

ACQUISITION VERSUS GREENFIELD INVESTMENT – THE IMPACT ON THE COMPETITIVENESS OF POLISH COMPANIES

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Abstract

There are many entry modes which help companies to develop overseas markets. Foreign direct investment (FDI) is one of them, usually described to be the most advanced choice. Foreign expansion by FDI requires two strategic decisions regarding the organizational form of its foreign activity. Firstly, the company has to choose the level of control over its overseas operation, such as full ownership or joint venture. Secondly, the company has to determine the mode of entry, whether to acquire an existing local company (acquisition) or to set up a new venture (greenfield investment). Undoubtedly the selected entry mode determines benefits which foreign operations generate. The purpose of this paper is to show essential issues referring to the role of international activities in the form of foreign direct investment in developing the competitiveness of companies. Special attention is drawn to the issue of the impact of two alternative entry modes of foreign direct investment on the competitiveness of investors and the identification of the main fields of internationalization advantages. The results prove the existence of the differences of FDI impact on competitive potential dependent on the form of FDI. They also show that nature of benefits from the international expansion by acquisition differs considerably from the other selected groups.

Key words: *foreign direct investment, acquisition, greenfield investment, competitive potential*

Introduction

The globalization and technological revolution is taking place, shaping the new competitive landscape. The nature of the forces in the new landscape requires from the company a continuous focus on the growth and development. One of many growth strategies is overseas expansion. The company can enter foreign markets through different entry modes. It may choose between non-equity entry modes such as export, licensing, franchising, and equity entry modes which assume the form of joint-venture or wholly owned enterprise. Both joint-venture and wholly-owned subsidiary constitute the mode of foreign direct investment (FDI) usually considered as the most advanced and complex example of foreign expansion.

Entering into foreign market by FDI requires two strategic decisions regarding the organizational form of its foreign activity. Firstly, the company must decide on the level of control over its overseas operation. It comes down to already mentioned two alternative entry modes such as joint-venture and wholly-owned subsidiary. Secondly, the company must decide whether to acquire an existing local company (acquisition) or to set up a new venture (greenfield investment). This is known as diversification mode choice (Yip, 1982).

The purpose of this paper is to show the essential issues referring to the role of international activities in the form of foreign direct investment in developing the competitiveness of companies. The paper starts with a brief discussion of a theoretical approach to the issue. After it the author intends to show the results of the research carried out in years 2007-2008 among Polish direct investors by a team of researchers from Nicolaus Copernicus University. Special attention is drawn to the issue of the impact of two alternative entry modes of foreign direct investment on the competitiveness of investors and the identification of the main fields of internationalization advantages.

Acquisition versus Greenfield Investment – theoretical framework

The choice of the entry mode is one of the crucial decisions which determine the future growth of the company. The company entering a foreign market may initiate its activities abroad in two alternative ways. Firstly, the enterprise may set up a completely new venture (establishment), which is being described as greenfield investment. Secondly, it may acquire an existing local firm, which is known as acquisition (Hennart & Park, 1993; Larimo, 2003; Slangen & Hennart, 2007). Naturally both modes may assume the form of either joint-venture or wholly-owned subsidiary. Greenfield investment is an example of an internal growth strategy which means that the company's development is based on its own internal resources

(Romanowska, 2009). It results in the internal growth process being considered as sequential and gradual. The entirely new production plants and commercial and service facilities are the direct results of investment from scratch. While the acquisition comes down to acquiring a part or the entire shares of existing local company (the limit of at least 10% ownership according to OECD benchmark definition of foreign direct investment (OECD, 1996)). In contrast to greenfield investment, acquisition represents external growth strategy. It leads to the development of the enterprise, but the development is based on resources from outside the company (Romanowska, 2009). The growth process has an abrupt nature. Two methods result in different benefits and costs as well as demand different initial requirements for the company to perform international operation. They are contingent on characteristics of the investing firm, the industry entered and the host country (Larimo, 2003).

