The Effects of Country-level Factors and Company-level Factors on Entry Mode Choice in China

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ABSTRACT

Companies seeking to operate outside their domestic markets must choose the most appropriate entry mode for the foreign market. The choice of entry mode has a great impact on the entrant’s performance and success of the foreign operation making it interesting and relevant to investigate the factors which may have an impact on the choice.

Even though entry mode is the third most researched field in international management and recognised frameworks try to explain the choice, there continues to be some inconsistency in the relationships between explaining predictors and mode of entry, especially in the context of China as a host country. A various number of entry mode alternatives exist, however this study examines the choice between an equity joint venture and a wholly owned subsidiary that represent the majority of the foreign direct investments made in China.

In this study, the entry mode literature is reviewed in the context of the transaction cost economics, resource-based view and institutional theory to analyse how the country-level factors; cultural distance, institutional distance and economic distance, and company-level factors; international experience, host country experience and firm size, affect the mode of entry. This study seeks to contribute to the entry mode literature by applying the three theories in the context of the emerging market China using empirical data from 2002 to 2013.

Although, the theories indicate and propose the optimal entry mode under specific circumstances there exist conflicting results in the scientific literature. Based on the theory review and the scientific evidence, the offered hypotheses in this study state that higher distance between the home and the host country and lower experience and firm size should result in the preference of an equity joint venture over a wholly owned subsidiary.

By performing a binary logistic regression on a dataset of 351 entries into China, this study finds no consistent significant support for the hypotheses. However, the statistical results yield different outcomes; a higher institutional distance increases the likelihood of choosing a wholly owned subsidiary as entry mode, which contradicts the hypothesis, while a higher economic distance increases the likelihood of choosing an equity joint venture, which supports the hypothesis. The remaining predictors find no
significant relationships, which may be due to the specific context of China and indicates that the entry mode issue continues to be a complex matter that may be influenced by factors beyond this study.

Keywords: Entry mode, Equity joint venture, Wholly owned subsidiary, China.
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LIST OF ABBREVIATIONS

- CD: Cultural distance
- ED: Economic distance
- EJV: Equity joint venture
- EM: Emerging market
- FDI: Foreign direct investment
- ID: Institutional distance
- IT: Institutional theory
- JV: Joint venture
- RBV: Resource-based view
- TCE: Transaction costs economics
- WOS: Wholly owned subsidiary
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We look forward to applying our gained knowledge in the nearest future and contributing to the society.

Jeppe Søgaard Larsen
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1 INTRODUCTION

“To say that a company cannot afford to plan an entry strategy is to say that it cannot afford to think systematically about its future in world markets” (Root, 1987, p. 3).

The way a company expands from their domestic market to a new geographical market is of great importance for its performance and selecting the optimal entry mode requires the company to consider a wide range of factors.

In this introduction the background followed by the motivation for this study are presented to clarify the purpose and scope of the study. The problem statement is then offered and finally the structure of the study is presented.

1.1 Background

The essence of this study is to research whether a foreign company’s entry mode into China is contingent on specific country-level factors between the home and the host country and company-level factors. In more detail, this study investigates the effect of cultural, institutional and economic distance between the home country of the entering company and the host country China, and the effect of international experience, host country experience and firm size on the entry mode choice since 2002.

During the past few decades the world economy has experienced an increased global integration and in today’s globalised business environment, it may be attractive and necessary for companies to expand and sell their products or services outside their home country. As a result, the number of foreign direct investments (FDIs) is increasing (UNCTAD, 2014); companies from different industries are affected by this process and they can choose between several different entry modes to establish their business in foreign markets. Despite that entry modes represent the third most researched field in international management, behind FDI and internationalization (Canabal & White, 2008), this field is still relatively new as it has only gained momentum in the last two decades (Brouthers & Hennart, 2007). Entry mode research investigates how companies should enter a foreign market with the aim of increasing long-term profit. As forces of globalization drive companies outside their home market, a primary issue continues to be how they can establish an effective form of operation when entering a foreign market.
Companies seeking to enter a foreign market are facing an important decision concerning which entry mode to use for organizing its foreign business activities (Agarwal & Ramaswami, 1992; Davis, Desai & Francis, 2000). This decision is self-selected and is based on the internal capabilities of the company and external contingencies in the environment. Each respective entry mode requires different amounts of investment, has consequences for the level of control that the company will enjoy and the degree of risk the company will face (Anderson & Gatignon, 1986; Erramilli, 1991; Madhok, 1997).

A number of scholars have identified different entry modes such as export, contracts, small shareholder, licencing, franchise, joint venture and wholly owned subsidiary. There is no clear consensus of opinion on how to classify and differentiate between entry modes but it is common to use the basis of the degree of control that the entering company possesses. This study focuses on the high-control modes, where most of the studies consider the two most common types of FDI; an equity joint venture (EJV) and a wholly owned subsidiary (WOS) (Hennart & Larimo, 1998; Brouthers, Brouthers & Werner, 1999; Meyer, 2001; Canabal & White, 2008). These two dominant entry modes accounted for 96.5% of the total value of FDIs in 2012 in China (Davies, 2013). This study uses China as focal setting and therefore the two primarily choices for the companies entering the country are applied. The primary difference between an EJV and a WOS is that the first represents a joint internationalization, whereas the latter is a sole internationalization.

Many scholars have researched and written about factors that may have an impact on the entry mode choice. Agarwal & Ramaswami (1992) determine that a company’s entry mode choice is influenced by company-level factors such as firm size and multinational experience, and by country-level factors such as country risk and market potential. Kogut & Singh (1988) demonstrate a relationship between entry mode choice and cultural distance and other studies find results showing linkage between entry mode and R&D intensity, advertising intensity, industry competition and timing (Erramilli, Agarwal & Dev, 2002; Canabal & White, 2008). Although, many scholars have demonstrated various relationships, no one has presented a framework that captures all major factors in predicting the choice of entry mode. Various theories have been used in the entry mode research, but among the most popular and recognised are the transaction cost economics (TCE), the resource-based view (RBV) and the institutional theory (IT). These theories are used in different contexts. In this study, they seek to determine the
appropriate entry mode choice based on their different focus and perspectives on the company and the market. The rationale behind the TCE is that companies seek to choose entry modes that will minimize the costs and inefficiencies associated with operating in the foreign market (Williamson, 1985). The RBV focuses on value with the main consideration of transferring the company’s competitive advantages to the foreign market with minimal erosion in their value (Barney, 1991; Sharma & Erramilli, 2004). Finally, the IT examines how companies enter and operate in a foreign institutional context defined by the host country’s environment (North, 1990).

These theories highlight some of the critical factors underlying entry mode choice. However, the prior studies have largely focused on developed market economies thus the understanding of the topic in emerging markets still needs to be advanced. China is one of the most important investment markets in the world and in 2012 it overtook USA as the most popular country for FDI. China is still considered to be an emerging market with a great economic potential, where companies face high environmental uncertainty making the choice of entry mode even more complex. In 2001 China entered WTO, which decreased the restrictions on FDI and led to a more liberalised economy. Therefore, this study investigates whether the entry mode choice in the emerging market China is in accordance with the findings of existing literature and seeks to contribute to this field of research.

1.2 Motivation

The strategic choice of entry mode is crucial and has a great impact on companies’ performance and success in the market entered. Based on previous studies consensus is determined between entry mode choices and different predictors, however, there exists conflicting literature and despite extensive existing research, there are still gaps in it. This study is mainly inspired by the research of Kogut & Singh (1988) which primarily investigates how national cultural distances influence the choice of entry mode. Their research does not seek to develop a full theory of entry mode choice, but rather it concentrates on explaining how the differences in cultures among countries influence the managers’ perception regarding costs and uncertainty of alternative entry modes. Additional to cultural distance, institutional and economic distance are implemented in this study to contribute in the area of national distances. Kogut & Singh (1988) additionally add country and multinational experience to their research and
discover that companies must possess superior skills that generate profit high enough to compensate for the higher costs of operating in foreign countries and these findings are supported by other scholars (Davidson, 1982; Agarwal, 1992; Erramilli, Agarwal & Dev, 2002). The success of transferring these skills highly depends on the choice of entry mode, therefore this study implements international and host country experience and firm size to enhance the understanding of it. These research components are addressed empirically in the context of China aiming to contribute with a deeper knowledge of how country-level factors and company-level factors influence the choice of entry mode in an emerging market.

1.3 Problem statement

The previous section highlighted that the entering company solely selects the choice of entry mode and that this choice is generally influenced by a combination of external and internal factors. Thus, the overall problem statement of this study is offered as follows:

*How do country-level factors and company-level factors affect a company’s entry mode choice in China?*

In order to answer this question, it is further specified into two sub-questions:

- **How do the country-level factors of cultural, institutional and economic distance affect a company’s entry mode choice between an equity joint venture and a wholly owned subsidiary?**
- **How do the company-level factors of international experience, host country experience and firm size affect a company’s entry mode choice between an equity joint venture and a wholly owned subsidiary?**

In order to answer these questions and examine the results, the three theories are applied to serve as the theoretical background and the evidence from previous studies is analysed. Based on this study’s data, a regression analysis is performed and the results are interpreted and discussed. This approach contributes to the literature by using objective data from secondary sources, providing a larger number of factors and focussing on the largest emerging market China.
This study is composed of nine chapters, where Chapter 1 outlines the background of the study, identifies the purpose and scope and declares the problem statement.

Chapter 2 describes the utilised research methodology in order to explain how this study is undertaken.

Chapter 3 analyses the existing theories. First, entry modes are reviewed and defined. Thereafter, the three widely employed theories: the TCE, RBV and IT are examined to establish the theoretical framework for the study.

Chapter 4 presents and analyses the previous studies within the entry mode literature in the context of the theories in Chapter 3. The series of previous evidence are presented to provide an overview of the existing similarities and contradictions of the factors that have been empirically tested on entry mode choice. This is done to highlight the complexities, increase the validity of the theories and develop the hypotheses.

Chapter 5 provides a brief analysis of emerging markets and China to enhance the understanding of the important factors that are characteristic and influential for this study’s host country.

Chapter 6 describes the empirical method – how the data for this study is collected to obtain the sample and how the dependent and independent variables are defined and measured. This is done to show how the major parts of the analysis work together to address the problem statement in this study.

Chapter 7 presents the binary logistic regression analysis, where the model is validated, the relevant results are presented and the hypotheses are commented and discussed.

In Chapter 8 conclusions are drawn and finally, the limitations and directions for further research are addressed in Chapter 9.
2 RESEARCH METHODOLOGY

The purpose of this chapter is to describe the methodology used for conducting the study. It should provide an important understanding of the methodological issues, since the choice of methodology affects the nature and reliability of the conclusions that can be drawn from the study (Saunders, Lewis & Thornhill, 2009).

2.1 Research philosophy

According to Saunders, Lewis & Thornhill (2009) the first element to begin with is defining the basic research philosophy, since it contains important assumptions about the way researchers view the world and underpin the study’s purpose and methods. The research philosophy depends on the way one thinks knowledge is developed and for this study the research philosophy of interpretivism is adopted. To better understand this philosophy the contrasting positivism philosophy is shortly explained.

Positivism is the dominant methodology in the “hard” physical sciences, where the researcher is an objective analyst that seeks to reveal casual relationships through an analysis of collected data in a value-free manner. Although this study seeks to find relationships between the entry mode choice and independent factors, the positivistic philosophy assumes that human actors are passive agents uncovering event regularities that are used to formulate law-like generalizations. Instead, the interpretivistic philosophy is adopted, which in contrast to positivism, regards reality as socially constructed rather than objectively determined. Interpretivism embraces causally connected observable events in a world, where humans are affected by the reality working behind them both by influencing and being influenced (Arbnor & Bjerke, 1997; Saunders, Lewis & Thornhill, 2009). Some would argue that the interpretivist philosophy is highly appropriate in the case of business and management research, since situations in these fields are functions of a particular set of circumstances and individuals, which makes business situations complex and unique. Interpretivism does not assume that reality is objective, but that it is objectively accessible, which is in accordance with this study.
2.2 Research approach

Overall, there exist two approaches of how a researcher can design the study. The choice mainly depends on the existence of theories and it enables the researcher to take a more informed decision about the design of the study. The inductive approach is likely to use and analyse qualitative data with the purpose of generating theories or hypotheses, while the deductive approach is more suitable if there are already well-established theories. According to Saunders, Lewis & Thornhill (2009) a research should be deductive if hypotheses are developed from theories and tested using quantitative data. The theories do not need to be proven completely true if they are logical, however it is important for the researchers to make sure that the theories and methods used are not obsolete to ensure a relevant report. Five sequential stages how the deductive research progresses are highlighted below (Robson, 2002; Saunders, Lewis & Thornhill, 2009):

1. Deducting hypotheses from the theories to provide testable relationships between variables.
2. Expressing the hypotheses in operational terms to indicate how the variables are measured.
3. Testing the hypotheses.
4. Examining the specific results in perspective of the theories.
5. If necessary, indicate whether the theories need to be modified.

This study uses the deductive approach, as it starts from the literature review, where the theories concerning entry mode are reviewed and the basic ideas are provided. Additionally, this approach illustrates if the theoretical background is consistent with the empirical data collected. The problem statement will be answered on the basis of the theoretical framework, empirical analysis and discussion.

2.3 Research strategy

In order to pursue the principle of scientific objectivity, the deductive approach dictates that the researcher should be independent of what is being observed. It implies that methods need to be operationalised in a way that enables them to be measured quantitatively. Therefore, it is essential to focus on the research strategy, since it can determine whether the study will enable the researchers to answer the problem statement.
Two main alternatives exist, where the qualitative strategy describes any data collection method that generates or uses non-numerical data, and the quantitative strategy, which generates or uses numerical data. The quantitative strategy is best characterised by providing descriptions of the variables involved and establishing statistical relationships among them. The technique relies on larger sample sizes and focuses on explaining and predicting phenomena between an independent variable (predictor) and a dependent variable. This procedure is deductive in nature and contributes to the scientific knowledge base by constructing hypotheses to test the theories.

