

# Research on the Effect of International Experience and Market Distance on the Market Entry Order of Enterprises

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**Abstract:** With the continuous advancement of China's "going out" strategy and remarkable achievements in foreign direct investment, China has become one of the world's most active and influential sources of foreign direct investment. Chinese enterprises have accumulated rich and valuable experience in the past decades. In this process, there are a lot of continuous FDI behaviors, and the previous investment behaviors will have an important impact on the subsequent investment decisions. How do continuous investments prioritize market entry? Existing studies do not pay attention to the correlation between successive expansion behaviors, and there are some gaps in the research on the order of international market entry of enterprises. From a dynamic perspective, this paper adopts the data from the List of Overseas Investment Enterprises (Institutions) issued by the Ministry of Commerce of China from 1983 to 2015, and based on the ordered Probit model, takes the continuous investment behavior of Chinese enterprises as the research object, and conducts the following research: The empirical study on the impact of market distance, which is composed of geographical distance, cultural distance and institutional distance, on the entry order of Chinese enterprises in international market. The empirical results show that: Geographical distance, cultural distance and institutional distance have a significant effect on the order of market entry. Chinese firms have the priority to enter the markets with small geographical distance and cultural distance, but the markets with large institutional distance.

**Keywords:** Market distance, International experience, Order selection, Foreign direct investment.

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## 1. Introduction

Since the 1980s, actively carrying out foreign exchanges and cooperation has been the main melody of China's policy, and the level of China's opening to the outside world has improved year by year. In this process, the "going global" strategy continues to evolve and foreign direct investment has achieved proud results. In 2019, OUTBOUND direct investment flows reached us \$136.91 billion, ranking second only to Japan, and the stock of outbound direct investment reached US \$2.2 trillion, ranking third only to the United States and the Netherlands. The global influence of China's OFDI is increasing day by day. Ofdi flows accounted for more than 40% of the global total from 2016 to 2019. Chinese enterprises have invested in 188 countries and regions around the world. In this process, according to the statistics of the Ministry of Commerce, by the end of 2015, the Directory of Overseas Investment Enterprises (Institutions) recorded 37,114 overseas direct investment activities, involving 26,444 enterprises, covering 202 countries and regions around the world. It is worth noting that 3,602 companies have made more than two consecutive investments in 154 countries (regions), and the total number of consecutive investments reached 12,094, accounting for 32.6% of all overseas investments. Among the enterprises with continuous investment behavior, the average investment of one enterprise is 3.36 times, and Sinohydro International Engineering Co., Ltd. has the most expansion times, up to 107 times. Among private companies, ZTE Corporation has expanded 83 times. Continuous investment plays an important role in the overseas practice of Chinese enterprises.

As Chinese enterprises move towards a broader international market, they will also face a more complex and

ever-changing international market environment. External environment factors, especially legal, cultural, institutional and other factors, have a huge restriction on the international expansion of Chinese enterprises. Under the premise of lack of experience, Every decision of Chinese enterprises will face huge risks. Especially for enterprises with continuous investment plans, how to choose the expansion path, that is, how to choose the priority of overseas investment when carrying out continuous overseas expansion? This is a question of the utmost importance. Today, China has become one of the most active and influential of DI players in the world, and Chinese companies have accumulated rich and valuable experience over the past decades. From the overseas practice of Chinese enterprises from 1983 to 2015, this paper attempts to study the order of market entry in the continuous and repeated overseas expansion of Chinese enterprises, explore and summarize the valuable experience of Chinese enterprises' overseas expansion, and provide some reference for Chinese enterprises' OFDI.

## 2. Theoretical Analysis and Research Assumptions

### 2.1. Market Size and Market Entry Order

Market seeking is one of the most fundamental and universal motives for enterprises to enter the international market. Therefore, enterprises prefer large-scale markets, because large-scale markets have greater opportunities for greater returns than small-scale markets. Market opportunity is usually defined as profit opportunity, and market size is generally considered to be the main driver of enterprise internationalization (Mittra and Golder, 2002). Market opportunities are the key drivers of the internationalization of

enterprises, the basic goal of transnational investment activities, gain profit opportunity, when the market scale is large enough, profit opportunities will be enough, though the size of the market, the greater the companies face the risk and cost of also increases, but companies willing to receive a larger market risks and costs. In the classical trade gravity model, market size is described as the most attractive factor for bilateral trade, and a large number of empirical results support this assertion.

