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Foreign market entry in transition economies:

Entry timing and mode choice

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Frederiksberg, September 27th, 2008

PREFACE

This dissertation consists of an introduction followed by four papers on issues related to the choice of entry timing and entry mode in transition economies. Below is a list of the papers that is included in the dissertation with information about their current publication status and co-authorships¹.

- Jakobsen, K. 2007. First mover advantages in Central and Eastern Europe: A comparative analysis of performance measures, *Journal of East-West Business*, 13(1), 35-61.
- Jakobsen, K. 2008. Competition for Markets in the Brewing Industry in Central and Eastern Europe. In J. Larimo (Ed.) *Perspectives on Internationalization and International Management*, Vassan Yliopiston Julkaisuja, p. 299-316. ISBN 978-952-476-228-1
- Jakobsen, K., & Meyer, K. E. 2008. Partial Acquisition: The overlooked entry mode. In J. H. Dunning and P. Gugler (eds.) *Progress in International Business Research 2*, Elsevier Science, p. 203-226. ISBN 978-0-7623-1475-1.
- Jakobsen, K., & Meyer, K. E. 2007. Negotiating entry modes: Partial acquisitions in transition economies. Revise and resubmit at *International Business Review*

¹ The paper “Competition for Markets in the Brewing Industry in Central and Eastern Europe” has been renamed “Competition for markets vs. competition in markets: The case of the brewing industry in Central and Eastern Europe” in the dissertation.

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First and foremost I would like to thank Klaus Meyer at the University of Bath for his ongoing support in his capacity as my supervisor. I would also like to thank him for his excellent efforts in his capacity as co-author on the papers “Partial acquisition: the overlooked entry mode” and “Negotiating entry modes: Partial acquisitions in transition economies”. In this respect we gratefully acknowledge the Social Science Foundation for the financial support for the project “Merger and acquisition strategies in Eastern Europe, under grant number 24-01-0152”, which has enabled the collection of the data used in 3 of the papers in this dissertation.

Most of the chapters included in this dissertation have undergone reviews at various conferences including AIB, EIBA and Vaasa IB; solid reviews are always appreciated and I would like to thank the reviewers for providing useful comments for the various papers. Also, in this regard I would particularly like to extend my gratitude to Jorma Larimo for his insightful comments on the papers “First mover advantages in Central and Eastern Europe: A comparative analysis of performance measures” and “Competition for markets vs. competition in markets: The case of the brewing industry in Central and Eastern Europe”. I would also like to extend my gratitude to Keith Brothers and Eric Tsang for their comments on the paper “Negotiating entry modes: The role of partial acquisitions in transition economies”. Moreover, I would like to thank John Dunning for providing feedback to the paper “Partial acquisitions: The overlooked entry mode”. Furthermore, I am particularly grateful for the work of the members of my committee; Bent Petersen, Ram Mudambi and Trond Randøy.

Thank goes to my colleagues at INT who have endured, at times, ice cold winters, muddy autumns and dusty summers at Porcelænshaven without losing their sense of humor. I would especially like to thank Jens Gammelgaard, Michael Jacobsen, Can Seng Ooi, Bersant Hobdari, Peter Gammeltoft, Steen Thomsen, Niels Mygrind, Lars Håkonsson, Ilduara Busta-Varela, Evis

Sinani, Ole Risager and Aleksandra Gregoric. Also, the administration at INT is worthy of praise and I would like to thank especially Marianne, Andy and Henrik for helping me cope with the administrative challenges that we all encounter on a regular basis.

Finally, I would like to thank my wife and son, Svetla and Martin for their love and support.

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1. Foreign Direct Investment Entry in Transition Economies

INTRODUCTION

The broader theme of this dissertation is market entry by foreign firms into transition economies. Transition economies are interesting not necessarily because they offer a large market per se, but often the long run perspectives are promising (Nakata & Sivakumar, 1997). Many transition economies will tend to be smaller, China of course being a very noticeable exception, and consumers have less purchasing power. The business environment in transition economies also tend to suffer from numerous maladies ranging from poor infrastructure, weak or arbitrary law enforcement, discrimination, corruption, lack of qualified suppliers, high political and economic uncertainty etc. In short, transition economies pose many challenges for the multinational enterprise (MNE), but they also offer growth opportunities and above all else a more conducive competitive environment than what is available in mature economies. A testament to the potential rewards of emerging markets is offered by Christos Pantzalis (2001) who found that MNE's with activities in developing markets on average outperformed MNE's without developing market exposure, suggesting that it is the market failures of developing economies that allows the MNE to capitalize on its firm specific assets.

It is particularly the competitive environment that characterizes the attractiveness of transition economies. Some firms do supply every, or nearly every, mature economy in the world and for those transition economies may offer what is essentially the last opportunity for growth available. However, the majority of firms that invest in transition economies could still expand their reach by investing in other mature economies. In my view, what prompt them to prefer transition

economies is by and large lower competitive pressure from established rivals and the promises of a solid competitive position in a growing market.

While there are many aspects to the study of foreign direct investments (FDI) the primary focus of this dissertation is on the decisions related to market entry; when and how to establish a subsidiary. These tend to be the big decisions that will shape the development and competitive position of the subsidiary for years to come and are thus some of the most fundamental strategic choices. Moreover, they will often be interrelated as early moves are faced with restrictions on the mode choices (Larimo, Marinov & Marinova, 2006) or seek to build a market position faster through acquisitions or Joint Ventures rather than greenfields (Meyer, 2008; Gil et al., 2006).

As such, both areas have attracted strong academic interest, although entry timing in foreign markets haven't received nearly as much attention as entry timing decisions per se. Nonetheless the broader body of first mover related papers is large enough that it has been able to support several Meta analyses during the 90ies including VanderWerf and Mahon (1997); Szymanski, Troy and Bharadwaj (1995). Similarly, a review of the mode choice literature was published in 2007 by Brouthers and Hennart which suggest the area has reached a certain stage of maturity.

However, despite a generally strong academic interest in the field(s) there are key aspects of the entry timing and mode choice decisions that remain under explored. In the following sections I will address these shortcomings and how this dissertation aim to contribute to the existing body of literature. I will also discuss the choice of the geographical area, Central and Eastern Europe (CEE), and how it affects the underlying assumptions of the study.

FIRSTMOVER ADVANTAGES

In this section I will present an overview of the components that make up the first mover advantage field and the focus/contributions of this dissertation. The study of first mover advantages

can be roughly divided into two primary components; the sources of first mover advantages/disadvantages and the study of the performance effect.

The sources of first mover advantages (and disadvantages), basically answers the question why we expect entry timing to affect a firms performance in the first place. The second and perhaps the most prominent part of the first mover research deals with the ability of first movers to outperform followers. One of the key issues within this performance literature is how competition for first mover advantages affects the ability of first movers to benefit from the advantages.

In this dissertation I focus primarily on later. Hence, I am concerned with the ability of firms to derive performance advantages from the entry timing decision and how competition for first mover advantages moderates the relationship.

Sources of first mover advantages and disadvantages

The basis for first mover advantages is of course the sources. These are the theoretical foundation from which we infer a possible performance effect from the entry timing choice.

In Lieberman and Montgomery's (1988) framework, these first mover advantages can arise from either technological leadership, pre-emption of scarce assets or buyer switching costs. Technological leadership are the self generated advantages arising from investments in development and learning that leads to proprietary rights, cost benefits or qualitative advantages. Hence, patent rights and experience effect from moving down the learning curve are good examples of self generated technological advantages that foster and sustain a first mover's advantage over followers. Pre-emption of scarce assets are the potential advantages that arises from locking competitors out off input sources, market segments, restraining competitors sales growth or even deterring entry all together through capacity investments. Good examples of this type of first mover advantages are gaining control over natural resources and distribution networks. Advantages associated with buyer switching costs are derived from the consumers need to spend resources to

learn how to use a new product, lack of compatibility with existing systems and processes and contractual limitations or restrictions. Also the consumer's uncertainty about the performance of the follower's product compared to the tried and tested brand of the first mover creates a buyer switching cost that adversely affects followers.

On the other hand followers may experience advantages from the ability to free ride on the first mover's investments, resolution of technological and market uncertainties, technological discontinuities and incumbent inertia (Lieberman & Montgomery, 1998; Lieberman & Montgomery, 1988).

Kerin, Varadarajan and Peterson (1992) advanced an expanded framework encompassing economic, pre-emptive, technological and behavioural factors that leads to first mover advantages. This framework also encompasses the moderating role of firm strategy and economic factors on the overall first mover advantage. In other words, firms can actively pursue strategies that enhance the original first mover advantages.

From an emerging market perspective Nakatar and Sivakumar (1997) offers a framework building on Kerin, Varadarajan and Peterson (1992). The model considers how economic, political/legal, socio/cultural and technological factors in emerging markets moderate the original sources of first mover advantages. Of particular note is their finding that specific emerging market conditions can have both a positive and a negative effect on the original sources of FMA thus creating an uncertain net effect.

For foreign markets, transition economies in particular, macro economic and political uncertainty may be quite strong first mover disadvantages in the sense that followers may wait for the development in the economic and political institutions to become clearer. Followers may also learn from the mistakes of the first mover in dealing with local institutions and can thus avoid some of the pitfalls. On the other hand, the first mover may have an opportunity to build strong

relationships with local institutions, trade associations etc that secure a lasting advantage in dealing with these.

The existence of both first mover advantages and first mover disadvantages are well documented both in theoretically and empirically studies. There is clearly enough evidence to support a basic assumption that entry timing affect performance for better or for worse. However, while more advantages and disadvantages will no doubt come to light over time, it is my view that the opportunities for advancing our knowledge of the relationship between entry timing and performance is relatively limited in this sphere.

A general performance advantage; the empirical question

If we know that there are first mover advantages and we also know that there are first mover disadvantages then all else being equal the primary empirical question is whether or not the sum of all first mover advantages (X) outweighs the sum of all first mover disadvantages (Y) on average thus establishing a “general” first mover performance advantage (VanderWerf & Mahon, 1997).

$$\sum (X^1 + X^2 \dots X^n) > \sum (Y^1 + Y^2 \dots Y^n)$$

All theory aside, it is perhaps not surprising that the empirical research question that attracts the greatest interest within the entry timing field is the extent to which the act of moving first into new markets produces higher economic rent than following. What we are thus concerned with is whether or not the advantages on average outweigh the disadvantages.

The implication of such an advantage is quite compelling from a strategic view point, in the sense that it is an “easily” actionable move. Hence, in its crudest form we might be tempted to describe the first mover literature as the strategy literatures equivalent to speculating in firms with low market to book value on the stock market. The foremost question that much of the empirical

part of the first mover literature seeks to answer is essentially if a market imperfection exists that allows a specific strategic choice, in this case moving first, to consistently outperform its alternatives?

The most comprehensive answer to this question available today is probably the Meta analysis produced by VanderWerf and Mahon (1997). Ultimately they found overwhelming support that first movers enjoy a general market share advantage. On the other hand they found no support that first movers are inclined to enjoy superior financial returns raising a fundamental question whether entering first implies a trade off. In a study of FDI carried out by Japanese firms Delios and Makino (2003) indeed found that early entry entailed greater firm size (measure of success) but at the cost of an increased exit risk.

However there are still room to refine the study of timing and performance. Two of the key areas of interest in this respect are how competition for first mover advantages affects the ability to profit from these advantages and how we strengthen the measure of performance in general. I will cover these in the two subsequent sections.

Endogeneity, competition and the market clearing mechanisms

An important issue that arises from the literature is whether or not first mover opportunities are endogenous. The prevailing view from the strategic and marketing literature tends to favour treating first mover opportunities arises as an endogenous process (Kerin, Varadarajan & Peterson, 1992; Lieberman & Montgomery, 1988). These frameworks suggest that first mover opportunities arise from the proficiency of the firm and at times basic luck. A related issue is whether the resource and competencies of the firm essentially dictates its choice of entry order. E.g. early movers are more innovative whereas late movers tend to be heavily marketing oriented (Robinson, Fornell & Sullivan, 1992). Hence, one type of firm may be more able to create first mover opportunities and willing to take the risks associated with early entry, whereas another type of firm

might be less inclined to take risks, but better at penetrating an established market. Consequently, the relative resource configuration of the firm and its competitors may *force* it into adopting a specific order of entry behaviour.

In a real asset option terminology, the option to enter a given market as the first mover, if held exclusively by a single firm, is consequently a proprietary right (Miller & Folta, 2002). The option might be proprietary as a result of a legally generated right e.g. a patent right or a license, it could also be a right generated by superior skill, market knowledge or even luck (Lieberman & Montgomery, 1988). In effect the proprietary right can be viewed as a window of opportunity in which a single firm is the only possible candidate to enter a given market. The order of entry is effectively fixed in the sense that the right holder would always get to move first and at a time that would be at its own discretion; at least within the window of opportunity. The holder of this proprietary option is in effect granted the rights to the first mover advantages and the associated profits which could effectively be viewed as a Ricardian rent.

However, the value of the proprietary option is dependent naturally on whether or not the first mover advantages outweigh the follower advantages. But it also depends on the ability of the right holder to actually choose whether to move first or to follow. Hence;

- If the proprietary right holder has a choice between entering first or not, the right holder would move first only if the sum of the first mover advantages $\sum (X^1 + X^2 \dots X^n)$ outweigh the sum of follower advantages $\sum (Y^1 + Y^2 \dots Y^n)$ otherwise it would choose to wait. In this case this proprietary right would be uniformly good.
- However, if the proprietary right holder does not have a choice between entering first or not, i.e. his resource configuration dictates that he must move first, the right would only be positive as long as $\sum (X^1 + X^2 \dots X^n) \geq \sum (Y^1 + Y^2 \dots Y^n)$ otherwise he would be worse off than the follower since he is forced to move first (or stay out) regardless.

Thus, even without adding an element of competitive pressure the endogenously generated right to move first isn't necessarily uniformly good.

Competition is likely to erode some of the advantage of moving first for instance;

- By compelling firms that lack firm specific advantages to speed to market (Rivoli & Salorio, 1996)
- Or by compelling firms to adopt order of entry strategies that are inconsistent with their type (Narashiram & Zhang, 2001)

Consequently, even if first mover advantages, on average, outweigh follower advantages it is by no means assured that first movers can appropriate the rent associated with these advantages. The way firms compete for these advantages will crucially affect the first mover's ability to appropriate rent.

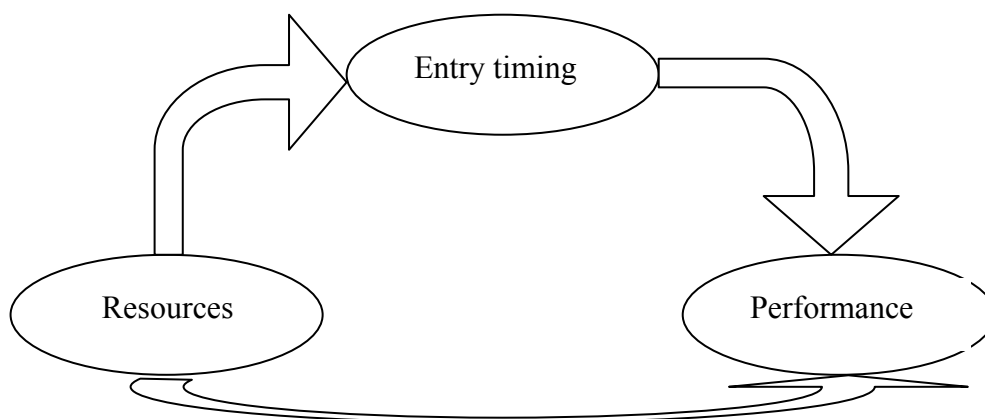
Measurement problems

Some of the key empirical issues with the general first mover performance advantage are largely related to the measurement. There are three main sources of contamination that may frustrate attempts to measure the relationship between entry timing and performance; survival biases, resource biases and strategic biases.

- Survival bias. This is mostly tied closely to the primary follower advantages; the information advantage. First movers make the entry decision at a time where uncertainties have yet to be resolved and as a consequence they may be more liable to exit the market should the conditions prove unfavourable. Followers on the other hand can wait for the uncertainties to be resolved and again should the market conditions prove unfavourable they can exercise the option not to enter. Failed firms will typically be difficult to integrate effectively in a sample. The consequence of the survival bias problem is that the advantage of moving first may be systematically overestimated.

- Resource bias. Entry timing may be linked directly to the overall quality of the entrant's resources either positively or negatively (Figure 1.1). Lieberman & Montgomery (1988) suggest that what determines who gets to the market first may primarily be driven by which firm has the stronger resources, proficiency or even who is luckier. On the other hand, Narashiram and Zhang (2001) suggest that comparatively resource weak firms may be forced to move first to attain first mover advantages that can offset their comparative resource disadvantage. As a consequence, first mover advantages could be either systematically over or underestimated. Although the analysis by Robinson, Fornell and Sullivan (1992) didn't find a general resource advantage to either first movers or followers, but rather suggest the possibility that first movers and followers have inherently different strengths and weaknesses.
- Strategic and sample timing bias. The most typical performance measure applied to first mover studies is market share followed by other financial profit measures (VanderWerf & Mahorn, 1997). While past literature (Capon, Farley & Hoenig, 1990) has provided evidence of their mutual association, the link is not without problem. A key issue is that firms may

Figure 1.1 Resources, entry timing and performance



pursue marketing strategies that systematically erodes one in favour of the other. First movers may systematically pursue a strategy that favours strengthening their local market position at the expense of short term profitability. A consequence of this type of strategic behaviour would be over or underestimation of first mover advantages depending on whether the performance measure used is market share or financial performance. Alternatively first mover may engage in profit skimming allowing a slow erosion of market share in return for higher short term profits. In general the timing of the sampling of profit data has a known effect on the results, in a survey of empirical studies Robinson, Kalyanaram and Urban (1994) found that early movers typically experience lower operating profits in the early years of operation compared to followers. Similarly, Luo (1998) found that early entrants experienced lower ROI but higher sales growth compared to followers when investing in China.

