Cristina López-Duarte/Esteban García-Canal

Stock Market Reaction to Foreign Direct Investments: Interaction between Entry Mode and FDI Attributes

Abstract and Key Results

- What is the expected reaction regarding the stock price of companies which carry out FDIs (Foreign Direct Investments)? Results from previous research focusing on specific entry modes are inconclusive.

- The aim of this paper is to test whether the stock market reaction to FDIs is dependent not only on the entry mode that the investing firm may have chosen, but also on the interaction between the entry mode and the other FDIs' attributes.

- By focusing on the recent international expansion by means of FDIs of listed Spanish firms, we have found that stock market reaction to FDIs depends upon the interaction between the entry mode and the location of the investment, the identity of the investor and the latter's international experience.

Key Words

Authors

Cristina López-Duarte, Associate Professor of Management, Faculty of Economic Sciences, University of Oviedo, Oviedo, Spain.
Esteban García-Canal, Professor of Management, Faculty of Economic Sciences, University of Oviedo, Oviedo, Spain.

Cristina López-Duarte/Esteban García-Canal

Introduction

Does the internationalization of firms by means of FDIs (Foreign Direct Investments) improve the wealth of their shareholders? Empirical results are inconclusive. While some studies find a positive effect (Berry/Sakakibara 2006, Doukas/Travlos 1988, Meschi/Cheng 2002, Morck/Yeung 1992), other studies – such as Christophe's (1997) and Click and Harrison's (2000) – show exactly the opposite. Contractor et al. (2003) summarize the main results of previous research showing these mixed results. However, they also show that the relationship between multinationality and performance is more complex than initially expected and that it varies according to the phase of internationalization of the firm. Lu and Beamish (2004) recent research also supports this view. Specifically, these two papers show a S-shaped relationship between multinationality and performance with a positive slope only for medium levels of internationalization. Nevertheless, Lu and Beamish (2004) conclude that more research is needed to analyze the impact of the interaction between the entry mode chosen and other attributes of the investment on the performance consequences of FDIs.

In a recent paper, Doukas and Kan (2006) analyze the performance consequences of multinationality for both shareholders and bondholders. However, the bulk of previous research has focused on the performance consequences of FDI for firm's shareholders – for example by using event study techniques (Brown/Warner 1985, McWilliams/Siegel 1997) to quantify the stock market reaction to internationalization decisions. Most of these studies confirm that a positive stock market reaction – in other words, positive abnormal returns[1] – to a FDI only takes place when the investing firm enjoys good investment opportunities and has important intangible assets to help it overcome the liability of foreignness (Morck/Yeung 1992, Chen et al. 2000).

Stock market reaction to two different types of FDIs, acquisitions and greenfield joint ventures (GJVs), has been analyzed in the literature. Both GJVs and acquisitions allow the foreign investor to gain access to specific resources owned by local companies. However, when analyzing stock market reaction to international joint ventures and acquisitions, some factors external to the internationalization itself should be taken into account as potentially influential. We can cite a few, for instance the intangible assets owned by the local company or, in the case of an acquisition, the price the investing firm pays for the acquired company. On the other hand, investing through both greenfield joint ventures and acquisitions implies the need to cope with additional costs which may also influence stock market reaction, such as those associated with dealing with a partner or managing the acquired company – see, for instance, Kogut and Singh (1988). However, GJVs and acquisitions do not account for all possible entry modes. As we shall argue later on, combining two logical distinctions regarding entry mode – ownership structure and the deci-

sion to set up a new company or not (greenfield versus acquisition) –, up to five different types of entry mode may be identified. Not all of them have been equally analyzed in the literature on the stock market reaction to FDIs. Consequently, there is a lack of studies which analyze the entire range of entry modes.

Since there are different types of entry modes, and each of them has distinctive features that can be of interest in different contexts, this paper aims at testing whether the stock market reaction to FDIs will depend not only on the entry mode itself, but also on its interaction with other attributes of the investment. More precisely, we argue that the stock market takes into account the four classic questions in the field of International Business: the firm that has made the investment (who?), the entry mode used (how?), the location of the investment (where?) and the experience accrued by the foreign investor (when?). An outstanding advantage of this paper is that its empirical study is focused on the FDIs made by listed Spanish companies between 1990 and 2003. As the Spanish outward FDI was not definitively liberalized until the end of the 80s, the bulk of FDIs carried out by Spanish firms took place during this period. The recent international expansion of Spanish MNCs is one of the most successful stories in the field of FDI (Campa/Guillén 1996, Guillén 2001, 2005). As UNCTAD's (2004) data shows, the share of the stock of outgoing FDIs from Spain on Spain's GDP grew from 3 percent in 1990 to 34.3 percent in 2002. This huge growth in foreign investment has provided us with very interesting and diverse evidence, as our database collects not only FDIs made by Spanish firms when they were already large multinationals, but also FDIs made during the earliest stages of their internationalization process. Such evidence allows us to test whether the stock market reaction to FDIs changes as firms gain experience in the international arena. Another advantage of our database is that it collects FDIs made using the whole range of entry modes: greenfield wholly owned subsidiaries (GWOSs), greenfield joint ventures and various kinds of acquisitions – total, partial and shared partial acquisitions. It thus became possible to analyze the differentiated stock market reaction to each one of these entry modes. In addition, our database collects not only new FDIs, but also accumulations, that is, FDIs aimed at expanding an international project previously carried out by the firm. Thus, we can also analyze whether these two different ways of running foreign investments (new projects and accumulations) are valued differently by the stock market.

The remaining of the paper is organized as follows. In section 2 we will analyze how the entry mode interacts with the characteristics of the investing firm, the location of the investment and the experience accrued by the foreign investor. Following this, Section 3 will be devoted to data features and methodology. We will show empirical evidence in Section 4. After a discussion of our empirical results, the main conclusions will be summarized in Section 5.

Theoretical Framework

Firms investing abroad have to deal with the so-called "liability of foreignness" (Hymer 1960/1976, p. 34, Zaheer 1995, p. 341). Such a disadvantage stems from the lack of local knowledge related to the host country's specific culture, customer needs and business practices, as well as from the lack of important relationships with local political and economic agents. The lack of these local resources creates a liability, insofar as they are difficult to transfer on the market. Therefore, we could expect firms to be unwilling to invest abroad unless they have a way of overcoming this liability. As we argue below, the entry mode chosen by the investing firm can reduce such a disadvantage.

The greenfield wholly-owned subsidiary is the conventional entry mode used by MNCs. In this case, the company creates a new entity in the host market, using its own resources and keeping 100 percent of its equity thereto. The foreign investor transfers its firm-specific capabilities to this new unit. They are then combined with some different resources available in the host market (Hennart/Park 1993). Nevertheless, companies often choose entry modes different from GWOSs. Sometimes, the foreign investor decides to acquire, either totally or partially, the capital of a firm located in the host country, and then transfers its firm-specific advantages to the acquired firm. In other cases, the investing company decides to share the ownership of the new unit by investing through a greenfield joint venture with other partners. Following Hennart and Park (1993), the use of entry modes other than the establishment of wholly-owned subsidiaries is justified when all of the assets possessed by the foreign investor are insufficient or inadequate to operate in a foreign market. This is the case when the assets the firm lacks are difficult to replicate or to obtain on the market. The most common asset a company may lack when successfully undertaking a foreign investment is a thoroughly localized specialist knowledge of the host market in aspects concerning, for example, the structure of distribution networks and the particular needs of local customers. These are tacit capabilities and, as such, they are difficult to transfer across an international market, owing to the difficulty of making this knowledge explicit and in the incentive problems posed. In addition, as these are all capabilities based on the local firms' experience, it is not possible for the foreign investor to create them by itself. In conclusion, there are two related decisions regarding the choice of entry mode. On the one hand, the firm has to decide whether to acquire an already existing firm or to set up a new one in order to operate in the host country. On the other, the firm has to choose between keeping 100 percent of the equity of the foreign unit or sharing it with other firms. By jointly considering both decisions, four different entry modes may be identified:

• Greenfield wholly-owned subsidiary. The investing firm sets up a new company in the host market without sharing its ownership with other companies. By doing

so, the investing firm gains access only to local resources that are available in the local market.