Based on the above analysis, this paper proposes the following hypotheses:

H1: The larger the market size is, the smaller the market entry order is, that is, there is a negative relationship between the market size and the entry order.

## 2.2. Market Distance and Market Entry Order

### (1) Geographical distance

Geographical distance is still an objective obstacle to transnational investment. Modern information and communication technology, the continuous development of modern means of transport, to a certain extent slowed the space geographic distance to the negative impact of transnational business, international business activities become more convenient, but the space geographic distance to transnational operation time, transportation and communication costs, access to information, such as cost does not disappear. Multinational business activities, some very important information often need through face-to-face communication to earn, geographic distance still hinder enterprises to obtain these important information, and geographic distance will reduce the possibility of these information, so the larger geographic distance still can bring higher cost of doing business in international business activities and risks. Due to objectively existing costs and risks, geographical distance not only has a decisive impact on the market entry mode, but also has an obstacle effect on the order of market entry.

Based on the above analysis, this paper proposes the following hypotheses:

H2: The greater the geographical distance, the greater the market entry order, that is, there is a positive relationship between geographical distance and entry order.

### (2) Cultural distance

Cultural distance has a significant impact on the investment activities of multinational enterprises. From personnel management, production and sales to brand building, cultural distance has a profound impact (Roth, 1995). Cultural distance refers to the differences in religious belief, historical background, language environment and consumption concept between citizens of two countries (Ojala, 2015), to a large extent, determines people's decision-making behavior patterns and consumption habits and preferences. In countries and regions with similar culture, religious belief and historical background, enterprises can not only gain more trust in the initial stage of entry, but also have lower communication costs and more accurate information reception, understanding and digestion, thus rapidly enhancing the sustainable operation ability of enterprises in new markets. On the contrary, when there is a large cultural difference between the enterprise and the host country, not only the communication cost and information acquisition cost will be higher, but also the relatively mature management experience, employee skills and production process of the home country will be difficult to apply to the new market. Therefore, it is necessary to pay

higher costs for internal and external adjustment. Cultural and psychological distance has a significant effect on the hindrance of transnational investment and transnational business activities (Dow and Ferencikova, 2010).

Based on the above analysis, this paper proposes the following hypotheses:

H3: The greater the cultural distance, the greater the market entry order, that is, there is a positive relationship between the cultural distance and the entry order.

### (3) Institutional distance

Institutional distance is considered to be one of the main obstacles to transnational activities (Maitland et al., 2011). The greater the institutional distance between the home country and the host country, the higher the cost of obtaining legitimacy and compliance in the host country. The policy system, legal system and economic system of the host country have an all-round impact on OFDI. It is important to study, understand and be familiar with local laws, regulations and political situations. If there are huge differences in the soundness of laws and regulations, law enforcement and political stability between the two countries, enterprises will need to spend more time, energy and cost to adapt to the local institutional environment, and investment risks and operating costs will be significantly increased. In existing studies, abundant results have proved the adverse impact of institutional distance on OFDI (Maitland, 2011). System from the costs and risks of that system of multinational companies have to distance is more cautious, enterprises in the international expansion will prefer system from a small market, institutional distance means risk big, the probability of failure will also increase, so start with similar market access system environment, accumulate more experience, Then expand production and business activities to further markets.

Based on the above analysis, this paper proposes the following hypotheses:

H4: The larger the institutional distance is, the larger the market entry order is, that is, there is a positive influence relationship between the institutional distance and the entry order.

## 3. Research Design

### 3.1. Model Design

The explained variable in this paper is the order of market entry when enterprises make OFDI. Therefore, the explained variable is not a continuous variable but a discrete variable. Considering that the variable is measured in the way of dummy variable assignment, it is sequential.

$$y^* = x'\beta + \varepsilon$$

$$y = \begin{cases} 1, & y^* \leq r_0 \\ 2, & r_0 < y^* \leq r_1 \\ n, & r_1 < y^* \leq r_2 \end{cases}$$

Where,  $y^*$  is an unobserved latent variable,  $y$  is the value assigned to the order selection of enterprise market entry, and the coefficient of this model can be estimated by maximum likelihood method. STATA13.0 is used for all model estimation in this paper.