The general performance advantage question is largely an empirical one, which means the key source of advancement is through overcoming some of the limitations of past studies. Even if it would appear to be a fairly straightforward question, whether or not first movers outperform followers, is in fact quite complicated to get right.

Central and Eastern Europe, geographic considerations

The choice to use the CEE setting for this study is directly linked to the key research interest in this dissertation. From a transition/emerging market perspective the area generally offered the same kind of opportunities as other transition/emerging economies; growth potential and limited existing competition. And on the other hand the challenges are similar to those of other transition/emerging economies; corruption, weak institutions, poor infrastructure etc. hence, in general these countries are largely similar to other transition/emerging economies. However, the area also offers some very interesting unique features.

- Proximity, CEE is geographically and culturally close to Western Europe, which encourages entry particularly from these countries and consequently ensures a large pool of potential entrants.
- Clear cut off date, the opening for FDI came after the system change before which there was virtually no FDI from Western countries. It is thus considerably easier to establish accurate order of entry information.
- Broad sample, the opening for FDI in CEE was a comprehensive one affecting a very broad range of production and service industries. The area thus, offers an excellent opportunity to establish a broadly representative sample of industries within a specific time period. Sample representativeness is a very important issue in the study of timing and performance, since the sources and strength of first mover advantages/disadvantages may vary considerably from industry to industry.
- Level playing field, the local industries were largely run down after decades of mismanagement. Consequently, foreign investors were not faced with effective entry barriers erected by local competitors and the order of foreign entry consequently takes on a more absolute form.

Hence, the Central and Eastern European setting for this study offers some powerful advantages both in terms of the business environment and the sampling possibilities. In my view it offers a unique opportunity to study the relationship between entry timing and performance in a competitive setting. Moreover, because of the comprehensiveness of the system change the area probably offers the best possibility ever to study the timing issue on such a broad range of industries.

Conclusion/research agenda

Whereas the drivers for first mover rights may appear reasonable enough for market entry into a new product market it is less obvious that the same would prevail for entry into foreign markets. While first movers in emerging markets may have a technological leadership as noted by Nakatar and Sivakumar (1997), this is chiefly against local rivals, not against other foreign contenders. Usually, firms entering new foreign markets will seek to extend their existing technologies to these markets, rather than develop new technology for the purpose. Hence, rival firms are likely to have similar levels of technology available and they are also likely to face the same restriction on growth in their domestic markets. The likelihood that an entry option is shared, that is more than one firm has the capability and the interest to enter a given market, is therefore potentially much greater for foreign market entry.

Therefore, my main research question is the following:

Do first movers generate superior returns from competitive entry into new geographical markets relative to followers?

I pursue two approaches to answer the question. In chapter two I use a general empirical study bases on a survey of foreign subsidiaries in Hungary, Poland and Lithuania. In this study I attempt to account for some of the core measurement issues through the use of multiple performance measures and timing constructs.

I seek to account for resource and firm strategy biases through the use of “self correcting” performance measures. Rather than using financial performance measures I use two performance constructs based on Likert scale variables. One of these measures the subsidiaries performance relative to that of its competitors and the other measures it relative to the expectations of the firm.

Using these subjective measures has the advantage that the respondent can take the specific strategy of the firm into account (Lou & Peng, 1998). Moreover, measuring performance both relative to competitors and own expectations, effectively allow us to account for differences in resource levels. Furthermore, the study separates the order of entry effect from the length of time the firms have been in the market. The primary conclusion of the study is that order of entry positively affects market share, but not the overall performance of the subsidiary. As opposed to order of entry, support is found that firms are generally rewarded for early entry into these markets. This effect is particularly strong for partial acquisitions suggesting that partial acquisitions may be a mode choice that is primarily suitable for acquiring resources in the early stage of the market development.

The second paper in chapter three is based on a study of entry by foreign brewers into Central and Eastern Europe. The empirical data used in this paper was primarily gathered through the databases Amadeus and Zephyr. The paper has two central aims: One is to address how multiple market opportunities can act as a market clearing mechanism, effectively allowing first movers to outperform rivals even in a highly competitive oligopolistic business environment. The other aim of the paper is to address the survival bias issue.

The core conclusion of the paper is that the availability of multiple market opportunities creates an environment where firms compete for markets rather than in markets. Competition in the individual markets is consequently blunted allowing first movers to retain strong performance advantages over followers.

ENTRY MODE CHOICES IN FOREIGN MARKETS: ENTRY THROUGH THE PARTIAL ACQUISITION OF A LOCAL FIRM

The second part of this dissertation is devoted to the study of entry mode choices in foreign markets, with a particular focus on the use of partial acquisitions. My focus on partial acquisitions is based on several factors. The first is that the area is exceedingly under researched in comparison to the main modes; full acquisitions, joint ventures and greenfields. The second reason is that past literature has suggested a positive association between riskier foreign markets and the use of partial acquisitions (Duarte & Garcia-Canal, 2004; Barkema & Vermuelen, 1998), suggesting that emerging/transition market factors could promote the use of PAs. Finally, part of the motivation to study partial acquisitions comes from my study of first mover advantages. For instance, partial or staged acquisitions are quite commonly used in the brewing industry to enter new markets (Meyer & Tran, 2006). Moreover, in the study of comparative performance measures in chapter (2) I also found a strong interaction effects between the use of partial acquisitions, entry timing and performance. In fact, by using only the sub-sample of partial acquisitions (table 1.1) from the data set, we can see that the age and performance of partial acquisitions are very strongly related. Hence, the use of partial acquisitions does appear to be a mean to achieve early mover advantages.

In the following sections I will discuss the position of partial acquisitions in the literature, what the main theoretical issues are and how this dissertation propose to contribute to this field.

Partial acquisitions

The study of partial acquisitions isn't a uniform field; there are a few finance oriented papers (Roy, 1988; Roy, 1985) which view a partial acquisition as a mean to internalise resources/synergies without carrying the full capital burden of fully acquiring a firm. The subject has also received some attention from a corporate governance perspective (Akhigbe, Martin & Whyte, 2007; Akhigbe, Madura & Spencer, 2004).

Though, in terms of the strategy and international entry mode literature, the treatment of partial acquisitions has been quite lacking and partially contradicting. For instance in the Meta analysis by Brouthers and Hennart (2007) partial acquisitions are effectively rejected as an independent type of entry mode; by virtue of how the input holders are remunerated Brouthers and Hennart (2007) argue that they are in effect similar to joint ventures. In contrast Duarte and Garcia-Canal (2004) concludes that the Partial Acquisitions are essentially similar to full acquisitions.

A select few studies have empirically studied the use of partial acquisitions in foreign entry. Among these, Duarte and Garcia-Canal (2004); Barkema and Vermuelen (1998) find some support that this type of entry mode may be preferred in riskier markets. Duarte and Garcia-Canal (2004) argues that the use of partial acquisitions in this capacity may be a mean to reduce capital commitments and accordingly the risk of entry. Chen and Hennart (2004) offer an alternative explanation based on a hostage theory. Their argument relies heavily on asymmetric information between the acquiring firm and the seller of the partially acquired firm, resulting in an initial

Table 1.1 Age and performance of partial acquisitions

	Performance Satisfaction	F test
Affiliate age	0,192 (0,043)	20,150***
N	54	

*** p<0,01. ** p<0,05. * p<0,1.

valuation problem.

Hence, there is a somewhat limited supply of theories trying to explain the use of partial acquisitions. Moreover, it is not altogether clear that the arguments advanced are particularly compelling. For one, the observed positive relationship between emerging markets/riskier markets could possibly be grounded in other arguments than a preference for risk sharing. It is true that the foreign investor would limit the capital commitment through a partial acquisition, rather than a full acquisition. However, it is in no way clear that a local partner would be more capable of carrying the risk than the foreign investor.

Moreover, high uncertainty environments increase the likelihood and the frequency of partner realignments leading to increased transaction costs (Williamson, 1975); suggesting that there would be a trade off between capital commitment and governance costs.

A similar problem could arise from applying a real option lens to the partial ownership context. Kogut and Kulatilaka (1994) correctly assess that multi-nationality could give rise to flexibility advantages in cross-border production. However, their assessment that the same logic might similarly apply to acquisition decisions is in my view less straight forward. In their model the option contract is effectively signed against “nature”. A critically important difference between the context specified by Kogut and Kulatilaka (1994) and the partial acquisition context is that the buy-out option is signed against a “third person”. Hence, it takes on the properties of a contractual or financial option. An immediate implication thereof is that it implies the payment of an option premium adequately reflecting the “if things go well we buy - if not you keep” nature of the contract. Hence, in order for the option lens to work in the given context we would essentially have to assume that either:

1. A systematic market failure exists that allows the foreign acquirer to obtain buy out options at prices below their real value

2. The local partner is better able to carry the risk than a “diversified” multinational enterprise

Evidence tends to suggest that, perhaps for this very reason, explicit buy-out options are virtually non-existent (Reuer & Tong, 2005).

It is possible that a partial acquisition could be considered an implicit buy-out option; this would go well with our argument that partial acquisitions might be a means to postpone “tricky” negotiations to a future point. However, I would be wary of claiming a true real option connection in such a watered down form.

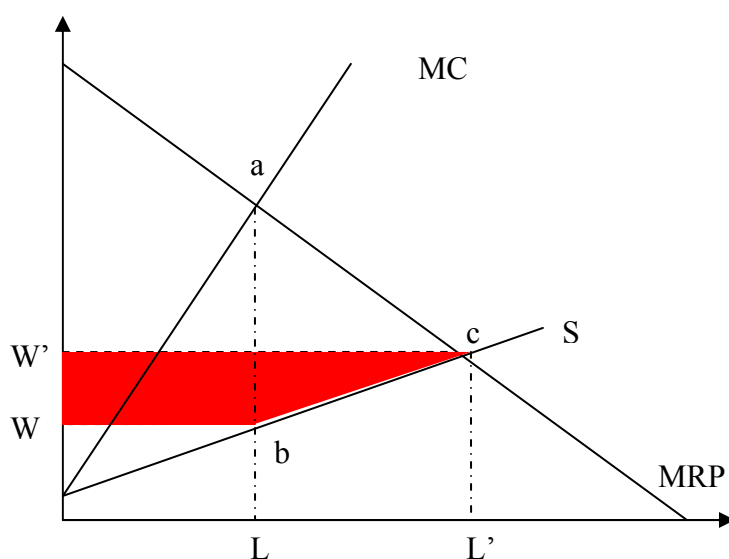
Incentives or influence

I feel that one of the core issues in terms of how we explain the purpose of partial acquisitions is the role that ownership plays. To Brouthers and Hennart (2007) the defining characteristic of shared ownership is that all partners share in the return on the assets. In their view the problem is how to create incentives that will encourage the partners to act in the best interest of the business unit; and this is solved through aligning the interest of the partners by creating a mutual interest in the success of the business unit. The control rights bestowed through ownership is thus a secondary characteristic insofar as it effectively only serves a mechanism to solve disputes when the partners disagree on how to advance the success of the business venture.

The focus of the remuneration perspective is clearly on the efficiency of the business unit. This view provides a reasonable explanation for the use of shared ownership structures as long as e.g. opportunistic free riding by the parties to the contract is the primary problem.

However, it fails to adequately explain the use of partial ownership structures, when the business unit actually has the ability to adversely affect one or more of the input holders vertically related assets.

Figure 1.2 Vertical disentanglement with monopsony



Let me use a simple example to illustrate this problem. Consider a case of a foreign investor acquiring a local firm from its employee owners. Suppose further, this firm is the only provider of a product which requires specially trained workers to produce. By acquiring the local firm from its employees the foreign investor may effectively gain monopsony power over the employees' main source of revenue, their labour. The profit maximizing equilibrium for the firm is at $[W, L]$ leading to an effective revenue loss for the employees represented by the red square in figure 1.2. Moreover, a general deadweight loss is created equal to the triangle $[a, b, c]$ resulting in an overall loss of revenues to the group [employees and owners] as a whole, compared to the jointly optimal equilibrium at $[W', L']$.

Therefore, while the equilibrium $[W, L]$ is Pareto optimal it is not jointly optimal. Moreover, how the residual claims are distributed would not affect the equilibrium choice. In other words, how the residual claims are distributed does nothing to promote jointly optimal solutions!

What is missing from this picture is the notion of cooperative adaptation (Williamson, 1975). Ownership is not just about aligning the interests of the parties, but also a mean to influence

the operational decisions towards mutually desirable outcomes and avoid or reduce the effect of harmful unilateral adaptations.

Conclusion/research agenda

Though, the literature on partial acquisitions is limited we do observe some general tendencies. Firstly, the mode choice tends to be viewed exclusively from the perspective of the acquirer. Hence, in Duarte and Garcia-Canal (2004) the local owner is required to hold some of the risk and in Chen and Hennart (2004) the local owner is required to provide a hostage to support the exchange. The second tendency is to view shared ownership decision from an incentives perspective alone (Brouthers & Hennart, 2007; Chen & Hennart, 2004).

What is missing is clearly to see partial acquisitions from a broader perspective, including the local owners and the role of control rights. Hence, the perspective that I adopt is to view the decision to partially acquire or divest a firm as the mutually agreed outcome of negotiations between the parties.

The main research question I seek to address is the following:

What is the role of partial acquisitions in transition economies and what are the factors that encourage the use of partial acquisitions?

In chapter four I provide a thorough discussion on the nature of partial acquisitions and how this mode choice distinguish it self from the traditional modes. Using two sets of data on foreign subsidiaries in the transition economies of Central and Eastern Europe and Asia, I also provide some general empirical evidence on key aspects including; how frequently used partial acquisitions are, the size of partial acquisitions, the efficiency of resource transfers between the parent and the subsidiary and job creation/destruction tendencies. This chapter also provide an overview of the

advantages and disadvantages associated with the use of partial acquisitions seen both from the perspective of both acquirer and sellers.

In chapter five I examine the determinants of mode choice using a Multi nominal logistic regression based on a sample of foreign subsidiaries in Central and Eastern Europe. In the chapter a broader stakeholder perspective on partial acquisitions is advanced. I suggest that the larger the firm the greater the likelihood that outside stakeholders will interfere in the negotiation process with the aim to secure special concessions. Consequently, to avoid costly and prolonged ex ante negotiations, foreign investors may chose to enter by acquiring a partial stake. In the chapter I also advance a reverse asymmetric information argument suggesting that acquirer's would often understand the value of the target better than its current owners. Support is provided for both hypotheses.

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2. First Mover Advantages in Central and Eastern Europe: A Comparative Analysis of Performance Measures

ABSTRACT. Businesses entering early into new markets are believed to attain crucial competitive advantages over later entrants. However, this contention receives only mixed support in the empirical literature, in part because performance is measured in different ways. We reexamine the performance difference between early movers and followers entering new geographical markets based on a sample of foreign entrants in Poland, Hungary and Lithuania. We contrast market share with two other measures of firm performance that are based on the managers' perception of their own performance relative to own prior expectations and relative to industry standards. We find that market share is strongly related to order of entry, but we did not find a positive relationship between order of entry and perceived performance. We found general support for early mover advantages in Hungary and Poland but a strongly negative relationship for Lithuania suggesting that early entry is a trade off between risk and return.

INTRODUCTION

The fairly extensive literature demonstrating the existence of first mover advantages (FMA) (Lieberman & Montgomery, 1988; Gal-Or, 1985) has in recent years been rivaled by a considerable literature on follower or late mover advantages (Narasimham & Zhang, 2000; Lieberman & Montgomery, 1998; Rivoli & Salorio, 1996). Crucial trade-offs have been shown with respect to the costs of waiting or the benefit of accepting more uncertainty by entering early. However, it is as yet unclear whether there is a general advantage to moving first (VanderWerf & Mahon, 1997). In a

Meta analysis of 90 empirical studies² VanderWerf and Mahon (1997) studied the likelihood of finding first mover advantage. After correcting for the use of market share as a performance measure, a possible self-selection bias and survival bias, they did not find support for a general FMA.

A unique opportunity to investigate FMA has arisen in the transition economies in Eastern Europe and Asia. Over the past two decades they have opened up and embraced foreign direct investment (FDI) as a mean to rebuild their economies (Marinova, Marinov & Yaprak, 2004). This has created new opportunities for multinational enterprises (MNEs) to sell their products in new markets and streamline their global production systems.

Thus, the societal quasi-experiment unfolding in transition economies provides an opportunity to investigate change processes in business strategies (Meyer & Peng, 2005). In particular, a fairly large number of firms were simultaneously considering the timing of an entry, which provides a large set of firms on which to investigate a phenomenon that often only can be investigated on specific industries with small numbers of players.