As this study will subject the data to statistical tests in order to get a clearer view of the variables relationships, therefore it may be termed as explanatory. An explanatory (casual) research tends to explain why specific events happen at specific moments and is measured by exploring one variable’s impact on another variable (Saunders, Lewis & Thornhill, 2009).

2.4 Data sources

To obtain relevant data there exist two different kinds of sources; primary and secondary. For this study, secondary data is useful for explaining and answering the problem statement.

The data usually forms the base of the literature review and in this study secondary sources such as scientific journals, reports and books published on the entry mode topic are reviewed. Often, secondary data has different scopes or perspectives, which implies that judgements of the data have to be made, which is the main disadvantage of using secondary sources. The collected data has to be investigated for its usefulness, which helps to define and explain the research within the entry mode field. This archival research (Arbnor & Bjerke, 1998; Saunders, Lewis & Thornhill, 2009) also allows the collection of objective data through secondary databases and websites, where access is granted to various compilations of useful information, making it possible to obtain the needed country-level and company-level data and perform the analysis in a structured way.
3 LITERATURE REVIEW

In this chapter, the existing theories are discussed with respect to the problem statement and the secondary data is converted into a critical appraisal to synthesize prior research and help to understand their contributions. The description of the theories is used to align the study with the existing literature and to validate the results of this study.

The entry mode choice is an important strategic decision for companies that seek to conduct international business and enter a foreign market (Anderson & Gatignon, 1986). The choice of entry mode is influenced by different factors and have been analysed through several frameworks that have gained varying recognition and application. Firstly, high entry mode theory is introduced. Thereafter, this study’s three main theories in relation to entry modes are presented: the transaction cost economics, the resource-based view and the institutional theory. Although, these theories are different in their approach, their purpose is to maximize the long-term profit of the company by selecting a better performing entry mode in the respective situation.

3.1 High entry mode

A company that seeks to enter a foreign market must decide which entry mode to use. According to Root (1987, p. 5) a foreign market entry mode is defined as “an institutional arrangement that makes possible the entry of a company's products, technology, human skills, management, or other resources into a foreign country.” The four most common entry mode alternatives that companies can choose among are export, licensing, equity joint ventures and wholly owned subsidiaries (Davidson, 1982; Killing, 1982; Root, 1987). As noted in Chapter 1 this study will only focus on the choice between an EJV and a WOS.

Entry mode theory suggests that the choice of entry mode should be based on a trade-off between risks and returns, where the company is expected to select the entry mode with the highest risk-adjusted return on investment (Anderson & Gatignon, 1986). From a practical perspective, it can be very difficult and resource-consuming to identify the appropriate entry mode, but managers are highly recommended to identify the advantages and disadvantages of them in a given context. They involve different resource commitments, control and risk at varying levels, which makes the initial
decision difficult to change without a loss of time and money. The choice of entry mode is therefore very important and may have high influence on the likely success of the foreign operation (Root, 1987).

The WOS mode provides the company with the highest degree of control and consequently it receives all profits and bears all costs and risks. Root (1997, p. 147) defines a WOS as a company where the “complete ownership of an entity is located in a host country by a company located in the home country to manufacture or perform value addition or to sell goods/services in the host country.” The WOS mode provides the entering company an opportunity to expand quickly independent of the partner and allows it to protect its intangible resources and processes against possible opportunistic behaviour by a partner. Moreover, the company prefers not to share the potentially high profit that its assets may generate. Typically, a WOS is used if the company possesses all the necessary skills and has a good knowledge of the market.

The EJV requires a relatively lower degree of involvement and therefore provides the company with control, risk and return corresponding to the extent of equity that the entrant commits. According to Root (1987, p. 146) an EJV takes place “when a company shares in the ownership of an enterprise in a target country with local private or public interests.” An EJV may be started by establishing a new business with the foreign partner or by acquiring partial ownership in an existing local company. As an alternative to a WOS, the EJV facilitates learning and transfer of knowledge between the partners (Luo, 1997; Brouthers & Hennart, 2007). However, since EJVs have more than one parent, the decision-making may be slow due to the multiple levels of management. If the benefits of an EJV, after subtracting the transaction costs related to it, are greater than the total benefits obtained from exploiting each firm-specific advantage separately, an EJV creates synergies that increase the wealth of both partners (Killing, 1982).

Entry mode literature has shown that selecting the appropriate entry mode depends on the given situation and the entering company’s internal and external factors (Leiblein, 2003; Zhao, Luo & Suh, 2004). Hence, the following review aims to state the assumptions and propositions of the TCE, RBV and IT. By reviewing them, the similarities and differences of each theory predictions are emphasized, which facilitates the comparison of existing findings with the findings of this study.
3.2 Transaction cost economics

As mentioned in Chapter 1 different frameworks have been derived and are used to analyse the optimum choice of entry mode. Ronald Coase (1937) made the first foundations of the TCE through studies of why companies emerge. The general perception of economic exchanges is that the market is more efficient compared to internalisation of the exchanges in the company, which implies lower costs. The reasoning is that the market offers specialization and economies of scale. According to Coase (1937) the main reason that companies are profitable to establish is due to the cost of using the market as a result of its imperfections. Contracts are almost impossible to make without shortages and companies may therefore encounter increased costs in the process of negotiating a satisfying market based agreement due to the difficulties of including all contingencies and the ability to obtain a fair price because of asymmetric information in the market (Brouthers, 2002).

In 1985, Oliver Williamson developed the TCE and it is the most applied framework addressing the choice of governance form. The TCE explains why companies expand or make use of activities in the external environment. Transaction costs are defined as “the costs of running the economic system” (Williamson, 1985, p. 18). Companies try to minimize the costs of exchanging resources using the market and minimize the costs of exchanges within the company. The TCE therefore relates to companies considering the costs of using the market against carrying out the activities themselves. This implies that companies should expand as long as the activities of the company can be performed cheaper within the company (Coase, 1937; Williamson, 1985).

There are two primary assumptions underlying the TCE. Despite that individuals try their best to deal with the complexity and unpredictability around them by collecting information and planning, they are limited by the information and time they have, to accurately predict and plan for the future. Individuals intend to be rational, but due to their human limitations, they do not necessarily behave like that. Therefore, the TCE assumes that individuals are subjects to bounded rationality, which is a fundamental assumption within the TCE (Williamson, 1985; March & Simon, 1993).

The other assumption is opportunism, which according to Williamson (1985; 1991) implies that individuals are self-interest seeking with guile. The rationale of opportunism describes that the parties in the exchange will try to take advantage of each
other and eases behaviour such as fraud, lie and theft. This is possible because of the bounded rationality, which implies that contracts will be incomplete and consequently makes it possible for the parties to exploit each other’s vulnerabilities in the attempt to obtain a more favourable result of the transaction. Companies can safeguard itself against the other party’s opportunism by making use of costly monitoring mechanisms or by using a more resource demanding governance mode (Leiblein, 2003).

Due to these behavioural characteristics, one can distinguish between ex ante and ex post transaction costs. Ex ante refers to the challenges of creating a contract that takes into account possible risks, since an opportunistic partner may be unwilling to disclose important information or directly distort it. To minimize and compensate for these possible risks, the partners seek to integrate “safeguards” through drafting and negotiating. Safeguards refer to the safety that the partners require to limit a potential loss while maintaining the other party within the contract. This often is done with a great deal of care by drafting complex documents that include numerous contingencies. Because the partners cannot foresee all potential risks and problems, ex post transaction costs apply, which consist of the setup and running costs associated with the governance structure and the necessary costs to control, enforce and change contractual agreements (Killing, 1983).

3.2.1 TCE in perspective of entry mode choice

The TCE is applicable in the choice of governance form and the same theory therefore applies to the choice of entry mode. Studies have found that companies that follow the propositions of the TCE perform better both financially and non-financially than companies that do not (Shrader, 2001; Brouthers, 2002). The risk of a partner’s opportunistic behaviour often leads to the monitoring procedure of the partner and in relation to this evidence shows that companies having high costs of finding, negotiating and monitoring a partner, are likely to use a higher degree of control (Brouthers, 2002).

According to Anderson & Gatignon (1986) control is the single most important determinant of risk and return in the perspective of entry mode, since control helps the company to influence strategies, decisions and actions to obtain a higher return (Davidson, 1982). However, control does not come for free, because it requires resource commitment, which creates switching costs. Switching costs will likely reduce the company’s ability to change its institutional arrangement if the initial entry mode turns out to be unfavourable. The TCE suggests that companies entering a new market should
view the entry mode choice as a trade-off between control and the resources it commits. Flexibility has to be taken into consideration, since opportunity to change the company’s systems and methods may be crucial for the company’s success in unfamiliar foreign markets (Mascarenhas, 1982; Anderson & Gatignon, 1986).

3.2.2 TCE factors

A large number of factors influence the entry mode choice, but the TCE has found three factors that the efficiency of an entry mode depends on. They assist in determining the optimal degree of control and consist of transaction-specific assets, external uncertainty and internal uncertainty, which are explained following (Williamson, 1985; Anderson & Gatignon, 1986).

Anderson & Gatignon (1986) explain transaction-specific assets to be investments specialised to one or few users or uses with the purpose of producing outputs more efficiently or creating positive synergies. If a company brings high specific assets into a relationship, it is exposed against the partner’s incentive of opportunistic behaviour, which therefore should lead to a higher degree of control. The threat of opportunism often occurs when a company possesses unique technology and knowledge or high R&D and as a result these assets will lose value in alternative use. The same applies to products with high service requirements, where they often are customized and to transfers of poorly understood products or processes across national boundaries, where the understanding is crucial. Therefore, the rationale is that companies with high specific assets tend to enter foreign markets with a WOS, while companies with simpler and lower specific assets tend to use an EJV (Anderson & Gatignon, 1986; Brouthers, 2002).

External uncertainty is the second factor and is defined as the unpredictability of the entering company’s foreign external market, which is often measured in terms of the foreign market’s volatility. Anderson & Gatignon (1986) argue that the uncertainty can take many forms such as political instability and economic fluctuations. Brouthers (2002) supports this and extends the measurement of risk to include institutional, legal and cultural systems as well as market attractiveness. In regards to the external uncertainty some researchers argue that to cope with the unpredictability the entering companies should exercise control to reduce the volatility (Killing, 1982). However, increasing the control in an uncertain environment implies a higher resource commitment and risk if inappropriate circumstances develop or technology changes. As
a result, the returns can disappear by the time a high control system is ready. Folta (1998) explains that by committing prematurely to a WOS the company imposes considerable risks because it gives up the option of waiting for new information that could change the investment’s value. Under high external uncertainty, companies should therefore prefer an EJV over a WOS to retain flexibility and share the risk. Further, high uncertainty increases the companies’ need of local knowledge, which an EJV can provide because of the pooling of information that lowers the long-term costs and simultaneously requires less resource commitment. However, given some degree of asset specificity, it becomes more desirable with control as uncertainty increases, since the entering company risks being more exposed to the partner’s opportunistic behaviour.

The internal uncertainty describes the difficulty for the entering company to measure its partner’s performance, which can occur if appropriate measures of the output are not available. To compensate for this, the company can e.g. measure inputs or use incentives to develop goal congruence, which it is likely to have experienced in its domestic environment. In spite of this, a foreign market is different and companies that are unexperienced in international settings may find it difficult to manage this internal uncertainty. This implies that a higher international experience should lead to a higher degree of control. Internal uncertainty also derives from the sociocultural differences between the domestic and foreign market of the entering company, because unfamiliar conditions and values in the foreign country are unknown to the management. This pushes the management to be reluctant to increase the commitment and since it is difficult to transfer home management values to a dissimilar market, the management alternatively tries to transfer this risk to the partner. The TCE suggests, however, that if there is no substantial advantage of using the entering company’s business approach, transferring it is more efficient (Anderson & Gatignon, 1986).

The argumentation of the TCE is very deterministic and focuses only on cost minimization. A fundamental limitation of the TCE is that it makes assumptions about the nature of human beings assuming that there exists an anti-trust tendency, but it is argued that there is a movement towards greater trust between organizations (Zhao, Luo & Suh, 2004; Brouthers, 2013). However, Williamson (1985) has a different point of view, stating that although not all partners are opportunistic the consequences are the same, since it is the opportunity of opportunistic behaviour that is crucial for adding costs to the contract negotiation, as the resource consumption of sorting out the
opportunistic partners is high. The TCE takes no account of e.g. power, personal relations and strategic challenges and it ignores the value or benefit side of the entry mode. The TCE is criticized for only emphasizing on the importance of transaction behaviour, while ignoring other relevant opportunities and advantages, such as the integrated value creation obtained through corporations. To look from a different entry mode perspective and complement the TCE framework, the resource-based view is described next, since this theory provides a much more central role to company capabilities.

3.3 Resource-based view

The resource-based view was developed in the mid-1980s and 1990s by Wernerfelt (1984), Barney (1991) and Madhok (1997), and is mainly based on Penrose’s (1959) theory on growth enterprises. It focuses on a company’s resources and capabilities which allow it to reach a competitive advantage and sustain a long-term growth. Lockett, Thompson & Morgenstern (2009) argue that “employing the resource as the unit of analysis the theory seeks to explain the extent to which a firm may be able to sustain a position of competitive advantage” (pp. 10-11).

According to Barney (1991), Barney & Clark (2007) and Lockett, Thompson & Morgenstern (2009) in order to hold the potential of a sustained competitive advantage, a company’s resources must be:

1. Valuable – can be used to exploit opportunities and/or neutralize threats in a company’s environment.
2. Rare – limited in supply and not equally distributed across a company’s current and potential competition.
3. Imperfectly imitable – difficult to replicate by other companies, due to the social complexity, causal ambiguity and specific historical circumstances.
4. Non-substitutable – one resource cannot be simply replaced (or substituted) by another one.

