 2008) or industry concentration in host-countries (Sharma 1998) as performance drivers of an establishment mode. A study of foreign investors in Greece hinted to higher performance of acquisitions, although the role of the investors' resource advantages was not considered (Georgopoulos, Preusse 2009).

Firm Resources and FDI Performance

Another stream, based mostly on the resource-based view, knowledge based view and dynamic capability perspective, analyses the resources on the parent company or subsidiary level, or the bilateral transfers between them, as the key performance drivers. On the level of the parent company, research confirmed the positive effect of such resources as firm size, product differentiation, international experience and host-country experience (Vega-Cespedes, Hoshino 2011), firm performance and ownership structure (Ghahroudi 2011), technological and marketing knowledge (Fang et al. 2012) or ethnical ties of managers with foreign business partners (Jean, Tan, Sinkovics 2011). On the level of the foreign subsidiary, technological skills, human resources, internal and external network ties (Xia, Qiu, Zafar 2007) or subsidiary size (Chiao et al. 2008) were found to be positively related to foreign subsidiary performance. Luo (2002, p. 48) argued that subsidiary performance depends on the exploitation of the possessed capabilities and, on the other hand, the development of new ones. These two resource-based dimensions were negatively influenced by contextual hazards – environmental complexity and industry structure uncertainty. The

[3] However, the study of Pangarkar and Lim (2003) found no statistically relevant effect of institutional distance on performance.

choice of a wholly-owned subsidiary was found to favour capability exploitation, while the joint venture was positively linked to capability building. It was further found that the negative effect of environmental hazards on capability building were reduced when the joint venture entry mode was used. Moreover, a stronger concentration on the local market of the host country favoured a stronger capability exploitation and building as compared to subsidiaries established as a mere export base. In the context of resource development and exploitation, little attention has been devoted to resource transfers between the parent firm and the subsidiary. The influence of the parent's unique resources and core competencies on subsidiary success was found to depend, among others, on the share of expatriates in the subsidiary (Fang et al. 2010), the relatedness of marketing and technological knowledge between the parent and the subsidiary (Fang et al. 2012) or cultural distance (Qin, Ramburuth, Wang 2011).

A distinct group of studies, based on organisational learning and evolutionary theory, have emphasised the relevance of firm experience for subsidiary performance, yet reaching inconclusive evidence. Contrary to the predictions of the internationalisation process model (Johanson, Vahlne 1977), general international experience might or might not favor FDI outcomes. The possibility to benefit from international experience can be negatively affected by cultural distance (Luo 1999a) or host-country development level (Makino, Isobe, Chan 2004). Moreover, in the light of extant research, experience in the host-country seems to be more valuable as opposed to the general one (Dikova 2009; Wu, Lin 2010), although its role depends on the context of application. Delios and Beamish (2001) found that for wholly-owned subsidiaries, host-country experience increased survival, but not profitability. Wu and Lin (2010) observed that host-country experience has a weaker influence on subsidiary profitability in unrelated rather than related foreign industries.

Another empirically stated problem relates to the value loss of experience. Both international and host-country experience can be perceived as a valuable, but not rare resource, hence its impact on profitability is short-lived (Fang et al. 2007). An excessive reliance on experience can restrict the learning effects in new markets and result in organisational intertia, which is detrimental to performance (Delios 2011; Wu, Lin 2010). Furthermore, different experience types and the substitution effects between them require an explicit differentiation. Gao et al. (2008) stated that although export experience in the host country was positively related to FDI performance, its relevance decreased for companies with previous investments in the same country. While most studies have included experience as control variables, studies explicitly differentiating the performance effects

of several experience types, such as export experience as opposed to international and host-country experience (see e.g. Gao et al. 2008) or subsidiary experience (Gao, Pan 2007), remain scarce. Also, the experience gained in similar markets in terms of economic or institutional characteristics has hardly been examined for its impact on FDI performance (Luo, Peng 1999). In their study of Scandinavian subsidiaries in China, Carlsson, Nordegren, Sjoholm (2005) stated the positive role of previous experience in Hong-Kong, Singapore and Taiwan for their performance. The benefits of firm experience used when investing in diverse host country contexts have yet to be examined, particularly in emerging markets (Luo, Peng 1999).