Our empirical analysis is based on a sample of foreign investors in Poland, Hungary and Lithuania. FMA research has primarily been conducted either on product markets in America (Lieberman & Montgomery, 1998) or for transition economies primarily on China. China is still geographically and culturally very distant for Western firms which may suggest a selection bias, furthermore most entry timing research has been conducted on Japanese firms (Delios & Makino, 2003) which may have different entry strategies than western firms (Chang, 1995). We believe the use of a Central and Eastern European (CEE) sample complements the timing literature by testing the first mover advantage in a different economic, institutional and developmental setting. Unlike China, where the process of opening up for FDI has been slow and incremental, the process

² From 22 different articles

proceeded very rapidly in CEE. The rapid opening to FDI and the close proximity to Western markets ensured a large number of potential entrants. Freedom in the choice of entry mode was also available from relatively early on. Consequently, we can proceed under the assumption that the entry decision has largely been strategic and competitive. It is therefore our view that the sample offers the best opportunity to date to study competitive entry timing decisions.

This paper contributes to the literature on timing and performance in four ways. First, we employ two unique measures for perceived performance and find that the choice of performance measure crucially influences, if first mover advantages are identified empirically. Secondly, our paper contributes to the growing body of literature on entry timing and performance in emerging and transition economies (Sui & Lui, 2005; Delios & Makino, 2003; Isobe, Makino & Montgomery, 2000; Pan, Li & Tse, 1999; Luo & Peng, 1998; Rivoli & Salorio, 1996). Thirdly, based on two unique performance measures, we identify the influence of endogenous firm specific advantages. Finally, we broaden the scope of the timing literature by studying the performance implications of early mover advantages in new markets.

CONCEPTUAL FRAMEWORK AND HYPOTHESES

A core argument in first mover literature is that first movers are able to preempt late movers by taking control of scarce assets (Lieberman & Montgomery, 1988 & 1998). Typical examples of local resources that can offer an advantage to first movers are the acquisition of a local distribution network, local brands and natural resources. In some industries the acquisition of production facilities can also be a source of FMA, Rockwool - a Danish producer of isolation material - primarily enter new foreign markets through acquisitions, because of the high costs of establishing new production facilities.

In the late 70's and early 80's many studies adopted a game theoretical approach to the role of entry timing and performance. Entry deterrence played a preeminent role in the first mover advantage literature. There is a long held belief dating back to Stackelberg (1934) that the first mover can capture the lion share of a market through his output decision provided that the decision is irreversible. This is generally the case if output is directly linked to investments in capacity and if these investments are sunk (Judd, 1985). Fudenberg and Tirole (1983); Spence (1979) suggest that through their investment decision first movers can prevent followers from growing. Investments in capacity may even be so large that they effectively make any subsequent entry unprofitable (Eaton & Ware, 1987; Gilbert & Harris, 1981; Dixit, 1980; Spence, 1977). However, there is little empirical evidence that first movers have actually been successful at preempting entry by rivals (Glazer, 1985; Johnson & Parkman, 1983). Later studies have increasingly adopted a resource based perspective on FMA (Lieberman & Montgomery, 1998).

Spatial preemption in geographic or product space has also been suggested as a source of FMA (Schmalensee, 1978). Robinson and Fornell (1985) found that pioneers typically have broader product range than followers.

Other sources of first mover advantages have been suggested, for instance, in the marketing literature. Schmalensee (1982) suggests that the rational consumer, having ascertained the merits of the first mover's product, will be hesitant to switch to a different and as yet untried brand. One study even found FMA derived from the consumers desire to link the pioneering brand image to their individual self-image (Alpert & Kamins, 1995). Brand names may even become synonymous with a specific type of product, for instance in Bulgaria instant coffee is referred to as Nescafé. Moreover, consumers may experience switching cost between products from different suppliers (Lieberman & Montgomery, 1998). This will typically be the case when the customers must spend resources to learn how to use a product. There may even be network effects that prevent customers

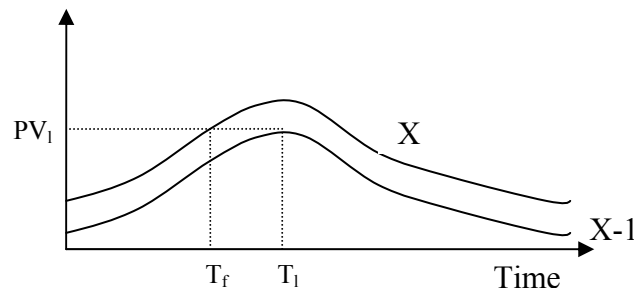
from switching to another supplier (Katz & Shapiro, 1994). An example of this is the compatibility problems between Microsoft Word and competing products, which has largely insulated Microsoft from competition.

Recently the relationship between timing and performance in international market entries has received increasing attention. A number of articles have focused specifically on the relationship between FMA and environmental conditions specific to emerging and transition economies. Doh (2000) suggests that strong FMA could be derived from participating in the privatization process. Nakata and Sivakumar (1997) compiled a list of factors that could potentially moderate the role of FMA in emerging markets both positively and negatively. In recent years many studies have been conducted using Chinese data. Isobe, Makino and Montgomery (2000) found a positive link between early entry, technology leadership and performance in China. A study by Li, Lam, Karakowsky and Qian (2003) showed no significant FMA for international entry into China in the telecommunication equipments industry. In fact they found considerable first mover disadvantages for overseas Chinese investing in China. Delios and Makino (2003) found that early entrants in China had larger sales but also a smaller survival rate. Luo (1998) found that early entrants tend to have higher sales, but later entrants have lower risk and greater accounting profit from the first years.

Hypothesis 1a: *The order of firms' entry into new markets is positively associated with market share.*

Concerns have been raised both in theoretical and empirical studies about firms' ability to exploit FMA. First, some critics assert that if FMA exist, then competition to enter first would erode all associated profits from early entry (Mills, 1988; Glazer, 1985; Gilbert & Harris, 1984). In a two stage, two player model Hirokawa and Sasaki (2001) find that a Stackelberg (1934) outcome is

Figure 2.1 Entry timing and payoff in a two player game



possible even with two initially homogeneous players if one player commit to a sticky output and in return takes on a prediction risk. Empirically in their meta analysis VanderWerf and Mahon (1997) found no support that early movers enjoy better performance, other than higher market share, over later entrants. In a recent study Boulding and Christen (2003) found support for a lasting market share advantage to the first mover, but also a long term cost disadvantage.

Based on three assumptions, that rivals are alert, homogenous and that uncertainty is resolved gradually over time, we propose a simple relationship between FMA, general business risk and performance in emerging/transition economies. The general business risk in CEE was characterized by high degree of macro economic and demand uncertainty in the first years. These uncertainties have then gradually been resolved over time so it is reasonable to infer that the risk function would be hyperbolic in nature $r = \frac{a}{s(t)}$. The discount factor for NPV would be $I = r + b$

where b is the risk free rate. Emerging markets are generally associated with high growth potential which makes it reasonable to assume that the total market dividends D increases at, for simplicity, a steady rate of G . Further, we can include a basic assumption that the first mover gains an advantage over the second mover which we model as X , the share of the total attributable to the first mover through the order of entry effect. We get that the PV of entry at any given time for the second mover would be:

$$PV = \left[\frac{(1 - X) * D}{I - G} \right] / (1 + I)^t$$

The model has some simple reasonable predictions, that the higher the initial risk (a) the later the second mover would choose to enter. Similarly, the faster the rate of uncertainty resolution $s(t)$, the sooner would the second mover enter. In a two-player game the second mover does not face further competition on entry; consequently he will choose the (t) that maximizes PV independently of the first mover's entry decision! However, for the first mover the equilibrium entry time t will be associated with a PV equal to the expected present value for the second mover. Figure 2.1 graphically illustrates that at any t greater than T_f but lower than T_l the present value for the first mover is higher than the present value of the optimal for the second mover in T_l . This will automatically induce one of the entrants to enter at T_f . Consequently, with alert rivals we get the proposition that the first mover gain a larger share of the revenues (market share), but have to enter earlier and take on more risk in return.

Hypothesis 1b: The order of firms' entry into new markets is not associated with better perceived performance.

A common property for all first mover advantages is that they contain an element of exclusivity, the action of the first player dictate or constrain the followers' strategic opportunities. We adapt a rather stringent definition of FMA. In essence a first mover advantage is either acquired or created at the moment of the investment. However, this may not always be the case. Some advantages associated with early entry are unrelated to order of entry but instead are related to how long the firm has been in the market. Firms may experience learning effects that build up over time. Many emerging and transition economies offered various forms of concessions on among other taxes to induce early entry. Political goodwill, association with the local business community,

financial institutions etc are not linked to order of entry, but to how long the firm has been in the local market. The same may hold true for some location advantages and the availability of skilled local workforce. The order of entry within a given industry is unable to affect the market for either, but the accumulated entry over time of a larger body of foreign firms will affect the relative scarcity of these resources. We shall refer to this type of advantages as early mover advantages rather than first mover advantages. These factors may be particularly important in emerging and transition economies where markets tend to be inefficient and personal relationships more important.

Hypothesis 1c: The age of the affiliate is positively associated with performance.

An endogeneity issue has also been raised. Our assumption is that the independent variable ‘entry timing’ explains the dependent variable ‘performance’. But it is quite possible that the causality go both ways. Lieberman and Montgomery (1988-98) suggest that first movers may be first because they are inherently stronger. Consequently performance differentials between first movers and late mover may be attributed to skill rather than entry timing. Narasimham and Zhang (2000) on the other hand suggest that first movers are weaker firms that attempt to avoid late mover disadvantages. Rivoli and Salorio (1996) suggest that firm with strong ownership advantages will seek to defer entry when uncertainty is high. Delios and Makino (2003) suggest that the fungibility of entrants’ resources determine whether they will enter early or late. Boulding and Christen (2003) found strong support that order of entry should be treated as endogeneous.

Market size. In a case study of the Wal-Mart chain, Ghemawat (1986) showed that Wal-Mart deliberately targeted smaller southern towns that Wal-Mart’s competitors found uninteresting. Wal-Mart would then enter with such a scale and product scope that effectively insulated Wal-Mart from competition. It is thus possible that first movers may derive superior performance not from gaining

an early foothold in large and profitable geographical or product markets, but rather from secondary markets where preemption through scale is more likely (Ghemawat, 1986; Robinson & Fornell, 1985). Small markets will be associated with larger MES; consequently, a first mover is more likely to preempt entry in a small market.

Hypothesis 2: *The effect of first mover advantages will be stronger in small markets than in large markets.*

Interaction effects. In recent years authors have adapted a contingent approach that includes interactions between entry timing and moderating variables (Cui & Lui, 2005). The choice of entry mode may be motivated by different preferences for risk, the industry structure or even government regulations. Previous literature has primarily focused on the difference between non-equity entry modes/equity based entry modes and timing/performance (Li, Lam, Karakowsky & Qian, 2003; Pan, Li & Tse, 1999; Luo, 1998). We examine the performance implications of different equity based entry modes. A partial acquisition may be a mean to acquire an option on important strategic assets early, while maintaining limited financial commitment. The choice of entry by a greenfield operation may result from the lack of sufficient quality takeover targets. This could mean that early mover advantages are more limited for firms or industries where greenfield operations are the predominant entry mode.

VanderWerf and Mahon (1997) suggested that research on FMA might suffer from a selection bias; ergo we cannot necessarily expect early mover advantages to be consistent across industries. Further, a part of the theoretical argument for FMA relies on preemption, which again is dependent on entry and exit barriers in the market. Since entry and exit barriers tend to differ from industry to industry it is therefore also likely that the advantage to early movers will differ. Finally,

firms from different countries are likely to have different entry strategies (Chang, 1995), cultural influence (Li, Lam, Karakowsky & Qian, 2003) or even political good will (Chen & Pereira, 1999). Each of these factors may affect the firm's ability to capitalize on early mover advantages.

***Hypothesis 3:** The effect of timing varies across firms depending on the choice of entry mode, the industry and home country of the entrant.*

THE SURVEY AND METHODOLOGY

The testing of early mover advantages requires a context in which new markets with distinct sub-market emerged roughly simultaneously, such that a fairly large number of firms would (potentially) enter this market – thus enabling the creation of a large dataset of early and late movers. Our analysis is based on such data, collected with a questionnaire survey of foreign owned firms in three CEE countries, Poland, Hungary and Lithuania.

The survey was conducted as a joint project in cooperation with a team of researchers in each of the three countries. The survey was administered by the local research teams in 2003. Where appropriate the survey was translated into local languages. The base population was derived from multiple local databases and surveys were then sent to the chief executive of firms where contact information was available. In most cases, this was followed up by phone contact and personal interviews to achieve a desired rate of response. Relative to the base population of all foreign investors identified through the local databases, the response rate was approximately 10 percent for Poland, 11% for Hungary and 22% for Lithuania.

The firms included were primarily established during the period 1990-2000 and had at least 10 employees and a foreign ownership participation of no less than 10%. This criterion was selected to eliminate administrative or representation offices and ensure that only fully operating firms are in

the sample. The majority, 62 percent of the firms had reported that they had less than 100 employees in 2001, 31 percent reported between 100 and 1000 and the remaining 7 percent reported that they had more than 1000 employees. Our sample thus represents both smaller and larger firms. Previous studies utilizing the PIMS database have primarily captured larger firms (Szymanski, Troy & Bharadwaj, 1995).

We had 528 firms respond to the questionnaire. Of these 170 reported that their main activity is manufacturing, 49 financial services, 129 trade and distribution, 160 other services, 1 mining & extraction and 13 utilities. Segmented on host country, the sample includes 224 firms from Hungary, 200 firms from Poland and 104 firms from Lithuania. Of the firms in the sample 141 reported that the home country of the primary foreign investor was Germany, 80 from the Nordic countries, 60 from North America, 25 came from Central and Eastern European countries, 176 from other Western European countries, 22 from Asia and other countries, and 24 did not report the home country of the primary foreign investor.

The survey is cross-sectional and by nature contains only data on firms that were operating at the time of the survey. It is, therefore, not possible to control for survival bias, however in their Meta analysis VanderWerf and Mahon (1997) did not find that controlling for survival bias would change the likelihood of finding FMA. Others, however, retain the expectation that survival plays an important role for entry timing, Lieberman and Montgomery (1998) and Delios and Makino (2003) did find that being first increased the likelihood of exit. Consequently survival bias remains a limitation on our findings. With multiple countries in the sample, albeit geographically and culturally fairly close, we can test for or rule out any country specific relationship between entry timing and performance, thus allowing for a larger degree of generalization than most studies in the field.

Table 2.1 Average market share distributed on host country

Country	Average market share
Hungary	31,01
Poland	24,81
Lithuania	55,90
All Countries	31,50

Dependent variables

Marketshare. As our dependent variable we will use the market share for 2001 for our first model. The market share measure is a percent measure where the range of observations is between $0 < Y \leq 100$. The market share is reported by the respondents³ which mean we do see a tendency towards approximations e.g. 50% so there is some loss of accuracy.

However, for cross-sectional data with many industries/products it is most practical to rely on respondent supplied information. The average market shares (table 2.1) are considerably larger than what Pan, Li and Tse (1999) and other China based studies report, which would be largely due to their decision to use the aggregated market share for all of China rather than the market share for the regions that the firms actually operate in.

Industry performance. The industry performance measure is a unique construct based on five different performance indicators of how the firm compares to its rivals. The scale for each of the performance indicators is a 5-point scale, where one indicates that the firm is among the weakest 20% in the industry and five that it is among the strongest. We use the average of the five items (table 2.2) as our dependent variable. The construct has a Cronbach's Alfa of 0.9, suggesting the aggregation is reasonable. The advantage of the construct is that it will automatically weed out the

³ The question asked was "Market share of the foreign investment in its main domestic market, in percent"

Table 2.2 Variables included in Industry performance

Variable	N	Mean
After tax return on total assets	420	3,41
After tax return on total sales	421	3,41
Firm total sales growth	428	3,62
Productivity	410	3,76
Overall performance	426	3,70

part of performance that is attributable to differences across industries. We are then able to measure whether timing is related to perceived successful firms without the need for an excessive number of industry dummies. A potential problem is that there may not be at least five firms in the industry and therefore the respondents have some discretion in the choice of category. Another possible problem is that there may be a tendency to overrate own performance relative to rivals⁴; however, if this occurs consistently then it should only affect the level not the direction of a relationship.

Performance satisfaction. The last performance measure we will employ is a measure of the firms satisfaction with their performance compared to their original objectives. The variable is constructed from the average of three 7-point Likert scale items (table 2.3), satisfaction with respectively productivity, profitability and revenue growth. A Cronbach's Alfa of 0.83 suggests that it is reasonable to aggregate the three items. Like the industry performance measure this measure is also comparable across industries and it has the added advantage that it should control for the relative inherent strength of the entrants. Stronger firms will have higher expectations and firms that are inherently weaker will adjust their expectations accordingly. Ideally this measure captures what is important to managers, the fulfillment of objectives.

⁴ The average is higher than the expected 3, which might suggest systematic overestimation. It is quite possible that the exclusion of locally owned firms can account for the upward bias (Sinani, 2004)

Table 2.3 Variables included in Performance satisfaction

Variable	N	Mean
Productivity	479	5,15
Profitability	497	4,87
Revenue growth	493	5,11

Independent variables

Timing. We use an order of entry construct to determine whether first movers have an advantage over followers. It is a sensible measure to capture the exclusive opportunities that the first movers possess. By his choice the first mover denies a choice to the follower regardless of how soon or late the follower moves. The surveyed firms were asked to state how many competitors were present in the market at the time of entry. The measure is a 5 point-scale where one is no competitors (first movers) and five is more than 10 competitors (late movers). The measure is cognitive neutral unlike PIMS based studies (Gaba, Pan & Ungson, 2002) consequently we find a much smaller ratio of first movers. We capture the order of entry effect by including dummies for category one to four leaving five as the base.

