Chapter 1

Introduction

Background and Significance of Research Problem

Since the 21st century, there has been an increased integration and development in the world economy, resulting in closer economic exchanges globally. Foreign direct investment (FDI) became a significant means of economic and trade communication between countries, leading to the emergence of numerous multinational corporations. China, too, actively embraced global economic globalization, implementing robust reform and opening-up policies. Particularly noteworthy are China's "Going Out" strategy and the "Belt and Road" Initiative.

In recent years, China's FDI has experienced remarkable advancements in both quantity and quality. Regarding quantity, the scale of investment has expanded, resulting in higher flows and stocks of FDI. Consequently, an increasing number of enterprises have been drawn to engage in overseas direct investment. In terms of quality, China's FDI structure has gradually improved. Previously, the focus was on attracting foreign investors to establish factories within China. However, now, Chinese enterprises are actively participating in outbound investment, establishing new factories or acquiring local enterprises abroad. As a result, the profitability of foreign investment for enterprises continues to increase.

Based on the Statistical Bulletin of China's Outward Direct Investment 2020, China's outward direct investment flow had reached US $153.71 billion in 2020, securing the top rank globally. Additionally, China's outward direct investment stock amounted to US $2,580.66 billion, maintaining the third position worldwide. By the end of 2020, China's 28,000 domestic investment companies had established 45,000 overseas companies in 189 countries and regions. China's foreign investment not only drove its own economic growth but also contributed to the economic development of recipient countries. As a result, its contribution to the global economy had been steadily increasing. China's investment cooperation with other countries was expanding and yielding win-win results, further promoting the establishment of an open world economy.

In spite of China's FDI flow and stock experiencing rapid development in the past, enterprises encountered challenges while engaging in FDI activities due to the complexities of the international investment landscape. Surprisingly, there has been limited research on the impact of FDI on entrepreneurship in the home country (Shen et al., 2020). Foreign direct investment represents a portion of enterprise investment, where companies undergo the process of making investment decisions and acquiring funds to convert them into capital across borders. However, not all enterprises were able to conduct FDI, as outbound investment activities required meeting specific thresholds. Additionally, overseas investment incurred corresponding investment costs. Given that overseas investment is a long-term endeavor, it involved risks and uncertainties in terms of returns (Agosin & Machado, 2005, pp.149-162; Al-Thaqeb, Algharabali, & Alabdulghafour, 2022, pp.2784-2794).

Therefore, enterprises take various factors into account, including their operational level and future development plans, when they decided whether to engage in overseas direct investment. One crucial factor that influenced FDI decisions was the availability of sufficient financial support. To obtain the necessary funds, enterprises had to overcome financing difficulties. However, not all enterprises could access ideal funding or find reasonable and legal financing channels, which led to challenges of "difficult financing" and "expensive financing." The financing difficulties of enterprises were inherently linked to their financing structure, which encompassed internal financing and external financing. External financing was further divided into debt financing and equity financing (Xiang, Liu, & Yang, 2022, pp.321-337; Feng, Yao & Yang, 2022, pp.1-22).

In developed Western markets, companies primarily raise funds through internal means, followed by debt financing, and finally, equity financing (Chittenden, Hall, & Hutchinson, 1996, pp.59-67). However, the financing order in China currently contrasts with this approach, as some enterprises prefer equity financing over debt financing, leading to higher levels of external capital. At present, the state's objective is to "increase the proportion of direct financing." Direct financing currently represents a small portion of the overall social financing scale, so enhancing direct financing and fostering its healthy development will play a crucial role in promoting the high-quality growth of enterprises and the broader social economy (Godke & McCahery, 2019, pp.663-664; Wang, Lu, & Yin, 2021).

In the forthcoming decade, financing systems are expected to undergo modifications aimed at improving the efficiency of fund utilization, better allocating capital to enterprise production and operations, strengthening investment capacity, and advancing the development of capital markets. Despite these adjustments, direct financing is still constrained, as indirect financing continues to hold a substantial share. Enterprises heavily rely on bank loans or have insufficient internal funds, impeding their ability to engage in large-scale overseas investment endeavors. Consequently, it becomes imperative for enterprises to readjust their financing structures to secure adequate funds and ensure the successful execution of various overseas investment activities. How does the financing structure influence enterprises' direct investment overseas, and what are the underlying mechanisms driving this impact?

In light of this context, the study utilizes detailed data from Chinese companies to investigate how the financing structure influences these enterprises' overseas direct investment.