### 3.2. Variable Description

#### (1) The dependent variable

The order of market entry is defined as the order in which a transnational enterprise chooses the host country (region) to

invest in its continuous OFDI activities, which is mainly described in the paper at the level of "distance". That is, whether the enterprise first invests in the "close" country or the "far" country, the "distance" here has many different measurement angles. Measurement this paper adopts the dummy variable assignment way, the order of enterprises to invest overseas assignment, according to the list of foreign investment enterprises (institutions) the approval date of the same enterprise continuous investment activities order, the first overseas investment counting 1, the second investment count 2, and so on. This paper focuses on the sequence of continuous investment. If the same enterprise has made overseas investment for many times in the same year, the same sequence value is taken. And for the same enterprise in different years to the same region investment behavior, take different order value. The time data of Chinese enterprises' overseas expansion activities come from the Directory of Overseas Enterprises' Investment issued by the Ministry of Commerce.

## (2) The independent variables

**Market size:** Market size describes the size of the market of the host country and is generally measured by the GDP of the host country. The market size of the paper is measured in terms of total GDP in current US dollars, using data from the World Bank.

**Geographic distance:** There are many ways to measure the geographical distance, the simple way is to take the geographical distance between two capitals as the geographical distance between two countries, but this measurement method has obvious defects. For example, the distance between China and the United States, the distance between Beijing and Washington is completely different from the distance between Beijing and Seattle. Therefore, the paper adopts the research results of Mayer and Zignago(2011) and calculates the weighted results based on the distance of important cities between the two countries. The calculation method is as follows

$$d_{ij} = \sum_{k \in I} (p_k/p_i) \sum_{l \in J} (p_l/p_j) d_{kl}$$

Where  $d_{ij}$  represents the geographical distance between country I and country J,  $p$  represents the population,  $k$  and  $L$  represent the major cities of country I and country J, and  $d_{kl}$  represents the distance between cities. The geographical distance data of major cities between the two countries were obtained from the CEP II database.

**Cultural distance:** Hofstede's data on six dimensions of cultural distance, namely, power distance, individualism and collectivism, uncertainty avoidance, masculinity and femininity, long-term/short-term orientation, indulgence and restraint, were adopted. As the six dimensions are all important manifestations of cultural distance, only one of them can not fully measure cultural distance. Therefore, according to the method of Kogut 1988, this paper calculates six dimensions to determine the cultural distance between two countries. Substitution processing and mean processing were carried out for missing data of some countries (Ojala and Tyrvaenen, 2007). Calculation formula:

$$CD_j = \sum_{i=1}^6 (I_{ij} - I_{ic})^2 / (6 * V_i)$$

Where,  $CD_j$  represents the cultural distance between country J and China,  $I_{ij}$  represents the score of country J in

dimension I,  $I_{ic}$  represents the score of China in dimension I, and  $V_i$  represents the variance of dimension I. Cultural distance data comes from hofstede's official website.

It is worth noting that there are many missing values in the original data of Hofstede's website. Missing values are processed according to the following principles: Principle 1: countries with similar cultural backgrounds are replaced by mean values; Principle 2: Mean values are used for geographically similar countries. For countries with similar cultural backgrounds, such as Denmark, Sweden, Finland, Norway and Iceland, if the cultural distance data of Iceland is missing, the mean value of cultural distance of Denmark, Sweden, Finland and Norway is used instead. Geographically close countries, such as the Caribbean region, missing Puerto Rico's data and replacing it with the mean cultural distance of neighboring countries such as Guatemala, Panama, El Salvador, and Costa Rica.

**System of distance:** Institutional distance describes the political, legal and social differences between two countries. Seven dimensions of the International Guidelines on Country Risk (ICRG), namely political stability, socioeconomic conditions, investment risk, law and order, democratic accountability, corruption and administrative quality, were selected for institutional distance, and the same weighting method was used as cultural distance. Data from ICRG website.

$$CD_j = \sum_{i=1}^7 (I_{ij} - I_{ic})^2 / (7 * V_i)$$

## (3) Control variables

The principle of adding control variables is that in addition to the main variables studied, there are other factors that will have an impact on the international market entry order of an enterprise. It can be divided into two categories, one is the conditions for attracting foreign investment in the host country, and the other is the internal characteristics of enterprises. Based on the above principles and data availability, three factors, population size, economic development potential and whether it is a central enterprise, are selected as control variables.