- Greenfield joint venture. The investing firm makes an alliance with, at least one other firm in order to jointly establish a new entity located in the host country. Both partners transfer part of their resources to this new venture. Usually, only two members – the investing firm and a second partner, generally speaking, a local one – take part in GJVs.
- Total acquisition (TA). The investing firm buys all of the equity of a local company, thus gaining access to all of its assets and resources. These resources are then pooled with those of the investing firm.
- Partial acquisition (PA). The investing company buys only a stake in the equity of a local firm. Although the investing firm does not own 100 percent of the equity of the target, it has an ownership position over its whole package of assets. We can also distinguish two different types of partial acquisitions: those which we have called "pure partial acquisitions" (PPAs) and those which have been termed "shared partial acquisitions" (SPAs). A PPA arises when the acquiring firm buys just a part of the equity of a company located in the host market. On the other hand, an SPA takes place when two or more different firms (which usually come from different countries) jointly acquire a third firm located in the host market. These are operations which take place in privatization processes very frequently. Thus, a shared partial acquisition requires a previous collaborative agreement amongst the different acquiring companies, entailing two different, consecutive processes: the establishment of a cooperative agreement amongst the bidders and the process of target acquisition.

When investing through joint ventures and acquisitions, the investing firm can gain access to local knowledge and resources not available through market contracting. By gaining access to such resources, foreign investors can overcome the aforementioned liability of foreignness and, as a result, increase the returns from their own resources, obtaining what economists call "rents" (returns above the opportunity costs of the used resources). These local resources can even increase the competitiveness of the investing firm in markets different from the host country. The expectation of these rents will result in an increase in the stock price of the company, which, in turn, will lead to positive abnormal returns. However, in the case of acquisitions, such expectation can be counteracted by the price paid for the target. When investing through an acquisition, the investing firm has to pay – totally or partially, depending on the type of acquisition – the market price of the whole package of target assets (Barney 1988). In fact, in most cases the investing firm has to pay a premium in order to gain access to the target's valuable resources. Such a price may, in turn, reduce or even eliminate the potential abnormal returns derived from the acquisition. On the other hand, when expanding abroad through GJVs, foreign firms do not need to enter into an equity position over the whole assets pack-

age of the local firm. As the foreign investor does not need to pay the whole value of the partners' resources, the potential profits derived from GJVs will be higher, particularly when the joint venture implies gaining access to local resources that are scarce and difficult to be imitated or substituted (Peteraf 1993). If this were the case, a positive stock market reaction to a greenfield joint venture could be expected. However, a firm entering into a GJV also assumes some "appropriability hazards" (Oxley 1997, p. 388), that is, the risk of leakage of its core competences. The size of such a risk will depend upon the characteristics of the deal. GJVs also imply sharing profits with other partners. For all of these reasons, it cannot be stated that stock market reaction to greenfield joint ventures should be higher than for acquisitions without knowledge of other attributes of the investment. What is more, GJVs and acquisitions are not always equally beneficial for the foreign firm. Their contribution to the firm's profitability is higher in those situations in which the firm faces a higher liability of foreignness due to, for instance, cultural differences between the host and the home countries. Nevertheless, the way in which the foreign unit is managed by the multinational firm can also be critical when valuing the FDI´s impact on the firm's profitability. Taking all of these factors into account, we can see that the impact of the entry mode on stock market reaction to FDIs will be dependent upon the answer to three other classic questions in the field of International Business: *Who* makes the investment; *When* and *Where* is the investment made. In the following paragraphs, we shall analyze how the entry mode interacts with each of the FDI attributes.

Who: The Investing Firm

An outstanding factor able to influence stock market reaction to an FDI is who makes the investment. It is to be expected that the aforementioned liability of foreignness does not affect all firms to the same extent. Although all foreign investors have to face such liability, those firms with a competitive advantage over their local competitors find it easier to overcome such a disadvantage. Following the Internalization Theory (Buckley/Casson 1976, Teece 1977, Hennart 1982) and the Eclectic Theory (Dunning 1979, 1988), competitive advantages which allow a firm to overcome the liability of foreignness are those derived from intangible assets accrued by the investing firm in its own home country.[2] The empirical evidence provided in relation to this issue (Morck/Yeung 1992, Chen et al. 2000) has confirmed that stock market reaction to FDIs is influenced by the investing firm's degree of accumulation of intangible assets. When the FDI is made by means of an acquisition, valuable intangible assets increase the potential to obtain benefits from the bidder's resources, once these are combined with those of the target firm. Since such profits can be only obtained by the bidder, they cannot be considered by the seller when negotiating the price to be paid for the target (Barney 1988, Morck/Yeung 1992).

When investing by means of a greenfield joint venture, intangible assets do not only increase the potential benefits of the investment, they also augment the bargaining power of the investing firm when negotiating the deal. Finally, when investing by means of GWOSs, intangible assets also improve the firm's potential to benefit from the investment. In fact, in such a case, intangible assets are the only way for the investing firm to overcome the liability of foreignness (Hymer 1960/1976). Should the investing firm not have valuable intangible assets, it would turn out to be quite difficult for it to benefit from its FDI. However, it has to be noted that transferring intangible assets to a partially owned subsidiary involves certain risks which do not arise when investing by means of entry modes implying full ownership. Investing by means of a partial-ownership entry mode implies having a partner in the international venture capable of gaining access to and expropriating the investing firm's assets (Oxley 1997). Furthermore, investing through partial ownership means sharing the rents generated by the foreign investor's intangible assets with other firms. For these reasons, we can formulate the following hypothesis:

Hypothesis 1. When the foreign firm has valuable intangible assets, FDIs involving full ownership – that is, FDIs made by means of GWOSs and total acquisitions – will generate abnormal returns higher than those made by using entry modes entailing partial ownership.

Where: The FDI's Host Country

The characteristics of the host country are critical when analyzing the stock market reaction to a FDI, since not all countries boast the same liability of foreignness for the investing firm. Two factors, potentially influential for such liability, have been widely analyzed: the cultural distance between the home and the host countries of the FDI and the policy instability of the host country.

The cultural distance between two different countries makes reference to all of those differences related to their populations' ways of thinking and acting. These differences increase the liability of foreignness and the difficulties which the investing firm has to face when trying to develop its activity in a new country (Johanson/Vahlne 1977).

Initially, one would expect the stock market to value, those entry modes which allow the foreign firm to overcome the cultural gap between both countries, that is, GJVs and acquisitions, more positively. However, as cultural distance increases, the integration of the partner or target's knowledge, personnel and other resources with those of the foreign investor becomes more difficult (Madhok 1997). Although GJVs, TAs and PAs allow the foreign firm to gain access to local knowledge, integration with the foreign firm's specific knowledge becomes more difficult in the case of partial acquisitions, as López-Duarte and García-Canal (2002) have already

pointed out. While the equity position of the local partner in a GJV is an incentive for him to cooperate in order to identify the optimal combination of resources, administrative systems and corporate cultures between foreign and local firms, the equity position of a local shareholder in an acquired foreign company may be an obstacle in the handling of the acquisition process. In GJVs, both local resources and employees not transferred to the GJV remain within the boundaries of the local partner. In acquisitions, resources and people which do not fit the interests of the acquiring firm have to be either sold or dismissed, respectively. This fact usually leads to political processes in the target as the local shareholder may not be interested in dismisssing local employees or managers or in divesting in some areas. Thus, factions may be formed around both the local shareholder and the foreign investing firm, blocking the effective integration process of both firms. On the other hand, if the foreign firm had 100 percent of the equity, it would keep only local managers when necessary. When cultural distance increases, the ability of the target personnel to absorb and exploit the foreign investor's know-how and routines decreases (Madhok 1997). Therefore, the amount of local resources, managers and personnel meeting the foreign investor's needs decreases. In such cases, total acquisitions and GJVs are more advantageous options for the foreign investor than partial acquisitions may be. In the first case, the acquiring firm is free to proceed with the necessary re-structuring of the foreign unit. In the second case, the local firm only transfers the appropriate local managers and resources to the GJV without having the need to re-structure its own organization. Taking all of these facts into account, we can formulate the following hypothesis:

Hypothesis 2. When the cultural distance between the home and host countries is high, FDIs made through GJVs and total acquisitions will generate higher abnormal returns than those made using other entry modes.