Greenfield investment is regarded as the mode which allows the company to optimize the size and structure of employment and adopt a new entity to technical and economic characteristics of the parent company. Start-ups are often used to exploit firm-specific advantages (Dunning, 1988). Especially those firm-specific advantages which are difficult to separate from the organization (Hennart & Park, 1993). Greenfield investment allows the company to select and train a new labour force which enables to incorporate firm-specific advantages transferred from the parent company (e.g. management practices, firm-embedded technological knowledge). Moreover, greenfields, unlike acquisitions, allow to avoid problems with integration and control of merging companies because they reduce the possibility to duplicate assets and to acquire established labour force with different culture (Slangen & Hennart, 2008). The company doing investment from scratch has the possibility to correct the project, but at the same time it is considered to be more risky because as a start-up it is at the beginning of the learning curve and suffers from liability of newness (Slangen & Hennart, 2008). In contrast, when the company acquires an existing local firm, it acquires already developed infrastructure operating on the local market including knowledge of the foreign market. The acquiring company buys a bundle of assets which encompasses technology, employees and the company's image and brands which are essential from the perspective of competitive advantage (Barney, 1991). Some of them constitute so called strategic assets understood as "the set of difficult to trade and imitate, scarce, appropriable and specialized resources and capabilities" (Amit & Schoemaker, 1993, p. 36). The purchase of value and unique resources substitutes their internal development. With a new firm the company buys a fully-formed group of consumers, suppliers, employees with knowledge of the local economy/market and established position on the market, which lower the level of operational risk. Moreover, acquisition allows also to enter the market and get back invested capital in relatively short time. Buying a going concern takes less time than building from scratch, so the faster the growth of the entered market is, the higher the opportunity cost of start-ups will be. Finally, it eliminates or weakens the competition and helps to reduce the risk of hostile response of the players on the market, where the competition is severe ("follow-the-leader" and "exchange of threat" strategy).

Characteristics of both entry modes presented above inspired to formulate two following hypotheses:

H1: There are differences in the fields of the FDI impact on competitive potential of the company depending on the FDI form.

H2: Entering into the market through the acquisition of local enterprises results particularly in getting access to strategic assets.

Methodology

The research was carried out in the years 2007-2008 among those Polish companies which had started their business activity abroad in the form of foreign direct investment. The research covered the whole group of companies that had their seats within the Polish Republic

and had made foreign direct investment¹. The data base of Polish companies dealing with direct investment was provided by the National Bank of Poland (NBP). The main research stage was realised by means of direct interview and questionnaires sent by mail. The questionnaire contained predominantly closed and multi-variant questions. They enabled the respondents to provide their own option. Respondents marked the selected answers with an 'X', or indicated their order of impact by granting marks corresponding to a specific level of impact. During the work on the research results, the number of respondents that had answered a specific question was always taken as the basis for the calculation.

The structure indices and arithmetical average were used during the work on the research results. In the case of the questions requiring setting a certain hierarchy by indicating evaluation based on the impact criterion, the author applied the impact index in the following form (Karaszewski & Sudoł, 1997, pp. 17-18):

$$W = \frac{\sum_{i=1}^k n_i w_i}{k \cdot N}$$

where: W – influence index; i – evaluation index; n_i – number of indications of a factor in the i -position; k – a maximum mark on the scale ranging from 1 to k (indicating the order of factors meant giving them marks in the reverse order); N – number of respondents who have answered this question; w_i – evaluation reflecting the position of the i factor.

Direct interviews and questionnaires were directed to senior level managers who were most likely to be involved in international operations. A total 486 subjects were invited to participate in the research. Overall 102 correctly completed questionnaires were received which means that the return rate reached the level of 20.6%.

Table 1 summarizes the number of respondents and foreign investment project by the entry form. Greenfield investment was the dominant method of entering into foreign markets by Polish companies. Out of the total number of 275 investment projects 79% of them took the form of investment from scratch. Analysis based on the number of companies confirms the dominance of greenfield investment. Among the surveyed subjects as much as 64% of them indicated investment from scratch as the only way of entering the market. Both methods of entering the foreign market were used by 20% of subjects and 16% declared acquisition as the exclusive growth strategy.