Research Objectives

1. To analyze the financing structure of Chinese enterprises and identify any existing issues from a micro perspective.
2. To identify financing structure challenges encountered by enterprises during foreign direct investment activities and provide guidance for addressing them.
3. To examine the relationship between foreign direct investment behavior and financing structure, with a specific emphasis on identifying factors that influence equity financing.

Research Hypothesis

1. The financing structure significantly impacts enterprises' overseas direct investment, with a higher proportion of equity financing in the financing structure leading to more favorable outcomes for enterprises' overseas direct investment.
2. Innovation research and development serve as a mechanism through which the financing structure influences enterprises' overseas direct investment. Specifically, a higher proportion of equity financing in the external financing structure increases enterprises' investment in innovation, thereby promoting their engagement in overseas direct investment activities.
3. Productivity acts as a transmission mechanism for the impact of financing structure on enterprises' overseas direct investment. Holding other factors constant, equity financing has a stronger positive effect on enterprise productivity. In other

words, a higher proportion of equity financing in the external financing structure enhances enterprise productivity, which, in turn, facilitates enterprises' overseas direct investment.

Scope of the Study

This research examines how enterprises' financing structure is evaluated, specifically by assessing the proportion of debt financing compared to equity financing. The study primarily investigates whether these enterprises participate in overseas direct investment and the quantity of such investments they undertake.

The research commences with an examination of China's present foreign direct investment and foreign direct investment by enterprises, offering a statistical summary of their size, features, and growth patterns. Moreover, it delves into the financing framework of Chinese companies, supported by concrete data. Through an investigation of pertinent theories and literature on foreign direct investment and corporate financing structure, the study identifies gaps and deficiencies in existing research and introduces novel perspectives.

The main focus of this study lies in the corporate financing structure, which serves as the central explanatory factor. By reviewing pertinent literature and thoroughly assessing the merits and drawbacks of debt financing and equity financing, the research puts forward a fundamental theoretical hypothesis: the way corporations are financed has an impact on their foreign direct investment endeavors.

Moreover, the study examines how the financing structure impacts corporate foreign direct investment by exploring two transmission pathways:

(1) investigating how changes in the financing structure affect innovation and research and development, which in turn influence overseas investment, and

(2) exploring how changes in the financing structure impact productivity, subsequently affecting overseas investment. The research utilizes panel data and combines the primary independent variable, corporate financing structure, measured by the ratio of debt financing to equity financing, with other control variables.

The study utilizes benchmark regression with a mixed Probity model to achieve the relevant outcomes. To ensure the reliability of the findings, robustness analysis is carried out by substituting models and variables. Furthermore, heterogeneity tests are conducted, taking into account regional, industry, and financing constraint factors. Additionally, the research investigates the mediation effect, using innovation, research and development input, and productivity as intermediary variables to explore the proposed transmission mechanisms. The ultimate goal is to enhance the empirical analysis mentioned earlier by providing a more systematic and comprehensive foundation.

This study consolidates the outcomes of the empirical regression and puts forward precise policy advice derived from the research conclusions. These proposals aim to enhance the financial structure of businesses and encourage equity financing, with the ultimate objective of easing the capital constraints that companies encounter during their overseas direct investment ventures. Additionally, they seek to facilitate Chinese enterprises' foreign direct investment, stimulate the growth of the capital market, and accelerate economic development. These policy recommendations are intended for adoption by both enterprises and the government, targeting the identified areas for enhancing the financing structure and fostering a favorable atmosphere for foreign direct investment.

Conceptual Framework

The conceptual framework as shown in Figure 1.1

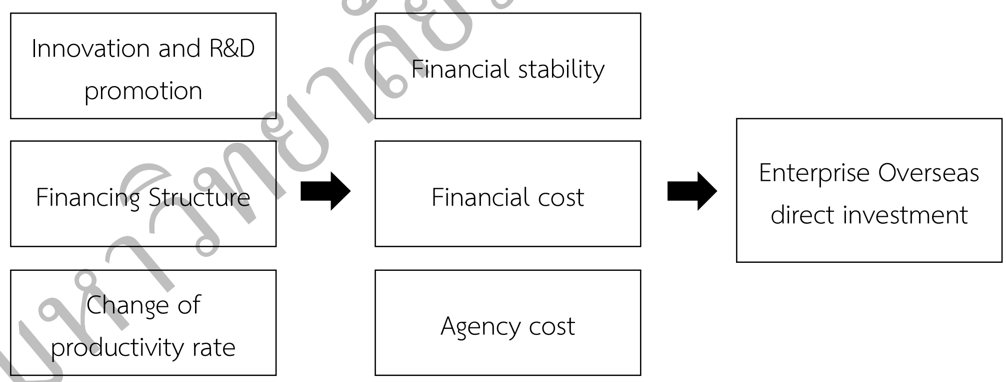

Figure 1.1 Conceptual framework

The main goal of this research is to accomplish several objectives. Firstly, it aims to examine the financial setup of Chinese companies from a detailed viewpoint and detect any prevailing issues or difficulties. The primary focus lies in comprehending the blend of debt financing and equity financing that constitutes the overall financing structure.