The host country's policy instability is a second factor related to the location of the FDIs which may be taken into account by the stock market. This factor is conditioned by the stability of the political system and the discretion that foreign governments show in changing the rules of the game unilaterally (Williamson 1996, Henisz/ Williamson 1999, Henisz 2000). Whereas some governments cannot easily act unilaterally to alter the situation of foreign firms, other governments have the possibility of expropriating foreign firms' assets or changing regulations and tax policies affecting the firm's profitability (Henisz 2000). The higher the host country's policy instability is, the higher the "liability of foreignness" will be. As a consequence, policy instability is a factor which firms expanding abroad should consider in their international expansion decisions (Henisz/Zelner 2001). Once a firm has invested abroad, this investment is somewhat exposed to the risk of value loss due to discretionary decisions made by the foreign government. For this reason the shareholders of foreign investors should value those international operations made by firms under conditions of policy stability more positively than those carried out

under high policy hazards. However, they should take the entry mode used by the foreign firm into account. Henisz (2000) has argued that firms tend to prefer entry modes which imply sharing the investment when expanding abroad under the conditions of policy instability, and has found some empirical evidence to support the fact. Therefore, policy instability influences the stock market reaction to a FDI not only in itself, but also through its interaction with the entry mode. It is then to be expected that the stock market will most probably react less positively to FDIs located in highly unstable countries, and that such a negative reaction will almost certainly be enhanced when the FDI is made by the investing firm alone. It is for all of these reasons that we can formulate the following hypothesis:

Hypothesis 3.   When investing in countries with high policy instability, FDIs which imply full ownership – that is, FDIs made through GWOS and total acquisitions – will generate lower abnormal returns than those made using other entry modes.

When: The Accrued Experience of the FDI

A final factor to be considered is the experience accrued by the foreign investor. As firms gain experience in doing business abroad by carrying out new projects in foreign markets, they accrue knowledge related to each of the host markets and also to the internationalization process itself. The greater the accrued experience, the lower the exposure to the liability of foreignness and, consequently, the lesser the need of local partners to compensate such a liability. The so-called Uppsala Model of Internationalization (Johanson/Vahlne 1977, Johanson/ Wiedersheim-Paul 1975) states that firms develop their internationalization process following a gradual development, in such a way that firms' commitments in host markets evolve as they gain experience and knowledge in and about those markets. This gradual development affects the entry mode choice. In this respect, investing by means of GJVs may be particularly interesting when the firm has no previous experience in a host country and is in the first stages of the internationalization process. As a result, the lack of experience and local knowledge is compensated for by the local partner's contributions. On the other hand, in those cases in which the firm has already accrued enough experience, local resources provided by the partner turn out to be less interesting for the foreign firm. However, acquisitions – which are another way to gain access to the local resources – are not only valuable at the beginning of the process of the international expansion, but also in the latter stages of the process, since they allow the foreign firm to exploit fast growth opportunities. Contrary to what happens in GJVs, in acquisitions, the bidder gains full access to the market share of the target – (Caves/Mehra 1986, Hennart/Park 1993). Furthermore, firms with greater international experience tend to use acquisitions because they can take

advantage of their accrued experience in managing the integration process to get the most out of their subsequent international acquisitions (Caves/Mehra 1986). It is for these reasons that we can formulate the following hypothesis:

Hypothesis 4. FDIs made by means of GJVs will generate higher abnormal returns than those made by any other entry mode providing such FDIs are made during the first stages of the internationalization process, as well as when the FDI is the first one made by the firm in a specific country.

Database and Methodology

Research Setting

We focus our analysis on the FDIs carried out between 1990 and 2003 by listed Spanish companies whose shares are traded on the Madrid Stock Exchange. As we show later on, banks and firms operating in regulated industries have been the most active foreign investors among Spanish listed firms. During the 1990-2003 period, large Spanish firms in banking and regulated industries have expanded abroad and become large multinationals (Guillén 2005). This stands in stark contrast to the situation at the end of the 1980s, when most of them were exclusively focused on the Spanish local market. The challenges posed by Spain's entrance into the European Union, the deregulation of different industries, and the full privatization of state-owned companies have been the main forces driving firms' internationalization. While deregulation and the change from economic isolation to entrance into the European Union were a threat to the traditional business model of most Spanish companies, both factors also generated profitable opportunities abroad. In addition, in the specific cases of firms which were partly owned by the state – like Telefonica, Repsol (now Repsol-YPF), Endesa or Argentaria (now BBVA bank) –, full privatization was an additional force pushing these companies to invest abroad. To see the magnitude of the investment effort of Spanish companies, we can take into account the fact that, as previously mentioned, the share of the stock of outgoing FDI from Spain on Spain's GDP grew from 3 percent in 1990 to 34.3 percent in 2002 (UNCTAD 2004). Our study thus includes the bulk of the outgoing FDI made by Spanish firms until now which is, furthermore, mainly a product of these 14 years. We believe that this empirical setting provides an excellent opportunity for studying the stock market reaction to FDIs for the following reasons. Firstly, unlike most studies that analyze FDIs made by firms which are already large multinationals, we are analyzing the internationalization of Spanish multinationals from the starting point of their internationalization process, so that our database includes their

first investments abroad. Secondly, we have covered the whole range of entry modes, particularly those entry modes which imply access to external resources (greenfield joint ventures and acquisitions), as one of the main features of Spanish multinationals is their interest in accelerating their international expansion.

Database

Our database has collected the FDIs carried out between 1990 and 2003 by listed Spanish companies whose shares were traded on the Madrid Stock Exchange. FDIs exclusively relative to distribution and marketing activities were not included in the database. In order to identify these FDIs, several steps, which we will now identify, have been taken. Firstly, a list with all of the Spanish firms listed in the Madrid Stock Exchange was made for every year included in the study. Secondly, an exhaustive and systematic research was carried out in PRENSA BARATZ database (this database includes all of the news published daily in all of the Spanish newspapers as well as in the leading economic newspapers in Spain such as *Expansión* and *Cinco Días*), as regards each of the companies involved. As an additional check we also completed and verified the collected information by using the reports presented by each firm to the *Comisión Nacional del Mercado de Valores* (*CNMV*) – the supervising authority of the Madrid Stock Exchange –, as well as other corporate reports. This research allowed us to identify not only the FDIs, but also the exact date for each of the FDI's first announcement, a particularly important input when applying the event-study methodology. A total of 682 FDIs were identified through this research.[3] Because of the methodology used, each FDI announcement had to meet the following criteria so as to be included in the final sample:

- The Spanish firm's daily stock prices were available in the DataStream database. This database contains, among many other data, the stock prices of all of the companies publicly traded in all the major European Stock Exchanges. Fifty-one announcements were eliminated from our sample because the necessary daily stock market prices were not available in DataStream, or because the investing firm's shares were not traded across the whole period needed to estimate abnormal returns.
- No major confounding announcement which could contaminate the effect of the studied event was made during the three days before or after the date of the announcement of the FDI. Following McWilliams and Siegel (1997) seasoned equity offerings, stock reductions, profit announcements, dividend payments, contracts with the State, other acquisitions or alliances different from the FDI considered, or decisions concerning changes in a key executive of the studied companies were all considered as confounding events. Three-hundred-seventy-six announcements were eliminated according to this criterion. The bulk of the confounding events detected in our study were announcements having

to do with other operations – national or international acquisitions, alliances, investments or projects different from the FDI – (82.2 percent). The break-down of the remaining events is the following: profit announcements (9.1 percent), development of new products or services (3.2 percent), dividend payments (2.2 percent), decisions concerning changes in a key executive (1.8 percent), stock increases or reductions (1.3 percent) and contracts with the State (0.3 percent).