The RBV argues that every company has developed unique firm-specific resources which are heterogeneous and immobile and they give a competitive advantage to outperform competitors in the foreign market. These resources can be assets, capabilities, organizational processes, brand names, information, in-house knowledge of technology, etc. (Wernerfelt, 1984; Barney, 1991) and they have to be developed
internally to provide a competitive advantage. The relationship between a company’s resources and sustained competitive advantage is summarized in Figure 1.

![Diagram of the relationship between a company’s resources and sustained competitive advantage](image)

**Figure 1: The relationship between a company’s resources and sustained competitive advantage (Barney & Clark, 2007).**

Peteraf (1993) argues that the RBV has strong implications for corporate strategy and it may help to differentiate between resources which might support a competitive advantage from other less valuable resources (Barney, 1991). The author claims that as long as a company’s assets are imperfectly mobile, inimitable and non-substitutable, other companies will not be able to mimic its strategy and therefore it will have precedence over competitors.

According to Meyer, Wright & Pruthi (2009) the RBV focuses on the exploitation of existing assets and the augmentation of resources to create new resources, thus establishing a link between a company’s resource endowments and its likely path of international growth.

### 3.3.1 RBV in perspective of entry mode choice

The RBV is useful for explaining international entry strategies because its framework provides a background to analyse the dynamics of foreign expansion. The theory focuses on the exploitation of firm-specific resources used for foreign entry and
how the existing knowledge is transferred through alternative modes (Meyer, Wright & Pruthi, 2009).

Sharma & Erramilli (2004) give a resource-based explanation of entry mode choice. They claim that entry mode decision has strategic implications for a company’s resource deployment, marketing program and competitive position in a market. Secondly, due to the spread of globalization, development of information technologies and emergence of highly knowledgeable global customers, the competitive world of companies has become highly dynamic. Lastly, the RBV empowers the explanation of entry mode choices based upon the exploitation of existing and new advantages.

From the RBV perspective, the entry mode will depend on whether a company has the necessary resources and capabilities to enter the foreign market. According to many RBV authors (Madhok, 1997; Luo, 2001; Sharma & Erramilli, 2004; Meyer, Wright & Pruthi, 2009) if a company has a strong knowledge base and possesses valuable resources and capabilities, it will select a WOS entry mode. But if the company enters into unfamiliar areas of activity where the technological and market distance is too high, then it will choose collaboration as a mode to enter. Therefore, ownership mode decisions are made based on the development and deployment of the company’s resources and capabilities.

Companies choose their foreign market entry strategies by evaluating the requirements of the foreign operations and the existing knowledge base. The choice of entry mode depends on the costs of transferring the firm-specific knowledge in-house relatively to the costs of market transactions. Even though, WOSs provide a competitive advantage, the development of all necessary know-how in-house is viewed as too slow a process while EJVs provide the structural mechanisms which allow deeper knowledge exchange (Luo, 2001).

Meyer, Wright & Pruthi (2009) also found that companies with few technological capabilities tend to obtain technology by acquiring innovative firms; and these acquisitions then reduce the need to develop new skills internally. Both EJVs and WOSs provide access to complementary resources. Therefore, Madhok (1997) claims that when the new knowledge development is more important, companies are more likely to choose collaborative entry modes.

According to Lockett, Thompson & Morgenstern (2009), who are supported by Kogut & Singh (1988), Hennart & Reddy (1997), and Thompson’s (1999) findings,
prior market experience encourages expansion by WOSs rather than EJVs and this is supported by the RBV, which states that the experienced entrant is able to purchase the relevant resources by acquiring a suitable company while outsider with incomplete resources needs to secure specific resources via cooperation with the insider. Luo (2001) supports this by analysing China and finding that EJVs are preferred when host country experience is low. On the other hand, obtaining access to specific assets in the countries with poorly developed capital markets or with restrictions on private and/or foreign ownership, the costs associated with the acquisition may be prohibitive and therefore companies have to be fully aware of this before entering the foreign market.

Agarwali & Ramaswami (1992) and Madhok (1997) find that entry mode choice is also influenced by the firm size factor and that larger companies are concerned with the overall competitive positioning. Therefore, compared to the smaller companies, they are more willing to contribute substantial resources to gain an edge in global competition.

The RBV emphasizes value maximization of the transaction rather than minimization of the costs; therefore, the entry mode choice, based on the theory, depends on a company’s resources and capabilities which create a sustained competitive advantage. If a company has capabilities to operate alone in a foreign market and is able to transfer in-house specific knowledge to exploit the advantages it produces, then it will choose a WOS mode. Otherwise, it will choose an EJV and will collaborate with a foreign partner that has knowledge about the market.

As the RBV analyses the relationship between a company’s resources and sustained competitive advantage, it confronts with a number of methodological and practical difficulties that limit the generation and testing of direct hypotheses. Lockett, Thompson & Morgenstern (2009) have found that the resources analysed in the RBV are often hard to identify and measure and it becomes even more difficult when the performance effects of specific resources have to be isolated in large companies. Another issue is a tautology which arises because “a competitive advantage is considered to be rooted in firm-specific circumstances that are themselves imperfectly observable” (p. 16). Furthermore, company heterogeneity creates problems for researchers to find the causes of competitive advantage across the sample. As a competitive advantage is directly unobservable, the company’s performance and identifiable resource endowments are measured instead. Lastly, much empirical work
has experienced problems of causality and multicollinearity of explanatory variables, which reduce the efficiency of estimates.

To analyse the choice of entry mode from a country’s perspective and to complement the TCE and RBV, the institutional theory is discussed in the following section. The IT has especially been helpful in explaining entry mode choices in emerging market environments where institutions are still in the development process.

3.4 Institutional theory

The institutional theory emphasizes how the host country’s institutional environment affects the entering company’s choice of entry mode. According to North (1991, p. 97) institutions are “humanly devised constraints that structure political, economic and social interaction.” Institutions are often referred to as “the rules of the game” and as North (1990) describes, consist of formal rules e.g. constitutions, laws and property rights, and informal constraints, which include for example taboos, traditions and codes of conduct. The purpose of institutions is to create order and reduce uncertainty in a society and thereby to provide the incentive structure of an economy. The reasoning behind the IT is that companies have to follow the formal and informal constraints to gain legitimacy in the host country, which implies that the entrant needs acceptance of the surrounding environment to do business within the host country (North, 1991; Brouthers & Hennart, 2007).

3.4.1 IT in perspective of entry mode choice

Empirical studies show that institutional factors significantly contribute in explaining the choice of entry mode by improving the understanding of institutional differences between the home and the host countries (Scott, 1995; Brouthers, 2002; Yiu & Makino, 2002). Scott (1995) created a set of three dimensions; regulatory, cognitive and normative, which vary by country and influence the way business is conducted in the respective countries, thereby influencing the entering company’s choice of entry mode.

The regulatory dimension consists of the rules and laws that exist to ensure stability and order in societies, which often are characterised by the country’s policy and court system (Scott, 1995). In the study of Yiu & Makino (2002) it is found that the more regulative the environment is in the host country, the higher the preference of an
EJV over a WOS appears. The reasoning is that an EJV implies cooperation with a local partner, which makes it easier for the entering company to legitimise its business in regards of regulatory constraints often imposed on foreign companies and furthermore it can learn from the partner’s experience on how to deal with the authorities (Delios & Beamish, 1999; Brouthers, 2002).

The normative dimension refers to the existence of social values, cultures and norms, which define how the companies are expected to behave professionally (Scott, 1995; Kostova, 1999; Yiu & Makino, 2002). Adapting to these objectives is important in order to operate successfully in the host country, since foreign companies often are more vulnerable to attacks from local interest groups, which increases the cultural pressure and threats to FDI. Therefore, the entering company must conform to the social expectations of the host country to demonstrate their social responsibility. However, due to the cultural distance between the home and the host country, this social legitimacy is not obtained easily, since a higher cultural distance makes it more difficult for the entering company to adapt and utilize the collective understanding of the local people. To overcome this, an EJV can help the foreign company, since it can benefit from the local partner’s social capital and reputation, skills and existing business relationships. Therefore, the more restrictive the normative objectives are, the more likely it is that the entering company will choose an EJV over a WOS (Davis, Desai & Francis, 2000; Yiu & Makino, 2002; Brouthers, 2013).

The cognitive dimension is defined as the established cognitive structures in a society that are taken for granted, which means that the entering companies tend to choose the entry modes that conform to them. This often implies that companies are more likely to copy the entry mode that the previous successful entrants have used (Scott, 1995; Yiu & Makino, 2002).

According to North (1990) institutions can be categorized in formal and informal institutions, which have similarities to the definition of Scott’s three dimensions. Formal institutions set the rules by which the companies have to interact and according to North (1990) the required restructuring will increase with institutional distance. Author suggests that first time entrants are capable to adapt their business practices more easily using an EJV, when the distance in formal institutions is high. The formal institutions correspond to the regulatory dimension in Scott’s (1995) work and are captured in the institutional and economic distance variables used in this study. According to North (1990) the informal institutions are not normally codified, but are often tacit and imply
that individual and organizational learning is typically rather slow. Informal rules influence the economic behaviour, which consequently means that the larger the difference in informal institutions between the home and the host country, the greater the need for local knowledge which can be obtained via an EJV. The informal institutions of North (1990) correspond to the normative and cognitive dimensions of Scott (1995). This study will primarily rely on the theory of North (1990), because it provides a clear and consistent terminology. The author describes informal institutions as humanly devised constraints that are not formalized, but embedded in the shared norms, values and beliefs of a society. This definition is close to the definition of Hofstede (1980), whose cultural dimension is used in this study.

North (1990) suggests that the TCE must be combined with the IT, since the institutions establish the structure in which transactions occur. According to Roberts & Greenwood (1997) companies may meet institutional structures and face pressures to tap into the host country’s socio-politically legitimate designs. The IT argues that entry barriers, such as legal restrictions on ownership, may exist in the host country, which can limit the entering company’s ability to utilize its capabilities through the entry mode choice predicted by the TCE. It implies that in countries where legal restrictions are high, the companies are more likely to enter using an EJV over a WOS to gain legitimacy and efficiency (North, 1990; Delios & Beamish, 1999; Brouthers, 2002). Meyer (2001) supports this argument and states that institutions are important for a functioning economy and they aim to reduce the transaction costs by establishing a stable structure and reducing uncertainty to facilitate interactions. Moreover, the author points out that the lack of knowledge about the host country’s institutional environment will likely increase the transaction costs, which as a result emphasizes the importance of entry mode choice.

3.5 Comparing TCE, RBV and IT

The TCE, RBV and IT provide different perspectives of foreign market entry strategies. They are based on different assumptions about the nature of economic actors, and therefore point to different conclusions regarding optimal company behaviour (Leiblein, 2003; Meyer, Wright & Pruthi 2009).

Anderson & Gatignon (1986), Madhok (1997), Oliver (1997), Davis, Desai & Francis (2000) and Meyer, Wright & Pruthi (2009) have found critical implications of
the differences between the three perspectives (Table 1). The unit of analysis in the TCE is the transaction, a company in the RBV, and the country in the IT.

According to the authors the RBV adopts an idea that a choice of entry mode is motivated by the aim to maximize the value of resources and capabilities created by transaction, while the TCE focuses solely on cost minimization. The IT highlights the pressure which yields to conform to the formal and informal institutional environments while choosing the right entry mode. Where the TCE is capable of explaining an exploitation of company advantages, the RBV additionally looks at the development of new advantages and the IT investigates how companies can exploit their advantages by conforming to social pressures.

The theories also differ in how certain modes are classified. Anderson and Gatignon’s (1986) classification focuses on control, while the RBV sees resource augmentation as a distinguishing criterion of entry modes. The TCE basis its argumentation on market failure and transaction costs involved but the RBV looks only at the company’s resources and capabilities. While the TCE minimization approach is driven by the assumption of bounded rationality and opportunism, the RBV argument is based on bounded rationality, knowledge exploitation and augmentation and operates independent of the assumption of opportunism. The IT classification categorizes institutions to formal and informal which can increase or decrease the institutional distance between the home and the host countries and thus influence the choice of entry mode.
### Table 1: Differences between the TCE, RBV and IT

<table>
<thead>
<tr>
<th>Unit of analysis</th>
<th>Transaction cost economics</th>
<th>Resource-based view</th>
<th>Institutional theory</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Transaction</td>
<td>Company</td>
<td>Country</td>
</tr>
<tr>
<td>Primary area of focus</td>
<td>Transaction characteristics</td>
<td>Company capabilities</td>
<td>Institutional environment</td>
</tr>
<tr>
<td>Objectives of the entry mode choice</td>
<td>Transaction cost minimization</td>
<td>Value maximization of resources and capabilities</td>
<td>Conformity to the formal and informal institutional environments</td>
</tr>
<tr>
<td>Source of competitiveness</td>
<td>Efficient management of transactions</td>
<td>Development and exploitation of capabilities</td>
<td>The gain of support and legitimacy</td>
</tr>
<tr>
<td>Key concepts</td>
<td>Bounded rationality, opportunism, asset specificity, internal and external uncertainty</td>
<td>Knowledge exploitation and augmentation, bounded rationality</td>
<td>Formal and informal institutions, regulative, normative and cognitive dimensions</td>
</tr>
</tbody>
</table>

Sources: Anderson & Gatignon (1986); Madhok (1997); Oliver (1997); Davis, Desai & Francis, (2000); Meyer, Wright & Pruthi (2009)

Even though the TCE, RBV and IT have many differences, yet they complement each other in explaining the entry mode choice and its underlying motives. The theories are highly recognized in this research field and because they operate at different levels of analysis – respectively the transaction, the company and the country – therefore the overview of them in this study helps to interpret the entry mode regression results.
4 SCIENTIFIC EVIDENCE AND HYPOTHESES

The deductive approach aims to provide facts that are observable in the social reality. Therefore, the purpose of the hypothesis development is to identify and synthesize the scientific evidence in the entry mode field to generate new research hypotheses.