Table 1: Number and structure of respondents and foreign investment project by the used entry form

Specification	Number of investment projects	Structure of investment projects (%)	Number of respondents	Structure of respondents (%)
Greenfield Investment	217	78.9	64	64.0
Acquisition	58	21.1	16	16.0
Greenfield Investment &	-	-	20	20.0
Total:	275	100.0	100	100.0

Source: compiled by the author on the basis of the research results.

Research results

There is no doubt that the distinct nature of alternative forms of entering foreign markets through FDI brings about different results in terms of competitiveness. A substantial number of studies have investigated the effects of diversification mode choice on the firm

¹ The research was carried out as a part of the research project granted by The Ministry of Science and Higher Education No. 1 H02C 044 30. The research team composed of W. Karaszewski (a director), M. Jaworek, M. Kuzel, A. Szóstek, M. Szałucka, K. Długolecka.

performance. However, there have been few empirical studies exploring the issue from the perspective of developing countries and no studies based on Polish companies' experience (Karaszewski & Jaworek & Kuzel & Szałucka & Szóstek & Długolecka, 2009). The indirect reason for neglecting the topic is still low-level international involvement of Polish enterprises in the form of FDI.

According to the Polish National Bank, at the end of 2008 Polish direct investors invested 22,520 million dollars abroad (NBP, 2009). The annual outflow reached the level of 3,011 million dollars. Polish investors have been locating their capitals primarily in European countries (92%). The largest recipients of Polish outflows are the EU-15 countries. Almost 44% of Polish FDI outward stocks were invested in the old European countries at the end of 2008. Less popular among Polish companies are the EU-12 countries which have attracted 16% of Polish FDI outward stocks in Europe (the EFTA countries – 24%). However, analyzing FDI outward stocks from the individual countries' level Switzerland (22%), Luxembourg (21%), and The Netherlands (8%) drew Polish investors attention.

The research results revealed that FDI has contributed to a positive change in the firm's competitive potential in relation to both main competitors on the domestic market and foreign markets (Table 2). However, the force of FDI impact was only slightly dependent on the entry method into foreign market (considering general positive change as sum of evaluations reflecting slight and considerable improvement).

Table 2: Evaluation of the influence of the surveyed companies' foreign direct investment on their competitive potential in relation to major competitors on the domestic and foreign markets by entry form

Specification	Evaluation in relation to major competitors on the domestic market			Evaluation in relation to major competitors on foreign market		
	Entry form					
	Greenfield Investment	Acquisition	Greenfield Investment & Acquisition	Greenfield Investment	Acquisition	Greenfield Investment & Acquisition
	Number of indications (%)					
Considerable improvement	27.9	13.3	25.0	36.1	26.7	40.0
Slight improvement	39.3	60.0	35.0	39.3	53.3	45.0
No change	31.1	20.0	40.0	23.0	13.3	10.0
Slight worsening	1.6	6.7	0.0	1.6	6.7	5.0
Considerable worsening	0.0	0.0	0.0	0.0	0.0	0.0

Source: compiled by the author on the basis of the research results.

Drawing attention to the situation on the domestic market it can be noticed that the largest percentage of the companies which observed the positive impact on their potential as the result of FDI is found among subjects which chose exclusively acquisition as an entry mode. Nevertheless, the difference in the percentage of indication of the positive FDI impact between the groups selected on the criteria was relatively little differentiated. It varies from 73% of responses of companies which decided to acquire a local company to 60% of companies which used both methods of entering the foreign markets². However, only 13% of respondents which acquired an existing local company on the foreign market declared considerable improvement. It is the lowest percentage among the selected groups. Significant improvement in potential was indicated most frequently by the companies which took only

² Understand as total sum of evaluations reflecting slight and considerable improvement.

greenfield investment. Almost 28% respondents of the selected group indentified the improvement in the potential as a considerable one. It is consistent with the theory. It is assumed that FDI will have more significant impact on the potential on the domestic market in the case of greenfield investment because the investor has then the possibility to adjust/optimize the business abroad to the operations located at the home country.