• The abnormal return associated with the announcement was not an outlier. We considered outliers those observations with abnormal returns outside the range defined by average abnormal return in the sample plus and minus 2.5 times the SD. Four announcements were thus eliminated since they became outliers once abnormal returns were calculated.

After the elimination of all the events outside the above criteria, the final sample consisted of 234 FDIs. The main features of the sample are the following: most FDIs were made during the second half of the 1990s, while the former years of the period under study account for a particularly low number of FDIs. The time distribution of these FDIs is shown in Figure 1 – as a reference, the time distribution of the outward overall FDI Spanish flow according to UNCTAD's (2004) statistics is also shown (UNCTAD's data relative to Spanish FDI is not disaggregated in different entry modes).

Figure 1a. Evolution of the Number of New FDIs Classified by Entry Mode
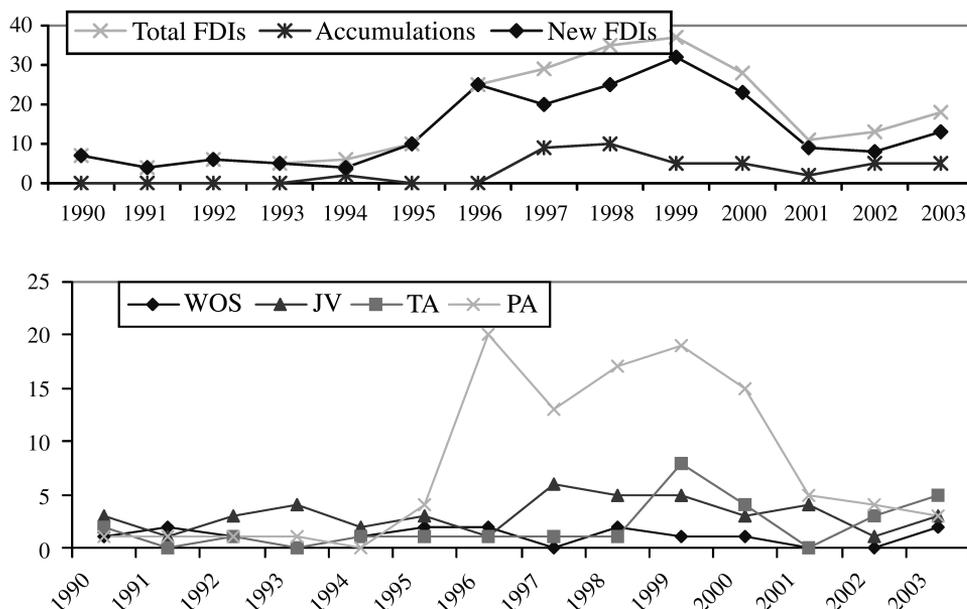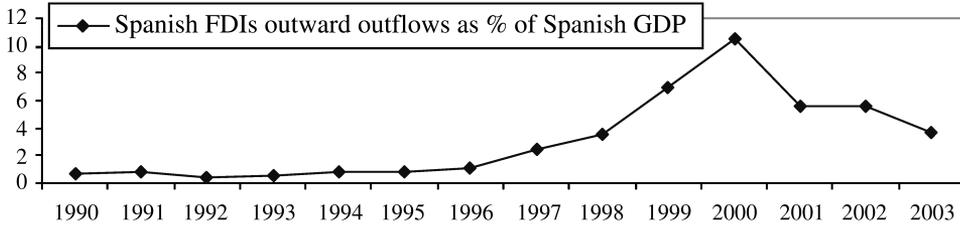
Figure 1b. Evolution of Spanish FDI Outward Flows according to UNCTAD's (2004) Statistics

FDIs collected in our database have been made by 56 listed Spanish companies whose shares were traded on the Madrid Stock Exchange. All of these firms are among the most important Spanish companies, including firms like the Santander Central Hispano and BBVA banks, Mapfre, Repsol-YPF, Telefónica and Endesa, which are leaders in their respective markets. Geographical and industry distributions show a very high degree of concentration: Latin America and the European Union are the host regions receiving the highest volumes of Spanish FDIs; financial and regulated sectors (activity sectors that have traditionally been regulated and are now being increasingly de-regulated, such as air transport, communications and energy sectors) account for more than 60 percent of the collected FDIs. It should also be pointed out that Spanish firms have a strong preference for acquisitions over greenfield investments (only 25 percent of the collected FDIs were made through GWOSs and GJVs). Nevertheless, this preference does not seem to be stable throughout the whole period under study. While GJVs are the preferred entry mode during the early years of our study, acquisitions turn out to be the most frequent entry mode in the second half of the 1990s.[4] Table 1 shows a geographical and industrial breakdown for our subsample of new FDIs.

Table 1. Geographical and Industry Breakdown of FDIs Collected in the Database

	Manufacturing	Service	Regulated Industries	Finance	Total
European Union (EU)	12	12	19	7	**50** **26.18%**
OECD (non UE) countries	6	7	8	2	**23** **13.04%**
Latin America	15	5	48	27	**95** **49.74%**
Rest of the world	15	1	7	0	**23** **13.04%**
Total	**48** **25.13%**	**25** **13.09%**	**82** **42.93%**	**36** **18.85%**	**191** **100%**

Methodology

In order to analyze the stock market reaction to FDIs made by listed Spanish firms, use of the event-study methodology (Brown/Warner 1985) was made, using the daily stock prices and the financial information for these companies available in the DataStream database as input. Event studies attempt to estimate to what extent a particular event – in this case, the announcement of a FDI – may influence the return on a share. In other words, they aim at analyzing to what extent the returns of a share differ from those expected had the said event not taken place. In this respect, the null hypothesis assumes the non-existence of abnormal returns. These abnormal returns are defined as the difference between the actual returns observed and those expected according to a market model on the day of the announcement of a certain event or in a time-window located around the same day. If the empirical evidence rejects the null hypothesis, it would demonstrate the existence of statistically significant abnormal returns. In order to calculate abnormal returns, we have followed the procedure of Dodd and Warner (1983), as well as the recommendations by McWilliams and Siegel (1997). Following the latter, both contaminated announcements and outliers were removed from our final sample. Abnormal returns (AR_{kt}) are calculated following Sharpe's (1964) model, as shown in the equation [1]:

$$[1] \quad AR_{kt} = R_{kt} - \left(\alpha_k + \beta_k \widetilde{R}_{mt} \right)$$

Here, R_{kt} represents the return for security k for period t,[5] and $\tilde{R}_{mt}$ the return on an equally weighted index compiled by DataStream for the Madrid Stock Exchange stocks for period t. This index is corrected by dividend payments as well as by seasoned equity offerings or stock reductions. The coefficient estimates α_k and β_k are calculated using a 120 trading-day period which started 130 days before the date of the announcement (t = -130) and finished 11 days before this same date (t = -11), t =0 being the day when the announcement was published for the first time in one of the economic newspapers consulted. The exclusion of the ten days prior to the announcement from the estimate of the market model seeks to remove data that might be affected by the event. Its inclusion might lead to an underestimation of the abnormal returns as a result of the effect of the announcement being partially incorporated in the expected returns. Brown and Warner's (1985) z-statistic was used to test the null hypothesis, namely, that the abnormal returns accumulated on the day of the announcement or during the days around the event (cumulative abnormal returns) are equal to zero.

Findings

Table 2 shows the average abnormal returns derived from the announcements of FDIs. The results correspond to the whole sample and consider different accumulation windows. For each accumulation window the average abnormal return, 95 percent confidence intervals, the value and significance of Brown and Warner's (1985) z-statistic and the percentage of cases in which abnormal returns are positive are all presented. It will be observed that the average abnormal return associated with FDIs is 0.27 percent on the day of the announcement (99 percent of statistical significance), although such an average abnormal return reaches 0.39 percent in some accumulation windows. Thus, generally speaking, Spanish firms have received a positive valuation for their internationalization process by means of FDIs. We must take into account, however, the fact that there is an important percentage (always above 45 percent) of FDIs which have obtained a negative stock market reaction.