The TCE, RBV and IT respectively seek to determine different factors that may influence the choice of entry mode. Despite much research within this topic, no single factor is likely to have an exclusively influence on the choice of entry mode for companies in general and according to Root (1987) different factors can only encourage or discourage a particular entry mode. The entry mode choice is a multivariate decision problem and undertaking a holistic study that considers all factors is impossible.

As stated in the Chapter 1, the purpose of this study is to investigate how particular country-level factors and company-level factors influence companies’ entry mode choice. Canabal & White (2008) provide a review of the theories, countries and variables that are used in entry mode research. The TCE is the most commonly applied theory in the entry mode studies and the RBV and the IT are also ranked in the top 10 research list, which confirms the importance of them. China is ranked as the third most studied host country and continues to be subject of interest due to the country’s size and further expected development. The majority of the variables analysed in this study are the most acknowledged and supported in this field, which increases the likelihood of finding significant effects on the entry mode choice.

The choice of the entry mode in an emerging market is complex and according to the theories different factors influence in various directions. The hypotheses, which explore the relationship between the entry mode choice and the independent variables, are described in more detail to support the predictions.

4.1 Cultural distance

Cultural distance has been widely accepted as a measure for calculating the similarity or the difference between two countries and this construct has been applied to most business administration disciplines (Shenkar, 2001). Though, the greatest impact it has had in explaining the entry mode choice (Kogut & Singh, 1988; Hennart & Larimo, 1998; Brouthers & Brouthers, 2001; Erramilli, Agarwal & Dev, 2002).
Many entry mode studies have used the cultural distance index of Kogut & Singh (1988) which is based on Hofstede’s (1980) framework. Four dimensions that allow evaluating the multidimensional effect of culture are described following.

1) **Power distance:** This dimension explains that different societies put different weights on inequalities in institutions and organizations, for example in areas such as prestige, wealth and power. In high power distance countries the inequality is seen as the basis of societal order while in the low power distance countries it is seen as a negative phenomenon. (Hofstede, 2001). Hence, companies in high power distance countries would prefer to maintain the full control over their business and enter the market with the high entry mode.

2) **Uncertainty avoidance:** The second dimension refers to an anxiety about the future in a country and it deals with it by minimizing uncertainty. This dimension acknowledges the need for well-defined rules for prescribed behaviour (Soares, Farhangmehr & Shoham, 2007) by using three kinds of measures; technology, rules and rituals (Hofstede, 2001). Uncertainty avoidance is probably the most important dimension to the new entrants due to the obscurity while moving to unknown markets.

3) **Individualism/Collectivism:** This dimension describes the relationships that individuals have with the other groups in a given society (Hofstede, 2001). In individualistic countries, people are only concerned about themselves and their family while in collectivistic cultures people become loyal to the groups that look after them (Soares, Farhangmehr & Shoham, 2007). Therefore, companies in high individualism countries may choose high entry modes to ensure successful entry and maintain their reputation.

4) **Masculinity/Femininity:** The fourth dimension is based on the male values that are assertiveness, toughness and also these values are focused on material success; career and money (Hofstede, 2001). In feminine countries the dominant values are caring for others and the quality of life (Soares, Farhangmehr & Shoham, 2007). Companies in masculine countries may choose high entry modes due to their perception of risk and more extensive willingness to take it.

The TCE and RBV find the same connection between cultural distance and the choice of entry mode. Based on the TCE high cultural distance is associated with high transaction costs therefore it is more likely to lead to high-control entry modes (Hennart
& Larimo, 1998; Brouthers & Brouthers, 2001; Luo, 2001; Shenkar, 2001). High cultural distance increases the information costs and the difficulty of transferring competencies and skills (Shenkar, 2001). It also increases the level of uncertainty and complexity while entering the new market. Hennart & Larimo (1998) claim that limited information about local conditions may push a company to choose an EJV as an entry mode, whereas it will make a full acquisition when it feels comfortable to operate alone in that country.

On the one hand, high cultural distance might increase the costs associated with cooperative agreements more greatly than the costs of direct control. “The TCE suggests that wholly owned modes of entry are preferred when the costs of finding, negotiating and enforcing a cooperative agreement are greater than the cost of direct control” (Brouthers & Brouthers, 2001, p. 179). On the other hand, EJVs provide an opportunity to decrease the cultural gap by delegating some tasks to a partner and learning from him how to manage locally (Hennart & Larimo, 1998).

The RBV perspective considers two possibilities, when high cultural distance exists. A company could experience difficulties while transferring their know-how in-house. These problems could erode and dissipate the information, and increase the costs, therefore the preference for an EJV may increase (Madhok, 1997). At the same time, high cultural distance could result in uneffective resource transfer between a foreign entrant and local company due to the mismatch of routines or lack of local collaborator’s capabilities. Therefore, the foreign company might prefer to keep the transaction of information and capabilities within the company and choose a WOS (Erramilli, Agarwal & Dev, 2002).

Previous studies have found that as cultural distance increases, companies tend to maintain control over their foreign operations. Even though, Brouthers & Brouthers (2001) have discovered that previous empirical evidence is ambiguous in explaining the relationship between cultural distance and collaborative modes. However, acknowledged studies of Kogut & Singh (1988) who researched Japanese companies entering the United States find that EJV modes are favoured in culturally distant markets. Erramilli & Rao (1993) compare service and manufacturing company entry choices and learn that both types of companies prefer EJVs when cultural distance is high. Hennart & Larimo (1998) discover that higher cultural distance leads Japanese companies to choose EJVs supporting the findings that the greater the cultural distance between the home and the host countries, the more likely the entering company will
choose an EJV over a WOS and therefore, based on the literature review and the scientific evidence the following hypothesis is offered:

**Hypothesis 1:** The greater the cultural distance between the home and the host country, the higher the probability that the entering company will choose an equity joint venture entry mode over a wholly owned subsidiary entry mode.

### 4.2 Institutional distance

The differences between the home and the host country institutional environments affect entering companies’ choice of entry mode. Xu & Shenkar (2002) proposed that institutional distance supplements the cultural distance construct and the combination of these two measures offer to some extent a comprehensive assessment of description of the host country’s business environment.

Institutional distance raises challenges for entering companies to adjust to the local institutional system. First of all, it increases market ambiguity and legitimacy pressure (Yang, Su & Fam, 2012) to establish a valid business practice and to transfer know-how to foreign subsidiaries (Kostova, 1999). Secondly, it has been found that the greater the institutional distance between the two countries, the higher the uncertainty will be perceived (Kostova & Zaheer, 1999; Hilmersson & Jansson, 2012; Ando & Paik, 2013). This obscurity negatively affects both understanding and interpretation of local institutional requirements and therefore, companies more easily adjust to institutionally similar countries (Kostova & Zaheer, 1999). Companies can decrease the uncertainty by generating local experience (Hilmersson & Jansson, 2012) and by increasing the level of control over their foreign subsidiaries (Ando & Paik, 2013).

Kostova (1999) and Xu & Shenkar (2002) have found that higher institutional distance will lead to an EJV, which is expected to lower the risk of institutional conflicts. The authors claim that a local partner may provide knowledge of local legitimacy and also a competitive advantage which can partially replace the transfer of internal practices. Therefore, based on the literature review and the scientific evidence the following hypothesis is offered:

**Hypothesis 2:** The greater the institutional distance between the home and the host country, the higher the probability that the entering company will choose an equity joint venture entry mode over a wholly owned subsidiary entry mode.
4.3 Economic distance

Companies may enter foreign countries in search of lower labour costs and thereby strengthen their competitiveness at home as well as in foreign countries (Root, 1987). In some industries, the competitive advantage derives from the exploitation of cost and price differences between countries. In the industries where labour costs are of high importance, the companies are likely to enter countries with different economic profiles. According to Barney (1991) and Ghemawat (2001) rich countries, compared to the poor, engage in more cross-border activity relative to their economic size. Companies that rely on economies of experience, scale and standardization are more likely to enter countries that have similar economic profiles, since these companies more often have to replicate their existing business model to exploit their competitive advantage.

According to the TCE, a higher economic distance between the home and the host country may lead to higher transaction costs due to the disparities, which increase business barriers and the complexity of adapting to a local standard. Consequently, the adaptation should be more easily achieved in countries that are economically closer to each other, since they have similar market segments that can afford to consume comparable types of goods and services.

Economically close countries have similar infrastructure which results in more efficient operationalization process and as companies develop their competitive resources in the markets they already operate in, this makes it easier to transfer and leverage them (Hennart & Larimo, 1998; Johnson & Tellis, 2008). Most scholars that have investigated the effect of economic distance on the degree of ownership or company performance find a negative relationship (Hennart & Larimo, 1998; Tsang & Yip, 2007; Johnson & Tellis, 2008). Therefore, based on the literature review and the scientific evidence the following hypothesis is offered:

Hypothesis 3: The greater the economic distance between the home and the host country, the higher the probability that the entering company will choose an equity joint venture entry mode over a wholly owned subsidiary entry mode.

4.4 International experience

International experience is the most commonly used independent variable in entry mode research (Canabal & White, 2008). Companies often choose to internationalize
for the first time through export, which requires low start-up costs, few risks and profits on current sales. Root (1987, p. 53) defines international experience as “a development process that takes the firm toward a more and more international sophistication and commitment.” Companies are concerned with minimizing market risk and increased international experience helps to reduce it. The knowledge of foreign countries and markets pushes companies to overcome the liability of foreignness and thereby displaces behavioural factors with more rational decision making (Root, 1987; Kogut & Singh, 1988; Agarwal & Ramaswami, 1992). This is in accordance with the acknowledged Uppsala model of internationalization based on psychic distance (Johanson & Vahlne, 1977), which explains that as a company advances from exporting to a WOS and gains international experience, it perceives lower risk regarding the foreign market.

EJV and WOS entry modes differ from each other on several dimensions with the degree of control being the major difference. Control is used to reduce the volatility of an uncertain environment (Killing, 1982, Williamson, 1985), but it also implies a higher resource commitment and risk (Anderson & Gatignon, 1986; Folta, 1998). Companies are initially risk averse when entering a new market and are not willing to invest significant resources in unfamiliar foreign markets. According to the RBV, as their international experience increases, it can lead to a competitive advantage and a valuable resource for the company (Barney, 1991). The decision makers in the company will become more confident and willing to commit more resources (Anderson & Gatijnion, 1986; 1988; Canabal & White, 2008).

According to the TCE, internal uncertainty should decrease as control increases. Agerwal & Ramaswami (1982), Anderson & Gatignon (1988) and Erramilli (1991) find a significant positive relationship between aggregate international experience and the degree of control of a foreign business entity. This implies that less experienced companies are more reluctant to make substantial resource commitment and assume control (Johanson & Vahlne, 1977; Root, 1987).

Kogut & Singh (1988) observe no significant results of multinational experience in explaining the choice between an EJV and a WOS. Blomstermo & Sharma (2006) also support the findings and discover that the experience, measured by the number of years since the first international operation abroad, does not yield any significant results on the entry mode choice. These results indicate that international experience may not have any influence on the degree of control. Some researchers even find a negative
relationship between the company’s international experience and its desire for control. Daniels, Ogram & Radebaugh (1976) observe that companies investing overseas without much international experience enter with complete control. The TCE suggests that lack of experience can increase the degree of internal uncertainty, which makes it difficult for the entering company to accurately assess the performance of a partner. The company may therefore find it easier only to monitor its own effort in a WOS (Williamson, 1985). Therefore, based on the literature review and the scientific evidence the following hypothesis is offered:

**Hypothesis 4:** The greater the international experience of the entering company, the lower the probability that it will choose an equity joint venture entry mode over a wholly owned subsidiary entry mode.

### 4.5 Host country experience

Host country experience is mainly based on the same rationale as international experience. After a company has gained experience from its first investment entry in the host country the subsequent investment entry decisions are likely to be made with more intelligence and skill than the first one making them less risky (Root, 1987). Host country experience reduces the uncertainty related to assessing the probable economic worth of entering the host country and strengthens the company’s ability to stabilize its operations in the host country environment due to the existing country specific knowledge like commercial practices, business culture and networking tactics (Luo, 2001). Once the foreign companies have accumulated local experience and obtained the necessary local knowledge, their dependence on local partners becomes less needed. High host country experience reduces the necessity for collaborating with a local partner, and the company may therefore prefer a WOS. The previous empirical evidence has found that host country experience should favour a WOS over an EJV (Erramilli, 1991; Andersson & Svensson, 1994; Luo, 2001). Therefore, based on the literature review and the scientific evidence the following hypothesis is offered:

**Hypothesis 5:** The greater the host country experience of the entering company, the lower the probability that it will choose an equity joint venture entry mode over a wholly owned subsidiary entry mode.
4.6 Firm size

The size of the company represents the amount of managerial and financial resources the company has at its disposal. Larger companies commonly have greater resource availability and may therefore be in a better position to make the high investments that a WOS entry mode requires (Nakos & Brouthers, 2002). A condition for companies to enter a foreign market is to have some kind of competitive advantage based on its tangible or intangible resources (Barney, 1991). According to the RBV companies need strong resources to engage in international expansion, successfully compete with the host country companies and absorb the high costs of such items as e.g. marketing and contract negotiations. The size of a company reflects its capability to absorb these costs and prior evidence has found that firm size is positively related to the size of the ownership (Agarwal & Ramaswami, 1992; Erramilli & Rao, 1993; Osborne, 1996). Horst (1972) argues that due to the fixed costs and risks involved in investing abroad, large companies are considered to be less credit risky than smaller companies and tend to have more resources, which can be applied to a market entry (Brouthers & Brouthers, 2003).