The research allowed also to take a closer look at change in the competitive potential in relation to major competitors on foreign markets (Table 2). Referring to general positive impact, it might be noticed that generally the differences between the selected groups of companies are very slight. The largest benefits from internationalization were observed by the companies which used both entry methods. The research result indicates that 85% of companies using mix strategy evaluated the changes in their potential in relation to major competitors on foreign markets as positive³. Additionally, almost 40% of them found them significant. It is the largest percentage among the selected groups. In turn, the companies which decided to enter into the market through investment from scratch the least frequently indicated that FDI contributed to improvement in their potential (75% of the companies). However, relatively lowest benefits from entering the market by FDI were identified by companies which used only acquisition as diversification mode choice. Only 27% of respondents from this group observed considerable improvement in their potential as the result of FDI. The largest benefits from internationalization by FDI were observed in the group of companies which used both greenfield investment as well as acquisition as the entry mode. It seems to be a natural consequence of the optimal entry mode adapted to external conditions of a host country and company's resources.

Interesting conclusions can be drawn also from the detailed analysis of the the FDI impact on individual elements of the potential. Companies were asked to evaluate the FDI impact on 41 elements of competitive potential. The positive FDI impact was found in all evaluated elements (Table 3). However, the force of FDI impact on specific elements was relatively little differentiated. Regardless of the selected entry mode the highest evaluations were given to the impact of FDI on the access to a market. It was evaluated by the respondents as strongly positive in all selected groups of companies. Nevertheless, the highest force of the impact was reported by the subjects which entered into the market both through greenfield investment and acquisition (0.65). A very positive impact was observed by the group's respondents also in 'knowledge of customers' needs and preferences' (0.60), 'company's market image' (0.58), 'relations with customers' (0.53), 'knowledge of competitors' activity' (0.53) and 'ability to respond quickly to market changes' (0.53). It means that as many as 6 elements were affected by FDI with the force evaluated as strongly positive. These are the best results comparing to the other two groups of companies. It confirms that subjects which use mix strategy entering into the market benefited from FDI the most. However, what seems surprising comparing to the other two groups of companies is that there are no elements from research and development in the first ten elements with the highest FDI impact. Generally, the FDI impact concentrates on elements related to a market. Out of ten elements with the highest FDI impact as many as five belong to the sales and marketing area. Two represent immaterial assets.

Significantly different fields of the impact were indicated by the respondents who decided to acquire a local company. In comparison to the other groups FDI contributed the most to 'innovation in products and services' (0.47 - second position), 'knowledge and skills in the area of innovation creation' (0.44 – third position ex aequo) and 'access to raw materials and semi-products/supporting services' (0.44 – third position ex aequo). Undertaken FDI also influenced particularly strong elements such as 'ability to allocate resources effectively' (seventh position ex aequo), 'technology advancement' (seventh position ex aequo), 'knowledge and skills in the area of logistics' (ninth position ex aequo) and 'access to

³ Understand as total sum of evaluations reflecting slight and considerable improvement.

labour resources' (ninth position ex aequo). Moreover, in the first ten elements with the highest FDI impact 'knowledge and skills in the area of organization' (ninth position ex aequo), 'risk diversification' (ninth position ex aequo) and 'ability to coordinate resources effectively' (ninth position ex aequo) were recorded. What seems surprising is the relatively low evaluation given to the impact on product and service brand (sixteenth position), knowledge of competitors' activity (twenty fourth position ex aequo) and relations with customers (twenty fourth position ex aequo). In other two groups those elements were placed in the first ten potential elements of highest FDI impact.