To test for early mover advantage we used the year of entry reported by the respondent, converted it by subtracting it from 2004 so we get the affiliates age. As a result a positive sign imply the existence of early mover advantages.

Small market. To test H2 that small markets should be more favorable for early movers, we use a country dummy for Lithuanian as a proxy for small markets. Our expectations are that early movers are more likely to preempt entry by rivals due to the limited market size. To capture this effect we include an interaction link between market time and the Lithuanian dummy.

Interaction effects. To test our hypothesis on the consistency of first mover advantages across groups, we use interaction links between the affiliate's age and the set of dummies for entry mode, industry and the investor's home country.

Table 2.4 Control variables

Group	Variable name	Description
Investment motives	Low cost labor Skilled labor	How important access to the before mentioned was for the investment decision. The variables are 5 point Likert scales where 1 is not at all and 5 is very important.
Resources	Human resources Tech	Factor outputs, based on a number of 7 point Likert scale response variables. Human resources capture efforts expended on training and upgrading personnel in the host country. Tech is the availability of technological resources from the parent firm.
Entry Mode	Greenfield, Acquisition, Partial acquisition, Joint Venture	Dummies for the entry mode.
Export intensity	Manuf*export	Export in percent of total sales for the first year of operation for the manufacturing sector.
Competitive Environment	Local industry Dumlocal	The strength of the local industry at the time of entry compared to the respondent. Dumlocal is a dummy for no local competitors
Home country dummies	Germany, Nordic, Other W. European, North American, CEEC, Asia	Dummies for the parent company's home country.
Respondent dummies	CEO, Expatriate, Employed with the parent company before current assignment.	To control for a possible bias derived from the status of the respondent we use three dummies. Whether the respondent is the CEO of the subsidiary. Whether the respondent is an expatriate and whether the respondent was employed by the parent company before his current position.
Source of Critical resources	Local resources	A 0-100 % scale for to what extent the 3 most critical resources for the firm were obtained from a local partner.
Industry dummies	Financial Services, Other services, Manufacturing, Utilities, Mining & Extraction, Trade	Dummies for the industry type.

Controls. In addition, we include a number of control variables that are summarized in table 2.4.

The Model

We use an OLS regression analysis to estimate the relationship between the dependent variable and the independent variables. We then ran regressions for each of the dependent variables a number of times to systematically exclude insignificant control variables and get the best model

fit. This was necessary to reduce the number of observations lost due to missing values in insignificant control variables. We found a best fit for each of the three dependent variables and for contrast we ran each of the three models with the three dependent variables. The base model for market share, industry performance and performance satisfaction are as follows:

$$Y = \beta \text{ intercept} + \beta \text{ order of entry} + \beta \text{ age} + \beta \text{ Lithuania*age} + \beta \text{ first affiliate} + \beta \text{ host market knowledge} + \beta \text{ market knowledge Eastern Europe} + \beta \text{ entry mode dummies} + \beta \text{ low cost labor} + \beta \text{ skilled labor} + \beta \text{ tech} + \beta \text{ human resources} + \beta \text{ manufacturing*export intensity}^5 + \beta \text{ local resources} + \beta \text{ local industry} + \beta \text{ no local industry} + \beta \text{ host country dummies} + \beta \text{ industry dummies} + \beta \text{ home country dummies} + \beta \text{ CEO} + \varepsilon.$$

Our sample contains both firms that mainly supply the local market, but also a reasonably large number of firms that focus mainly or even entirely on export markets. Since local market share is an irrelevant performance measure for these firms we have decided to exclude them from the analysis for market share. We have also excluded them from the analysis for industry performance because of uncertainties in terms of which industry they compare themselves to. Pan, Li and Tse (1999) corrected for the problem by excluding 22 export oriented industries. We have retained all firms which reported that they exported less than 90 percent of their total sales⁶. For the model for performance satisfaction we found that the variance tended to be larger for smaller firms and decreasing with firm size. To correct for this we ran the model as a WLS with the natural log of the number of employees as the weight. The results are reported in table 2.6.

Interaction effects. We introduce one set of interaction links into the three basic models at a time. We do this so we are able to report the impact on the explanatory power, adjusted R square, of the

⁵ As export intensity is highest amongst manufacturing firms we include it as an interaction link

⁶ At this level we feel the answers should be acceptable, the remaining part of the export bias is eliminated by including a control

model when controlling for cross group differences. Furthermore this procedure limits a possible problem with multi-collinearity where too many variables attempt to explain the same thing, thus creating computational problems. The model design is,

$$\text{Dependent variable}(Y1,Y2,Y3) = \beta \text{ intercept} + \text{base model}(x1,x2,x3) + \beta \text{ dum}(1)*age + \beta \text{ dum}(2)*age \dots \beta \text{ dum}(n)*age + \varepsilon$$

The results are reported separately in table 2.7 with three regressions for each dependent variable for a total of 9 regressions. The results from the interaction links in model I, II and III indicate the extent to which the relationship between affiliate age and a given group departs from the base group.

Missing values and multi-collinarity. We do experience a problem with missing values particularly for market share. In order to test whether there was an underlying response bias, we limited the samples for the other performance measures to the firms that actually reported market share. For the limited sample the results were not materially different from the full sample. The models joint explanatory power (adjusted R square) did not change materially nor did the direction and significance level of the independent variables. Consequently we decided to report the results for the full sample.

The level of multi-collinarity is generally within acceptable bounds, however, the variables *Lowcost labor* and *skilled labor* do cause a collinarity problem and subsequently only one of the variables are used in each regression. The Pearson correlations between the independent variables are reported in table 2.5.

Pearson Correlations

	X1	X2	X3	X4	X5	X6	X7	X8	X9	X10	X11	X12	X13	X14	X15	X16	X17	X18	X19	X20
X1 Orderfertility	1																			
X2 Age	-.063	1																		
X3 Firstaffiliate	-.089*	.123**	1																	
X4 Hostmarketknowledge	.083	-.047	-.451**	1																
X5 MarketknowledgeEE	.081	-.112*	-.099*	.050	1															
X6 Greenfield	.011	-.014	.119**	-.054	.008	1														
X7 Acquisition	-.019	-.051	-.165**	.074	-.011	-.487**	1													
X8 JV	-.047	.093*	.052	-.100*	-.042	-.456**	-.287**	1												
X9 Part_Acq	.062	-.030	-.039	.107*	.056	-.321**	-.202**	-.189**	1											
X10 Lowcostlabor	-.168**	-.053	.059	-.006	-.092*	-.017	.033	.071	-.113*	1										
X11 Skilledlabor	-.049	-.005	.050	.016	.023	-.037	.029	.031	-.022	.317**	1									
X12 Tech	-.041	.010	.043	.060	.079	.132**	.009	-.079	-.112*	-.028	-.047	1								
X13 Humanresources	-.038	.084	-.001	.101*	.148**	.070	.017	-.046	-.071	-.063	.087	.370**	1							
X14 % exp_fly	-.196**	-.121**	.056	-.026	-.140**	.025	.067	-.030	-.101*	.414**	.128**	.012	-.097*	1						
X15 Localindustry	.254**	-.043	-.134**	.099*	.101*	-.117**	.093*	.024	.027	-.094*	-.078	-.160**	-.104*	-.086	1					
X16 dumlocal	-.197**	-.013	.093*	-.045	-.152**	.050	-.049	.001	-.018	.078	.038	.108*	.027	.145**	-.748**	1				
X17 Localresources	.066	-.012	-.114*	.063	.069	-.430**	.268**	.130**	.155**	.010	.075	.017	-.023	-.074	.067	-.012	1			
X18 Poland	.012	.083	-.043	.081	.022	.032	-.070	-.018	.071	-.103*	-.175**	.173**	.188**	-.151**	.022	-.093*	-.022	1		
X19 Lithuania	-.051	-.256**	-.059	-.206**	.131**	-.040	.064	-.012	-.003	.030	.162**	-.112*	-.240**	.105*	-.005	-.089*	-.019	-.387**	1	
X20 Hungary	.029	.124**	.090*	.087*	-.127**	.001	.017	.028	-.067	.076	.040	-.080	.007	.061	-.018	.170**	.037	-.670**	-.425**	1

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

Table 2.5 Bivariate correlations matrix

Table 2.6 Regression results for the 3 models

	Model market share			Model industry			Model performance		
	Marketshare	Industry	Performance	Marketshare	Industry	Performance	Marketshare	Industry	Performance
(Constant)	-4,053 (10,627)	3,373*** (0,306)	4,488*** (0,420)	-5,876 (14,563)	3,276*** (0,350)	3,774*** (0,507)	-32,003*** (12,150)	3,091*** (0,323)	3,156*** (0,416)
Order 1	31,313*** (6,322)	0,249 (0,180)	-0,142 (0,242)	24,680*** (7,250)	0,151 (0,169)	-0,544** (0,244)	23,284*** (6,176)	0,418*** (0,158)	0,095 (0,196)
Order 2	26,116*** (5,648)	0,056 (0,159)	0,183 (0,221)	24,764*** (5,822)	-0,013 (0,141)	-0,006 (0,207)	23,593*** (5,725)	0,141 (0,143)	0,230 (0,189)
Order 3	19,844*** (5,131)	0,267* (0,150)	0,394* (0,208)	15,768*** (5,333)	0,111 (0,131)	0,207 (0,195)	11,015** (5,275)	0,160 (0,138)	0,473*** (0,182)
Order 4	13,785** (5,891)	0,012 (0,168)	0,075 (0,227)	9,721 (6,273)	-0,191 (0,147)	-0,077 (0,212)	7,514 (6,370)	-0,019 (0,152)	0,014 (0,205)
Age	-0,506 (0,675)	0,035* (0,020)	0,096** (0,026)	-0,400 (0,752)	0,006 (0,018)	0,067*** (0,025)	0,585 (0,644)	0,032* (0,017)	0,072** (0,022)
Lithuania*age	0,919 (2,057)	-0,120** (0,048)	-0,167** (0,067)	2,169 (2,260)	-0,088** (0,044)	-0,126* (0,065)	2,450 (2,072)	-0,095** (0,044)	-0,153*** (0,059)
First affiliate	21,584*** (4,938)	0,201 (0,140)	0,075 (0,199)	21,072*** (5,091)	0,029 (0,128)	-0,096 (0,187)	23,937*** (5,021)	0,002 (0,129)	0,116 (0,167)
Hostmarket knowledge	9,672** (4,467)	0,046 (0,130)	0,092 (0,180)	11,199** (4,731)	-0,044 (0,119)	-0,050 (0,171)	16,367*** (4,572)	-0,120 (0,120)	0,051 (0,152)
Market knowledge EE	-1,355 (3,614)	0,031 (0,103)	0,072 (0,144)	-2,350 (3,998)	-0,068 (0,095)	-0,010 (0,140)	-1,424 (3,712)	-0,033 (0,094)	0,007 (0,125)
Acquisition	11,955** (5,249)	0,008 (0,141)	-0,108 (0,199)	8,616 (5,499)	0,098 (0,124)	-0,163 (0,184)	6,632 (4,824)	-0,189 (0,121)	-0,230 (0,161)
JV	6,519 (5,105)	-0,134 (0,145)	0,316 (0,203)	3,583 (5,190)	-0,014 (0,127)	0,340* (0,187)	9,392* (5,167)	-0,167 (0,130)	0,210 (0,173)
Part_Acq	8,357 (5,912)	-0,082 (0,175)	-0,472** (0,240)	0,744 (6,483)	0,099 (0,155)	-0,341 (0,225)	9,843* (5,659)	-0,008 (0,148)	-0,160 (0,190)
Lowcostlabor	14,029*** (4,146)	-0,071 (0,116)	-0,164 (0,163)						
Skilled labor							3,618* (2,164)	0,023 (0,056)	0,187*** (0,073)
Tech				0,739 (1,214)	0,086*** (0,029)	0,112*** (0,041)	5,053 (4,108)	0,309*** (0,110)	0,593*** (0,141)
Human resources				1,844 (1,763)	0,109*** (0,040)	0,139** (0,057)	3,040 (2,194)	0,237*** (0,055)	0,183*** (0,070)
Manuf*export	-0,288*** (0,096)	0,000 (0,003)	0,003 (0,004)						
Localresources	-0,138*** (0,046)	-0,001 (0,001)	-0,001 (0,002)						
Local industry				-1,420 (1,009)	-0,103*** (0,025)	-0,039 (0,037)			
dumNolocal				-4,441 (9,456)	-0,735*** (0,234)	0,211 (0,320)			
Lithuania	29,317* (15,278)	0,498 (0,368)	0,870* (0,507)	19,614 (16,633)	0,293 (0,341)	0,592 (0,493)	13,550 (16,590)	0,527 (0,347)	0,886* (0,460)
Hungary	8,690** (4,199)	0,017 (0,125)	0,206 (0,173)	5,664 (4,791)	0,165 (0,117)	0,038 (0,171)	0,826 (4,357)	0,128 (0,113)	0,249* (0,150)
Industry dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Homecountry dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Respondent dummy				Yes	Yes	Yes	Yes	Yes	Yes
N	219	282	314	215	281	313	235	302	343
F test of joint sig.	4,833***	1,600**	1,799***	3,182***	3,827***	3,330***	4,340***	3,453***	4,907***
Adjusted R square	0,330	0,056	0,067	0,234	0,232	0,183	0,293	0,191	0,249

*** p<0,01. ** p<0,05. * p<0,1.

RESULTS AND HYPOTHESES TESTS

In table 2.6 we report the results of the three basic models. We find that Order of entry is positively and significantly associated with market share. First movers enjoy approximately 31 percent point higher market share than late movers, whereas early followers could expect 26 percent point higher market share.

These effects are considerably stronger than what especially the China based studies report. This difference is likely to be attributable to a tendency towards international market segmentation. Aggregating sales on all regions fail to account for the option that later entrants are in fact first movers in other regional markets. Order of entry does not appear to be strongly related to performance, only one of the three models suggests that first movers experience statistically significantly superior performance. When we use performance satisfaction as dependent variable the relationship actually appears to be closer to an inverted U shape. Thus we can support both hypotheses 1a and 1b. We found no support that affiliate age should influence market share, the results were also very weak for industry performance in two of the models and insignificant in the primary model. However there was a positive and statistically significant relationship between affiliate age and performance satisfaction. Hypothesis 1c is thus partially supported.

Our results suggest that order of entry is important for acquiring market share, but order of entry as such is unrelated to profitability, productivity and revenue growth. When corrected for entrant quality we found some evidence of early mover advantages. This may suggest the existence of early mover advantages. Our findings suggest that early movers on average are more satisfied with their results, but they do not feel they do relatively better than other firms in their respective industries. This may suggest that early movers in CEE have been inherently weaker. Narasimham and Zhang (2000) suggested that weaker firms would tend to move early to overcome “laggard” disadvantages. Rivoli and Salorio (1996) also suggested that firms with strong firm specific

resources, when faced with uncertainty, would tend to wait for uncertainty to be resolved. Here we would like to stress the geographical influence of our results though. It is possible that such a relationship is specific to CEE rather than a general rule. The OLI paradigm suggests that only firms with strong ownership advantages will internationalize in the first place. It is possible that the opening of CEE to FDI have encouraged a host of resource weaker firms that have had little previous international experience to enter. The opening of CEE has propelled firms with little internationalization experience to re-evaluate their “lack” of international commitment. In CEE, European companies in particular, have seen an opportunity to expand in less congested market that are still geographically and culturally close and, in no small part due to these countries’ close association with the European Union, with-in an acceptable risk range. It is possible that the greater geographical and cultural distance that Western firms face when investing in Asia would naturally weed out resource-weak firms.

Our small market test between the Lithuanian dummy and market time was statistically insignificant though positive for market share. However, the interaction link was negative and significant for both industry performance and performance satisfaction in all the regressions indicating that the effect of timing is different for firms in Lithuania, though the direction was not as predicted. We can thus reject hypothesis two that timing related advantages are stronger in smaller markets. Our results may suggest that firms investing early in Lithuania are likely to have suffered comparatively more during the Russian crisis in the late 90’s than early movers in Hungary and Poland. Liu (2005) suggest that FMA exist only when realized demand is close to expected demand.

To test the contingent approach on early mover advantage we ran a number of regressions including interaction links between affiliate age and entry mode, industry group and home country (table 2.7). For market share we found no statistically significant differences between any of the

groups. Consequently there appears to be neither a general nor a conditional effect of affiliate age for market share.

