A Note on Corporate Overseas Investment Decision Priorities of Taiwanese Direct Real Estate Investors

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***Abstract**. Data generated from a situationally adapted analytical hierarchical process (AHP) questionnaire focusing on two politically confrontational countries (the People's Republic of China and the Republic of China on Taiwan), provides a revealing assessment of the decisionmaking priorities for three types of direct foreign investment, namely wholly foreign-owned subsidiaries (WFSs), equity joint ventures (EJVs) and contractual joint ventures (CJVs). Cross-case comparison shows distinctly different priorities among the three types for the two countries, and that country selection entails more caution than does the subsequent selection of city. Whereas political environment factors are of only marginal importance for domestic decisions, they are of primary consideration in overseas investment decisions.*

Introduction

The economic reform and open door policies enacted in mainland China in 1978 have eased earlier hostilities to foreign investment and trade and have opened China to the world economy, and to Asia in particular (Yeh, 1995). Concurrent with the rapidly growing global trend, Taiwanese overseas direct real estate investment in mainland China has increased remarkably in recent years, despite a variety of political and economic risks. For instance, although there is essentially no securitization of Taiwanese real estate investment in the People's Republic, many investments are undertaken under the name of companies incorporated in Hong Kong or other countries.

According to Sen-Chung Hsieh, president of the Central Bank of the Republic of China, ten billion U.S. dollars have gone from Taiwan to mainland China since Taiwanese investors, escaping a depressed domestic real estate market, began to respond to the real estate incentive policy instituted in the People's Republic of China. Although the Tiananmen Square massacre in 1989 cooled the investment fever considerably, a worsening domestic market, double-digit growth of the mainland economy and Deng Xiao-Ping's announcement of a more liberal economic policy during his South Eastern Provinces tour in 1992 made investors forget the massacre and speed up their investments. In terms of economic and urban development, the Special Economic Zones (SEZs) and open coastal cities have benefited more from the open door policy than inland cities (Yeh, 1995). With respect to real estate investment by Taiwanese investors, similar regional patterns are observed, with investment concentrated in such cities as Shanghai, Beijing, Guangzhou, Shenzhen, and Wuhan (Hsieh, 1995).

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Taiwan (The Republic of China, or ROC) and mainland China (The People's Republic of China, or PRC) are now under the control of two politically confrontational regimes. Since the mainland Chinese government started to release the rights of nationally owned land to the private sector in March 1987, there has been approximately 5.5 billion U.S. dollars worth of real estate investment by the Taiwanese in mainland China (Hsieh, 1994). However, there has not been any analogous reciprocal investment from the mainland to Taiwan. This is due not only to explicit prohibition from both regimes, but also to the significantly less affluent mainland Chinese economy as illustrated in Exhibit 1.

Because of this conspicuous imbalance, and because of the significant amount of real estate investment that has been made despite political adversity, it is important to study the real estate investment decisions between the two sides (a research problem scarcely touched upon in previous literatures). Basically, there are three types of Taiwanese real estate investment in mainland China: wholly foreign-owned subsidiaries (WFSs), equity joint ventures (EJVs) and contractual joint ventures (CJVs).[1] The variety of these forms of investment, combined with the politically confrontational situation mentioned above, leads to the hypothesis of the present study: investors in each of these venture categories have distinctly different priorities tempering their decisionmaking processes.

Theoretical Framework and Hypotheses

According to the International Monetary Fund, foreign direct investment (FDI) refers to investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor, the investor's purpose being to have an effective voice in the management of the enterprise (IMF, 1977). Dunning's (1981) "eclectic theory" is perhaps the most widely accepted theory for explaining FDI, describing the host investor's ownership advantages, internalization of profits across the boundary, and locational advantages. An earlier industrial organization approach developed by Hymer (1972), in contrast, emphasizes the host investor's superiority in some intangible assets such as marketing techniques, managerial skills and innovative ability. This last theory seems most applicable to the present study.[2] The theory put forth by Hymer and his colleagues can be utilized to hypothesize how Taiwanese investors in different types of