Table 3: Influence of the surveyed companies' foreign direct investment on the competitive potential elements (The Impact Index)

Specification	Index Value - Entire Population	FDI Entry strategy		
		Greenfield Investment	Acquisition	Greenfield Investment & Acquisition
The Impact Index				
Research and Development	0.29	0.27	0.39	0.27
Research and development facilities	0.21	0.19	0.34	0.18
Knowledge and skills in the area of innovation creation	0.31	0.29	0.44	0.28
Innovations in products and services	0.39	0.39	0.47	0.35
Innovations in production processes	0.25	0.23	0.31	0.28
Production	0.30	0.28	0.35	0.33
Production (service) facilities	0.34	0.29	0.38	0.48
Technology advancement	0.28	0.26	0.41	0.25
Knowledge and skills in the area of technology	0.28	0.29	0.31	0.25
Employees' qualifications	0.40	0.44	0.34	0.30
Access to labour resources	0.31	0.29	0.38	0.33
Access to natural resources	0.20	0.19	0.31	0.15
Access to raw materials and semi-products/supporting services	0.28	0.26	0.44	0.25
Knowledge and skills in the area of logistics	0.28	0.23	0.38	0.35
Relations with suppliers	0.32	0.28	0.34	0.45
Quality assurance system	0.30	0.28	0.25	0.40
Knowledge and skills in the area of quality	0.32	0.31	0.34	0.38
Sales and Marketing	0.43	0.42	0.36	0.54
Access to a market	0.58	0.56	0.53	0.65
Knowledge of customers' needs and preferences	0.48	0.44	0.44	0.60
Knowledge of competitors' activity	0.42	0.42	0.31	0.53
Ability to assure reliable supplies	0.31	0.28	0.28	0.43
Knowledge and skills in the area of marketing	0.37	0.35	0.31	0.50

Relations with customers	0.45	0.47	0.31	0.53
Finance	0.27	0.26	0.26	0.29
Own capital	0.30	0.31	0.31	0.25
Access to external capital	0.16	0.15	0.19	0.18
Level of costs	0.28	0.30	0.09	0.40
Knowledge and skills in the area of finance management	0.26	0.25	0.34	0.23
Risk diversification	0.33	0.31	0.38	0.38
Organization and Management	0.29	0.27	0.31	0.32
Company size	0.35	0.33	0.28	0.45
Company culture	0.27	0.28	0.25	0.28
Organizational structure	0.28	0.25	0.31	0.33
Knowledge and skills in the area of organization	0.33	0.30	0.38	0.38
Employee relationships in the company	0.22	0.21	0.34	0.15
Immaterial assets	0.36	0.35	0.33	0.43
Company's market image	0.47	0.45	0.44	0.58
Product and service brand	0.43	0.44	0.34	0.50
Other intellectual property rights	0.17	0.15	0.22	0.20
Other	0.28	0.25	0.30	0.33
Ability to gain advantages of the scale	0.34	0.31	0.38	0.43
Ability to respond quickly to market changes	0.40	0.38	0.34	0.53
Ability to allocate resources effectively	0.36	0.34	0.41	0.38
Ability to coordinate resources effectively	0.33	0.30	0.38	0.38
Location advantage resulting from legal norms and economic conditions for business activity	0.31	0.27	0.31	0.40
Other relations with environment	0.19	0.15	0.28	0.20
Other	0.02	0.03	0.00	0.00

Comments: the impact index ranges within -1 to 1, where the index value: $-1 \leq w < -0.5$ means very negative influence, $-0.5 \leq w < 0$ – negative influence, $w=0$ – no influence, $0 < w \leq 0.5$ – positive influence, $0.5 < w \leq 1$ – very positive influence; by bold font were marked the first ten elements of the potential with the highest FDI impact force.

Source: compiled by the author on the basis of the research results.

Analysing the answers of companies which chose greenfield investment as the diversification mode choice it might be observed that the FDI influence focused mainly again on elements related to a market (similarly to companies which used mix strategy). Out of ten potential elements with the highest impact as many as five derive from the sales and marketing area. Two elements belonged to the field of immaterial assets. However, FDI contributed to a significant improvement only in case of 'access to a market'. Other elements obtained just a positive impact. The relatively high evaluations comparing to the other selected groups were also given to the impact on relations with customers, employees' qualifications (fourth position) and product and service brand (sixth position). 'Relations with customers' were located on the second place and 'company's market image' took the third place in the order of the impact force.