Table 2.7 Regressions including interaction links

	Performance			Industry performance			Market share		
	I	II	III	I	II	III	I	II	III
Acq.	-0,506 (0,434)			0,070 (0,333)			16,968 (13,752)		
JV	0,660 (0,606)			-0,303 (0,426)			-1,210 (17,517)		
Part_Acq.	-1,132** (0,488)			-0,070 (0,420)			4,246 (16,727)		
Utilities		-0,416 (0,997)			-1,876** (0,775)			-24,633 (33,059)	
Fin serv.		0,815 (0,505)			1,113*** (0,412)			-35,020* (17,765)	
Trade		0,410 (0,555)			-0,432 (0,424)			-3,852 (16,006)	
Other serv.		-0,647 (0,474)			-0,259 (0,354)			-6,185 (15,883)	
Nordic			0,109 (0,557)			0,237 (0,442)			-1,424 (18,619)
Other W.			0,669 (0,453)			1,179*** (0,377)			4,358 (14,515)
Europe			-0,657 (0,886)			0,093 (0,661)			21,634 (26,595)
CEEC			0,036 (0,698)			0,685 (0,511)			11,792 (21,801)
North A			1,311 (0,905)			0,726 (0,713)			39,904 (24,394)
Asia and Other									
Age	0,042 (0,037)	0,060* (0,032)	0,104*** (0,038)	-0,003 (0,027)	0,001 (0,029)	0,090*** (0,033)	-0,539 (1,097)	-0,543 (1,136)	-0,061 (1,176)
Lithuania*age	-0,165*** (0,059)	-0,159*** (0,059)	-0,153** (0,065)	-0,088** (0,044)	-0,096** (0,044)	-0,115** (0,050)	1,057 (2,081)	0,441 (2,195)	1,617 (2,361)
JV*age	-0,049 (0,068)			0,034 (0,048)			0,910 (1,961)		
Acq*age	0,033 (0,050)			0,003 (0,038)			-0,555 (1,506)		
Part_acq*age	0,121** (0,056)			0,022 (0,051)			0,541 (1,936)		
Utilities*age		-0,014 (0,121)			0,189* (0,100)			1,496 (3,873)	
Finserv*age		-0,024 (0,056)			-0,117** (0,049)			1,671 (1,899)	
Trade*age		-0,028 (0,062)			0,051 (0,048)			-0,699 (1,747)	
Otherserv*age		0,094* (0,053)			0,031 (0,040)			-0,442 (1,724)	
AsiaAO*age			-0,193* (0,104)			-0,134 (0,082)			-4,390 (2,773)
CEEC*age			0,089 (0,120)			-0,041 (0,098)			-3,450 (3,809)
Nordic*age			-0,047 (0,066)			-0,058 (0,052)			-0,296 (2,191)
OtherWE*age			-0,067 (0,051)			-0,141*** (0,043)			0,242 (1,614)
NorthA*age			0,046 (0,073)			-0,087 (0,054)			-1,467 (2,279)
N	342	343	343	281	281	281	219	219	219
F test of joint sig.	4,737***	4,477***	4,437***	3,465***	4,014***	3,709***	4,332***	4,239***	4,197***
Adjusted R square	0,260	0,251	0,255	0,225	0,268	0,253	0,321	0,322	0,326

*** p<0,01. ** p<0,05. * p<0,1. Base Greenfield, Manufacturing, Germany.

For industry performance we found a considerable change in the explanatory power of the model when we included links between home countries and age, and especially for the links between industry group and age. Most markedly for the utility industry early entry appears to be positively associated with industry performance. This relationship does not persist when we use the corrected performance measure. This suggests that the observed relationship is primarily related to the relative quality of early entrants in the utility industry. Rivoli and Salorio (1996) suggested that well endowed firms would give up the option to wait when the country specific early mover advantages are high. Since utilities tend to be associated with natural or legal limitations on entry and the potential number of firms in the industry, this may explain the observed relationship. In a study of the international expansion of the telecom industry Sakar, Cavusgil and Aulakh (1999) found strong evidence that firms engage in a pursuit to preempt markets.

Early movers among financial service firms on the other hand seem to be associated with lower performance compared to the industry. Again when corrected for entrant quality the relationship does not persist. This may be explained by great difficulties in estimating credit worthiness, considerable amounts of bad debt to state owned and former state owned firms and possibly an unwillingness by the host countries to relinquish the option to interfere in strategically important industries. Consequently, uncertainty was high and preemption tends to be difficult for the financial service industry, suggesting that firms with strong ownership advantages would choose to postpone entry until uncertainties have been resolved. Conclusively, the advantage to enter early may be fairly general, but the quality of early entrants will vary considerably depending on the particularities of the industry.

We tested whether entry mode was associated with performance, but our results were not conclusive. We found a tendency for greenfield operations to have lower market share, but the

relationship was statistically weak across the models. Finally, we found some indication that the interaction between affiliate age and entry mode is associated with performance satisfaction.

Our results indicate that early movers amongst joint ventures tended to under perform compared to late movers. A likely explanation is that the use of the joint venture entry mode in the early 90's was motivated primarily by political or regulatory considerations. Consequently, these early movers are likely to have experienced considerable control problems due to incompatible partners. The joint ventures established later in the period are more likely to be motivated by resource/competency complementarities and the entry mode may then have a value adding property.

In the other end of the scale we have acquisitions and in particular partial acquisitions for which moving early is more strongly positively associated with performance. So we do observe a pattern between entry mode, affiliate age and performance. Entry modes that are associated with the acquisition/preemption of local assets are more sensitive to entry timing than other entry modes.

DISCUSSION AND CONCLUSION

In line with previous research we find a positive relationship between order of entry and market share (VanderWerf & Mahon 1997). However, we did not find a positive relationship between order of entry and performance. The results suggest that order of entry is likely to be a tradeoff between greater market share and risk or costs. In the most recent comparative study of performance measures, Cui and Lui (2005) found similar results based on a sample of Chinese firms. Consequently there is growing evidence that these results can be generalized. We did find a positive relationship between the affiliate's age and performance satisfaction. Our findings suggest the existence of early mover advantages. Early movers in emerging/transitional economies may benefit from incomplete markets for factor inputs such as, labor, location, assets etc and consequently gain Ricardian rent. However early movers are punished when faced with adverse

economic conditions. This suggests that entry timing remains largely a tradeoff between risk and return. We also found that entry mode had a considerable moderating effect on the likelihood of finding an early mover advantage.

Overall our results suggest that the factors that explain performance vary considerably depending on how we measure performance. Order of entry, previous market knowledge and market size are all useful for explaining market share, but they are not very useful for explaining other measures for performance. Rather we found that the length of time the firm has been in the market, the firm's human resource activities and transfer of technology were determinants of firm performance.

Our findings suggest that more empirical studies on timing and performance is warranted, but with other performance measures than market share. Previous literature and the empirical results in this article suggest that endogeneity has a significant impact on the extent to which we observe timing related advantages. It is therefore clear that any attempt to control for the inherent strength of the entrants would also be a fruitful addition to FMA literature. It is possible that more studies that take account of survival would be a valuable addition to the field. However, exit is not necessarily failure and the magnitude of failure associated with exit is not always the same. The challenge will be to find a way to measure failure that takes account of these factors. There has only been a few attempt to study FMA and multiple international market entry (Mascarenhas, 1992 & 1997), this is clearly an important aspect for the MNE and worthy of more studies. Finally, a key factor in empirical research is often to find an environment that is conducive to studying a specific relationship. We believe the environment and development of CEE are particularly conducive for FMA studies. We would like to urge others to take advantage of this opportunity, ideally by using a contingency approach that can tell us more about the link between firm strategy and FMA.

The managerial implication of our study is that managers should not rush to market in the hope of achieving advantages that may not materialize. Management should carefully consider whether the potential advantages are enduring. Evidence of superior market share for first movers is very strong, which suggest that firms that can leverage a high market share to improved performance may do well to pursue a first mover strategy. If this is not the case, it may often be better to adapt a wait and see or an early follower strategy. Results from recent studies may also be good news for firms that have not yet entered and are afraid they have forfeited their chance. The opportunities are still there!

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3. Competition for Markets vs. Competition in Markets: The Case of the Brewing Industry in Central and Eastern Europe

ABSTRACT. This study explores interdependent competitive market entry behavior in multiple geographical markets. In an explorative study of the dynamics of competition in the brewing industry in Central and Eastern Europe (CEE) we establish stylized facts of this industry, including that moving first is associated with strong performance advantages. On this basis we develop a theoretical analysis of the interaction between multiple potential entrants considering multiple markets to enter. These performance advantages suggest that firms may compete to obtain first mover opportunities across multiple geographical markets. Hence, sustainable first mover advantages (FMA) in foreign entry may lead to a competitive behavior akin to “competition for markets” rather than “competition for market share”. Nevertheless, rivals frequently challenge incumbents by following into their markets. We suggest, that these follower investments may be made primarily for the purpose of tying up the incumbent’s resources rather than actually challenging its position. Furthermore, we suggest that, in spite of high exit rates, foreign market entry by small players may be motivated by comparatively low exit barriers brought on by acquisition based industry consolidation processes.

INTRODUCTION

As we have observed with the opening of CEE and many markets in Asia to foreign direct investment (FDI), new market opportunities can arise in short spurts rather than in slow incremental

steps. Consequently, multinational enterprises (MNE) may often find themselves competing for market opportunities in a range of new promising international markets. In this pursuit for dominance in multiple local markets, getting to the market first may play a pre-eminent strategic role.

Much of the first mover literature, empirical studies in particular, has focused on bringing to light the preconditions for first mover advantages and the extent to which first movers generally enjoy greater returns than followers. On the other hand, few studies actually try to answer the question; how might the existence of first advantages affect firms' strategic behavior?

We develop the paper as an explorative study of multi-market entry competition, utilizing data on entry timing, performance and acquisition activities of foreign entrants in the brewing industry for 9 Central and Eastern European (CEE) countries. Using the emerging industry structure of CEE, we seek to explore the strategic aspects of first mover advantages and their role in shaping entry patterns across international markets. We then develop propositions that seek to account for these dynamics between the pursuit of market leadership through early entry, competitive interaction and ultimately performance. Our methodology is thus to use mix of quantitative and qualitative evidence to indicate relationships between entry timing and performance in a multi-market competitive setting. As argued by Eisenhardt (1989) this type of methodology is well suited to explore areas of research that is insufficiently accounted for by existing theories.

The brewing industry in CEE is particularly interesting for this study for several reasons. 1) The industry has a typically oligopolistic structure with a few active large international players suggesting interdependence between these players. 2) The industry players faced stagnant or declining demand in the major markets particularly in Western Europe compelling them to seek growth opportunities in less contested markets. 3) The prevalence of acquisition type market entries and the fact that, typically, only a few of the large international players are represented in the

individual national markets points towards the existence of barriers to entry and accordingly potential first mover advantages. 4) The relevant major players all entered CEE fairly early and today account for the lion share of the production and sale of beer in the region which should largely rule out or minimize the role of path dependent or other gradual evolution oriented explanations.

Moreover in our view, international market entry in emerging or transition economies is an excellent point of departure for studies on entry timing competition. While for instance Nakata and Sivakumar (1997) argue that first movers may enjoy technological leadership over followers it is important to note that this leadership will predominantly exist in relation to potential local competitors. Quite often, especially in oligopolistic industries, potential entrants will compete over who gets to the market first against other foreign rivals with the same level of technology, capital resources and capabilities. The entry option is thus likely to take on the characteristics of what Miller and Folta (2002) refers to as “shared entry options”. That is, usually more than one firm has the ability, resources and interest in exercising the option to enter a given market. The entry decision of any given firm is thus not taken in isolation, but rather it is part of a competitive process within a group of firms that share this option.

The core issue is thus how FMA can be obtained under entry competition? In this respect two previous entry studies are particularly interesting. Mills (1988) found that when a new entry is undertaken through a series of sequential investment steps, what might qualify as a compound option, a first mover advantage could potentially be secured with an infinitely small resource commitment. Similarly, in an empirical study of international market entry in the offshore drilling product market Mascarenhas (1997) found that the initial resource commitment of the entrant was of less importance than moving first per se. Hence, these studies challenge a long held belief dating back to Stackelberg (1934) that first mover advantages are derived primarily from large irreversible

investments in capacity. The potential implications of these studies are interesting in the context of the brewing industry since the study by Meyer and Tran (2006) provides evidence suggesting a sequential or staged entry process. It is thus possible that firms advantageously pursue a strategy of multiple low commitment entries over a strategy of fewer high commitment entries.

Therefore, in this paper we examine the influence of potential FMA on firm strategies. In particular we explore the effect of market opportunities in multiple markets on the entry decisions of firms. Initially, we argue that given strong first mover advantages, firms have an incentive to avoid following other competitors and would rather pursue first mover opportunities of their own in other markets. Extending this logic we would thus expect that oligopolistic competition leads to perfect market division along geographical lines; or in other words “competition for markets”.

However, we rarely observe an industry with perfect market division, the brewing industry included, and hence late entry in a new geographical market could be grounded in strategic advantages derived in other markets. Miller and Folta (2002) argue that firms may undertake or threaten to undertake investments in order to force competitors to prematurely exercising their options. Consequently follower investments may be strategically exercised in order to gain a competitive advantage in the competition for markets.

Moreover, we examine the role of smaller foreign entrants and observe that these tend to have considerably higher exit rates. We proceed to argue that small firm entry may be economically sensible to the extent that the player can assume that an implicit buyout option exists. In effect, in industries where new market entry and consolidation is acquisition driven the investment made by a small foreign entrant may not be particularly sunk.

We develop our argument as follows. In the next section we review the literature on first mover advantages. We then present empirical evidence from the brewing industry which raises puzzles that existing theory does not adequately explain. On this basis, we discuss and develop

propositions on the competition for first mover advantages in multiple international markets. In section five we address the role of small MNEs entry. Finally, in section six we discuss the results in the broader context of the literature.

LITERATURE REVIEW

The nature and sources of first mover advantages

First mover advantages have been associated with a wide range of business characteristics. First movers can gain an advantage over followers through preemptive investments in capacity (Lieberman & Montgomery, 1988), either deterring followers from entering all together (Eaton & Ware, 1987), capturing the lion share of a market (Stackelberg, 1934) or limiting the growth potential of followers (Fudenberg & Tirole, 1983).

Pioneers may also seek to preempt the product space by providing a broad product line hence limiting follower ability to capture product niches (Robinson & Fornell, 1985). Or preempt the geographical space through carefully targeting regions that cannot support competition (Ghemawat, 1986).

Pre-emption of local resources is another potentially important source of FMA (Lieberman & Montgomery, 1988). First movers may have the chance to secure access to or acquire certain local resources that are essential to conduct business in a market. These could potentially include business licenses, natural resources, distribution networks or even production facilities.

Brand perception can form a strong FMA, for instance Schmalensee (1982) found that search and trial costs could lead buyers to stick with the first product that they find to perform adequately, i.e. the first movers brand. Another study by Alpert and Kamins (1995) even suggest that pioneering per se may create additional brand value as consumers link their self-image to the

pioneering brand. Moreover, tie-in's with end users or distributors can be a source of advantage to the first mover, particularly when there are costs involved in switching to another product (Katz & Shapiro, 1994).

Nevertheless, despite a fairly large body of research on market entry timing and performance the question whether first movers are able to extract superior rent compared to followers has produced mixed results. In a Meta analysis by VanderWerf and Mahon (1997) a strong positive link between early entry and market share was documented. Market share in turn has been positively linked to other measures of performance (Capon, Farley & Hoenig, 1990). However, less consistent results, even to the point of suggesting a possible negative relationship has been derived from studies attempting to link order of entry directly to financial performance measures (VanderWerf & Mahon, 1997).

Perhaps as a consequence of this a stream of literature has emerged that seek to explain the apparent lack of connection between moving first and superior performance. Lieberman and Montgomery (1998) for instance suggest that firms may simply be subject to a number of first mover disadvantages that could erode or even supersede the advantage of moving first. Among other, they suggest that followers may be able to free ride on the first mover, that followers may gain an advantage from entering after technological or market uncertainties have been resolved or even that followers can overtake the first mover as a result of incumbent inertia.

Another line of inquiry suggest that relatively advantaged firms might deliberately postpone entry to avoid some of the market risks associated with moving first into unexplored territory. Hence, Nashiram and Zhang (2000); Rivoli and Salorio (1996) found that endogenous firm specific advantages may induce advantaged firms to wait and force disadvantaged firms to speed to market. Therefore, lower performance or higher fatality among first movers could be attributed to the inherent quality of the entrants.

Finally some studies have found that competitive entry timing may drive out all advantages associated with early entry. While this does not necessarily suggest that first mover advantages do not exist it does suggest that a competitive market-clearing mechanism eliminates the firm's ability to derive superior rent from these advantages. Hence in their study on entry options Miller and Folta (2002) question the extent to which early exercise of entry options when they are shared with other players can lead to superior performance.

Therefore even when all the preconditions for first mover advantages exists it is not self evident that the advantages can be exploited, it also requires a suitable competitive environment that allows firms to take advantage of these opportunities.

How firms compete over first mover opportunities and the way these opportunities are distributed then appears to be a key determining factor as to the extent that these can generate superior returns.

Size and pre-emption

The only studies to our knowledge that have addressed the relationship between pioneering and performance in multiple international markets have been conducted by Mascarenhas (1992 & 1997). In his initial study from 1992 he found a positive relationship between pioneering in international markets and market share within the offshore drilling product market, yet also noted that the effect was considerably smaller when controlling for survival.

In a subsequent study however Mascarenhas (1997) found that first movers had both on average larger market share and a higher probability of survival when correcting for firm specific factors. Moreover, Mascarenhas noted that it was the act of moving first rather than the initial resource commitment that was the primary source of the performance advantage. The results of his study lead him to suggest that firms may advantageously seek first mover advantages in an increased number of markets through comparatively smaller resource commitments.