According to the TCE, companies with high asset specificity tend to enter foreign markets through a WOS, because of the benefits gained from control. Additionally, Erramilli & Rao (1993) find that, as companies grow larger they become more reluctant in giving up control, when entering new markets. The power of asset specificity is greatest when companies are small and becomes progressively weaker as the firm size increases. This supports the majority of previous study findings that company size positively correlates with high entry modes (Brouthers, Brouthers & Werner, 1999).

However, a few studies have found conflicting results. Nakos & Brouthers (2002) find no significant results of difference in the choice between equity and non-equity entry modes based on firm size and Quer, Claver & Rienda (2012) find that firm size has a significant negative impact on a WOS. The explanation of this may be that larger companies tend to be involved in a more diverse set of activities and markets, which makes them more focused on the overall competitive position and less concerned with the disadvantages of collaboration with a partner (Madhok, 1997). Therefore, based on the literature review and the scientific evidence the following hypothesis is offered:

**Hypothesis 6:** The larger the entering company is, less likely it will choose an equity joint venture entry mode over a wholly owned subsidiary entry mode.
The model associated with the hypotheses tested in this study correlates the country-level factors and company-level factors to entry mode choice. The relationship and expected signs between the variables are illustrated in Figure 2.

**Country-level factors:**
- H1: Cultural distance
- H2: Institutional distance
- H3: Economic distance

**Company-level factors:**
- H4: International experience
- H5: Host country experience
- H6: Firm size

**Entry mode choice:**
- Equity joint venture (0)
- Wholly owned subsidiary (1)

**Control variables:**
- Industry
- Year of entry

**Figure 2: The relationship between independent and dependent factors**

Before the regression analysis is performed, Chapter 5 describes and analyses the most important factors of emerging markets and China that may influence the entry mode choice to enhance the interpretation and understanding of the results.
More and more attention of international business has been drawn to analysing emerging markets (EM) and the rising opportunities in them. EMs can be defined as countries that are rapidly growing in GDP, have increased integration in the global economy and are affected by progressive economic reforms. Factors such as market liberalization, increased political stability, economic and legal reforms have built a basis in EMs for an attractive business environment and this has led to a higher number of FDIIs (Cavusgil, Ghauri & Akcal, 2013). The best example of EMs is BRIC countries (Brazil, Russia, India and China) due to their fastest growing economies in the world.

Even though, EMs provide many opportunities to achieve higher returns, companies have to deal with many difficulties before entering these markets. First of all, the choice of entry mode is complex due to the high external uncertainty and internal constraints in the markets. Therefore, companies have to analyse the conditions of marketing infrastructure and government policies toward foreign investment. Secondly, high growth and rapid change of EMs result in global competition within these markets (Lin, 2000). Companies compete between each other for the share of the market and profit. Additionally, companies face costs and risk due to their limited market knowledge. The risk rises from psychic distance which can be reduced by increasing knowledge of the business environment. The knowledge is accumulated by building relationship with a local partner, gaining experience and acquiring information (Cavusgil, Ghauri & Akcal, 2013).

Lin (2000), Brouthers (2002) and Johnson & Tellis (2008) find that companies prefer to enter the EMs using an EJV mode. This mode is more popular due to the high uncertainty in these markets and institutions. EJVs provide the ability to reduce risks and strengthen competitiveness in the market (Lin, 2000). Furthermore, EJVs grant ability to access local know-how, networks of suppliers and distributors or leverage local partners’ relationships with regulatory authorities or interest groups (Cavusgil, Ghauri & Akcal, 2013).

On the other hand, Meyer, Wright & Pruthi (2009) find that higher level of development of market-supporting institutions in EMs will influence the choice of choosing a WOS as an entry mode. In the countries, where institutional environment is weaker, an EJV will be preferred. Even though WOSs are associated with higher costs
and risks, they can prevent companies to lose their know-how, realize location economies, maintain control and establish a strong presence in the market (Cavusgil, Ghauri & Akcal, 2013).

According to Hoskisson et al. (2000) the TCE, RBV and IT help to explain the choice of entry mode in the EMs. Researchers argue that these theories should be used in different stages of the development. The IT is best in explaining the strategies of entry in the early stages of market emergence while institutions are still in establishment process. As markets mature, institutional environment becomes stable and therefore the TCE and the RBV are more important in later stages.

In the context of emerging markets, China’s economic and business environments are described in the following chapter. Emphasis is put on the Chinese market and the FDIs into the country.

5.1 Overview of China

China is presently the second largest economy in the world but due to the rapid GDP growth it should overtake the United States in the near future. According to Niu, Wang & Dong (2013) China has become one of the world’s most attractive markets, because of its vast population, enormous development potential and increasing disposable income. In 2012, China was the most popular destination for FDI, with inflows of $253.4 billion, including Hong Kong (The World Bank, 2014).

During the process of economic transition over the past three decades, China has been smoothly transitioning from a planned economy to a market economy (Niu, Wang & Dong, 2013). In 1978, China implemented the “open-door” policy and a year later a law on joint ventures was passed which opened the market for foreign investment. In 1986, China adopted a law allowing wholly foreign owned enterprises to be established. Since then, one of China’s main objectives has been to attract foreign capital by liberalising foreign investment and attempting to create a suitable framework for such investment (Claver & Quer, 2005). Another big step of opening the economy was done in 2001, when China joined WTO. This helped to integrate the country into the world’s economy, become the world’s greatest exporter and second-biggest importer (WTO, 2014).
5.2 Two sides of the Chinese market

Before entering the market, foreign companies need to understand the Chinese business environment. The government has introduced a catalogue for foreign companies of permitted, encouraged, restricted and prohibited investment projects (The Ministry of Commerce People’s Republic of China, 2012). This list is a guideline for new companies which are interested in entering the country’s market.

On the one hand, China is very attractive for foreign investors due to its economic potential. Since the economic reforms, the Chinese government has been implementing special policies for foreign companies, such as reduced taxation, in an effort to attract foreign investment and boost China’s economy (Niu, Dong & Chen, 2012). Also, the current regulations on repatriation of profits by foreign investors, compared to the early days of economic reform, are fairly non-restrictive; overseas investors are allowed to repatriate before-tax profits by means of intercompany charges, such as royalty fees, management fees and service fees (Lau & Bruton, 2008). There are three main reasons why foreign companies are so willing to enter the Chinese market.

First of all, it offers a high volume and differentiated consumer market. According to Story (2010) China is undergoing a transition from a rural to an urban society; therefore its middle-class is rapidly growing and this increases the demand for foreign branded products. Niu, Dong & Chen (2012) find that due to the unique consumer mentality in China, foreign products are considered a symbol of superior quality and better design.

Secondly, China has been known for its supply of cheap labour and raw materials. Recently, this began to change in coastal regions due to the rising costs, therefore companies started to move to western cities, where there is a relatively cheaper labour and better access to inland markets (Story, 2010). Also, a large provision of engineers and scientists in the country attracts companies to set up R&D laboratories and product development centres (Tse, 2010). This offers companies various natural and human resources, and knowledge that are available in the market.

Lastly, due to China’s geographic location it enables companies to profit from the country’s new role as a regional manufacturing hub for the production of consumer goods and reach other growth markets in Asia (Story, 2010). China has been improving its transport and communication infrastructure to link new markets, coastal areas and
the rest of the world with one another (Tse, 2010). These upgrades have made the country more accessible to the world’s market.

On the other hand, even though economic reforms have significantly improved the path for foreign companies to enter the Chinese market, there are still many issues that have to be considered before choosing an entry mode. Foreign companies find entering China difficult for the following reasons.

First of all, foreign companies must understand the government’s priorities and modify their entry strategies accordingly. There are still core sectors such as telecommunications and media that foreign companies are not allowed to enter (Appendix A). The government will intervene even in completely open industries if it thinks it is necessary (Tse, 2010).

Secondly, according to Cremer & Ramasamy (2009) a weak rule of law and corruption continue to be major issues. Patent and intellectual property laws are still not strictly applied in China; therefore it makes it easier for latecomers to copy new technologies or designs and to sell similar quality products to their customers at lower prices. Also, most of the banks and financial institutions in China are owned and operated by the government. Consequently, this results in unfair judgments and policies regarding commercial loans because government agencies will base their decisions on the need to develop certain industries or areas (Niu, Dong & Chen, 2012).

Lastly, governmental policies regulating business practices vary from region to region and sometimes change over time because business infrastructure is still in the process of being built, modified, and improved. It is often difficult to assess or forecast the necessary investments that have to meet the local requirements due to the missing information on the market in different regions and lack of timely updates on any changes in policies (Niu, Dong & Chen, 2012).

The Chinese government has always kept their control over business with the balance of political and social stability. Although, economic reforms have improved business environment, companies still have to be cautious of the Chinese government’s priorities and choose the entry mode in regards of internal and external factors.

5.3 FDI in China

High entry modes attract a great attention of Chinese market researchers. Cremer & Ramasamy (2009) argue that it may be due to the poor governance in China that
direct investment is more popular than other forms of investment, e.g. portfolio investment. Lau & Bruton (2008) find that FDI is the main source of the growth in China and it has enabled the country to become the leader in exporting.

There are two types of joint ventures that are used in China: equity joint venture, with limited liability on the equity, where the Chinese and the foreign party jointly manage the business, but the foreign share cannot be lower than 25 percent; and cooperative or contractual joint venture, which is more flexible and partners may agree on a share of the profits different from their share in the equity. For example, a foreign partner will provide most of the financing, but its share is limited to a maximum percentage allowed by the government, as the sector the company operates is restricted (Claver & Quer, 2005).

According to Lau & Bruton (2008) due to the new policies that resulted in higher openness of the market, EJVs are no longer the major type of FDI into China. WOSs have taken this place. They started to dominate as the most popular entry mode in China increasing from 47.3% in 2000 to 78.3% in 2008. In 2009 and 2010 it fell below 77% while in 2011 it rose to 78.6% and 77.1% in 2012. Additionally, this trend has been resulted not only by the regulatory liberalisation but also by a mistrust of Chinese EJV partners and the knowledge of Chinese culture and business environment the foreign companies have acquired since the country first opened to foreign investment.

Presently, there has been a small resurgence of EJVs. They decreased from 35.2% in 2000 to 18.7% in 2008. In 2009 and 2010 it rose to 19.2% and 21.3% respectively, while in 2010 it fell down to 18.6% before increasing to 19.4% in 2012. This trend has been resulted by a fierce competition from Chinese companies which made the acquisitions of local companies more difficult and also local potential partners have improved their quality of doing business. Thus, these factors are expected to help to maintain the interest in EJVs for the nearest future (Davies, 2013).

Choosing the entry mode for foreign companies is the key objective which will determine if they are able to achieve a successful start and receive government support. And although there are still a lot of unknowns, membership in the WTO, the presence and influence of many multinationals, as well as many important reforms and adjustments in the legal system have made China much more predictable today than in the past (Cremer & Ramasamy, 2009).
6 EMPRICAL METHOD

In this chapter, the method for the empirical research is described including data collection, variables and measures employed, to address the study’s hypotheses.

6.1 Data

In this study a deductive approach and quantitative strategy method is used. This method allows collecting a large amount of data, quantifying it and performing a statistical analysis, which makes the method suitable for testing the previously offered hypotheses and comparing the results with the previous findings (Arnbor & Bjerke, 1997; Saunders, Lewis & Thornhill, 2009).

The companies selected for this study have entered China from 01/01/2002 to 31/12/2013 using EJV or WOS entry modes and the data is collected using secondary sources. The companies are found using Zephyr, which is the most comprehensive database of deal information, and since the focus is on the entry mode via an EJV or a WOS two deal types are selected; joint venture and acquisition (with 100% stake increase). The target country is China and the acquirer countries are chosen from the rest of the world except Hong Kong, Macau and Taiwan, because they are subjects to some regulations of China, and also countries commonly related to tax havens; Bermuda, British Virgin Islands and Cayman Islands are excluded. A boolean search with these criteria results in a list of 1159 deals, which is exported to excel. A correction for target country to only represent China is made and company deal duplicates are removed, so only the earliest remains, which leaves 923 deals. The focus of this study is not on a specific industry. However, the Chinese government has made a catalogue of restricted foreign investment industries (Appendix A) describing the industries, where foreign companies are only allowed to participate with a local Chinese partner that has the majority ownership. As the choice between an EJV and a WOS is investigated in this study, the acquiring companies cannot be restricted in the choice between them. As a result target companies operating in the restricted industries are excluded.

The interest is in companies both with and without previous entry in China. To investigate this Orbis, a database that contains comprehensive information on companies worldwide, LexisNexis and ABI/INFORM Global that both offer easy access to the most credible business, legal and news sources and the companies’
respective websites are used. As information about the company size, industry and international experience is needed, company deals missing this information are removed.

The collected sample size therefore consists of 355 company deals from 23 different countries (Appendix B), where 165 (46.5%) are acquisitions and 190 (53.5%) are joint ventures. This sample amounts of 166 (46.7%) company deals with the first entry into China during the 2002-2013 time period. The size of the sample is consistent with prior studies that primarily range from 138 (Caves & Mehra, 1986) to 829 (Barkema & Vermeulen, 1998). The data is analysed using binary logistic regression, which is the most suitable method when the dependent variable is binary (Verbeek, 2004; Canabal & White, 2008).

In the following section, the particular measures that this study employs are described. A number of scales that measure the same phenomenon may exist and therefore empirical studies that demonstrate the use of measurements in researches that have similar characteristics to this study are located. This approach increases the validity of how well the variables actually measure what they are supposed to (Saunders, Lewis & Thornhill, 2009).