Secondly, the primary objective of the study is to pinpoint distinct financial challenges faced by enterprises when engaging in foreign direct investment endeavors.

The aim is to offer valuable advice and suggestions to assist enterprises in effectively overcoming these obstacles. Moreover, the research endeavors to explore the connection between foreign direct investment behavior and financing structure, focusing particularly on comprehending the factors that affect equity financing. The underlying hypothesis is that a higher proportion of equity financing in the overall financing structure will positively influence the outcomes of enterprises' foreign investments.

The research also examines how innovation research and development act as a channel connecting financing structure and enterprises' foreign direct investment. It proposes that a larger share of equity financing in the external funding structure will encourage enterprises to invest more in innovation. This, in turn, will foster overseas direct investment behavior among enterprises.

Furthermore, the study explores the role of productivity as another channel through which financing structure influences enterprises' foreign direct investment. It suggests that, under similar conditions, equity financing will have a more pronounced positive impact on enterprise productivity. A higher proportion of equity financing in the external funding structure is expected to boost enterprise productivity, thus facilitating their overseas direct investment endeavors.

In essence, this study seeks to investigate the financial setup of Chinese companies, assess how it influences foreign direct investment, and gain insights into the mechanisms driving this connection.

Definition of Terms

1. The financing structure of a company involves the multiple elements of how it acquires and applies funds for its day-to-day activities and ventures. This entails examining the origins of funding, the diverse forms of financing employed, and the conditions set forth in financing arrangements.

2. Financial stability refers to a company's ability to maintain its financial position and withstand external shocks or changes in market conditions. It reflects the company's resilience in navigating uncertainties and preserving its financial health.

3. Financing cost denotes the costs a company bears while securing capital, encompassing both expenses related to debt financing, like interest payments on loans, and equity financing costs, such as dividends paid to shareholders.

4. Agency cost pertains to expenses that result from conflicts of interest between a corporation's managers, who represent the company, and its shareholders, who

possess ownership in the company. These costs occur due to the differing interests of these parties and may encompass outlays related to supervision, control mechanisms, and efforts to synchronize the managers' interests with those of the shareholders.

5. The overseas investment behavior of enterprises pertains to the actions and choices made by China A-share listed companies while investing in foreign nations. This includes the strategies, reasons, and results connected to their activities involving foreign investments.

Expected Benefits

1. Analyzing the financing structure of Chinese enterprises and identifying any issues from a micro perspective offers several benefits. Firstly, it enhances our understanding of the financing practices employed by Chinese enterprises, providing valuable insights for policymaking and investment strategies. Secondly, it helps identify potential barriers faced by Chinese enterprises in accessing financing, which can inform efforts to improve access to finance and support the growth of the private sector. Lastly, it highlights areas where Chinese enterprises may have an excessive reliance on certain types of financing, prompting efforts to diversify funding sources and mitigate risks.

2. Identifying challenges in the financing structure during foreign direct investment activities and providing guidance yields multiple advantages. It enhances our understanding of the risks and obstacles associated with financing cross-border investments, informing policymaking and the development of tools to facilitate international investment. Additionally, it identifies areas where collaboration and support between governments, international organizations, and the private sector can enhance access to finance and support for cross-border investments. Moreover, it increases awareness among enterprises of the risks and benefits of different financing structures in foreign direct investment, leading to better investment decisions and improved overall outcomes.

3. Investigating the relationship between financing structure and foreign direct investment behavior offers several advantages. By identifying the factors that influence equity financing, the study enhances our understanding of the financing choices made by enterprises engaged in foreign direct investment. This knowledge can assist policymakers and investors in making informed decisions. Furthermore, it identifies potential barriers to equity financing for such enterprises, paving the way for

improved access to finance and support for cross-border investments. Additionally, it raises awareness among enterprises of the risks and benefits associated with equity financing in foreign direct investment, leading to improved investment decisions and overall outcomes.

4. This study has the potential to contribute to theoretical knowledge in various ways. For instance, it may reveal previously unexplored connections between financing structure, equity financing, and foreign direct investment behavior. These new insights can lead to the development of new theoretical models or advancements in existing ones. Moreover, identifying the factors that influence financing structure and foreign direct investment behavior can contribute to the development of theories related to investment decision-making and financing choices.