Exhibit 1
Per Capital Income and Trade Volume, Taiwan and Mainland China

Statistics	Taiwan (ROC) (1994)	Mainland China (PRC) (1994)
1. Per Capita Income[a] (U.S.$/year)	11,604	606
2. International Trade[b] (U.S.$/year)	178,415,000,000	236,740,000,000

Sources: [a]World Tables 1994, Baltimore and London: Johns Hopkins University Press; [b]Department of Statistics, Ministry of Economic Affairs, 1995, Domestic & Foreign Express Report of Economic Statistics Indicators

ventures would have different decisionmaking priorities. A reasonable theoretical prediction is that the more advantage, superiority or assets Taiwanese investors bring to the venture, the more independent the venture form, i.e., wholly foreign-owned subsidiaries (WFSs), equity joint ventures (EJVs) and contractual joint ventures (CJVs). The real estate investment decision process is quite complex in terms of the various decision factors and the relative priorities it incorporates and the entire hierarchical process it entails. Jaffe and Sirmans (1989) suggest the process includes four phases: investment goals and constraints, investment environment and market situations, financial analysis, and decision criteria. Pyhrr, Cooper, Wofford, Kapplin, and Lapides (1989) divide the process into three parts: strategies, analysis and decisionmaking. Synthesizing these opinions, this study analyzes Taiwanese mainland investment decisions via the following two-stage process: overseas investment environment analysis (choice of different countries in which to invest), and local market situation analysis (choice of different cities in which to invest).
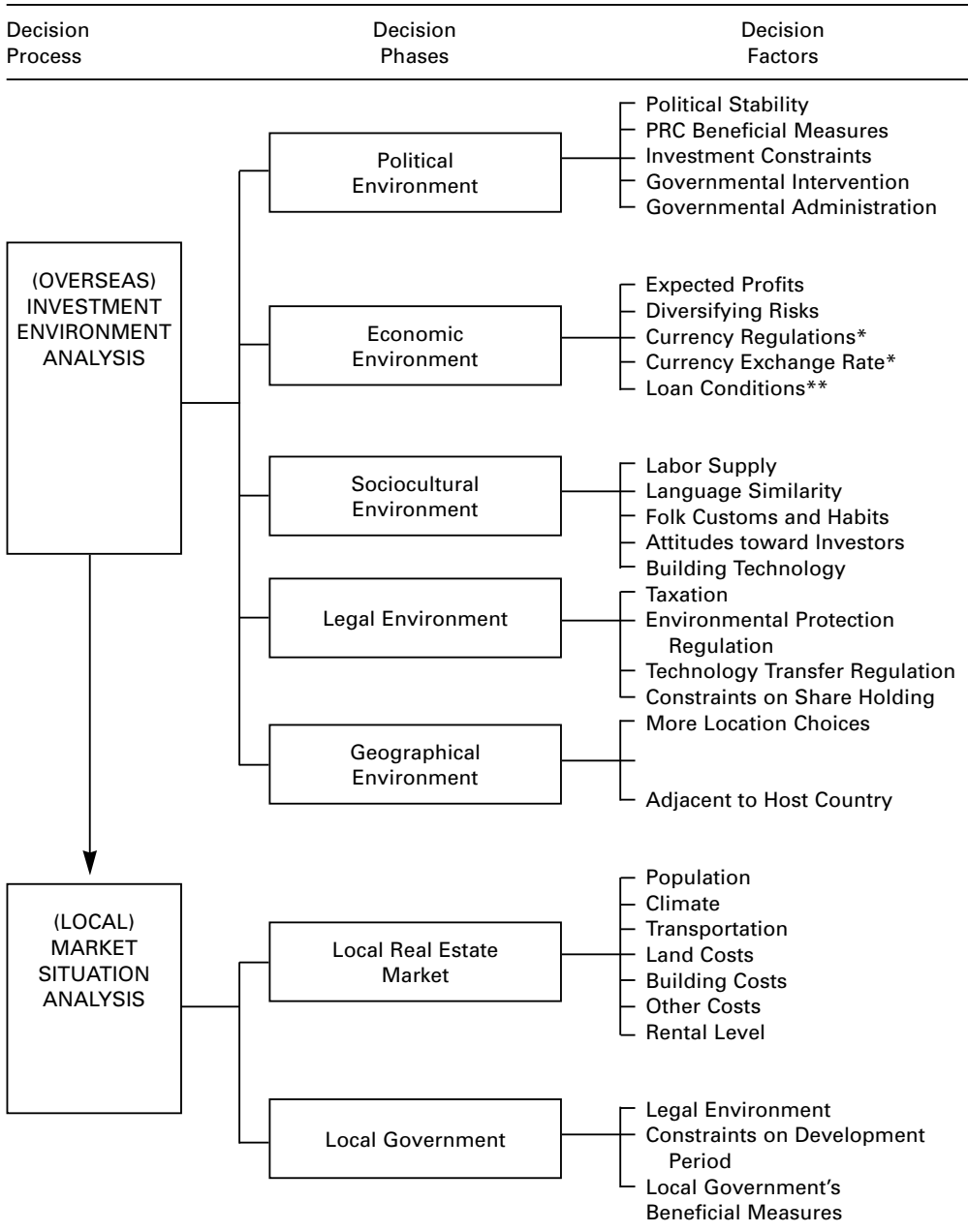
For the purpose of assessing the priorities of different Taiwanese venture investors' decisions, it is necessary first to define those factors involved in the process. Nededog (1990) has a very extensive review of literature relevant to these factors, some of which will be incorporated in the analysis that follows.[3] In analyzing investment decisions, Fama (1972) addresses the importance of environment and personal psychological factors. Lewellan, Lease and Schlarbaum (1977) consider the factors of liquidity, income, capital appreciation, tax environment, marketability, and heterogeneity of products. Greenberg (1982) emphasizes inherently emotional factors. Wofford (1983) stresses expectations, information and financial planning. Nededog (1990) himself suggests type of investment, timing, location, and long-run cycle.

