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Project Title: U.S. and Chinese Executive's Risk Focus When Evaluating Foreign Direct Investment Opportunities in China

In today's dynamic and expanding global economy, corporations are being forced to recognize the need to better address various forms of risk that historically have not been managed adequately. While corporations have recognized the need for risk management for decades, recent losses of economic value associated with illegal actions by corporate management and their network of alliances (i.e., accountants and investment bankers) have caused oversight agencies and professional associations to strengthen controls intended to protect the rights of stockholders and employees. Although there is still a need to manage financial risk, the impact of reputation, strategic, operation and market risks are becoming more apparent. Corporations are challenged to manage risks all across the enterprise and have adopted a variety to techniques in an effort to do so. The management of enterprise risk management (ERM), however, requires the roll-up of risks associated with broad spectrum of business decision categories. Foreign direct investment decisions are a particularly important strategic and operational business decision that requires an evaluation of a diverse set of risks as a firm seeks to minimize their risks while maximizing the value they create.

The study we are conducting investigates risk management from a behavioral perspective. While executives are aware of a variety of risks associated with foreign direct investments, they are limited in their cognitive ability to integrate and weight the vast amount of information that staff and consultants have collected. Thus, they rely on cognitive schema and mental models they have stored from past experience when they are asked to process information and make judgments regarding foreign direct investments (FDI). A prominent destination for FDI today is China. Many U.S. corporations have or are considering making FDI in China and top executives of these corporations must weigh and balance a broad spectrum of risks in making this strategic decision. Our study investigates what risks are predominant in the minds of executives when they consider FDI into China.

In this study we are asking U.S. executives to assess opportunities to make FDI in 30 Chinese enterprises based on information that has been collected by a major consulting firm at the request of their corporation. They assess these opportunities after considering the desirability of 16 characteristics associated with the target and its market. We are also asking Chinese executives to assess the desirability of gaining FDI from 30 U.S. corporations interested in investing in their Chinese business using similar characteristics. Most research suggests that firms are more concerned and able to address financial reporting risks than other types of risks associated with their business activities. ERM initiatives have revealed that most companies have not gotten very far in evaluating other forms of risks. Therefore, we consider the risks associated with four theoretical arguments put forth in the academic literature: transaction cost economics, real options, resource based view, and information economics. Four criteria representing each theory are embedded in the 16 characteristics comprising the 30 policy capturing scenarios created. A panel of ERM experts agreed that 2 of these criteria represented financial risks, three strategic/reputation risks, and three marketing risks. This policy capturing methodology will allow us to determine which forms of risk executives focus on when asked to assess Chinese FDI opportunities using an

experimental design rather than espoused or reported behavior. In addition, we have had executives complete a company risk appetite scale, a company performance scale, and a demographic survey which includes two self report items of interest: How developed is the business' risk management approach and how much experience do you have in evaluating the risks associated with international joint ventures?

Five hypotheses will be tested. First we will build logic to suggest that U. S. executives will focus more on financial risks than strategic or market risks during the evaluation process (H1a) while Chinese executives will focus on market and strategic risks rather than financial risks (H1b). Secondly we will argue that information processing and focus will be moderated by executives' educational background and work experience for both the U.S. and Chinese samples (H2a: accounting/finance versus other educational background; H2b: accounting/finance versus other work experience). We will next establish theory to suggest that the executive's firm risk appetite will directly affect assessments (H3a) and moderate their processing of information when assessing FDI opportunities (H3b). Finally, we will test hypotheses regarding the moderating effect of the executive's firm risk management approach (1= simplistic to 5=advanced) (H4) and personal experience in evaluating the risks associated with international joint ventures (H5) when assessing information associated with FDI opportunities.

Careful selection of the appropriate participants has made the data collection phase long and time consuming in the US. Over 500 executives (alumni of NCSU or UNC) have been called, some requiring as many as 6 contacts, 71 have agreed to participate and 36 have returned the materials. We expect to get at least twice that many before we complete US data collection. A Chinese academic is working with us and has collected 45 packets of data from Chinese executives. We are extending the study to include European executives with a colleague at IESE Business School, Barcelona, Spain, a well-known provider of executive education programs all over Europe. Preliminary talks have begun with a professor at Kansai University, Osaka, Japan to see if the study might be extended to a Japanese sample. This would be an excellent way to consider the similarities and differences in how the three major providers of FDI in China evaluate potential Chinese investment opportunities.