### 3.3. Data Source and Processing

The research of this paper takes the Directory of Overseas Investment Enterprises (Institutions) provided by the Ministry of Commerce of China as the main data source. This document records all overseas investment practices of Chinese enterprises since the beginning of their records in an approved way, including key information such as investment time and investment subjects. However, after 2015, the approval system was changed to the record system, and the Ministry of Commerce did not publish the record time and other information. Therefore, the research sample of this paper is the data from 1983 to 2015.

As this research focuses on the continuous investment behavior of Chinese enterprises, the enterprises with only one investment behavior are excluded from the research sample. Among the investment destinations, the investment in Cayman Islands, Virgin Islands and other places often takes tax avoidance as the core goal, so the investment in cayman Islands, Virgin Islands and other tax havens is excluded from the sample. Some host countries are relatively special countries, many data is not perfect, such as Afghanistan, Iran, so they are excluded. Finally, 12094 pieces of investment data were obtained, involving 3602 enterprises, covering 154

countries (regions), with an average of 3.36 times of investment by one enterprise.

**Table 1.** Variable Description

The variable name	The data source	Variable to measure
Market entry order	The Ministry of Commerce	The list of Overseas Investment Enterprises (Institutions) published by the Ministry of Commerce shall be taken as the basis of the approval date of investment activities recorded in the list of Overseas Investment Enterprises (Institutions) published by the Ministry of Commerce. The first overseas investment shall be counted 1, the second overseas investment shall be counted 2, and so on
The size of the market	The world bank	Measured in total GDP in current dollar terms
Geographic distance	CEP II database	The weighted calculation is based on the distance of important cities between the two countries
Cultural distance	Hofstede website	Hofstede weighted the six dimensions of cultural distance
System of distance	ICRG database	The seven dimensions of international Guidelines on Country Risk (ICRG) were used for weighting calculation
International experience	CSMAR database	The international experience of the enterprise is measured by the number of subsidiaries operating overseas and the duration of continuous operation
Control variables	The world bank	Population size, GDP growth
Is it a central enterprise	The Ministry of Commerce	According to the definition in the directory, enterprises of the central government and Ministry of Commerce take 1, and others take 0

## 4. Empirical Results Analysis

### 4.1. Descriptive Statistics

The period from 1983 to 2015 spans 32 years and is divided into two periods from 1983 to 2007 and from 2008 to 2015. During 1983-2007, 355 enterprises completed 1453 overseas investment activities in 111 countries, with an average investment of 4.09 times. During this period, only 21 central enterprises completed 141 overseas investments, with an

average of 6.71 times. 334 private enterprises made 1,294 overseas investments, with an average of 3.86

From 2008 to 2015, 3,383 enterprises completed 10,659 overseas investments in just seven years, with an average of 3.15 investments. Among them, 316 state-owned enterprises invested 2,136 times in 137 countries and regions, with an average of 6.76 times. 3,067 private enterprises invested 8,523 times in 146 countries and regions, with an average of 2.78 times.

**Table 2.** Descriptive Statistics of Main Variables

	1983-2015(The total sample)					
	All the samples			state corporation		
Number of countries (PCS)	154			137		150
Number of enterprises (PCS)	3602			320		3292
Total investment times (times)	12094			2277		9817
The average number of times a company invests	3.36			7.12		2.98
	1983-2007			2008-2015		
	All the samples	state	corporation	All the samples	state	corporation
Number of countries (PCS)	111	53	103	156	137	146
Number of enterprises (PCS)	355	21	334	3383	316	3067
Total investment times (times)	1453	141	1294	10659	2136	8523
Total investment times (times)	4.09	6.71	3.86	3.15	6.76	2.78

Note: the enterprises that only invested once were excluded

### 4.2. The Influence of Market Distance on Market Entry Order

Model 1, Model 2 and Model 3 use geographical distance, cultural distance and institutional distance respectively to measure market distance. The empirical results are shown in the table below. The sample numbers of the three models were 12094, Prob & GT; Chi2 values were all 0.000, indicating that the three models fit well. The coefficient P value of the variable market size in model 1, Model 2 and Model 3 is all less than 0.01, which is significant at 1% level. There is a

significant relationship between market size and market entry order. If the coefficients are all negative, there is a negative relationship between market entry order and scale. The larger the scale, the smaller the order. Chinese enterprises will choose to enter large-scale countries and regions at the initial stage of investment, H1 has been verified. Model 1 and model 2, the geographical distance and cultural distance coefficient are 1% significance level, and is positive, that geographic distance, cultural distance and in order to present positive correlation, two distance is smaller, the smaller order also, namely enterprise priority into the geographical distance and

cultural distance smaller markets, H2 and H3.