The existing problems encountered by Taiwanese investing in mainland China should also be taken into account by other investors in their future decisions. The factors governing Taiwanese investors' decision processes have been discussed frequently in recent years, and include instability in terms of political leadership, policy, administrative efficiency, as well as infrastructure provisions, continuous depreciation of the mainland Chinese currency, high speculative land prices, constraints on currency flows, management difficulties due to distance, higher input purchasing costs, governmental intervention, the absence of formal negotiation channels for investment disputes because of the political confrontation on both sides, the legal prohibition of investment from the Taiwanese side, and other such factors.

From the above analyses regarding the decision process, decision factors and current Taiwanese investment difficulties, a decision hierarchy process can be developed for Taiwanese investors and is shown in Exhibit 2. By assuming the applicability of this hierarchical decision framework to the analysis of FDI, this study ascertains the priorities of different Taiwanese venture investors' decisions within this framework. Political confrontation between Taiwan and mainland China is also shown to have a particular impact on the decision priorities.

With the above decision framework in mind, a questionnaire based upon the Analytical Hierarchical Process (AHP) model[4] formulated by Saaty (1981) was developed and used to survey 111 Taiwanese real estate firms with investment experience in mainland China. The complete questionnaire is available from the author. The cross-case results of this questionnaire provide valuable information with respect to the various venture forms.

Exhibit 2
Decision Factor Hierarchy for Taiwanese FDI Investors

Decision Process	Decision Phases	Decision Factors

(OVERSEAS) INVESTMENT ENVIRONMENT ANALYSIS

Political Environment
- Political Stability
- PRC Beneficial Measures
- Investment Constraints
- Governmental Intervention
- Governmental Administration

Economic Environment
- Expected Profits
- Diversifying Risks
- Currency Regulations*
- Currency Exchange Rate*
- Loan Conditions**

Sociocultural Environment
- Labor Supply
- Language Similarity
- Folk Customs and Habits
- Attitudes toward Investors
- Building Technology

Legal Environment
- Taxation
- Environmental Protection Regulation
- Technology Transfer Regulation
- Constraints on Share Holding