This result is interesting especially considering the studies of Folta and O'Brien (2004); Rivoli and Salorio (1996) who suggests that a higher degree of reversibility decreases the value of the option to defer hence increasing the incentive to move early in the first place. Furthermore an empirical study by Gaba, Pan and Ungson (2002) also found that low commitment entry modes were positively associated with early entry, although not with performance. Therefore a smaller initial investment leads to two potential advantages. Firstly, a relatively small commitment of resources leads to less risk, which again encourages early entry. Secondly, smaller initial resource commitments in each individual market leave excess resources to enter more markets.

However this leaves a basic inconsistency; without commitment it may be impossible to create first mover advantages. As an example, Hirokawa and Sasaki (2001) argue that it is not the first mover per se that secures a first mover advantage, it is the first firm to commit to a quantity sticky output that secures the first mover advantage. Hence some form of mechanism need to exist that allows a small investment to carry with it commitment value. As pointed out by Mills (1988) this could be the case when investments are undertaken in a sequence of steps.

EVIDENCE FROM THE BREWING INDUSTRY IN CENTRAL AND EASTERN EUROPE

Over the last two decades the brewing industry has witnessed a rapid internationalization process spearheaded by a small group of brewers. Due to the maturity of the beer market in developed economies these brewers have turned to the newly opened and rapidly expanding markets in Eastern Europe, Russia and Asia (Larimo, Marinov & Marinova, 2006).

Similar to Mascarenhas (1992), this study focuses on foreign entry in a single industry but in multiple international markets. The data in this study have been derived from multiple sources.

Most of the data on ownership and the financial information we use were gathered from Amadeus, a database containing information on approximately 7,000,000 firms in Europe. Additional information on the acquisition activities within the industry was obtained through Zephur, a database containing information on ownership transfers of firms. Furthermore, we have sought information from yearly accounts and press releases from the major players in the industry. The information we collected was then cross referenced against data collected by another research group doing a study of the brewing industry in CEE.

We consider only subsidiaries engaged in the production of beer (primary Nace 1.1 code 1596), this definition of our base population is set from a belief that firms in the industry need a fairly broad range of products, including medium range products, to acquire a substantial market position. Consequently we consider local production essential to compete effectively. Comparatively low production costs in Central and Eastern Europe and often restrictive import taxation generally also rules out the option to successfully build a strong market presence through export based strategies (Larimo, Marinov & Marinova, 2006). Moreover, contractual types of entry most notably licensing agreements, are subject to potentially abrupt discontinuation caused by acquisitions of partner firms by rivals. This is a problem that Carlsberg, in particular, has experienced in e.g. Spain.

Initially, data was obtained for 13 East European countries. However, some of the countries had to be dropped. Bulgaria was ruled out due to insufficient accounting data for the latest years. Bosnia and Herzegovina had no foreign brewers until 2006 and is consequently ruled out. Slovakia was dropped due to insufficiently available ownership data and finally, Slovenia was dropped, as no foreign brewers are present in the market anymore. Russia was excluded from the study due to its comparatively large size which could suggest regionalization issues that could not be account for appropriately.

Table 3.1 Approximate market size and the presence of major competitors

Country	Market Size. (thousand USD)*	N. of large players present in the market
Poland	2,582,204	3
Czech Republic	867,382	3
Hungary	692,450	3
Romania	656,212	4
Serbia and Montenegro	588,550	2
Croatia	275,299	3
Lithuania	177,547	1
Estonia	123,052	1
Latvia	105,755	1

*Based on accumulated data from Amadeus

Our study identified more than 100 brewers in the nine countries. Of these, a large part was relatively small locally owned enterprises and a few were owned by smaller foreign owners. The locally owned breweries accounted for apx. 20% of total sales whereas the small foreign owned firms accounted for 9%, while the four large players Carlsberg, Heineken, SABMiller and INBEV accounted for more than 70% of total sales for the region. Both SABMiller and INBEV are the products of large mergers in 2002 and 2004 respectively; however, there are no indications that the firms involved in these mergers had competitive contact in the region prior to the mergers.

We eliminated all locally owned firms from the population, for the remaining observations the financial data was aggregated or when possible the consolidated accounts were used so that for each host country all assets held by one foreign parent is pooled together.

It is important to note that the empirical material presented in this paper primarily serves as

explorative evidence of the nature of first mover advantages and structures of post-entry competition in the brewing sector.

Preemption and first mover performance advantages

We find reasonable support that pre-emption is an important factor in smaller markets. In fact we find that in only one of the markets in this survey (Romania) all four major competitors were present through direct foreign investments (table 3.1).

To determine the relationship between order of entry and performance we use mean tests between order of entry and three measures of market performance. To determine order of entry we coded the first firm(s) that entered a market as 1 and all other firms that entered the market were coded 0. Below is a short description of the performance variables.

- Market leadership – the firm with the largest sale in the last year of operation in a given country was coded 1, all other firms were coded 0.
- Market share – we derived the market share of a given firm's sales in a country relative to the total sales by all local and foreign firms in that country. This measure may be slightly exaggerated since it ignores imports by firms not registered as brewers and sales by local micro breweries too small to be included in Amadeus.
- Return on sales – a percentage value given by the formula $EBIT/sales \times 100$. To increase the stability in the values we computed the return of sales as two year average.

Of the first movers 64% were market leaders, suggesting a strong positive order of entry effect (table 3.2). Similar results were derived from mean tests on market share, first movers on average enjoyed close to 20% market share lead over followers. Moreover, whether due to scale related efficiencies or marketing advantages, first movers on average enjoyed a 9% higher return on sales compared to followers.

Consequently, first movers appear to derive not only significant market share advantages, but are also more able to capitalize on each unit of sales. Overall, the general level of significance for the tests is very good, especially considering the small population size.

Acquisition driven international expansion

The brewing industry is generally characterized by highly acquisition driven expansion (Meyer & Tran, 2006; Larimo, Marinov & Marinova, 2006). In their study Larimo, Marinov and Marinova (2006) found that the prevailing mode of entry was through a partial acquisition of an

Table 3.2 Order of entry and performance

	First movers	Followers	F test
Market leadership	0.636 (0.505)	0.105 (0.315)	12.693***
Market share	35.461 (11.989)	16.137 (11.945)	18.184***
Return on sales	15.200 (9.866)	6.482 (9.179)	5.953**
N	30		

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

existing local brewery. In the majority of cases the strategy of the large foreign investors has been to acquire multiple local breweries in the individual markets. In a few cases the local subsidiaries have been acquired indirectly through the acquisition of the foreign parent itself such as the takeover of Brau Union AG by Heineken.

The prevalence of acquisition as the dominant mode of entry may be attributable to marketing advantages derived from local brands and products that cater to local tastes. Moreover, access to existing distribution networks is of crucial importance to foreign entrants. Hence, despite their often run down conditions local brewers still offer a bundle of resources that is very difficult or costly to duplicate.

This has important implications from a first mover perspective. Since potential acquisition targets are a finite resource, this suggests that early entrants are able to acquire the best available resources and consequently either pre-empt or put followers at a disadvantage. Entry and expansion opportunities are thus largely dependent on the pool of firms that can be acquired. Moreover, as argued by Giovanni (1996) when the cost of time-compression is high, ie an investment in capacity must be gradually undertaken leaving room for competitors to observe the move and counter it, an acquisition of existing capacity allow an effective preemptive strike which the competitors can only react to after the fact. Hence, the prevalence of a highly acquisition driven expansion pattern may, in it self, be a strong indicator of the presence of first mover advantages.

Low exit rates for large firms, high exit rates for small firms

The study also tends to suggest a strong survival bias in terms of large and small MNEs. The four major players Carlsberg, Heineken, SABMiller and INBEV account for approximately 70 percent of the sales in the region and other foreign players account for roughly 8 percent of the sales.

Of the four large players there is only one reported case of market exit. INBEV sold its share

in Pivovarna Union dd (Slovenia) to Pivovarna Lasko, Delniska Druzba (Slovenia) in 2005, this followed after a bidding contest against the second major shareholder Pivovarna Lasko, Delniska Druzba in 2002-2003. The failure to acquire full control of Pivovarna Union dd appeared to be the principle motive for the market exit. While INBEV was the only foreign brewer to enter the Slovenian market the case doesn't quite suggest an increased risk of moving first pr see. Rather the case illustrated that the incumbent advantages enjoyed by Pivovarna Lasko were substantial enough that even the potentially superior firm specific resources enjoyed by INBEV was insufficient to overcome them. It is however illustrative of one of the main risks involved in the use of partial acquisitions as a mode of entry.

A key observation from this study relates to the difficulty of operationalizing firm exist at the subsidiary level. Internal mergers designed to consolidate the foreign parent's assets in a market in to a single legal entity cause most subsidiary exits. This was a practice undertaken by virtually every major player in most markets. Similarly the closing of individual plants tend to be motivated by a desire to consolidate production into fewer more efficient plants.

In other cases the sale of assets may be primarily structural or strategic; following Heinekens takeover of Brau Union AG, Brau Union's Polish assets were transferred to Heinekens Polish subsidiary (Zywek) which was subsequently transferred back to Brau Union! Another example is the case of Carlsberg's sale of its Baltic assets to BBH, a joint venture between Carlsberg and Scottish & Newcastle plc. In yet another case Carlsberg divested a local subsidiary Kalnapilis AB in Lithuania to the Danish brewer Bryggerigruppen A/S (Unibrew) in 2001. This was part of a settlement with the Lithuanian competition watchdog that had requested this sale. Consequently, despite a substantial number of subsidiary exits we in fact only observe one actual market exit by the four major players.

In contrast a relatively large number of smaller foreign firms entered the Central and Eastern

European markets particularly in the early years (Larimo, Marinov & Marinova, 2006). Of these many have exited the markets again often through acquisition by other foreign firms or because the parent was acquired by a larger firm.

Summary

We thus observe a number of strong characteristics for the brewing industry in Eastern Europe. Some of the main characteristics are:

- The opening of Eastern European has created a large pool of new market opportunities which the industry has aggressively pursued.
- The overall market share of the 4 large brewers in the region is very large which suggest that the competitive entry game may primarily play out between these large firms.
- We find strong indicators for the existence of first mover advantages both in terms of market share and profits.
- Moreover the extensive use of partial, staged or full acquisitions as a means of entry suggest a strong reliance on local assets and this in turn suggest that entry opportunities are limited by the availability of these assets.
- The rate of exit is considerably larger for small foreign firms than for the large multinational firms. Moreover, the primary mode of exit for these firms is divestment to a larger competitor.

Our exploratory study raises interesting questions as to how a group of competitors interact in a situation where many new market opportunities become available. How are market positions distributed between these firms and how does first movers retain a strong performance lead over followers even in a highly competitive setting? Also the role of entry mode choices and entry by smaller foreign actors offers puzzling research questions.

MULTI-MARKET COMPETITION; COMPETING FOR MARKETS

Pursuing first mover advantages in new markets

How can firms achieve superior performance from moving first in a competitive multi-market setting? The term competition for markets is often associated with industry structures that tend towards monopolies, however this need not be the case. In this theoretical analysis we presuppose that a firm's decision to enter a market is not only dependent on the actions of its competitors, but also depend on its potential opportunities in other markets. Based on the evidence from our study of the brewing industry in Central and Eastern Europe we observe that:

- There is a strongly positive order of entry effect.
- Entry competition can be characterized as rivalry between a group of firms sharing a basket of market entry options in the sense that Miller and Folta (2001) suggest.
- Market entry require a non trivial resource commitment as firms generally need local production, access to an extensive local distribution network, a broad range of products and brands.

While these results should be intrinsically contradictory according to the study by Miller and Folta (2001), we will argue that the emergence of this result is plausible in a multi-market setting on the condition that firms are under resource constraints. Firms rarely have the financial or organizational capabilities to enter a large number of markets simultaneously or near simultaneously, therefore we can expect that firms would be forced to make strategic tradeoffs in the entry choices they make. Resource scarcity and multi-market opportunities are invariably linked together in the sense that a great number of entry opportunities strain a given resource base more than if the market opportunities are comparatively few. To see why this have an important impact on entry competition we will consider two alternative models with the first assuming that resources are not restricted and the latter assuming that resources are restricted.

Entry dynamics without resource constraints

To see why resource scarcity is important let us consider a two player-two market game. We assume that both the players and the markets are homogeneous and denote the markets A and B and players Z and P. To avoid the result that both would enter simultaneously we assume that the players take turns, these turns can however be infinitely small hence the assumption of homogeneity is not dramatically violated. Furthermore we assume that there is a benefit to waiting hence the payoff is an increasing function over time until the point t^K after which point the payoff is constant. Consequently, the second mover will enter no earlier than t^K and achieve the payoff Y^a in market A or Y^b in market B. Since the markets are homogeneous then $Y^a = Y^b$ we can denote the payoff Y^K which must take a positive value and therefore represents the opportunity cost of entering first. Since any player can always wait and enter second at t^K achieving a payoff Y^K then it would follow that no player would enter at any t where the payoff denoted X^t is smaller than Y^K , we shall refer to the point where X^t is precisely 1 unit higher than Y^K as t^0 .

Therefore we get the decision rule that at any $t < t^0$ the payoff $X^t < Y^K$ meaning both players will wait. The window of opportunity is between $t^{-1} < t < t^K$ where the payoff $X^t > Y^K$. Based on backward induction we know that the entry time of the first mover will be t^0 yielding a payoff X^0 for the first mover, the second mover in turn waits and enters at t^K yielding a payoff of Y^K . Since both markets are perfectly identical and resources do not restrict the first mover it will enter at t^0 in both markets gaining a total payoff $2X^0$. The second mover in turn will enter both markets at t^K yielding a combined payoff of $2Y^K$.

Since competition forces the players to rush to capture the first mover advantage the payoff for the first mover is thus only very marginally better than for the second mover. Therefore the result of this model suggests that it is the opportunity cost that forms the benchmark for the first mover's performance potential.

Entry dynamics with resource constraint

If on the other hand we assume that each player can only take one action per turn due to resource restrictions the results are somewhat different. Again no player will enter before t^0 however the decision to enter at t^0 is no longer optimal. Let's assume that player Z gets to move at t^0 . If player Z decides to wait and player P enters market A at t^1 then player Z can still enter first in market B at t^2 . Since $X^2 > X^0$ player Z should under no circumstance pre-empt at t^0 . Similarly player P will not attempt to pre-empt at t^1 as the payoff of entering first in market B at t^3 will be X^3 which is larger than X^1 . Hence as long as the payoff is an increasing function, which it will continue to be until t^K both players will choose to wait for the other to move first. Since both players will enter at t^K regardless of the choice of the other player Z maximizes his utility by entering market A at his last turn before t^K which we take to be t^{K-2} yielding a payoff of X^{K-2} and at t^K player Z enters market B yielding the payoff Y^b . Player P in return enters market B at t^{K-1} yielding a payoff of X^{K-1} and at t^K player P enters market A for the payoff Y^a . The opportunity cost of moving first is no longer Y^K but what could have been achieved by entering another market.

While both games are very crude they do produce an interesting result. As long as there are multiple market opportunities that cannot simultaneously be pre-empted the relative performance difference between entering first and second in a market does not affect the entry decision of the first mover and its corresponding payoff. The level of the entry competition game is moved from the individual market to a higher order competition for markets where firms weight the payoff potential of entering a specific market against all the other entry opportunities they have.

With this in mind we can consider a series of market opportunities with declining attractiveness, again we denote the pay off for moving first into market A as (X^a) and the payoff of being the second mover in market A (Y^a) . Since the market opportunities have declining attractiveness $X^a > X^b$.

$$X^a > X^b > X^c >>> X^n$$

$$Y^a > Y^b > Y^c >>> Y^n$$

Without resource constraints each market would be treated independently hence the optimal entry timing and subsequent performance would be determined exclusively by the second movers performance potential in that market, hence $X^a = Y^a$, $X^b = Y^b$ $X^n = Y^n$.

With resource constraints however each entry decision depends on the best available opportunity in any market, consequently as long as $X^n > Y^a$ then the decision must be between first mover alternatives thus the time of entry in market A is determined by $X^a = X^b$, the entry time in market C is determined by $X^c = X^d$ and the entry time in market N is determined by $X^n = Y^a$.

We can draw several insights from the models. For one, under resource constraint, multi-market opportunities move the level of competition from the individual market to the group of markets, which subsequently leads to an entry behavior that resembles market division. Firms will seek to obtain first mover advantages across multiple markets and generally avoid entering markets that are contested, up to the point where new uncontested markets becomes relatively unattractive.

Proposition 1: *When multiple international market opportunities exist, firms are more likely to compete for markets rather than in markets.*

Moreover, this also means that first mover advantages in the individual markets are not eroded by competition to the extent that they would otherwise be. Firms will pursue first mover advantages, but not nearly as aggressively as what is generally suggested. Therefore if we were to test for first mover performance advantages in markets that share the characteristics of model one, we would generally not expect to find evidence thereof. On the other hand, if we were to do the

same for the markets that share the characteristics of model two we would indeed expect to find strong first mover performance advantages. Hence we expect that:

Proposition 2: *When multiple international market opportunities exist, first movers are more likely to secure a performance advantage over followers.*

The models also suggest another important practical implication. Player Z, who eventually got to move first, did not actually get a greater combined payoff than player P. Player Z merely achieved a greater payoff in one market and player P in return achieved a greater payoff in another market. Hence, there is no global first mover advantage only a local advantage. Therefore it becomes clear that the market definition can crucially influence the likelihood of finding a relationship between early entry and performance. In large geographical areas like China or the US that consists of a number of relatively autonomous regional markets the likelihood of finding a positive link between early entry and performance is going to be considerably large if the level of analysis is at the level of the region rather than the country as a whole. Hence:

Proposition 3: *The narrower the geographical market definition the greater the likelihood of finding first mover performance advantages.*

Resource rationing through small scale/low commitment entry

How can firms maximize their ability to exploit FMA's under resource constraints? While we have observed that resource constraints in a multi-market setting has a decidedly positive influence on the ability to secure performance advantages from moving first, resource constraints also effectively eliminate the possibility to secure a more global advantage by turning market entry competition into little more than a card trading game.