Host-Country Characteristics and FDI Performance

The third identified stream, drawing on the structure-conduct-performance paradigm, industry organisation and broader location theories, has indicated that host-country effects can be equally relevant in explaining FDI performance as industry or firm effects (Makino, Isobe, Chan 2004). Related studies have analysed the impact of industry structure (Anand, Delios 1997; Lecraw 1984; Miller, Eden 2006; Cui, Griffith, Cavusgil 2005); psychic distance (Dikova 2009; Dow, Larimo 2011; Gaur, Lu 2007); economic or institutional development (Brouthers, Brouthers, Werner 2008; Chan et al. 2010; Chan, Isobe, Makino 2008; Chung, Beamish 2005), yet reaching inconclusive evidence. In particular, research using psychic distance to conceptualise the differences between countries established no statistically significant performance effect of this variable. Dikova (2009) found that the negative relationship between psychic distance and subsidiary performance occurred for wholly-owned subsidiaries and for companies without prior experience in the region.

Extending the distance concept to embrace institutional variables, the relatively few studies drawing on institutional theory found that the institutional development of host-countries is positively related to subsidiary performance (Gugler et al. 2009). The institutional environment of host countries can namely affect the transaction costs of subsidiary operations (Demirbag, Tatoglu, Glaister 2007; Meyer 2001). However, it also determines the ability to deploy the possessed resources (Erramilii, Agarwal, Kim 1997). Companies possessing weaker resource advantages were found to prefer joint ventures in case of high institutional distance, while wholly-owned subsidiaries in terms of small institutional distance (Brouthers, Brouthers, Werner 2008). This interdependence between the value of firm resources in various host-country contexts is still to be explored. In coun-

tries with weaker institutions, where market-based advantages can be of lesser importance, the performance variation between individual firms is higher (Makino, Isobe, Chan 2004). In line with institutional theory, this can result from the absence of patterns of legitimate behaviour, which guarantees certain outcomes (Chan, Isobe, Makino 2008). On the other hand, it has been suggested that the differences in subsidiary performance can be related to a differentiated ability of firms to cope with environmental uncertainty. Gugler et al. (2009) noted the highest productivity of subsidiaries in host countries with low institutional development when the investing firm also originated from weak legal institutions.

Corporate Strategy and FDI Performance

Last but not least, a relatively narrow research stream related to strategic management theory, links FDI performance to international product diversification and entry timing on the parent level, and to local market orientation and subsidiary roles within the MNC network on the subsidiary level. Studies devoted to market entry timing present a relatively homogeneous image: pioneers in a foreign market noted better results in terms of survival (Delios, Makino 2003), market share (Pan, Li, Tse 1999) and profitability (Magnusson, Westjohn, Boggs 2009). However, Luo (1998) showed that while early entrants gain advantage in market share growth, they were confronted with a higher operational risk and lower long-term profitability.

A frequently overlooked determinant of subsidiary performance is that of FDI motives. Dunning (1998) grouped the motives for undertaking FDI into resource seeking, market seeking, efficiency seeking and strategic-asset seeking. While the latter category of motives is aimed at enhancing the resource base of a company in a given location, the former three motives can be collectively labeled as asset-exploiting. The few related studies show that FDI oriented towards market seeking is more related to local market sales than other location advantages (Demirbag, Tatoglu, Glaister 2007). Uhlenbruck (1997) compared the influence of market- and resource-seeking motives, finding the effect of lower labour costs in Eastern European host countries but no influence of market factors. A similar positive performance effect of labour costs was found by Chan, Isobe and Makino (2008) and Li et al. (2011).

FDI motives are also related to the international strategy of the company, which can be roughly divided into multinational (local market adaptation), global (cost efficiency) and transnational. Luo (1999b) underlines the importance of the subsidiary role in the parent firm's strategy for its finan-

cial and non-financial results. It was found that the subsidiary focus on cost efficiency positively relates to the return on assets, export growth and risk reduction, while a local market focus relates to local market growth (also see Demirbag, Tatoglu, Glaister 2007).