Geographical Environment
- More Location Choices
- Adjacent to Host Country

(LOCAL) MARKET SITUATION ANALYSIS

Local Real Estate Market
- Population
- Climate
- Transportation
- Land Costs
- Building Costs
- Other Costs
- Rental Level

Local Government
- Legal Environment
- Constraints on Development Period
- Local Government's Beneficial Measures

*These capital restrictions include restriction on profit remittance back to Taiwan, prohibition of the use of new Taiwan dollars (N.T.S.) in mainland China, and other such instances.
**This factor reflects the characteristics of the PRC's financial systems in the minds of Taiwanese investors. Due to the existing politically confrontational situation between the ROC and the PRC, there are no institutional investors operational in both countries.

Exhibit 3
Priorities of Decision Factors in the Analysis of the Overseas Investment
Environment by Venture Forms

Decision Phases	WFSs	EJVs	CTVs	Decision Factors	WFSs	EJVs	CTVs
Political Environment	.26	.23	.26	Political Stability	.08	.15	.17
				Beneficial Measures	.25	.12	.25
				Investment Constraints	.08	.31	.20
				Governmental Intervention	.17	.21	.17
				Governmental Administration	.42	.21	.21
Economic Environment	.19	.25	.19	Expected Profits	.22	.23	.39
				Diversifying Risks	.00	.17	.11
				Currency Regulations	.22	.17	.33
				Currency Exchange Rate	.22	.26	.11
				Loan Conditions	.34	.17	.06
Sociocultural Environment	.26	.27	.24	Labor Supply	.17	.13	.14
				Language Similarity	.14	.40	.44
				Folk Customs and Habits	.17	.21	.14
				Attitudes toward Investors	.17	.13	.14
				Building Technology	.08	.13	.14
Legal Environment	.19	.12	.18	Taxation	.22	.41	.29
				Environmental Protection Regulations	.45	.24	.41
				Technology Transfer Regulations	.11	.06	.18
				Constraints on Share Holding	.22	.29	.12
Geographical Environment	.10	.13	.13	More Location Choices	.60	.44	.33
				Adjacent to Host Country	.40	.56	.67
Totals	1.00	1.00	1.00				

Kang and Stam (1994) describe AHP as one of the most prominent and successful methods of using pairwise comparisons of the alternatives and criteria for solving discrete alternative multicriteria decision problems. Olson, Venkataramanan and Mote (1986) demonstrate that AHP techniques provide a valuable tool in multiple objective analyses. Vargas (1990) asserts that AHP is a theory of measurement for dealing with quantifiable and /or intangible criteria that has found rich applications in decision theory. Shim (1989) categorizes 141 references of methodological and applied papers on AHP and then points out that AHP has became a powerful, and likely the most widely used, tool for analyzing multiple objective decision problems. The potential economic motives for Taiwanese investors to invest in mainland China can be ascertained from the weights of the decision factors, expected profits and diversifying risks in Exhibit 3.

For CTVs, EJVs and WFSs, "expected profits" can be seen to be far more important to investors than "diversifying risks" since the respective weights 0.39, 0.23 and 0.22 are significantly greater than the overall 0.11, 0.17 and 0.00. Two things worth noting are that wholly foreign-owned subsidiaries (WFSs) ignore the importance of "diversifying risks"

with a relative weight of 0.00 and equity joint ventures (EJVs) almost equally emphasize both "expected profits" and "diversifying risks" with relative weights 0.23 and 0.17, respectively. Since the smaller the degree of direct cooperation with local partners of the venture (this degree is smaller in WFSs, relatively larger in EJVs, and even greater in CJVs), the more easily investment can be withdrawn in case of political unrest. The above analyses about economic motives indicates that high-risk investments indeed are accompanied with higher expected returns to compensate investors for this risk.