Table 2. Stock Market Reaction to FDIs

	Abnormal Return %	Z statistic	Positive Cases %
Whole sample (N = 234)	$AR_0 = 0.27$ (0.51, 0.02)	2.423***	53.4
	$AR_{0,1} = 0.34$ (0.65, 0.03)	2.238***	53.0
	$AR_{-1,1} = 0.39$ (0.77, 0.01)	1.534**	54.7
New FDIs (N = 191)	$AR_0 = 0.3$ (0.58, 0.03)	2.63***	53.4
Accumulations (N = 43)	$AR_0 = 0.12$ (0.61, –0.37)	0.15	53.5

* p<0.1 ** p<0.05 *** p<0.01

95% confidence intervals are given in parentheses.

The following pages are aimed at analyzing how the FDI's features – how, who, where and when – condition the stock market reaction. For the sake of simplicity, only abnormal returns on the day of the announcement will be presented.

How: New Projects versus Accumulations and the Entry Mode of New Projects

As we have already pointed out, our sample has collected two different types of FDI projects. On the one hand, it has collected new FDIs, that is, FDIs which are the first investment relative to a particular internationalization project. On the other hand, it has collected accumulations, that is, FDIs which mean an increase in the amount of resources committed to a project carried out previously. Accumulations account for less than 20 percent of the FDIs collected in our database, most

of them having been made through acquisitions of small stakes of the equity of the host firm.

Our analysis shows that, while new FDIs are valued by the stock market, on average, in a positive and statistically significant way, accumulations are not. Such a different stock market reaction may be due to the fact that the announcements of accumulations are previously discounted by the stock market. That is to say, investors are expecting this accumulation. In fact, re-investments in previous projects tend to be the rule, rather than the exception. Every new investment project is a platform for further investments in which firms can take advantage of the resources and knowledge previously accumulated (Kogut/Kulatilaka 1994). Additionally, accumulations are generally FDIs of a much smaller volume than new FDIs: more than 80 percent of these accumulations were made through acquisitions of less than 20 percent of the host firm's equity. This is a second factor which may be responsible for lowering the stock market valuation of these FDIs.

For new FDIs, Table 3 shows abnormal returns observed for greenfield investments, acquisitions, FDIs implying full ownership, FDIs implying partial ownership, as well as the five entry modes which arise when taking into account the greenfield/acquisition as well as ownership structure choices: greenfield wholly-owned subsidiaries, greenfield joint ventures, total acquisitions, pure partial acquisitions and shared partial acquisitions. These results show that the stock market does not value all entry modes equally. First of all, it can be seen that abnormal returns of greenfield investments are higher than those of acquisitions. Along the same lines, FDIs implying full ownership by the investing firm obtain a higher valuation from the stock market than those which imply sharing the equity of the host firm.

When analyzing the five different entry modes, it must be noted that all entry modes are valued by the stock market, on average, in a positive and statistically

Table 3. Stock Market Reaction to New FDIs: Different Entry Modes

	Abnormal Return %	**Z statistic**	**Positive Cases %**
Greenfield FDIs (N = 59)	$AR_0 = 0.46$ (0.95, 0.04)	2.03***	54.2
Acquisitions (N = 132)	$AR_0 = 0.23$ (0.56, 0.10)	1.81**	47.1
Full ownership (N = 43)	$AR_0 = 0.79$ (1.39, 0.19)	2.98***	67.4
Partial ownership (N = 148)	$AR_0 = 0.16$ (0.48, -0.13)	1.38*	49.3
GWOSs (N = 15)	$AR_0 = 0.51$ (1.58, -0.57)	1.45*	53.3
GJVs (N = 44)	$AR_0 = 0.43$ (0.99, -0.13)	1.50*	54.6
TAs (N = 28)	$AR_0 = 0.93$ (1.66, 0.20)	2.64***	75.0
PAs (N = 73)	$AR_0 = 0.04$ (0.47, -0.39)	0.83	45.2
SPA (N = 31)	$AR_0 = 0.05$ (0.73, -0.63)	-0.04	51.61
* p<0.1 ** p<0.05 *** p<0.01			

95% confidence intervals are given in parentheses.

significant way, except for partial acquisitions – both pure and shared. Notwithstanding, in spite of their statistical significance, results relative to GWOSs must be analyzed with care owing to the small size of the sample.

The positive stock market reaction to greenfield joint ventures confirms that this is an entry mode which allows the investing firm to benefit from the combination of firm-specific assets from at least two different companies, most usually the one investing and a local partner.

Results relative to total acquisitions are particularly relevant. Previous empirical research on the stock market reaction to mergers and acquisitions has shown contradictory results as far as average abnormal returns gained by bidding firms are concerned – see Sudarsanam (2003) or Campa and Hernando (2004) for a review. One of the reasons which could explain a non-positive stock market reaction to acquisitions on the side of the bidder would be the premium paid for the target. When investing through an acquisition, the premium paid for the local resources can be so high that it may partially (or even totally) compensate the potential rents stemming from the use of this entry mode. It seems, however, that the Spanish stock market has positively valued the internationalization of Spanish firms through a particular kind of acquisitions, those which imply acquiring 100 percent of the equity of the target company. Acquisitions allow the investing firm to accelerate its internationalization process (Barkema/Vermeulen 1998). This fact is particularly relevant for Spanish firms due to the important delay which these firms have traditionally suffered in their internationalization process, as mentioned earlier in the introductory section of this paper, in which the stock of outgoing FDI accounted for just 3 percent of the Spanish GDP at the beginning of the 90s.

As has already been pointed out here, within the group of acquisitions, only total acquisitions obtained positive and statistically significant average abnormal returns, which reached 0.93 percent. What is more, 75 percent of the FDIs made by means of a TA are positively valued by the stock market. No significant results have been obtained for any of the other type of acquisitions analyzed. These results may be explained by following different paths. When comparing results relative to total and pure partial acquisitions, we find that the latter are not as positively valued by the stock market as the former. This might be a consequence of investors having positively valued acquisitions as a means of accelerating the firm's internationalization process. As a result, it seems that they have penalized FDIs which involve sharing the control and management of the acquired firm, as well as profits derived from the international use of the investing firm's intangible assets. As López-Duarte and García-Canal (2002) point out, a partial acquisition is a hybrid option between a greenfield joint venture and a total acquisition which may combine the disadvantages and costs of both entry modes, depending upon the context of the internationalization process. On the other hand, results in relation to SPAs fulfill our expectations. Accordingly, SPAs are usually related to privatization processes of state-owned firms. Very frequently, these are competitive processes in which dif-

ferent firms compete for the acquisition of the privatized company. Such rivalry among potential bidders may lead to an increase in the acquisition price,[6] which in turn penalizes the stock market reaction.

Who: The Investing Firm

As we have already pointed out in this paper, firms expand their boundaries in order to exploit certain firm-specific assets abroad (most usually, intangible assets developed in their home market). According to the Internalization Theory (Buckley/ Casson 1976, Teece 1977, Hennart 1982), such assets enable foreign direct investments, since they allow the foreign investor to compensate the liability of foreignness. In most cases, they are also responsible for the positive stock market reaction to FDIs.