The analysis of the general areas of the FDI impact provides also some interesting outcomes. The evaluations made by the companies which used greenfield investment and mix strategy entering into a foreign market are similar. Undoubtedly there is high concentration of the impact on the field of sales and marketing. On the second place in both groups of investors there was evaluated the impact on immaterial assets. However, significant differences were observed in evaluations made by subjects who acquired a foreign company. The highest FDI impact was attributed to research and development area. The field of sales and marketing was found on the second place. It confirms assumptions about different motives are realized by various entry modes.

Conclusions

This paper offers the first whole population empirical studies of the FDI impact on Polish companies' competitiveness. Most of the international business literature approaches greenfield vs. acquisitions issue from the point of view of the highly developed countries. It studies for the first time the fields of the FDI impact depending on the entry mode in case of Polish investors.

The review of the research results referring to the detailed analysis of the FDI impact on the competitive potential allows to draw the following conclusions. Firstly, regardless of the entry mode into a foreign market FDI influences company's competitiveness positively. However, the dominance of 'slight improvement' answer in all selected groups of companies may confirm that Polish companies do not fully use the opportunities provided by the internationalization. The largest benefits from internationalization on foreign markets by FDI were observed unquestionably by companies using both greenfield investment as well as acquisition as the entry mode. Those companies evaluated the most frequently the changes in their potential to major competitors on foreign markets as positive and significantly positive. It proves that the mix strategy allows the company to optimize the entry mode to external and internal factors which determine the impact on competitiveness of the company. The companies which enter into the market by both entry modes - greenfield investment as well as acquisition - flexibly adopt the strategy to encounter conditions in the environment and the organization. Although the evaluations of the FDI impact on the potential in relation to major competitors on the domestic market were not so explicit as in the relation to competitors on foreign markets, the research results provide a coherent statement with the theory. The companies which took only greenfield investment indicated most frequently 'the significant improvement' in the potential as the result of realized FDI among the selected group. Greenfield investment allows the investor to optimize the business abroad to the operation located in the country. Hence, this entry mode is assumed to have a more significant influence on competitiveness of the subject at the home country than in the case of acquisition. These results might support the first formulated research hypotheses. However, it must be remembered that there are some limitations of the study and problems with clear and consistent conclusions concerning general and significant positive impact⁴.

The paper shows also that regardless of the entry mode into a foreign market, FDI contributed to the improvement of all 41 components and 7 areas of the competitive potential. The largest benefits from realized investment were observed again among the companies which decided to use the mix strategy entering the host country (in 6 elements identified impact was evaluated as very positive). The research results indicated that the FDI impact focuses mainly on the components referring to the market and sales area. A significant concentration of the highest impact on the elements from this field was particularly visible in the group of companies which undertook greenfield investment and those respondents which used both entry modes. It might imply that Polish investors are still in the initial

⁴ The general positive impact includes a total sum of evaluations reflecting slight and considerable improvement.

internationalization stage and benefit only from easily reached advantages accompanying FDI.

Different evaluations were provided by the subjects which entered into the market via acquisitions. It seems to be consistent with the theoretical assumptions about different goals, motives and benefits which accompany external growth strategies and internationalization through these strategies. The high position in the order of the FDI impact in the area of research and development may indicate that the companies use acquisitions as a tool for providing access to new and complementary resources and capabilities. Those resources are examples of strategic assets which are acquired usually through acquisitions. The higher level of diversification in the first ten elements with the highest FDI impact is considerably evident. The research proves the existence of differences of FDI impact on competitive potential dependent on the form of FDI. The most distinctive group were unquestionably the companies which entered into a foreign market by acquiring a local existing firm. It might support the second formulated research hypothesis. Their board spectrum of benefits which nature differs considerably from the other selected groups indicates various goals and motives lying behind the international expansion by acquisitions.

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