Cross-Case Comparisons

The AHP results based upon the overseas investment environment analysis are shown in Exhibit 3. In various decisions phases, two of three ventures pay the least attention to geographical environment with relative weights around 0.1–0.13.[5] As for WFSs, the top three priorities are political environment (0.26), sociocultural environment (0.26) and economic environment (0.19); EJVs, sociocultural (0.27), economic (0.25) and political (0.23) environments; and CJVs, political (0.26), sociocultural (0.24) and economic (0.19) environments. It is clear that both WFSs and CJVs place primary importance on political environment. The politically confrontational situation between the two countries leads to this phenomenon. In other words, wholly foreign-owned subsidiaries and contractual joint ventures are more sensitive to political change in this confrontational atmosphere. Sociocultural environment considerations also command the second highest weights for both WFSs and CJVs. Racial, language and custom similarity between the two countries, it is reasonable to assume, form these results.

The AHP results of the (local) investment environment analysis, which refers to subsequent local decisions made after the initial selection of country for investment illustrated in Exhibit 3, are shown in Exhibit 4. The weights of the local real estate market range from 0.67 to 0.75 for the three forms of venture, while those of the local government only from 0.25–0.33. This implies that market considerations are far more important than administrative considerations at the local level.

Concerning the decision factors in Exhibit 4, WFSs, EJVs and CJVs pay no attention to climate (all with weight 0.00) in the local real estate market phase. Conversely, population commands the largest weights (ranging from 0.38–0.52) in the decision. Likewise, transportation and rent level both play important roles in the decision for the three ventures, rent level being relatively more important (with weight 0.33) to WFSs than to EJVs and CJVs.

In the local government phase, legal environment is the single, most dominant consideration for all three venture types. WFSs pay no attention to constraints on development period, and both EJVs and CJVs give little consideration to benefits offered by local government. On the contrary, WFSs take these benefits into account more closely (with priority of 0.33) than either of the other two ventures. In addition, both EJVs and CJVs take into account constraints on development periods (with weights 0.20 and 0.17, respectively).

The relative priority of the two decision processes, namely, overseas investment environment analysis and local market situation analysis, are shown in Exhibit 5. One detail worth noting in the former process is that all the weights for WFSs, EJVs and CJVs are relatively high (ranging from 0.79 and 0.84), especially the one for WFSs, the highest (0.84). This indicates that WFSs are significantly more cautious in selecting the countries

Exhibit 4
Priorities of Decision Factors in the Analysis of Local Market Situation

Decision Phases	WFSs	EJVs	CTVs	Decision Factors	WFSs	EJVs	CTVs
Local Real Estate Market	.67	.73	.75	Population	.50	.52	.38
				Climate	.00	.00	.00
				Transportation	.17	.19	.28
				Land Costs	.00	.07	.06
				Building Costs	.00	.04	.06
				Other Costs	.00	.00	.06
				Rental Level	.00	.00	.06
				Legal Environment	.67	.80	.83
Local Government	.33	.27	.25	Constraints on Development Period	.00	.20	.17
				Local Government's Beneficial Measures	.33	.00	.00
Totals	1.00	1.00	1.00				

Note: It may seem that "local real estate market" overlaps with "local government," but they can be distinguished very clearly by comparing the respective decision factors under them one by one.

Exhibit 5
Priorities in the Two Decision Processes by Venture Form

Decision Process	WFSs	EJVs	CTVs
(Overseas) Investment Environment Analysis	.84	.79	.79
(Local) Market Situation Analysis	.16	.21	.21
Totals	1.00	1.00	1.00

in which they invest. The ratio of weight between the former and the latter processes is approximately four to one (i.e., 0.79–0.84 to 0.16–0.21).

All factors presented in Exhibit 3 and 4 reflect the AHP-confirmed actual decision factors confronted with those theoretical factors mentioned previously. All these factors are of immediate practical relevance in China today. For example, the actual situation of those factors listed under sociocultural environment in Exhibit 3 indicates that labor supply is abundant, language is almost the same, folk customs and habits are similar, and other such factors.