In Model 3, the coefficient of institutional distance is significant at the level of 1%, but it is indeed negative, indicating that institutional distance has a negative relationship with market entry order. The larger the institutional distance is, the smaller the entry order is. In other words, enterprises have the priority to enter the market with a larger institutional distance, which is inconsistent with H4. The analysis shows that there is a large institutional distance between China and Europe, The United States, Russia and other markets with a large market size. This result will occur

on the premise that Chinese enterprises take the market size as the investment target. In addition, in the ofDI of Chinese enterprises, diversified operating environment is attractive to some extent, which is also one of the reasons for the negative relationship between institutional distance and market entry order [77]. According to the full-sample empirical model, Chinese enterprises prefer to invest in big markets and enter countries with close geographical and cultural distance, but countries with large institutional distance.

**Table 3.** The influence of market distance on market entry order

variable	Model 1	Model 2	Model 3
The size of the market	-0.060*** (-9.61)	-0.062*** (-9.51)	-0.042*** (-6.52)
International experience	0.0002*** (27.55)	0.0002*** (27.61)	0.0002*** (27.60)
Geographic distance	0.111*** (6.80)		
Cultural distance		0.082*** (4.93)	
System of distance			-0.049*** (-5.42)
Population size	0.046*** (4.94)	0.051*** (5.35)	0.027*** (2.81)
GDP growth	0.014*** (4.84)	0.015*** (4.97)	0.010*** (3.67)
Is it a central enterprise	1.195*** (42.96)	1.207*** (43.55)	1.205*** (43.43)
Wald chi2(6)	3385.61	3338.20	3493.23
Prob > chi2	0.000	0.000	0.000
Number of samples	12094	12094	12094

Note: Z statistic value in parentheses, \*, \*\* and \*\*\* respectively represent P<0.1, P<0.05, P<0.01.

## 5. Conclusions and Implications

In order to answer the question "how do Chinese enterprises choose the order of market entry in the process of continuous overseas investment", this paper studies the key concepts such as the order of market entry, internationalization experience, geographical distance, cultural distance, institutional distance and market size. The continuous overseas investment behaviors of Chinese enterprises during 1983-2015 were selected as the research object, and the enterprises that had made overseas investment twice or more during 1983-2015 were selected, and a total of 12,094 investment records of 3602 enterprises were sorted out. This paper empirically examines the influence of market size, geographical distance, cultural distance and institutional distance on overseas investment, and explores the moderating role of internationalization experience in this process. The main conclusions are:

(1) Market size has an important impact on the market entry order of Chinese enterprises' overseas investment. In all empirical models in this paper, the coefficient of market size is significantly negative, and Chinese enterprises tend to preferentially enter countries and regions with larger market size. Chinese enterprises show a strong desire for market scale, both central enterprises and private enterprises, market scale shows steady attraction. There was no significant change before and after 2008. Market seeking has been one of the main motivations for Chinese enterprises to expand overseas

since 1983.

(2) Geographical distance has a significant positive impact on market entry order. In the full-sample empirical model, the coefficient of geographical distance is significantly positive, and Chinese enterprises follow the "proximity principle" to preferentially enter countries with smaller geographical distance. In the grouping model, geographical distance has no significant effect on the investment activities of central enterprises, but has a significant effect on private enterprises, and private enterprises will take the lead to enter countries with small geographical distance. The ownership characteristics of central enterprises, strong financial resources and national credit guarantee central enterprises overcome the negative effect brought by geographical distance.

(3) Cultural distance has a significant positive impact on market entry order. The coefficient of cultural distance is significantly positive in most models. Chinese enterprises have priority to enter countries and regions with smaller cultural distance, but central enterprises are more sensitive to cultural distance than private enterprises.

(4) Institutional distance has a significant negative impact on market entry order. In most models, the coefficient of institutional distance is significantly negative, and Chinese enterprises have priority to enter countries and regions with larger institutional distance. Chinese enterprises prefer to enter markets with large market sizes such as Europe and the United States. The institutional distance between these countries and China is often huge. Meanwhile, compared with

institutional distance, market size has a greater impact. By employing experienced management teams in the host country market and deepening cooperation with the host country government, the negative effects of institutional distance can be alleviated, but enterprises cannot change the market size of the host country.

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