6.2 Dependent variable

6.2.1 Entry mode (ENMO)

To test the hypotheses, the dependent variable in this study is entry mode (ENMO). Past studies have investigated entry modes using different levels of commitment. While some studies distinguish between low and high entry modes, the focus of this study is on the level of commitment being either shared or full. High entry mode consists of EJVs, acquisitions and greenfield investments. An EJV is a new entity established in corporation with a partner from the host country, an acquisition is an entry mode to fully integrate a company in the host country and a greenfield investment is defined as entering the host country independently. The primary difference between these three entry modes is the level of commitment, which is shared in an EJV and full in an acquisition and a greenfield investment. However, Zephyr does not contain information about companies’ that are using greenfield investment, therefore they are not considered and only EJVs and acquisitions (WOSs) are used. Researching EJVs and WOSs is consistent with previous studies of entry mode literature, where focus is on the
high entry modes (Gatignon & Anderson, 1988, Kogut & Singh, 1988; Woodcock, Beamish & Makino, 1994). The entry mode in this study is defined as a dummy variable taking 0 for a joint venture entry (equally split) and 1 for an acquisition entry (100% stake increase).

6.3 Independent variables

6.3.1 Cultural distance (CUDI)

In consistency with the past studies on the effect of cultural distance (CD) on entry mode choice, the CD is measured using the Kogut & Singh (1988) index (Hennart & Larimo, 1998; Luo, 2001; Brouthers, 2002). This index is based on Hofstede’s (1980) country scores that were obtained by analysing a large database of employee value scores collected within IBM from 40 countries. This study considers the four dominant dimensions among which national cultures can be statistically categorised and differ; power distance, uncertainty avoidance, individualism versus collectivism and masculinity versus femininity. The latest updated scores that were published on Hofstede’s website in 2010 (Hofstede, Hofstede & Minkov) are used. Year to year data is not available therefore the same index is used independently of the time of entry. According to Hofstede (2010) this approach is justified, since the relative scores have proven to be relatively stable over time, as the forces that cause cultures to shift tend to be global or continent-wide. The following formula is applied, where the differences between the home country and China are corrected for distinctions in the variance of each dimension and arithmetically averaged:

\[
CD_j = \sum_{i=1}^{4} \left\{ \frac{(I_{ij} - I_{ic})^2}{V_i} \right\} / 4
\]

where CD\(_j\) is the cultural distance between the home country j and China, I\(_{ij}\) is the index for the \(i^{th}\) cultural dimension and \(j^{th}\) country, I\(_{ic}\) is China’s score on the \(i^{th}\) cultural dimension, and V\(_i\) is the variance of the \(i^{th}\) cultural dimension. The sum of these indices is divided by four, since it contains four cultural dimensions. A higher score implies a greater cultural distance between the home country and China.

6.3.2 Institutional distance (INDI)

Institutional distance measures the distance between the host and the home country’s institutional development during the year of entry. This variable is calculated
by using Kogut and Singh’s (1988) approach to measure cultural distance. The following formula is applied:

\[ ID_j = \frac{1}{6} \sum_{i=1}^{6} \left\{ \left( I_{ij} - I_{ic} \right)^2 / V_i \right\} / 6 \]

where \( ID_j \) is institutional distance between the home country \( j \) and China, \( I_{ij} \) is the index for the \( i \)th institutional dimension and \( j \)th country, \( I_{ic} \) is China’s score on the \( i \)th institutional dimension, and \( V_i \) is the variance of the \( i \)th institutional dimension. The sum of these indices is divided by six that are measures of the economic freedom index (property rights, freedom from corruption, business freedom, trade freedom, investment freedom, financial freedom) and are used to calculate institutional distance.

### 6.3.3 Economic distance (ECDI)

Economic distance between the host and the home countries is calculated using GDP per capita in the year of entry. The data for this variable is obtained from the World Bank website (2014). According to Hutzschenreuter, Kleindienst & Lange (2014) GDP per capita is the most applied variable to measure the economic development and distance between countries. Based on the study of Tsang & Yip (2007) the economic distance between China and less developed countries is calculated as \( \ln(y_c) \) minus \( \ln(y) \) and between China and more developed countries as \( \ln(y) \) minus \( \ln(y_c) \), where \( y_c \) and \( y \) represent the real GDPs per capita in U.S. dollars of China and the home country, respectively. Natural logarithm is used as it is a standard practice in econometrics and it provides better analysis of economic distance when there are small differences in GDP per capita.

### 6.3.4 International experience (INEX)

International experience in entry mode literature is measured in different ways; number of foreign subsidiaries, international sales and geographical scope or spread. In this study international experience is measured in terms of the number of years the company has been doing business outside its home country prior to the entry in China (Erramilli, 1991; Osborne, 1996; Brouthers, Brouthers & Werner, 1999; Brouthers, 2002). Instead of using the absolute number of years, the natural logarithmic difference is used.
6.3.5 Host country experience (COEX)

Host country experience is measured as a dummy variable, taking the value of 1 if the entering company has already undertaken at least one FDI in China and 0 otherwise.

6.3.6 Firm size (SIZE)

Firm size has been applied in many studies by computing assets, sales, employees or value added. In this study sales figures are not used as a measure, because some companies do not provide this data, which may reduce the number of usable companies. The variable SIZE is calculated by taking the natural logarithm of the foreign company’s total number of employees. Previous studies (Wolf & Pett, 2000; Nakos & Brouthers, 2002; Brouthers, 2002; Ittner, Lambert & Larcker, 2003; Becker-Blease et al., 2010) have also used the number of employees as a measure of firm size.

6.3.7 Industry (INDU)

Previous research suggests that manufacturing companies are more investment intensive, since entering a new country requires greater resource commitment in plant, equipment and inventory, compared to service companies that mainly require investments in people (Luo, 2001; Brouthers & Brouthers, 2003). In perspective of the TCE, manufacturing companies are more influenced by host country uncertainty compared to service companies and Erramilli & Rao (1993) find that service companies prefer entering with full control modes. Service companies in this study are not excluded and therefore to control for any industry effects a dummy variable taking 0 for a manufacturing company (defined through its making of products or articles, especially in factories and by industrial means or processes) and 1 for a service company (not a manufacturing company) is included (Kogut & Singh, 1988; Brouthers, 2002).

6.3.8 Time fixed effects

As the time period of the sample extends over 12 years it is important to include a control variable for every year. This is done using time fixed effects, where a dummy variable indicates which year the entries correspond to. This approach does not impose any structure and will therefore take changing economic conditions or business cycles into account (Wooldridge, 2002).
Table 2: Summary of variable measures

<table>
<thead>
<tr>
<th>Variable</th>
<th>Measured as</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Dependent variable:</strong></td>
<td></td>
</tr>
<tr>
<td>Entry mode (ENMO)</td>
<td>Dummy variable: Taking 0 for an EJV and 1 for a WOS.</td>
</tr>
<tr>
<td><strong>Independent variables:</strong></td>
<td></td>
</tr>
<tr>
<td>Cultural distance (CUDI)</td>
<td>Distance between the home and the host country’s four dimensions calculated using the following formula:</td>
</tr>
<tr>
<td></td>
<td>[ CD_j = \sum_{i=1}^{4} \left{ (I_{ij} - I_{ic})^2 / V_i \right} / 4 ]</td>
</tr>
<tr>
<td>Institutional distance (INDI)</td>
<td>Distance between the home and the host country’s institutional development during the year of entry calculated using the following formula:</td>
</tr>
<tr>
<td></td>
<td>[ ID_j = \sum_{i=1}^{6} \left{ (I_{ij} - I_{ic})^2 / V_i \right} / 6 ]</td>
</tr>
<tr>
<td>Economic distance (ECDI)</td>
<td>Natural logarithm of the difference between the host and the home country’s GDP per capita in the year of entry.</td>
</tr>
<tr>
<td>International experience (INEX)</td>
<td>Natural logarithm of the number of years the company has been doing business outside its home country prior to the entry in China.</td>
</tr>
<tr>
<td>Host Country experience (COEX)</td>
<td>Dummy variable: Taking 1 if the entering company has previous experience of FDI in China and 0 if not.</td>
</tr>
<tr>
<td>Firm size (SIZE)</td>
<td>Natural logarithm of the foreign company’s total number of employees.</td>
</tr>
<tr>
<td><strong>Control variable:</strong></td>
<td></td>
</tr>
<tr>
<td>Industry (INDU)</td>
<td>Dummy variable: Taking 0 for a manufacturing company and 1 for a service company.</td>
</tr>
<tr>
<td>Time fixed effects</td>
<td>Dummy variable: Indicates which year the entries correspond to.</td>
</tr>
</tbody>
</table>
7 RESULTS AND FINDINGS

This study employs logistic regression to test the hypotheses, since the dependent response variable is binary (Fidell & Tabachnik, 2007). The purpose of using the logistic regression is to determine the impact of multiple independent variables to predict the outcome of either an EJV or a WOS. The analysis is undertaken using Binary Regression in the IBM SPSS Statistics 20 package to assess the variables’ effect on entry mode choice. Empirically this statistical method is the most commonly used in entry mode research (Canabal & White, 2008), which allows to compare this study’s results to prior findings. By incorporating the variables discussed in Chapter 6, the binary logistic regression equation is generated as follows, which is in accordance with previous studies, where the aim is to estimate the effect of the explanatory factors on the probability that each of the two alternatives will be chosen (Gatignon & Anderson, 1988; Kogut & Singh, 1988; Agarwal & Ramaswami, 1992).

\[
ENMO = \beta_0 + \beta_1CUDI_1 + \beta_2INDI_1 + \beta_3ECDI_1 + \beta_4INEX_1 + \phi_5COEX_1 + \beta_5SIZE_1 + \phi_6INDU_1 + \delta_t
\]

where ENMO represents the choice of the entry mode, \( \beta_0 \) is the constant, \( \beta_i \) are the independent variables of interest, \( \phi_i \) represents the dummy variables and \( \delta_t \) represents the year dummy variables included in the model.

Logistic regression is more flexible than other techniques. It does not assume a linear relationship between the dependent and independent variables and also the independent variables are not required to be normally distributed, linearly related or of equal variance within each group. Since the dependent variable is binary, logistic regression cannot predict a numerical value for it. Instead, it uses a method called maximum likelihood, which maximizes the probability of classifying the observed data into the appropriate dependent category. This study satisfies the recommended condition that the sample size should consist of minimum 30-50 cases per explanatory variable (Menard, 2002; Fidell & Tabachnik, 2007).

To analyse the equation, the full model that contains the entire sample consisting of companies with and without prior host country experience in China is run. Additionally, a second model only consisting of the companies without prior host country experience is analysed. The choice of entry mode is either classified as an EJV with a 0 or as a WOS with a 1. First of all, the sample is checked for outliers, secondly descriptive statistics and correlations are discussed, and finally the models are analysed.
7.1 Descriptive statistics

It is important to check if there are any outliers or cases in the sample that are not well explained by the model. For example, it may be the situation that a case is strongly predicted by the model to be an EJV but in reality is classified as a WOS. It is not expected to find a perfect fit between the observed cases and the model’s predictions across a large number of cases, but as excessive outliers can affect the results significantly, these outliers may be removed. Outlying cases can be identified by inspecting the standardized residuals and should be considered removed if they exceed 2.58 (outliers significant at the 0.01 level). If the accuracy of the model after excluding outliers increases less than 2%, the baseline model will be interpreted. Running the baseline model with all cases results in a goodness of fit of 28.1% interpreted using the Nagelkerke pseudo R-squared, which is found in Appendix C. Four cases are identified as outliers and by removing them and running the revised model the goodness of fit increases to 33.9%. The revised model without outliers is therefore applied in the analysis.

In Table 3 the descriptive statistics are presented, which give some information concerning the distribution of the data and an indication of whether any data are misspecified. None of the values look incorrect and since there is no assumption about normality the skewness and kurtosis indicate how the observations are distributed.

<table>
<thead>
<tr>
<th></th>
<th>N</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std. Deviation</th>
<th>Skewness</th>
<th>Kurtosis</th>
</tr>
</thead>
<tbody>
<tr>
<td>ENMO</td>
<td>351</td>
<td>0.000</td>
<td>1.000</td>
<td>0.470</td>
<td>0.500</td>
<td>0.132</td>
<td>-1.994</td>
</tr>
<tr>
<td>CUDI</td>
<td>351</td>
<td>0.414</td>
<td>4.855</td>
<td>2.908</td>
<td>0.742</td>
<td>-1.239</td>
<td>4.972</td>
</tr>
<tr>
<td>INDI</td>
<td>351</td>
<td>0.849</td>
<td>8.969</td>
<td>5.145</td>
<td>1.817</td>
<td>-0.443</td>
<td>-0.857</td>
</tr>
<tr>
<td>ECDI</td>
<td>351</td>
<td>0.560</td>
<td>3.841</td>
<td>2.794</td>
<td>0.586</td>
<td>-1.478</td>
<td>2.196</td>
</tr>
<tr>
<td>INEX</td>
<td>351</td>
<td>0.000</td>
<td>5.263</td>
<td>3.120</td>
<td>1.128</td>
<td>-0.765</td>
<td>0.140</td>
</tr>
<tr>
<td>COEX</td>
<td>351</td>
<td>0.000</td>
<td>1.000</td>
<td>0.530</td>
<td>0.500</td>
<td>-0.109</td>
<td>-2.000</td>
</tr>
<tr>
<td>SIZE</td>
<td>351</td>
<td>1.609</td>
<td>13.193</td>
<td>8.061</td>
<td>2.346</td>
<td>-0.262</td>
<td>-0.472</td>
</tr>
<tr>
<td>INDU</td>
<td>351</td>
<td>0.000</td>
<td>1.000</td>
<td>0.270</td>
<td>0.443</td>
<td>1.053</td>
<td>-0.896</td>
</tr>
</tbody>
</table>

Before performing the logistic regression and interpreting results, it has to be considered if there is correlation among the independent variables, because
multicollinearity can have significant effect on the estimation of the coefficients. The existence of multicollinearity may increase the variances of the independent variables, result in incorrect signs and therefore lead to incorrect conclusions about the relationship between the entry mode choice and the explanatory variables. Ideally, the independent predictor variables should be strongly related to the dependent response variable, but not strongly related to each other. The simplest method of identifying the presence of multicollinearity is by examining a Pearson correlation matrix of the variables, which is presented in Table 4.