Apart from the decision priorities discussed above, the relative distribution of the various types of venture companies sampled provides interesting cross-case comparisons as well. Among our samples, the distribution among WFSs, EJVs and CJVs are 15, 55 and 41, respectively. These results are only slightly different from that of other countries'—such as Japan's and Hong Kong's—investment in mainland China. According to

Yen (1995, p. 4), "The most popular form of investment was in the form of equity joint ventures (EJVs), followed by contractual joint ventures (CJVs). Fully foreign-owned enterprises (WFSs) are relatively unimportant." The reason for the differences in WFSs may be due in part to the political tensions between the mainland and Taiwan, which tend to make the Taiwanese more cautious in entering into ventures with the local Chinese. In other words, WFSs are less difficult to withdraw from the mainland in the event of political crises. This result coincides with the above analysis regarding the dominant priority of political environment in the investment decisions of WFSs.

Summary and Conclusions

This study addresses the timely issue of foreign direct investment (FDI) in the rapidly developing mainland Chinese economic system, using data generated through an AHP-based survey specially designed to address the unique situation between Taiwan and mainland China, for the decisionmaking priorities of Taiwanese investors engaged in the three different types of ventures. Among the interesting findings of this study is that while each of the three venture categories utilizes a similar process in making decisions, the respective priorities of each venture type in decisionmaking are significantly different. Investors in all three types of ventures are more cautious in the initial country-site selection than they are in subsequent decisions regarding city-site selection. In addition, it can be seen that the smaller the degree of direct cooperation with local partners of the venture (as mentioned before, this degree is smaller in WFSs, relatively larger in EJVs, and even greater in CJVs), the more easily can investments be withdrawn in case of political crises.

In the decision of Taiwanese to invest overseas, and in mainland China in particular, political environment is the primary consideration, whereas in the domestic decision regarding city selection, this consideration is of only marginal importance. All these findings provide useful information for future research in the study of foreign direct real estate investment. The disproportionate emphasis of Taiwanese FDI decision priorities on political environment considerations will most likely be sustained far into the foreseeable future because of the yet-unresolved confrontation between mainland China and Taiwan. This imbalance will be alleviated only with a change in the political policies of China and Taiwan towards each other.

The implications of the findings of this study for investors considering direct investment in mainland China are numerous. First of all, the AHP-verified hierarchical decision scheme with the two decision phases and their respective factors offers a systematic framework for evaluating the two primary decision issues for real estate FDI—in which country to invest and in which city region to invest.

Notes

[1]According to Phillips and Yeh (1990) and Yeh (1995), the foreign investment types in China may be defined as follows: *Equity Joint Ventures* (EJVs)—Foreign and Chinese investment partners pool money in agreed proportions, investing and operating the venture, sharing profits and losses in proportion to their equity stake. This is the form of investment preferred by mainland China. *Wholly Foreign-Owned Subsidiaries* (WFSs)—Wholly owned subsidiaries of foreign companies and wholly foreign companies can be incorporated in China. The investors will be responsible for

capital and input costs, as well as marketing and management of the venture while it runs for an agreed period of time. Profits after tax can be repatriated overseas. *Contractual Joint Ventures* (CJVs)—The Chinese enterprise provides the land, factory buildings and labor services for a foreign firm that provides equipment, capital and technical expertise. The period of investment in a CJV is shorter than for the above methods, usually five to seven years. The flexibility and short period make CJVs popular with foreign investors.

[2]Hymer's and Dunning's theories are common in their emphasis on the host country's certain advantages, superiority or assets. Their theories are still most relevant and applicable to this study after reviewing modern FDI theories.

[3]All the decision factors in the real estate investment process in Pyhrr et al. and Jaffe and Sirmans' books are basically one-dimensional in nature. The various factors identified in this study are transformed, via pairwise comparisons by the AHP method as described in Note 4, into one common comparable dimension.

[4]Zahadi (1986) provides a very brief and clear description of AHP operational steps: (1) setting up the decision hierarchy by breaking down the decision problem into a hierarchy of interrelated decision elements; (2) collecting input data by pairwise comparisons of decision elements; (3) using the eigenvalue method to estimate the relative weights of decision elements to arrive at a set of ratings for the decision alternatives.

[5]Using WFSs as an example, and relative weights 0.1–0.13 for geographic environment analysis in comparison with political environment (26%), sociocultural environment (26%) and economic environment (19%). The rating clearly shows that geographical environment is the least important one in the analysis.

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