In order to measure the value of the intangible assets owned by investing firms, Tobin's q ratio has been used. This is the ratio between the market value of the firm and the replacement cost of its tangible assets. This means that, as Morck and Yeung (1992) have pointed out, the higher the ratio, the higher the value of the firm's intangible assets. In our study, we have used Tobin's q ratio for each Spanish investing company calculated on the 31st of December of the year immediately before the FDI was made – the ratio was calculated following Chung and Pruitt's (1994) procedure. Available data in DataStream has allowed us to calculate this ratio only for 144 FDIs included in the database. Once Tobin's q is calculated, the sample is divided into two groups. On the one hand, there are investments made by firms whose q value proves to be higher than the median of the q for the whole sample. On the other hand, there are investments made by firms whose q value is lower than the median. Our results (Table 4) show that the stock market reacts more positively to FDIs made by firms with a higher Tobin's q ratio, thus with a greater accumulation of intangible assets. Accordingly, FDIs collected in the high Tobin's q sub-sample obtained, on average, a positive and statistically significant abnormal return of 0.41 percent, while there is no significant stock market reaction to FDIs made by firms in the low Tobin's q ratio sub-sample.

Upon analyzing the interaction between the FDI's ownership structure and the foreign investor's accumulation degree of intangible assets, we found that when investments are made by firms with a higher Tobin q, entry modes involving full ownership generated higher abnormal returns than those involving partial ownership, as stated in Hypothesis 1. Although such a positive valuation is observed for both GWOSs and TAs, only results relative to total acquisitions are statistically significant, because the small size of the GWOSs sample makes it impossible to test the statistical significance of results relative to this sample. Thus, it seems that investors prefer firms with a high Tobin's q value to invest in by means of total acquisitions. The reason may lie in the fact that, as firms accrue international

Table 4. Stock Market Reaction to FDIs: How?, Who?, Where?, and When?

AR₀ % / N	Whole sample of new FDIs	Greenfield FDIs (GWOSs + GJVs)	Acquisitions (TAs + PAs)	Full ownership (GWOSs + TAs)	Partial ownership (GJVs + PAs + SPAs)	GWOSs	GJVs	TAs	PAs	SPAs
Low Tobin q	0.22 / 64	0.55* / 20	0.07 / 44	0.22 / 16	0.23 / 48	-0.21 / 5	0.8** / 15	0.42 / 11	0.11 / 22	-0.38 / 11
High Tobin q	0.41** / 80	0.36 / 18	0.42** / 62	0.98*** / 19	0.24 / 61	1.07 / 4	0.15 / 14	0.96** / 15	0.08 / 30	0.72** / 17
Manufactur.	0.55** / 48	0.9** / 19	0.33* / 29	1.05*** / 15	0.33** / 33	1.0 / 8	0.82* / 11	1.1 / 7	0.22 / 19	-0.83 / 3
Service	0.89** / 25	0.83 / 3	0.89** / 22	2.06 / 6	0.51 / 19	0.51 / 1	0.98 / 2	2.37 / 5	-0.14 / 14	3.28 / 3
Regulated industries	0.19* / 82	0.51 / 31	0.16 / 51	0.55 / 13	1.24 / 69	0.67 / 4	0.28 / 27	0.77 / 9	0.23* / 22	-0.19 / 20
Finance	-0.19 / 36	-0.07 / 6	-0.21 / 30	-0.17 / 9	-0.2 / 27	-0.55 / 2	0.17 / 4	-0.06 / 7	-0.23 / 18	-0.38 / 5
Low K&SI	0.4*** / 89	0.7 / 21	0.30 / 68	0.62 / 18	0.34*** / 71	1.16 / 7	0.46 / 14	0.27 / 11	0.55 / 38	-0.15 / 19
High K&SI	0.22 / 102	0.32 / 38	0.16 / 64	0.91*** / 25	0.00 / 77	-0.06 / 8	0.42 / 30	1.36*** / 17	-0.05* / 35	0.38 / 12
Low POLCONV	-0.18 / 75	-0.19 / 24	-0.17 / 51	0.13 / 10	0.22 / 65	-0.43 / 3	-0.15 / 21	0.37 / 7	0.01 / 28	-0.75*** / 16
High POLCONV	0.78*** / 81	1.18*** / 20	0.64*** / 61	0.99** / 20	0.79*** / 61	0.43 / 8	1.69*** / 12	1.33** / 12	0.41*** / 35	0.97** / 14
1990–1995	0.59*** / 36	0.83*** / 23	0.16 / 13	0.31 / 12	0.73*** / 24	0.74 / 7	0.86* / 16	-0.34 / 5	0.34 / 1	0.04 / 7
1996–1999	0.18 / 102	-0.23 / 22	0.29 / 80	1.08*** / 16	0.04 / 86	-0.44 / 5	-0.17 / 17	1.76*** / 11	0.02 / 49	0.27 / 20
2000–2003	0.35*** / 53	0.92** / 14	0.14** / 39	0.86** / 15	0.15 / 38	1.53 / 3	0.75 / 11	0.7* / 12	0.05 / 23	-0.99 / 4
1st FDI in the host country	0.39*** / 123	0.80*** / 42	0.18 / 81	0.84*** / 28	0.26 / 95	0.79* / 11	0.80*** / 31	0.87** / 17	-0.16 / 44	0.38 / 20
Following FDI in the host country	0.14* / 68	-0.41 / 17	0.32*** / 51	0.68* / 15	-0.01 / 53	-0.27 / 4	0.45 / 13	1.02** / 11	0.38** / 29	-0.54* / 11

* p<0.1   ** p<0.05   *** p<0.01

experience, integration problems related to acquisitions decrease (Caves/Mehra 1986).

This finding is coherent with the results from previous research. As Morck and Yeung (1992) have pointed out, firms with valuable intangible assets can do well by transferring them to acquired firms. FDIs made through partial ownership do not generate positive abnormal returns statistically different from zero in the sub-sample of investments made by firms with a higher q. As was mentioned above, when investing through GJVs and/or partial acquisitions, the investing company has to share the rents stemming from the transfer of its own intangible assets to the host firm with other shareholders. What is more, the investing firm becomes exposed to several types of opportunistic behavior by the other shareholders.

When focusing on the low Tobin's q sub-sample, we found that only FDIs made by means of greenfield joint ventures obtained, on average, positive and statistically significant abnormal returns. Firms with a low Tobin's q ratio may compensate their lack of intangible assets by gaining access to their partners' capabilities through joint ventures.

Our sample has also been divided into four different sub-samples in order to allow for differences in abnormal returns across various industries. In previous research, industry has been a control variable. In fact, there is no clear reason why we could expect different, average abnormal returns across industries. According to received theory it is a firm's characteristics, and not industry characteristics, which explain the stock market reaction to FDIs (Hennart 1982, Morck/Yeung 1992). As can be seen in Table 4, FDIs were grouped into four categories, according to the industry group of the foreign investor: manufacturing, finance, service and regulated industries (oil & gas, energy, telecommunications and construction). As shown in the Table, average abnormal returns are positive and significant – which is what happens for the sample as a whole – for all industries except for banking. One possible explanation underlying this result is that the bulk of FDIs in this industry have been made in Latin America. As we can see in Table 1, while Latin America has received, on average, 50 percent of the Spanish FDI, in the case of the banking industry this percentage rises to 75 percent. Since political and macroeconomic risks are higher in Latin America than in Europe, the stock market could be taking those risks associated with investing in emerging markets into account, especially considering the fact that financial institutions are particularly vulnerable to such risks.

Where: The Host Country of the FDI, Cultural Distance and Policy Instability

The aim of this section is to analyze the two factors related to the FDI location which have already been highlighted in the theoretical section of our paper: the cultural distance between the home and host countries of the FDI, and the latter's policy instability.

The cultural distance between Spain and each of the various host countries was measured through an index similar to the one used by Kogut and Singh (1988). This index (henceforth Kogut and Singh Index or K&SI) is, in turn, based on Hofstede's (1980, 2001) four dimensions of cultural distance: individualism, power distance, uncertainty avoidance and masculinity. This composite index is represented algebraically as:

$$[2] \quad K\&SI_j = \sum_{i=1}^{4} \left\{ (I_{ij}-I_{is})^2 / V_i \right\} /4$$

Here $K\&SI_j$ is the cultural distance of the jth country from Spain; I_{ij} is the index of the ith cultural dimension and the jth country, while I_{is} represents the index of the ith cultural dimension and Spain. Finally, V_i is the variance of the index of the ith dimension.