Table 4: Pearson correlations

<table>
<thead>
<tr>
<th></th>
<th>ENMO</th>
<th>CUDI</th>
<th>INDI</th>
<th>ECDI</th>
<th>INEX</th>
<th>COEX</th>
<th>SIZE</th>
<th>INDU</th>
</tr>
</thead>
<tbody>
<tr>
<td>ENMO</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CUDI</td>
<td>0.115*</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>INDI</td>
<td>0.365**</td>
<td>0.459**</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ECDI</td>
<td>-0.075</td>
<td>0.444**</td>
<td>0.317**</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>INEX</td>
<td>-0.057</td>
<td>0.205**</td>
<td>0.022</td>
<td>0.161**</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>COEX</td>
<td>0.052</td>
<td>0.091</td>
<td>0.059</td>
<td>0.146**</td>
<td>0.123*</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SIZE</td>
<td>0.016</td>
<td>0.091</td>
<td>0.039</td>
<td>0.115*</td>
<td>0.561**</td>
<td>0.079</td>
<td></td>
<td></td>
</tr>
<tr>
<td>INDU</td>
<td>0.091</td>
<td>0.000</td>
<td>0.086</td>
<td>-0.129*</td>
<td>-0.175**</td>
<td>-0.097</td>
<td>-0.078</td>
<td></td>
</tr>
</tbody>
</table>

*Correlation is significant at the 0.05 level (2-tailed).
**Correlation is significant at the 0.01 level (2-tailed).

The results of the Pearson correlation matrix show that several correlations are statistically significant. However, only the correlation between international experience (INEX) and firm size (SIZE) has a magnitude greater than 0.5. Fidell & Tabachnik
(2007) suggest considering carefully before including two variables with a correlation of 0.7 or more in the same analysis. This implies that there is no sign of high multicollinearity across the individual variables and therefore all variables will be retained in the regression (Nakos & Brouthers, 2002). Additionally, it is recommended to perform two other measures for assessing multicollinearity; Tolerance, which explains how much the variability of the respective independent variable is not explained by the other independent variables and VIF (Variance Inflation Factor), which is the inverse of the Tolerance value. A common cut-off point denoting multicollinearity is a Tolerance value of less than 0.10 or a VIF of more than 10. The values are presented in Table 5 and indicate no sign of multicollinearity.

![Table 5: Coefficients](image)

<table>
<thead>
<tr>
<th>Model</th>
<th>Collinearity Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Tolerance</td>
</tr>
<tr>
<td>CUDI</td>
<td>0.526</td>
</tr>
<tr>
<td>INDI</td>
<td>0.578</td>
</tr>
<tr>
<td>ECDI</td>
<td>0.306</td>
</tr>
<tr>
<td>INEX</td>
<td>0.619</td>
</tr>
<tr>
<td>COEX</td>
<td>0.898</td>
</tr>
<tr>
<td>INDU</td>
<td>0.894</td>
</tr>
<tr>
<td>SIZE</td>
<td>0.661</td>
</tr>
</tbody>
</table>

Dependent Variable: ENMO

7.2 Empirical results

The following results of the logistic regression are analysed and used to assess the main effects of the independent variables and test the proposed hypotheses. In model 1, the entire sample and all independent variables are applied and in model 2, the sample consists of the companies that have made no previous FDI in China, therefore the independent variable host country experience is omitted.

The Cox & Snell R-square and the Nagelkerke R-square values of model 1 are 0.254 and 0.339 respectively suggesting that between 25.4 percent and 33.9 percent of the variability in the dependent variable is explained by the set of variables. In model 2 the pseudo R-square values are 0.233 and 0.312 for the Cox & Snell -square and the Nagelkerke R-square respectively.
Model 1 is only applied for testing the hypotheses because Model 2 does not satisfy the rationale of logistic regression that for every variable there should be from 30 to 50 observations. Additionally, based on the Hosmer-Lemeshow Goodness of Fit Test, which is the most reliable test of model fit available in SPSS, Model 1 estimates fit the data at an acceptable level (p<0.05), while Model 2 fails to meet this condition and is not well-fitting model. It may be also resulted by a too small sample size.

Table 6: Logistic regression results

<table>
<thead>
<tr>
<th>Variable</th>
<th>Model 1</th>
<th>Model 2</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>S.E.</td>
</tr>
<tr>
<td>CUDI</td>
<td>0.112</td>
<td>0.225</td>
</tr>
<tr>
<td>INDI</td>
<td>***0.558</td>
<td>0.098</td>
</tr>
<tr>
<td>ECDI</td>
<td>***-0.988</td>
<td>0.388</td>
</tr>
<tr>
<td>INEX</td>
<td>-0.145</td>
<td>0.140</td>
</tr>
<tr>
<td>COEX</td>
<td>0.204</td>
<td>0.260</td>
</tr>
<tr>
<td>SIZE</td>
<td>0.059</td>
<td>0.066</td>
</tr>
<tr>
<td>INDU</td>
<td>0.283</td>
<td>0.294</td>
</tr>
<tr>
<td>Constant</td>
<td>-1.657</td>
<td>1.048</td>
</tr>
<tr>
<td><strong>Cox &amp; Snell R-square</strong></td>
<td>0.254</td>
<td>0.233</td>
</tr>
<tr>
<td><strong>Nagelkerke R-square</strong></td>
<td>0.339</td>
<td>0.312</td>
</tr>
<tr>
<td><strong>Correct Classification Rate (%)</strong></td>
<td>71.8</td>
<td>69.3</td>
</tr>
<tr>
<td><strong>Hosmer-Lemeshow Test</strong></td>
<td>0.770</td>
<td>0.045</td>
</tr>
<tr>
<td><strong>Number of Observations</strong></td>
<td>351</td>
<td>166</td>
</tr>
</tbody>
</table>

*p<0.10, **p<0.05, ***p<0.01

To test the hypotheses, six predictors are assessed, where the results of the regression can support or reject the hypotheses. In Table 6 the beta coefficients and significance levels are presented. The coefficients’ sign points to the direction of the relationship and which predictors increase the likelihood of a WOS entry mode and which factors decrease it. A positive coefficient implies that the likelihood of choosing a WOS as entry mode increases when the value of the independent variable increases, while a negative coefficient implies that the likelihood of choosing an EJV as entry mode increases when the value of the independent variable increases. The asterisk
represents statistical significance of a coefficient and indicates whether the corresponding explanatory variable significantly affects the choice of entry mode.

The coefficient for cultural distance is positive, which is contradicting with the hypothesis 1. However, the result is statistically insignificant and therefore the hypothesis is rejected. Gatignon & Anderson (1988) and Erramilli (1996) also discovered no significant relationship between cultural distance and the choice of entry mode when they tested Latin American and Germanic cultures.

The coefficient for institutional distance is found to be statistically significant and positively correlated, implying that the greater institutional distance between the home and the host country, the higher the probability that the entering company will choose a WOS entry mode over an EJV entry mode. Hypothesis 2 is rejected, which implies that there is a relationship between the variables, but since the coefficient is positive, there is no support for the hypothesis.

The coefficient for economic distance is found to be statistically significant and negatively correlated, indicating that the greater the economic distance between the home and the host country, the higher the probability that the entering company will choose an EJV entry mode over a WOS entry mode. Hence, hypothesis 3 is supported by the regression results that are validated by Hennart & Larimo (1998) who studied EJV and WOS entry modes into USA, Johnson & Tellis (2008) who investigated drivers of success for market entry and Tsang & Yip (2007) who used the concept of economic distance to examine FDI.

The coefficient of international experience is negative, which is contrary to previous studies, but since it is insignificant, it may not have any impact on the entry mode choice. Therefore, hypothesis 4 is rejected. The coefficient of host country experience is positively correlated with the entry mode choice, but is found statistically insignificant, therefore hypothesis 5 is rejected.

The coefficient of firm size is positively correlated with the entry mode choice, but is found statistically insignificant, for which reason hypothesis 6 is rejected. Nakos & Brouthers (2002) and Nakos & Brouthers (2004) in their studies examine the entry mode choice of SMEs and discover no relationship between firm size and entry mode choice.

The industry coefficient is positive as expected, which indicates that service companies favour WOSs over EJVs. However, the coefficient is not significant. In model 2 all the coefficients except from cultural distance are in the same direction as in model 1.
model 1. Though cultural distance is still insignificant, the coefficient is now in align with the proposed hypothesis 1 that a higher cultural distance leads to a higher probability of choosing an EJV as entry mode. In model 2 the economic distance is no longer significant. A summary of the hypotheses testing results can be found in Table 7.

Table 7: Hypotheses testing results

<table>
<thead>
<tr>
<th>Hypotheses</th>
<th>Explanatory variable</th>
<th>Statistical testing results</th>
<th>Expected sign</th>
<th>Observed sign</th>
<th>Support</th>
</tr>
</thead>
<tbody>
<tr>
<td>H1</td>
<td>Cultural distance</td>
<td></td>
<td>-</td>
<td>+</td>
<td>No</td>
</tr>
<tr>
<td>H2</td>
<td>Institutional distance*</td>
<td></td>
<td>-</td>
<td>+</td>
<td>No</td>
</tr>
<tr>
<td>H3</td>
<td>Economic distance*</td>
<td></td>
<td>-</td>
<td>-</td>
<td>Yes</td>
</tr>
<tr>
<td>H4</td>
<td>International experience</td>
<td></td>
<td>+</td>
<td>-</td>
<td>No</td>
</tr>
<tr>
<td>H5</td>
<td>Host country experience</td>
<td></td>
<td>+</td>
<td>+</td>
<td>No</td>
</tr>
<tr>
<td>H6</td>
<td>Firm size</td>
<td></td>
<td>+</td>
<td>+</td>
<td>No</td>
</tr>
</tbody>
</table>

*Significant results

Overall, the results show no consistency with the predictions of the theories and scientific evidence. In the following section the test results are discussed in details and compared to the existing literature findings in the context of China.

7.3 Discussion

Based on the statistical testing results presented above, this section discusses these findings. This discussion examines the findings related to the problem statement and sub-questions. Moreover, the relationships between the variables and the existing empirical evidence are explored. The general attempt is to generate more conclusive evidence concerning the role of country-level and company-level factors in the choice of entry mode.

7.3.1 Cultural distance

This study finds that cultural distance has no significant impact on the choice of entry mode, which is supported by results of Gatignon & Anderson (1988) and Erramilli (1996). However, these findings are inconsistent with the majority of previous studies on cultural distance.
The TCE suggests that in situations where the cultural distance is high and the host country environment is volatile, the entering company is better off accepting an EJV. The scholars suggest that companies utilize EJVs when entering culturally distant markets due to the managers’ perception regarding uncertainty and costs of alternative entry modes. Greater cultural distance commonly results in a more demanding and difficult management, which leads to higher administrative and organizational costs. When a company enters a country that is culturally similar to the home country, it may already possess most of the required information to operate in the market. However, when the company is culturally unfamiliar with the host country, it may have difficulties in implementing judgement systems to determine how the employees should behave and evaluating inputs and results (Gatignon & Anderson, 1988). These challenges may be reduced by assigning a local partner the tasks of coordination and control, since this facilitates the process of coping with knowledge barriers and minimizing cultural gaps and uncertainty. Additionally, scholars reason that an EJV increases flexibility and reduces potential losses in case of market exit (Killing, 1982; Brouthers & Hennart, 2007).

On the other hand, some scholars submit that the challenges of cultural distance should be addressed through a WOS (Shane, 1994; Erramilli, Agarwal & Kim, 1997). Here the rationale is that in situations where the cultural distance is high and the host country environment is volatile, the entering company may encounter increased costs in finding and monitoring a local partner, because of difficulties in including all contingencies in the agreement and because of the inability to negotiate a fair price due to the challenges with asymmetric information (Erramilli & Rao, 1993). High cultural distance may increase the costs of a WOS, but the costs related to an EJV may be even higher due to the several factors. High volatility in the host country environment, especially in an EM, less potential partners, which reduces the choices leading to an increased risk of opportunism and adds to transaction costs, and higher internal uncertainty making it more difficult to monitor the employees’ activities (Anderson & Coughlan, 1987; Hennart, 1989). These factors may increase the transaction costs and therefore the entering company may be better off selecting a WOS entry mode, since this allows it to absorb external uncertainties more easily via a centralized decision making, reduce the communication costs and protect itself from opportunistic behaviour (Killing, 1983; Barney, 1991; Meyer, Wright & Pruthi, 2009). As China is still a growing market and it shows high potential for FDI it also continues to experience an
increasing global competition. This increases the external uncertainty and makes the choice of entry mode even more complex, which the insignificant result of cultural distance indicates.

7.3.2 Institutional distance

The coefficient of institutional distance is positive and statistical significant, which is in contradiction with existing literature. A regression without Japanese companies is performed to eliminate the possibility of bias results because for a long time the government of Japan demanded domestic companies to enter through joint ventures (Killing, 1983; Kawamura, 2011). Currently, Japan still has a culture of entering through joint ventures making domestic companies more active in EJVs compared to WOSs, which may overstate the Japanese contribution in the total number of EJVs. However, the interpretation of the result remains the same.

To foreign companies, China is an unfamiliar territory with cultural traditions, norms and values far from those of the western countries. This implies that the rules of the game (North, 1990) are dissimilar making local knowledge of particular importance. Despite the conflicting result of institutional distance compared to previous studies, some arguments may support the discovered relationship. Typically, the IT focuses on the role of formal institutions’ effect on organizational decisions and behaviours. Hence, institutional distance is of special concern for foreign companies entering an EMs, where distinctive regulatory settings may constrain international business (Meyer, 2001). Unclear regulatory frameworks, underdeveloped court systems, corruption and inexperienced bureaucracies increase transaction costs and makes efficient and reliable negotiating difficult. The IT posits that companies choose entry modes to gain legitimacy and reduce uncertainty.