The study by Meyer and Tran (2006) does suggest that firms in the brewery industry engage in activities which purpose could be resource rationing. They found that Carlsberg pursued a staged entry process where it would enter through a partial or staged acquisition of an existing brewery and gradually increase its ownership stake over time. A similar result is found in Larimo, Marinov and Marinova (2006) which found clear evidence that partial acquisition was the predominant mode of entry in Central and Eastern Europe. Moreover, over time additional breweries would be acquired thus further consolidating its position. This does suggest that first mover advantages might be secured without necessarily requiring large initial resource investments to deter further entry. If there are alternative market entry options, a player's entry into a specific market might be enough to convince other players not to follow but to pursue market opportunities elsewhere.

The possibility advanced by Mascarenhas (1997) that firms might seek to ration their resources and try to take advantage of first mover opportunities in a greater number of markets through limited commitment of resources is consequently quite appealing. Especially since a smaller resource commitment also allows firms to move earlier in general (Folta & O'Brien, 2004).

Mills (1988) found that even an infinitely small cost could be enough to deter followers from carrying out a threat to enter. The argument is that on the condition that leapfrogging isn't possible, a first mover can enter early with a small initial commitment of resources and then defer the final resource commitment to a time that would be individually optimal. Even a small lead would be enough to isolate the first mover from competition as long as entry threats are costly to carry out and the follower can't leapfrog the leader. Mills (1988) results of hinges on the assumption that a series of steps must be taken in a specific sequence in order to bring about a market entry and that only the first to complete these steps gain any rent (becomes the monopolist).

While the underlying conditions that Mills (1988) make are relatively strict the insight warrants some merit. Ultimately a series of acquisitions would usually be required in order to

achieve market leadership, these are however not necessarily interdependent. Despite that it may still be quite difficult for a follower to snatch the market leadership through a rapid series of acquisitions. It is doubtful that such an undertaking could succeed without the first mover discovering it, especially since the sellers would have every incentive to solicit a competing bid from the first mover. Since the first mover will usually be able to respond to an attempt to leapfrog it follows that it is not an efficient strategy when other market opportunities are available to the follower i.e. opportunity costs are high.

Hence, as long as market opportunities are amply available pre-emption could be possible with limited commitment.

Proposition 4: *When multiple international market opportunities exist, first movers are more likely to pursue low commitment/resource modes.*

Exercising threats to counter competitors attempt to ration resources

Why do firms follow in markets that exhibit strong FMA? The logical result of Mascarenhas (1997) conclusion is that every player will attempt to skew the market distribution game in their favor by pre-empting other players in a large number of markets with small initial commitments of resources. The end result consequently changes little.

However, Miller and Folta (2002) suggest that firms may act strategically to force a competitor to forfeit option value, though they do not address when they would be likely to do so or if they would willingly do so when it is not costless. While Mills (1988) found that a follower would not enter on the provision that it could never win a staged game against a player with a head start, the possibility remains that the follower might not need to win. As long as the follower derives a strategic benefit from tying up the first mover's resources and consequently gaining a free hand in

other markets it is strategically viable to make strategic investments in rivals markets with the object to force them to commit additional resources to defend their first mover position. The first mover is then forced to speed up the acquisition and consolidation process or in case no targets are immediately available bolster its war chest to prepare for when they do become available. If the relative difference in terms of resource commitment between threatening and defending is sufficiently large then, even when threats are costly, players may still choose to exercise them to bring about a global strategic advantage by tying up the defenders resources.

Proposition 5: *When multiple international market opportunities exist, rivals are more likely to follow the leader in order to tie up the global resources of the leader, rather than to challenge the leader's local market position.*

This may also suggest that a potentially viable first mover strategy is to avoid competition by targeting smaller or less attractive markets. A fairly well known case is the Wal-Mart chain which has consistently target less congested areas where it could pre-empt subsequent entry (Ghemawat, 1986). Similarly Carlsberg appears to have avoided entry into comparatively attractive beer markets like Hungary and the Czech Republic, instead Carlsberg has build up, through BBH, a dominant and highly profitable position in the small Baltic stats. In China, Carlsberg has turned towards the less developed Western regions and build a strong market presence in many of these regions. Entries into this type of markets may be less likely to be subject to threats therefore they can be secured with a smaller commitment of resources.

Proposition 6: *When multiple international market opportunities exists, firms may pursue first mover advantages in a larger number of markets by entry with small commitments of resources in comparatively smaller or less attractive markets.*

Small firm entry and exit

Why do small foreign firms enter when the risk of exit is large? A key issue that arises from our study is the motivation and role of small MNCs entry into new markets. Our study indicates a comparatively high exit rate for this type of firms. It is thus worth considering what motivates these firms to enter and whether there are factors that encourage entry despite low probability of long term survival.

Joaquin and Khanna (2001) modeled an entry situation with a small and large firm contemplating an investment project, their results suggested that small firms are more likely to enter earlier and exit earlier. In other studies comparatively weak firm specific resources has been linked to early entry (Narasimham & Zhang, 2000); Rivoli & Salorio, 1996). Hence, Narasimham & Zhang (2000) argue that resource weak firms may enter early in order to offset the advantage of better endowed firms. As a result they conclude that high failure rates by early movers could be a case of; the least capable of entering first, have to enter first. However, this leaves a fundamental question unanswered; why would these small or less well endowed firms engage in business ventures with much lower probability of success? In effect it would appear that the decision not to enter might be optimal for many of these smaller firms when faced with entry competition from stronger rivals. Obviously in industries where the potential pay off from a successful venture can cover the costs of several failed ventures this type of risk may be perfectly reasonable, but in more mature consumer goods industries the profit margins of successful ventures are unlikely to cover multiple business failures.

However, it is likely that these firms may be more able to offset some of the risk of entry by a proportionally lower exit cost. The evidence from the brewing industry does suggest that the primary exit mode is divestment to a larger brewery. Hence, in reality the high exit rates endured by these firms masks an active market for this type of assets. In some cases, such as the investment of Nomura Investment Bank in the Czech brewing industry, the acquirer might have no long term interest in the market (Larimo, Marinov & Marinova, 2006). A strong case can thus be made that the relative sunkness of the investments made by smaller MNEs is lower.

We thus suggest that a key explanation for entry by smaller firms may be that they are able to divest their assets to larger firms seeking a way into a market or a means to consolidate their position in the market. Hence we propose that:

Proposition 7: *A greater propensity in an industry to enter international markets through acquisitions reduces the exit barriers and consequently encourages entry by small MNEs into new international markets.*

CONCLUDING DISCUSSION

Managerial perspective

From a managerial perspective the key strategic goal in the competition for markets is to secure a dominant position in as many markets as possible. The successful rationing and allocation of resources and choice of markets is thus the primary means to achieve this goal.

Firms need to pursue entry strategies that provide a strong enough commitment and head start that it induces rivals not to challenge. But at the same time ration resources effectively to ensure that the greatest possible number of markets can be reached. Targeting one strategy at the

expense of the others may place a firm at a disadvantage. If a firm were to pursue a strategy of targeting many markets with small initial investments as suggested by Mascarenhas (1997) it would most likely induce competitors to threaten, hence forcing the firm to protect its markets by committing considerable resources to consolidate its position. On the other hand a strategy that relies on entry with large investments in consolidating the firm's position would result in few resources available to enter new markets. Firms need to pursue a balanced strategy; they need to commit enough resources to minimize the likelihood of threats, while retaining enough resources to pursue first mover opportunities in new markets. And when the opportunity arises they should exercise the option to threaten competitors markets in order to tie up their resources.

The choice of entry mode, in particular partial acquisitions, is likely to be an effective means to obtain a strong market position with limited resources commitment. One caveat here though is that the extensive use of partial acquisition as a mode of entry may not be entirely at the discretion of the entrant. Studies by Jakobsen and Meyer (2008); Larimo, Marinov and Marinova (2006) find that partial acquisitions will often be motivated by reluctant sellers rather than at the explicit request of the foreign acquirer.

Also targeting markets that are less attractive and consequently less likely to be threatened may be a way to stretch resources further.

To many small firms, entry into a new market is an endeavor that offers a proportionally small chance of long term sustainability. However, a redeeming factor is that these firms acquire scarce assets that are potentially valuable to other players in the industry. Hence, from the very beginning of an investment these firms should clearly consider and integrate an exit strategy in their planning. Hence a local firm's market positioning, geographical scope and distribution should be tailored not only to fit with the strategic objectives of the parent, but also with a keen eye to the effect of these on the potential exit value of the local firm.

Contributions and suggestions for further research

The main contribution of this study is to extend the first mover literature to incorporate interdependent entry competition across multiple markets. The study offers several important insights in regard to entry competition. Above all we argue that the presence of first mover advantages can lead to competition for markets. One important implication is that it may in fact be possible to retain a performance advantage from early entry if competitors are better off seeking alternative market opportunities. Hence, while assuming low opportunity cost offers powerful modeling results, these might not be practically applicable; firms do tend to have alternative investment options!

Another implication of the study relates to the notion of competition. We argue that strong first mover advantages could effectively lead to market division. While it appears intuitively sensible to judge a firm or the level of competition within an industry by its regional or even global market share, such crude concepts may be entirely misleading. Competition, in the type of industry we concern ourselves with in this study, is inherently local. Regional or even global measures of success strictly speaking measure a firm's relative success in the competition for markets game.

This study offers a unique view on the reasons to follow in a market. We suggest that firms may follow in markets not with the actual purpose to challenge the leader's position, but rather to force the leader to commit additional resources. A potential implication of this is that the performance difference between first movers and followers could in fact be artificially high on the grounds that followers may choose to invest just enough resources to trigger a response; hence effectively under-investing. This could also suggest that studies can find performance advantages associated with early entry even when first mover advantages are not naturally strong. This argument can be viewed as an alternative or complementary explanation to the line of research that

stress scope economies or the stabilizing effect of cross market retaliation as a motive for following (Gimeno & Woo, 1999).

Another important implication relates to the survival bias issue in performance studies. Previous studies have raised the problem that entry order might be affects either positively (Lieberman & Montgomery, 1988) or negatively (Narasimham & Zhang, 2000) by the relative strength of the firm. Hence, controlling for survival biases is potentially as likely to create measurement biases as not doing so. However, it is quite possible that there are a group of “natural” winners and losers in foreign market entry. Future studies encompassing multiple geographical markets may consider studying order of entry and performance effects using only the segment of “winning” firms that have successfully entered several foreign markets.

We strongly suggest that in order to advance research with in the field more longitudinal studies should be conducted that considers both the local competitive and regional or global competitive dynamics. It is also worth considering the effect of competition for markets in the internationalization literature. Take the example of Carlsberg its investments in the Baltic States and Poland, which might be constructed as a case of internationalization towards geographically close destinations. However then why the Balkan countries and not Hungary or the Czech republic? Why Western China? It is quite feasible that firms develop some underlying decision guidelines to decide between markets that are dependent on the expected interests of competitors.

Limitations

While it might have been interesting to observe the relationship between order of entry and performance for each investment, this is hindered by the fact that in most cases multiple acquisitions are subsequently merged into one organization.

The acquisition driven entry patterns observed in this study have important implications for the conclusions we draw, but of course also set the limitations of the study. The relevance of this

study is likely to be limited to industries that exhibit a strong multi-domestic structure, where key local assets are very difficult to create and build up from scratch.

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4. Partial Acquisition: The Overlooked Entry Mode

ABSTRACT. In certain locations, foreign investors frequently use partial acquisitions (PAs) to access locational advantages controlled by local firms. This chapter aims to explain the use of PAs as a mode of entry in emerging economies, based on two unique samples of foreign direct investments in transition economies and a review of recent entry mode literature. Theoretical considerations and empirical data show that PAs are insufficiently explained by combining arguments for acquisitions (viz Greenfield) and for joint ventures (viz wholly-owned subsidiary). We thus challenge some of the assumptions and assertions of recent entry mode research. In particular, reverse asymmetric information effect may override buyers' informational disadvantages. Thus, PAs are often desired by sellers to attain a share in the expected increase of the firm's value.

INTRODUCTION

Multinational enterprises engaging in foreign direct investment (FDI) combine their ownership advantages with locational advantages of the host country (Dunning, 1992). They can access such locational advantages through different modes of entry. Research on entry modes mostly takes a theory driven approach distinguishing modes either by ownership or based on the 'build or buy' decision (Brouthers & Hennart, 2007; Luo, 2002; Meyer, 2001). This approach, however, disguises the richness of entry modes as a means to combine ownership and locational advantages. Many firms enter by partial acquisition (PA), especially in transition economies. These PAs combine elements of joint ventures (JVs), namely shared ownership, and of acquisitions, namely taking over an existing operation. Yet, they also have unique features that have been

overlooked by prior research. The understanding of PAs is also important to government policy makers as they are the seller side of a privatization by ‘partial divestment’.

PAs are a form of acquisition as the investor acquires an equity stake in existing organization, yet without obtaining full equity ownership. Hence, the investors lack full control over the strategy of the business and thus have limited power to effect organizational change. PAs occur in many different facets – in some cases the investor takes over management control and engages directly in the strategic management of the firm, in other cases the acquirer acts more like a financial investor or venture capitalist, advising and possibly indirectly influencing the management, but not taking over direct control.

What all PAs have in common are two defining characteristics: (1) an existing organization, and (2) shared ownership among one or more owners. This definition suggests that a combination of the theoretical literatures on respectively joint-versus-wholly-owned and acquisition-versus-greenfield may provide an appropriate explanation of the phenomenon. However, this does not hold true, as we will argue and demonstrate with empirical data in this paper.

We review PAs in the context of other modes of entry or expansion, and outline their unique characteristics. We present empirical evidence from two recent research projects covering seven emerging economies in Central and Eastern Europe (CEE), Asia and Africa (Meyer & Estrin, 2007; Estrin & Meyer, 2004) to investigate when and where foreign entrants use PAs. We find them to be fairly common across a wide range of emerging economies, despite the disadvantages of having operational responsibilities for an existing firm without carrying full equity control. We then proceed to discussing the reasons why both buyers and sellers may prefer a partial acquisition over other modes, despite these disadvantages. We conclude by outlining future research agendas to investigate not only PAs, but also to address conceptual challenges arising from our discussion for the validity of findings of earlier entry strategy research.

PARTIAL ACQUISITION AS AN ENTRY MODE

Defining partial acquisitions

Foreign direct investment (FDI) is an investment in a company in another country with the aim to influence its business strategies (Dunning, 1992). This definition distinguishes FDI from portfolio investment, where equity stakes are too low to exert substantive control, and from contractual relations that normally do not involve equity participation. We focus on entry modes of foreign direct investors.

Categories of entry modes for foreign direct investors are normally defined by their ownership, and whether a new legal entity is created or an existing entity is being taken over. Hence, a greenfield operation is a wholly owned new venture, while an acquisition is defined as obtaining full ownership control of an existing local firm. A JV is defined as the establishment of a new venture owned by one or more foreign owners and one or more local owners, while a PA is defined as the acquisition of a substantive stake in an existing local firm.

We operationalize these definitions as follows: Following common practice, we consider investment in equity stakes below 10% as portfolio investment (OECD 1996), which we do not consider in our analysis. We draw the boundary between partial and full ownership at 95% foreign equity stake. These operationalizations are fairly robust in that few FDI projects would shift into other categories if the boundaries change by small increments.

Figure 4.1 illustrates the features of PA shared with other modes of entry. Like a full acquisition, a PA relies on an existing business organization with all of the advantages and disadvantages associated with this. Much like a JV, the acquirer, however, does not obtain full claim to the residual proceeds nor does the acquirer hold complete equity control. It is the

Figure 4.1 Ownership control and the make or buy decision

	New organization	Existing organization
Full equity control	Greenfield	Acquisition
Shared equity control	Joint Venture	Partial Acquisition

combination of these primary features that distinguishes the PA from the three other principal modes of entry and helps us define what constitutes a partial acquisition.

Challenges to classifying entries

The formal definition appears fairly clear, yet case evidence suggests that classifying modes in practice is not as easy. For instance, studies in CEE (Artisien-Maksimenko & Rojec, 2001), China (Tsang, 2003) and Vietnam (Nguyen et al., 2004) show that it is fairly common to transfer state assets into a jointly owned new legal entity. Legally, this is a JV because a new legal entity has been created. However this type of investment *de facto* involves the partial transfer of ownership rights to an existing organization, hence for strategic purposes it resembles a PA. Following Estrin and Meyer (2004) we refer to this type of entry mode as ‘JV Type II’; Tsang (2003) uses the term ‘acquisition JV’.