The higher the index value, the larger the cultural distance between Spain and the FDI host country. Among the literature on International Management, cultural distance has traditionally been used to proxy for two related factors (Kogut/Singh 1988, Hennart/Reddy 1997). On the one hand, the liability of foreignness which investing firms have to face when investing abroad, and, on the other hand, the difficulties foreign investors have to face while managing a foreign unit. The greater the cultural distance between two countries, the greater the difference between their respective clients, workers and institutional behavior.

Once again, we divided our original sample into two sub-samples using the median of the calculated K&SI. Results relative to both the whole sample and to sub-samples related to different entry modes are shown in Table 4. As can be observed in the Table, the stock market values those FDIs located in countries showing a less important cultural distance from Spain positively and in a statistically significant way. So it is that an abnormal return of 0.4 percent on the same day of the FDI's announcement (99 percent statistical significance) can be observed. Such a positive reaction is not seen when FDIs are located in host countries that prove to have a greater cultural distance from Spain. The smaller the cultural distance between the home and host countries involved in the FDI, the smaller the liability of foreignness the investing firm must face.

Results in Table 4 show, however, that the influence of cultural distance on stock market reaction to an FDI strongly depends on its interaction with the entry mode chosen. More precisely, it can be observed that, in the high cultural-distance subsample, FDIs made by means of GJVs and TAs generate higher abnormal returns than those made using alternative entry modes, as previously stated in Hypothesis 2. Although the results relative to GJVs do not comprise any statistical significance whatsoever, those relative to TAs prove to be statistically significant at the

99 percent level. In addition, PPAs are negatively valued by the stock market in a statistically significant way, although at the 90 percent level. It has to be noted that so different a valuation regarding both kinds of acquisitions is not to be found when FDIs are located in countries not significantly distant from a cultural point of view.

These results may reflect the difficulties arising from investments through partial acquisitions in culturally distant countries. As has already been pointed out here, partial acquisitions in culturally distant countries are the least advisable entry mode, for the equity position of a local shareholder in the target firm may be an obstacle when handling the acquisition process. While a total acquisition allows the investing firm to protect itself from value destruction derived from the clash between two different corporate cultures (Madhok 1997) – the acquiring firm is free to develop its own organizational routines and corporate culture in the host country, without having to negotiate with any local partner – a partial acquisition does not.

Even though results are not conclusive due to the small size of both sub-samples, it can clearly be observed that investments by means of GWOSs are also valued differently by the stock market, depending upon the cultural distance between Spain and the host market. While GWOSs located in countries showing a smaller cultural distance from Spain are positively valued by the stock market, those located in the most culturally distant countries obtain negative abnormal returns.

Policy instability is a second factor related to the host country which may be able to influence the stock market reaction to a FDI. In order to measure such instability, the POLCON V Index has been used (see Henisz 2000). This index, ranging between 0 and 1, identifies the number of independent governmental branches with veto power over policy change in each country, thus considering the alignment across these branches. The higher the number of branches with veto power and the higher the alignment among them (that is, the higher the POLCON V Index), the higher the constraints local governments need to overcome in order to change the rules of the game arbitrarily. In other words, the higher the POLCON V Index, the greater the policy stability of the country. Due to methodological constraints, the index value is only available for 156 new FDIs collected in the database. Once again, the median value was used in order to split the sample into two groups.

Results in Table 4 show that the stock market reacts positively to those FDIs located in host countries with greater policy stability – FDIs involving a lower exposure to policy risk. The average abnormal return obtained by new FDIs located in these policy-stable countries is one of 0.78 percent, which is also statistically significant. Such a positive reaction takes place regardless of the entry mode that the firm may have chosen. However, some sub-samples are so small that it is practically impossible to test the statistical significance of their results.

On the contrary, it seems that the stock market does not value FDIs located in countries with low policy stability positively. However, results are not statistically significant in the low-stability sub-sample, which makes it impossible for us to

obtain support for Hypothesis 3. The results for partial acquisitions in this sub-sample are particularly interesting. While pure partial acquisitions are positively valued in countries with low policy stability, – although not to a statistically significant extent – shared acquisitions are negatively (99 percent statistical significance) valued. As mentioned previously, SPAs usually comprise the acquisition of firms operating in regulated industries – as Doh (2000) points out. Most of the times, this kind of acquisition is the only available entry mode firms can use for these industries. Although it should be expected that partial ownership reduces the exposure to policy risk, the negative stock market reaction to SPAs reflects the fact that firms operating in regulated industries can be more affected by policy risk (Henisz/Zelner 2001). This result could show us that the impact of policy risk on the stock market reaction to a FDI could vary across industries. At any rate, this is an issue which deserves more attention.

When: The Experience Accrued by the Foreign Investor

A final factor to be taken into account is the experience accrued by the foreign investor relative to both the internationalization process and the host country. We have used two variables in order to measure such international experience. On the one hand, the foreign investor's experience concerning the internationalization process has been measured through a proxy, the very moment in which the investment took place. In so doing, the initial sample was divided into three different sub-samples. By replicating the Madrid Stock Market's cycles, three different periods of time have been identified: 1990-1995, 1996-1999 and 2000-2003. On the other hand, the firm's experience regarding the host country has been measured through a dummy variable valued one when the FDI is the first investment made by the firm in the host country, and zero otherwise.

As we can observe in Table 4, generally speaking, the stock market reacted positively (and significantly), to FDIs announced by Spanish firms in the first and last periods analyzed. On the contrary, such a positive reaction cannot be observed in the case of those FDIs announced between 1996 and 1999, which is the period accounting for the highest volume of FDIs and which coincides with a bullish cycle in the Madrid Stock Exchange. To some extent, this result was puzzling as it was somewhat inconsistent with the S-shaped relationship between multinationality and performance found by Contractor et al. (2003) and Lu and Beamish (2004). The high number of FDIs that took place between 1996 and 1999 may explain the lack of statistical significance of the average abnormal returns for FDIs in the 1996-1999 subsample. Such a high concentration of FDIs in such a short period of time may be due to imitative behavior by investing firms. Such behavior may be due, in turn, to oligopolistic movements carried out in order to maintain the *status quo* (Knickerbocker 1973), or to legitimacy reasons (DiMaggio/Powell 1983). Therefore, the

main reason underlying some of these investments may be the fact that other Spanish firms may be investing abroad, rather than internal factors. In fact, the 1996-1999 period turns out to be outstanding not only due to the high overall amount of FDIs, but also due to the important number of FDIs made by a particularly small group of firms (those in regulated industries), directed at a particular host region (Latin America) and made through a particular entry mode (acquisitions). In any case, the internationalization process by means of an FDI of firms from regulated industries has been compressed in the 1996-1999 period. Such compression, indeed, may have negatively affected these companies. As Vermeulen and Barkema (2002) have pointed out, there are limits for the growth a firm can "digest" in a given period of time, so that a regular expansion pattern leads, in the long run, to higher profits for the investing firm. FDIs made by the investing firm in the first and last periods analyzed are probably better valued by the stock market because they can be more easily digested by the investing firm and also because there are less imitative investments in these periods than in the 1996-1999 period.