Conclusions

The present article undertook an effort to critically review extant empirical research on subsidiary performance, in order to consolidate extant knowledge, identify the major research streams and pinpoint their major findings. The results of the review suggest that despite an apparent maturity of research on firm internationalisation and foreign direct investment, there still exist several research gaps that should be addressed by future studies.

Firstly, there is no agreement in existing international business scholarship as to the scope of the performance term and, consequently, to its specific measurement. Prior studies have conceptualised performance as the survival of operations in a foreign market, as a set financial measures such as profitability or cost efficiency, as well as non-financial success measures including i.a. foreign market share, sales growth or firm reputation. While some studies used multiple dimensions of subsidiary performance, most of them recurred to single constructs, thus exposing the results to serious limitations of the adopted measures. Very few studies acknowledge the fact that both internal and external determinants can affect distinct performance dimensions in different ways. For instance, Pan and Chi (1999) found that joint ventures outperform wholly-owned subsidiaries in terms of profitability, but show no differences for investment survival. Thus, there is a clear need for studies on FDI performance aiming at a more holistic and theoretically grounded selection of performance constructs.

Secondly, research comparing the performance outcomes of different FDI modes shows that their relative superiority is strongly context-dependent, thus it is necessary to consider both firm-specific and country-specific determinants, which affect the results achieved in foreign markets. Future studies should focus more on the role of firm resources and their value in different host countries. More specifically, an attempt to verify the relevance of experience gained in similar contexts for the ability of doing business abroad in form of own operations should be further explored. This notion seems to be particularly relevant in the context Central and Eastern European countries, including Poland, due to their geo-political heritage. In conditions of systemic change, the ability to cope with the institutional environment based on home-country advantages can be of high importance.

In the context of the developing and transition economies, the lack of resource advantages typical of MNEs from developed countries was found to be frequently compensated for by the embeddedness in or experience with similar institutional contexts (Child, Chung, Davies 2003; Gorynia et al. 2012). Dunning and Lundan (2008) distinguish a specific type of ownership advantages, related to the ability to manage relationships with the institutional environment in the host country, particularly valuable in cases of imperfect institutions. Indeed, past research in emerging countries has shown that the home-country advantage of coping with a weakly developed or changing institutional framework can positively affect the competitive position of subsidiaries in similar host countries (Cuervo-Cazurra, Genc 2008; Del Sol, Kogan 2007). Therefore, future quantitative studies should examine the effects of firm resources (such marketing abilities and managerial skills) on subsidiary performance, as well as their role in mitigating institutional distance. Thereby, alongside looking at the economic determinants of host country attractiveness for FDI, more attention ought to be paid to the role of both formal (regulatory) and informal (normative and cultural) institutions, which shape the foreign business environment and can affect the results of investing companies (Chan, Isobe, Makino 2008).

Thirdly, due to the apparently inadequate recognition of investment motives in studying FDI performance, further research should consider the actual role that a subsidiary plays in the network of its parent company. Few efforts have also been undertaken to study strategic choices on the subsidiary level. Subsidiary strategy in terms of local sales, pricing or advertising (Christmann, Day, Yip 1999) or export activity (Beamish, Lee 2003) were found to affect its financial performance to an equal extent as industry structure, yet they require a more detailed analysis, including different aspects of the subsidiary value chain, such as production, distribution or research and development.

Finally, none of the reviewed studies made an attempt to relate the foreign subsidiary success to the foreign parent firm, which is its major stakeholder. The conditions under which a foreign direct investment can contribute to the overall competitive position of the entire company is of vital theoretical and practical importance and can be one of the ways to resolve the conflicting nature of the internationalisation-performance relationship (Verbeke, Li, Goerzen 2009, p. 158). While it has been conceptually argued that the FDI contribution to overall performance is contingent on the motives of investing abroad (Verbeke, Brugman 2009; Li 2007), this relationship is yet to be examined empirically.

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