In the RBV, the entry mode choice is influenced by the development and deployment of the company’s resources and capabilities and if the company possesses a competitive advantage in the form of valuable resources and knowledge, it tends to select a WOS. The entering companies are typically concerned with the host country’s respect for protection of intellectual property rights, which usually increases the preference for a WOS entry mode. Weak intellectual property right regimes increase the need to safeguard proprietary assets such as patents and trademarks (Delios & Beamish, 1999), which should be done via a WOS that reduces the uncertainty and risk of asset appropriation (Scott, 1995; Madhok, 1997; Luo, 2001).
Most scholars emphasize the importance of gaining legitimacy and conforming to the cultural and social expectations in the host country, which may be done easier by engaging with a local partner (Davis, Desai & Francis, 2000; Yiu & Makino, 2002, Brouthers, 2013). However, this study has found different results, which are supported by Ionascu, Meyer & Ersting (2004) who argue that by acquiring a local firm the entering company can access the institutional and market knowledge embedded in the existing local partner. To sum up, the institutional distance of this study suggests that the formal institutions are of high importance.

### 7.3.3 Economic distance

Of all the tested variables, economic distance is the only predictor which is both statistically significant and correlated in the same direction as previous studies. Johnson & Tellis (2008) argue that companies find it difficult to deal with economically distant host countries. High economic distance of dissimilar markets increases the external uncertainty, since knowledge about e.g. demand is not transferred so easily from the home to the host country, which increases the likelihood of choosing an EJV over a WOS. It grows even higher in emerging markets, where the uncertainty is perceived to be very high.

Entering a host country that is economically different requires the companies to adjust to the new market conditions, which reduces the probability of success. Therefore, both previous literature and this study’s findings suggest that companies should choose an EJV entry mode to reduce the commitment and risk when the economic distance is high.

### 7.3.4 International experience

The relationship between international experience and choosing a WOS as an entry mode in this study is found negative and is in contradiction with the existing findings. Although, the result is insignificant implying that no statistical trend is found.

The majority of empirical evidence supports the rationale that higher international experience leads to a WOS entry mode. Additionally, a high degree of uncertainty is associated with an EM, thus pushing companies further to maintain the control of their foreign operations. According to Johanson & Vahlne (1977) experiential knowledge is critical, because it cannot so easily be acquired as objective knowledge and because companies highly base their present and future activities on previous experience. The
RBV complements that the combination of specific experiences of individuals, organizations and markets can lead to a competitive advantage making the company more willing to choose a WOS entry mode, since an experienced company is likely to manage a foreign operation better compared to an inexperienced one (Anderson & Gatignon, 1986; Barney, 1991; Nakos & Brouthers, 2002). Less experienced companies may need to complement their resources in order to service the foreign host market through an EJV and thus sharing the risk with the local partner. By forming an EJV with a local partner, less experienced companies gain country specific knowledge, which can reduce vulnerability to contextual risks and promote the stability of the EJV’s activities in a complex environment (Root, 1987; Erramilli, 1991).

In general, when the entering company has a competitive advantage in the form of e.g. international experience, WOS entry modes are preferable, since this increases the resource utilization and the effectiveness of the its internal management (Killing, 1983; Root, 1987). Over time in the domestic environment of the company, the management has learned how the employees should behave and how to evaluate results that are difficult to measure, but in a foreign country the settings are different and it is unlikely to know how to manage the internal uncertainty (Anderson & Gatignon, 1986). As international experience increases, so do the company’s competences, confidence and understanding of foreign risks and returns. Therefore, it becomes less content in sharing the business and instead retains the control to pursue the most efficient outcome.

Some scholars (Daniels, Ogram & Radebaugh, 1976; Weichmann & Pringle, 1979) argue that less international experienced companies have a tendency to demand their own preferences, such as own nationals in key positions and implement its own strategy, even if the result is inefficient. They argue that this approach is easier achieved through full ownership than negotiation in an EJV. Over time, these companies become more comfortable in local differences and are more willing to delegate control reflected in a lower degree of ownership. However, these arguments are in contrast to TCE, which assumes that such inefficient practices will be eliminated by market pressures. Furthermore, the effect of cultural distance is strong in China, where the reason for success or failure strongly depends on how well or poorly the entering company adapts its products to the local culture. Companies are aware of this and even after several decades of international experience, they may prefer EJVs to avoid imposing e.g. western consumption habits and production methods in the emerging market. Despite several arguments for a positive relationship between international experience and the
degree of ownership, the insignificant result of this study is in accordance with Kogut & Singh (1980) and Blomstermo & Sharma (2006).

### 7.3.5 Host country experience

The observed relationship of host country experience in this study is in accordance with the proposed hypothesis and previous literature, but is found not significant. A dynamic environment in an emerging market like China requires local responsiveness, which host country experience and familiarity enhance by improving the company’s ability to scan and analyse the external environment. Scholars have found that previous host country experience, regardless of the type of experience, leads to an increase in the likelihood of choosing a WOS for later entries (Davidson, 1982). According to Johanson & Vahlne (1977) much of the experience of a company’s management is closely associated with the particular set of circumstances. This implies that the experiential knowledge is critical in the present context and makes it difficult to transmit between countries. Therefore, companies without previous host country experience may encounter even higher uncertainty in China and it implies that they should try to limit their exposure through an EJV, while companies with host country experience may be better at managing a WOS and should choose it. Additionally, EJVs may even give rise to unnecessary challenges in the communication and administration with the local partners.

Another influential factor in China is the business culture, where commercial practices can be different from the domestic country and cultivating good relationships with governmental authorities is essential. As a result, companies without host country experience are more likely to benefit from an EJV with a local partner possessing country specific knowledge, compared to the more experienced companies, which already has the Chinese market knowledge and can enter it independently. With respect to the EJVs, the value of the local partnership in China should not be overestimated, since the process of country’s opening to the world allows the foreign companies to accumulate knowledge about the Chinese market by themselves rather than through local partners. The result of the host country experience predictor is in accordance with some prior studies, where no significant results are found (Caves & Mehra, 1985; Kogut & Singh, 1988; Chang & Rosenzweig, 2001).
7.3.6 Firm size

The firm size coefficient is not statistically significant, but the observed relationship is supported by the majority of prior research. The existing literature primarily suggests that firm size is positively correlated with the degree of ownership, but the fact that firm size has no significant effect on entry mode choice in this study indicates that small and large companies have uniform ability to establish a WOS, which is in accordance with Caves & Mehra (1986), Erramilli (1991) and Nakos & Brouthers (2002).

The main argument for a positive correlation is that large companies tend to have greater managerial and financial capacity and are in a better position to undertake the investments needed to establish a WOS. Large companies tend to pursue more aggressive expansion strategies, benefit from economies of scale and have a more centralised management system. This is consistent with the RBV rationale that in order to succeed internationally companies need competitive resources and as they increase in size their willingness to give up control decreases (Agarwal & Ramaswami, 1992). On the other side, control of the company’s resources and how they are deployed is important for the success in China, because the market is characterized by environmental dynamism that requires continuous adaptability. Thus, small companies with a less bureaucratic burden and limited economies of scale may be able to adapt more quickly and therefore prefer the entry mode of a WOS. This duality of firm size may explain the insignificant result that has been found.

The sign of the industry variable is correlated as expected, though the variable is not significant. Previous studies suggest that many service companies tend to have low capital intensity and often choose to establish an office using a WOS entry mode, which usually does not require investments in buildings, plants and machinery (Erramilli & Rao, 1993). Therefore, service companies are more capable of establishing a WOS than manufacturing companies. Although, the theories described in Chapter 3 have relatively clear implications for impact of the variables on a company’s entry mode choice, the findings are ambiguous. Therefore, these conflicting results may explain the contradicting empirical evidence.
8 CONCLUSION

Once a company decides to enter a foreign country it has to choose a mode of entry and since this has a major effect on the company’s foreign business performance, the choice becomes an important international business decision. This study analyses several of the most commonly used country-level factors and company-level factors in entry mode literature. Three frequently used and conceptually linked theories to the entry mode research; the transaction cost economics, the resource-based view and the institutional theory are applied in the setting of the emerging country China to enhance the current literature and understanding of the factors’ effect on companies’ choice of entry mode.

This study uses a sample size of 351 companies from around the world, which have entered China since 2002. Of the six hypotheses tested, only one has been supported and the significant result shows that a greater economic distance should lead to the preference of an equity joint venture over a wholly owned subsidiary. The findings show no consistent relationships, which confirms that even though the choice of entry mode is one of the most researched areas in international business literature, mixed results still emerge.

The cultural distance factor is insignificant, implying that no relationship to the entry mode choice is found. This may be supported by the contradiction that on the one hand high cultural distance complicates the management of the foreign operation and should be facilitated through an experienced local partner. While on the other hand, high cultural distance increases uncertainty and transaction costs, and should be reduced using a wholly owned subsidiary entry mode. The institutional distance factor is significant, but positively related to the degree of ownership. This supports the argument that uncertainties regarding the formal institutions can be reduced via a wholly owned subsidiary. As the economic distance factor is found to be significant, it supports the rationale that it is easier for companies to replicate their existing business model between economically similar countries. The international experience factor shows no significant relationship to the entry mode, which may be explained by the argument that international experience is idiosyncratic for each country and therefore difficult to apply in other countries. Host country experience also provides no significant result and therefore it is not an explanatory variable. Firm size yields no
significant result and therefore is not an explanatory factor, which may imply that small and large companies have a uniform ability to establish a wholly owned subsidiary.

Prior studies have primarily focused on developed host countries and paid less attention to entry mode choice in the emerging markets, where the government and societal influences are stronger than in developed markets. Emerging markets are commonly characterized by governmental interference, market liberalization, high external uncertainty, limited intellectual property rights protection and high growth. Such complex environments require companies to understand multilevel contingencies, since some country-level or company-level factors push companies to choose a wholly owned subsidiary as an entry mode, while other factors may present major challenges, leading companies to choose equity joint ventures. Therefore, the entry mode choice depends on complicated sets of internal and external factors, of which the most examined, are investigated in the three theories.

The default mode in the transaction cost economics moves towards the lowest possible degree of ownership and is insightful in describing the commitment and risks of entry mode choices. The default mode of the resource-based view moves towards the highest degree of ownership and helps to provide a useful ground for the resource effect on international entry and their advantages. The results in this study find no support for the propositions of the transaction cost economics in the emerging market of China where high internal and external uncertainty exist due to rapid environmental changes. It may be difficult to use the transaction cost economics under high uncertainty as this makes it complicated to estimate the transaction costs and thereby choose the entry mode based on calculated efficiency when circumstances change. The problematic challenge of being unable to estimate the transaction costs may induce managers to look for other sources of information. Institutional theory suggests that high institutional uncertainty increases the likelihood of choosing an equity joint venture to gain legitimacy. However, this study does not support this and finds the opposite result, which may be explained by the rationale that under high institutional risk entrants prefer to protect their business using a wholly owned subsidiary entry mode. No support is found for the resource-based view that companies with valuable resources tend to favour wholly owned subsidiaries as entry mode.

The literature and this study’s findings show the need to integrate relevant theories, since choosing an entry mode is a complex and dynamic process that involves several contingencies at different levels. The choice of entry mode depends on a
multiplicity of variables such as the contingencies of both the company’s domestic country and the host country, the characteristics of the parent company, the strategy of the operation and the situation in the industry. Even though previous studies have introduced many variables and models, entry mode choice continues to be empirically complex to research, especially in an emerging market.

Additionally, it is discovered that even though most of the existing literature and empirical evidence support the rationale that for entering emerging markets an equity joint venture entry mode should be selected, however for more than a decade the tendency to enter China is by entering via a wholly owned subsidiary entry mode. To sum up, it can be implied that the theories are normative frameworks, while the sample data describe actual choices, thus the discovered contradiction and the insignificant results may be explained by the other influences that come from factors beyond this study.
LIMITATIONS AND IDEAS FOR FURTHER RESEARCH

This study pursues to contribute with the new findings within entry mode literature in an emerging market. However, it has limitations, which are discussed to indicate potential directions for future studies.

First of all, unlike most previous studies that collected information by surveys, the data of this study uses secondary sources collected via databases and websites. This improves the objectiveness of the data, but particularly limits the selection of the company-level factors and leaves some uncertainty in the interpretation of the variables. This and previous studies have investigated cultural distance using aggregate national measures, such as Hofstede’s dimensions. However, as companies become more global, their individual perceptions of country distance may be different from the aggregate national cultural distance, therefore it could be relevant to research if the company culture has a different effect on the entry mode. Previous literature provides different view on experience and applying number of years outside the company’s home country as international experience measure contains some uncertainty, since companies may perceive it differently. Additionally, it may not necessary describe the companies’ real international experience, since it may depend on e.g. the proportion of international sales or geographical spread, which this study does not take into consideration due to the unavailable information. Although, much has been researched about the factors that influence a company’s choice of entry mode, the empirical literature has not been as robust as it would be preferred. Since a various number of entry mode choices exists this provides future opportunities for researchers to investigate the differences between differing ownerships and improve the knowledge of international entry mode choice.

Although, past studies of international entry mode have used many acknowledged theories, no comprehensive framework can completely explain entry mode choice. The asset specificity dimension in transaction cost economics is suggested to have a great impact on the entry mode choice, but is partly measured in this study using company-level factors. A higher specification of the asset specificity dimension may enhance the understanding of entry mode choice and may be addressed via questionnaires in the future research. Moreover, questionnaires would provide better knowledge of other various variables such as the motivation or strategy of the entry, management
knowledge or resources each partner contributes with. Additionally, it would be interesting to measure and compare the weights of country-level factors or company-level factors in explaining the entry mode choice that the companies emphasize.

The understanding of international entry mode choice into emerging markets remains incomplete and it is important to examine if the findings discovered in this study are similar in other emerging markets. This offers an opportunity for further research of this important topic in international business.
REFERENCES