Results in Table 4 also show that different entry modes are differently valued by the stock market depending on the moment at which the FDI has been made. During the first years of the period analyzed, the greenfield joint venture is the entry mode best valued by the stock market. FDIs made by means of GJVs obtained a positive and statistically significant abnormal return in the 1990-1995 period, a positive reaction which may not be observed for GWOSs and acquisitions. Nevertheless, such a positive and statistically significant reaction of the stock market to GJVs only takes place in this period of time (1990-1995), but not later. This evidence confirms Hypothesis 4 of this paper. Exactly the opposite is observed for FDIs made through acquisitions and, most particularly, for total acquisitions. These have been valued positively and in a statistically significant way by the stock market in the later years of the analyzed period, although not in the former years.[7]

Results relative to accrued experience in the host country also confirm Hypothesis 4: GJVs generate positive (0.80 percent) and statistically significant (at the 99 percent level) abnormal returns when the FDI is the first one made by the foreign investor in a particular host country. On the contrary, once the foreign investor has accrued knowledge and experience concerning the country – derived from previous investments –, this entry mode is not positively valued by the stock market, at least in a statistically significant way. On the other hand, results in Table 4 bring to the surface the fact that acquisitions – both total and pure partial – are better valued once the investor has experience in the host country. A particularly interesting result is that SPAs generate negative and statistically significant abnormal returns when made by firms which have previously invested in the host country, which is exactly the opposite to what happens with TAs and PPAs. As mentioned earlier, this entry mode is used particularly often in regulated sectors and privatization processes. It seems that in such cases, the sooner the investment is made, the better. In fact, the literature about the international expansion of firms operating in regulated indus-

tries shows the existence of first-mover advantages when entering a new country (Sarkar et al. 1999, Bonardi 2004). It is for this reason that it is coherent for the stock market to value earlier entries more positively than later ones.

Taking into account the distinctive features of acquisitions and GJVs, these results turn out to be rather logical: GJVs are more flexible than acquisitions as entry modes. When investing by means of a GJV, the investing firm does not need to pay for the partner's resources (which is what happens when investing by means of total acquisitions), nor take an equity position over them (which is what happens in partial acquisitions). Furthermore, a GJV can be more easily dissolved. It seems that the stock market has positively valued the greenfield joint ventures' flexibility during the early stages of the firm's internationalization process. In this respect, the uncertainty related to the international success of Spanish firms was greater in these early stages. On the contrary, in the later stages of the process, once Spanish multi-nationals were a reality, investors value those investments involving greater com-mitments in foreign countries more positively. Such a divergent valuation for each entry mode across time, even along the different stages of the internationalization process, fits with Kogut's (1991) and Kogut and Kulatilaka's (1994) view of joint ventures as options or platforms for future investments. Accordingly, in contexts displaying a considerable uncertainty, a GJV is an entry mode which allows the investing firm to gain access to local experience and local knowledge while at the same time controlling the exposure to various risks. A GJV is thus a platform to invest in the future, once the uncertainty has disappeared.

Conclusions

The contribution of our paper to the literature dealing with the stock market reaction to FDI rests on a systematic analysis of the interaction between the entry mode chosen and the FDI's main attributes: the firm's characteristics and international experience, on the one hand, and the location of the investment, on the other. Building on the insights of received theory, we have predicted a different reaction depending on the influence that each one of the FDI's attributes may have upon the liability of foreignness the investing firm must face. As empirical evidence, we have used the FDIs carried out by listed Spanish firms between 1990 and 2003, a period comprising the bulk of FDIs made by these firms. In fact, the main advantage of our sample is that it includes the whole internationalization process by means of FDIs by Spanish firms since 1990 (just after the FDI liberalization process). This, in turn, offers us the unique opportunity to analyze the existing interaction between entry modes, on the one hand, and the experience accrued by the foreign investor, on the other. Our main results have been the following:

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- Greenfield wholly-owned subsidiaries, total acquisitions and greenfield joint ventures have been positively valued by the stock market. Results regarding total acquisitions are noteworthy as, due to the premium that is usually paid for the target, the stock market sometimes penalizes bidding firms in these operations.
- None of the types of partial acquisitions having been analyzed (pure partial acquisitions and shared partial acquisitions) has obtained, on average, significant abnormal returns.
- Not all firms are equally prepared to obtain rents from their international expansion. Firms with valuable intangible assets obtain abnormal returns higher than those of the remaining companies. In fact, the stock market values FDIs made by these firms more positively when they go abroad alone rather than when they have to share the rents stemming from the international exploitation of their intangible assets with other firms. On the other hand, firms lacking such valuable intangible assets generate higher abnormal returns when they invest abroad by means of GJVs, for by doing so they can gain access to valuable external resources.
- Both the cultural distance between the home and the host country of the FDI as well as the host country's policy instability affect the stock market valuation of FDIs negatively. The reason is that they are both factors which enhance the liability of foreignness with which the investing firm must deal.
- Stock market reaction to each entry mode changes as firms gain more and more experience within the international market. Greenfield joint ventures have generated positive and significant abnormal returns in the early stages of the period analyzed. The same has happened for first investments in a foreign country. Acquisitions, on the other hand, generated positive and significant abnormal returns in the later stages of the period.

These results prove to be coherent with the insights of the Eclectic Theory on multinational firms. However, some new empirical tests have been presented in this paper, given that previous research has not considered a typology of entry modes as thoroughly detailed as the one used here. The newest result of all is the interaction between the international experience of the foreign investor and the entry mode. Our results have shown that GJVs only generate positive and significant abnormal returns upon the first entry in a foreign country, and in the early stages of the period analyzed. This evidence suggests that the distinctive features of GJVs are especially suitable for this context.

We believe our study to provide useful insights into the effects that interaction between the entry mode and firm's characteristics has on stock market reaction to foreign direct investment. However, some of the characteristics of our study could limit the indiscriminate widespread extrapolation of our conclusions. First of all, the results may be influenced by the particular characteristics of our sample. Accordingly, all of the investments collected in the database were made by listed Spanish firms, a database in which firms operating in regulated industries are over-

represented. In these industries, FDIs are usually associated with privatization and liberalization processes in the host country. Secondly, our sample is not very large and we do not have complete information for all of the independent variables, nor for all cases. As a consequence, it has not been possible for us to conduct a more complete multivariate analysis, which would have allowed us to account for several factors that might have biased our results, such as the cycle of the stock market – the latter stages of the period being analyzed coincided with the high-tech bubble. Finally, some information regarding several variables was not available. For instance, although we were able to measure the global value of firm intangibles using the q ratio, we were unable to obtain more detailed information regarding the value of specific intangible assets.

Therefore, it appears that further research based on large samples including data from other countries is needed in order to reach conclusions which may be generalized for all types of foreign direct investments, regardless of the home country or industry of the investing firm. Similarly, another interesting research line could be the study of the relationship between the value of the specific types of intangible assets, the entry mode and the stock market reaction to foreign direct investment. The effect of agency problems on the stock market valuation of FDI is another promising research issue. To conclude, the study of the effects of policy risk on the effectiveness of FDI across various industries could clarify the interaction between policy risk and entry mode when attempting to explain stock market reaction to FDI. Are firms' international projects operating in regulated industries valued differently by the stock market to those of other companies? Without a shadow of a doubt, it is essential that researchers within the field of international business pay more attention to this issue.

Acknowledgements

Endnotes

1 Abnormal returns are the returns on a share directly attributable to a specific event, in this case a foreign direct investment.
2 Eclectic Theory and also the Knowledge-Based View of multinational firms suggest that MNCs also have an advantage just for having a network of subsidiaries. See Dunning (1988) and Kogut and Zander (1993).

3 Following the Spanish regulations relative to FDI, we included in our database only those investments that give the Spanish investing firm the authority to influence the control and management of the host country firm in an effective way. FDIs directed to tax havens were not included in the database.

4 We have to take into account the fact that during the second half of the 1990s there was an important merger and acquisitions wave worldwide (OECD 2001). In addition, as Treviño and Mixon (2004) point out, during the 1990s, institutional reform was initiated in many Latin American countries in order to attract foreign FDI. Although different types of reforms were developed, the privatization of stated-owned companies was a particularly important one. Such privatizations gave rise, in turn, to an important wave of acquisitions in this region.

5 To calculate these returns, we used the Total Return Index included in DataStream for each stock. This index reflects the variation in the stock price of a specific company in relation to a specific date. This index is already prepared to conduct event studies and is corrected for dividend payments and equity operations. Seventeen announcements were eliminated because the β_k coefficient in the estimated market model for the event was not statistically significant.

6 In the Mergers and Acquisitions literature it is said that the winning firm in competitive bids receives the so-called 'winner's course' (Hitt et al. 2001).

7 Eight of the eleven total acquisitions included in the 1996-1999 period were made in 1999.

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