Furthermore, many full acquisitions related to a privatization come with significant contractual limitations on what the acquirer is allowed or obliged to do often within a certain time period; a type we refer to as “contractually restrained acquisitions”. For example, contracts with

privatization agencies often require an investor to commit to employment guarantees or capital investment as a condition for the deal to be approved (Meyer, 2002; Uhlenbruck & De Castro, 1998). In other cases, a government agency may retain a golden share with veto-rights for certain strategic decisions. Thus, contrary to common perceptions, full equity ownership does not always provide full control.

A different obstacle to classifying entries is the instability of the ownership arrangement. Many – but not all – partial acquisitions are from the outset planned to be taken over by the foreign investor within the foreseeable future. In many cases, the foreign investor even attained management control ahead of acquiring majority equity ownership. In these cases, the shared ownership is a temporary phenomenon, called ‘staged acquisitions’ by Meyer and Tran (2006). Analysts would however find it hard to distinguish temporary and stable PAs at the outset.

Types of owners

The identity of the local partner varies considerably in partial acquisitions and can have a crucial influence on the operation of the PA. In some cases the partner may be a single entity, e.g. the state or a large industrial group, while in other cases ownership may be dispersed between large numbers of small private owners.

In transition economies in CEE, the PAs are in particular associated with the transfer of state assets into private hands. A number of different privatization methods have been employed, including direct sale to foreign owners, transfer of ownership to insiders of the firm, or broader transfers into public hands (Estrin, 2002). Thus foreign acquirers are confronted with a diversity of ownership constellations across CEE.

If the acquisition occurs directly from the privatization agency or a government ministry, foreign acquirers have to deal directly with a state owner. In other cases, new owners (and thus the ‘sellers’ of the firm) include managers and/or employees of the firm. Some countries experimented

with privatization programs designed to spread ownership of formerly state owned enterprises (SOE) broadly, usually through voucher-based schemes. However, the recipients of the vouchers would often invest them in funds, often indirectly controlled by the state, hence inadvertently transferring control rights back into the states sphere. Potential acquirers may thus be negotiating with state-backed investment funds.

A primary challenge for the acquirer is that these owners pursue different objectives that may conflict with the objectives of the acquirer. Particularly, the state or management/employee owners are likely to pose special challenges for the acquirer. These types of owners are likely to have special interest in the firm and pursue objectives other than solely profit maximization. This can be at odds with the interest of the foreign owner and complicates both the initial negotiation process and the management of the operation after the investors has assumed its equity stake.

In most of our discussion, we assume that the acquirer is a multinational firm taking a strategic interest in the partially acquired firm. This is however not always the case, as a PA may be undertaken for a number of other reasons. For example, private equity funds acquire equity stakes with the aim of benefiting from increased stock values, while helping management to improve the performance of the firm (or even introducing new management). Since these investors actively influence the firm's strategy and equity stakes typically over 10%, this does not qualify as portfolio investment. However, the dynamics of post-acquisition change are quite different than if the acquirer is an MNE aiming to integrate the acquired unit with its global operations. This form of investment is however of lesser importance in emerging economies and does not contribute much to the PAs analyzed in the data presented later in this paper.

THEORETICAL PERSPECTIVES

The OLI paradigm (Dunning, 1992) proposes three necessary conditions for FDI to take

place. It suggests that a foreign investor must hold ownership (O) advantages that can be exploited in the foreign market. Furthermore there must be locational (L) advantages that encourage local production. Finally there should be drivers for internalization (I) that encourages internalization of the control rights in the hand of the foreign investor. It is particularly the acquisition and internalization of these location specific advantages that is essential to understand why firms use PA as an entry mode.

Nonetheless, despite the sheer size of the mode choice literature in general (Brouthers & Hennart, 2007), we know surprisingly little about the use of PAs. And what little we do know may not be relevant for emerging economies. Why might our current theoretical understanding of partial acquisitions fail to capture the motives behind them in emerging economies?

Transaction cost economists explain the partial internalization in JVs by double market failure (Hennart, 1991): The project depends on contributions from two or more partners, yet the markets for these contributions from the parents are subject to market failure, i.e. transaction costs are high. A JV structure can overcome the inherent opportunism problem by making both parties residual claimants and thus aligning their interests. Hence, the method of remunerating the input providers is seen as the main motivation for shared ownership.

Brouthers and Hennart (2007) apply this logic and conclude that JVs and PAs are conceptually the same. This argument may be quite useful to explain newly established JVs, yet we consider it misguided to apply the same reasoning to explain the choice of PAs. What distinguishes a PA is that a share of the ownership of *all* organizational resources of the local firm is transferred to a new owner; hence the market failure appears to be of a different nature than that motivating establishment of a JV.

A small number of studies have considered PAs as a distinct entry mode. Cheng and Hennart (2004) suggest an asymmetric information view: An acquirer facing difficulties in

valuating the underlying assets would favor a PA over a full acquisition. This would force the seller to provide the acquirer with a “hostage”, something the seller would avoid if the underlying asset is a “lemon”. It also ensures that the seller continues to act in the best interest of the business.

In transition economies, the nature and importance of asymmetric information may however be different. Evidence suggests that valuations of state enterprises in CEE widely differed between potential buyers and sellers, which greatly complicated negotiations processes (Tsang and Yip, 2007; Meyer, 2002; Antal-Mokos, 1998; Ferris et al., 1995). On the one hand, the greater institutional distance between the home and host country would increase asymmetric information between the foreign buyer and the local seller.

Hence, the underlying assumption that sellers understand the market value of the assets better than prospective buyers is doubtful at best. In particular, the disparity between the value of assets in their current use compared to their first best use would tend to be much higher, due to the weaknesses of incumbent management and rapidly changing industry structures. The seller’s knowledge about the potential value of the assets of the local firm is thus limited. Consequently, in the transition context, the asymmetric information argument may not be applicable in the form proposed by Chen and Hennart (2004).

Another study by Duarte and Gacia-Canal (2004) suggests that in high risk contexts, such as emerging economies, firms may prefer to limit their financial exposure by decreasing their equity commitment and pursue a partial acquisition. However this argument is fragile at best. For one, from a transaction cost perspective (Williamson, 1975) higher levels of uncertainty is likely to lead to more frequent and more substantial needs for strategic and operational realignments, with corresponding increases in hold up problems. Hence higher levels of uncertainty should all else being equal lead to a greater drive to internalize, not less. Furthermore, from a financial perspective, it is not clear that retaining local shareholder(s) would reduce the cost of capital. Local

owners may attach a smaller risk premium to local assets, yet they also face insufficient diversification opportunities, inefficient capital markets and weak institutional protection.

IB scholars may be too accustomed to view the choice of entry mode from the perspective of the foreign acquirer. This may be misleading in transition economies, where firms are often acquired from the state or from employee owners. Ultimately the host governments decided to change the economic system from central planning to a more market based system. Similarly, employees in employee-owned firms decide if and when to externalize the management rights and the residual claim to that enterprise.

In state or employee owned firms, the owner(s) have a vested interest in maximizing the combined value of both their equity stake and other resources, such as labor, that are tied to the firm. Especially the protection of jobs is often a major concern for sellers in transition economies. The main motive of PAs is thus not to maximize the economic efficiency of the acquired unit by curbing opportunism, but rather to provide protection against harmful (autonomous) adaptation (Hayek, 1945; Williamson, 1975). Thus, the choice of entry mode is not a unilateral decision made by the acquirer but the result of a negotiated process between two or more parties.

EMPIRICAL EVIDENCE FROM QUESTIONNAIRE SURVEYS

Empirical evidence on PAs in a wide range of emerging economies is available from two surveys conducted in emerging economies. The first survey was conducted using a set of countries from Asia and Africa, while the second survey was conducted in transition economies in CEE. Together, these surveys represent more than 1000 observations in seven countries: India, Vietnam, Egypt, South Africa, Hungary, Poland and Lithuania. The data collection process has been described in Estrin and Meyer (2004) for the Asian survey and Meyer and Estrin (2007) for the CEE survey. These data illustrate the distinct features of PAs, which international business scholars

Table 4.1 Mean, Standard Deviation and Correlation Matrix

	Mean	SD	1	2	3	4	5	6	7
1 Subsidiary Size	374,63	2284,13	1						
2 Ln(subsidiary size)	3,37	1,81	0,48**	1					
3 Change in employment	-9,70	231,14	-0,84**	-0,34**	1				
4 Absolute change in employment	45,96	226,72	0,87**	0,46**	-0,79**	1			
5 Government influence	2,94	1,24	0,08	0,17**	-0,08	0,14**	1		
6 Resource transfer (principal component)	0,00	1,00	-0,05	-0,03	0,11*	-0,03	0,02	1	
7 Human resource develop. (principal component)	0,00	1,00	0,05	0,12*	0,05	0,07	0,11*	0,39**	1

Poland, Lithuania and Hungary only, levels of significance: P<0.01 **, P<0.05 *.

ought to consider when advancing their theories. All the statistical analyses were conducted using the SPSS software package. Table 4.1 reports the bivariate association between the included variables.

Location

Table 4.2 indicates a fairly consistent distribution of PAs across all seven countries with investors in India being the least likely to use PAs and those in Poland being the most likely with respectively seven and sixteen percent of all entries. However, these figures may possibly under represent the true importance of PAs because of deal structures that for practical purposes resembles PAs but legally are JVs (Estrin & Meyer, 2004; Tsang, 2003). In the case of Vietnam, no partial acquisitions have been captured by the survey, however a large number of foreign entries followed the ‘JV type II’ mode which had been listed as a separate option in the Vietnam version of the questionnaire (Nguyen et al., 2004), and which we tabulate here as PA.

In contrast, full acquisitions are rare in Egypt, India and Vietnam compared to the three CEE countries and South Africa. An important reason for this factor is related to legal ownership

Table 4.2 Distribution of affiliates by entry mode (% of affiliates)

Entry Mode	Hungary	Lithuania	Poland	Egypt	India	South Africa	Vietnam
Greenfield	43	40	42	46	35	31	56
Joint Venture	23	19	20	37	53	23	32
Acquisition	25	30	21	5	4	31	2
Partial Acquisition	9	11	16	12	7	14	11^{1/}

Notes: Column total = 100 +/- rounding;

^{1/} Vietnam: Partial acquisitions were defined as JV where local firms transfer part of the existing operation to the newly created JV. Source: Meyer et al., in Meyer and Estrin (2007).

restrictions in these countries and the liquidity of markets for corporate equity. Hence institutional factors are clearly an important determinant in the entry mode choice as MNEs normally expanding by acquisitions need to find alternative means to access local resources. This suggest that the theoretical position of Brouthers and Hennart (2007) to isolate the make or buy viz. full or partial ownership decision is not very helpful to understand the realities of business in emerging economies. Firms need to consider all the available alternatives simultaneously.

More importantly, our evidence establishes PAs as an important entry mode in its own right in emerging economies, especially transition economies. For the remaining empirical analysis, we focus on the CEE data set to ensure that meaningful comparisons can be made to full acquisitions.

Subsidiary size

Table 4.3 reports the initial mean firm size in terms of number of employees and the natural log of the number of employees⁷ for different entry modes, along with an ANOVA significance test of the variation (F) and the Eta measure of association. For a relationship between a continuous dependent variable and an independent variable that have a limited number of categories the Eta

⁷ Since the relationship between size and entry mode choice is not expected to be strictly linear and since the type of dependent variable has a long tail the natural log tends to provide more robust results.

measure is similar to the correlation coefficient. For each (ANOVA) test the F value and the Eta measure of association is calculate. The F value is derived using the formula:

$$F = \frac{SST / (Z - 1)}{SSE / (N - 1)}$$

Where $(Z - 1)$ is the degrees of freedom of the independent variable and $(N - 1)$ is the degrees of freedom for the sample. SST, the total sum of squares is calculated by aggregating the squared difference between Y and the grand mean \bar{Y}_G .

$$SST = \sum (Y - \bar{Y}_G)^2$$

SSE, the Sum of squares error is then calculated by aggregating the squared difference between Y and the treatment mean \bar{Y}_{mode}

$$SSE = \sum (Y - \bar{Y}_{mode})^2$$

Finally the measure of association is derived by the formula:

$$\text{Eta} = \sqrt{\frac{(SST - SSE)}{SST}}$$

Due to the limited number of full acquisitions in the Asia-Africa data set (Table 4.2), we

Table 4.3 Mean initial size of the local enterprise by entry mode

Entry Mode	Subsidiary Size		LN(Subsidiary size)	
	Mean	SD	Mean	SD
Greenfield	38,23	99,54	2,60	1,29
Joint Venture	66,65	141,16	3,15	1,38
Acquisition	275,11	530,65	4,37	1,68
Partial Acquisition	2665,02	6589,15	5,07	3,38
F	17,60***		41,92***	
Eta	0,347		0,496	

Poland, Lithuania and Hungary only, levels of significance: P<0.01 ***, P<0.05 **, P<0.10 *.

include only the CEE countries. The results suggest that PAs are on average larger than entries by any other mode, including full acquisitions. This suggests that partial acquisitions have a comparatively large economic impact on host countries and account for a substantial share of the employment of foreign owned firms. Understanding the peculiarities of this entry mode should therefore be of great practical concern to both policy makers and business strategists.

This strong association between size and partial acquisition suggests that it may be necessary to control for this influence in some of the subsequent empirical analysis. We thus adopt a stepwise approach estimating the marginal contribution of the entry mode using a methodology adapted from Cantwell and Mudambi (2000). We first regress, using an OLS regression, the dependent variable Y against the independent variable X which either takes the values of *subsidiary size* if the expected relationship is mathematically conditioned or $LN(\textit{subsidiary size})$ if the expected relationship is conceptually conditioned.

$$Y = a + \beta X + u$$

We then collect the residual denoted by r of this regression and use them as the dependent variable in a one-way analysis of variance (ANOVA) test with the entry mode choice as the independent variable. The key advantage of this technique over a multivariate OLS regression is that this method eliminates any multi-collinearity between *subsidiary size* and *entry mode*. Furthermore it is hierarchical in the sense that the size effect is controlled for before conducting the ANOVA on the marginal influence of the entry mode choice⁸.

Governmental influences

Table 4.4 reports the relationship between government influence on a business and entry mode. The variable *government influence* is measured as a 5 point Likert scale variable; see the Appendix for a description of this variable. The initial values suggest stronger government

⁸ Consider the government influence in the next subsection. If we make the plausible case that governance influence is larger in partial acquisitions because they are large then it makes sense to eliminate this proponent first.

Table 4.4 Mean influence of local governments by entry mode

Entry Mode	Government influence		Government influence (with control for size)	
	Mean	SD	Mean	SD
Greenfield	2,76	1,24	-0,06	1,29
Joint Venture	2,92	1,25	0,00	1,22
Acquisition	3,05	1,24	0,03	1,19
Partial Acquisition	3,34	1,07	0,14	1,04
F	3,78**		0,33	
Eta	0,150		0,051	

Notes: Poland, Lithuania and Hungary only, levels of significance: P<0.01 ***, P<0.05 **, P<0.10 *.

influences on PAs. However, when correcting for subsidiary size using the two step approach, the overall significance of the relationship disappears. Hence the effect of government influence appears to be largely derived from the size of the enterprise; in other words the political establishment is more likely to interfere the larger the enterprise – but not in PAs per se.

This suggests two important factors that may explain the use of PAs in transition economies: First of all, employment is a major concern for governments in transition economies, as suggested above when discussing types of owners. Moreover, governments have the means and the incentive to indirectly interfere in the operation of firms, regardless of entry mode. Full ownership in it self is thus not necessarily sufficient to guaranty complete managerial control. Consequently, foreign owners may more willingly accept some form of shared ownership if it provides an element of protection against adverse interference by the state (Meyer, 2002).

Resource transfers

A common concern about PAs is that investors may be reluctant to transfer resources, especially hard to value and intangible assets, to their new affiliate if they do not control the use of these transferred resources, and have to share any rents thus generated with a local co-owners.

Table 4.5 reports the relationship between entry mode and the transfer of knowledge to the affiliate. Two proxies for transfers are used, investment in human resource development and the

Table 4.5 Human resource development and resources access from foreign parent

Entry Mode	Human resource development (with control for size)		Access to resources from the parent (with control for size)	
	Mean	SD	Mean	SD
Greenfield	0,16	1,02	0,14	1,01
Joint Venture	-0,08	0,91	-0,20	1,08
Acquisition	-0,06	1,01	0,01	0,80
Partial Acquisition	-0,36	1,11	-0,12	1,01
F	3,425**		2,287*	
Eta	0,164		0,135	

Notes: Poland, Lithuania and Hungary only, levels of significance: $P < 0.01$ ***, $P < 0.05$ **, $P < 0.10$ *.

foreign subsidiary's access to resources from the parent company. The human resource measure is a principal component based on three 7-point Likert scale variables (see Appendix). The Cronbach's Alpha test yielded a result of (0,801) indicating a good fit. As larger enterprises are more likely to have formal human resource development programs we account for this by adopting the two step approach regressing the principal component against the $LN(subsidiary\ size)$. The residual is then used as the dependent variable in the ANOVA test.

The second measure is a principal component based on three 7-point Likert scale measures of perceived access to financial, managerial and technological resources from the parent company. The Cronbach's Alpha test yielded a result of (0,797) indicating a good fit.

Both measures were found to be significantly related to entry mode at the 5 percent and 10 percent level respectively. The results show that partial acquisitions are *less* likely than any other mode to benefit from investment in human capital and also receive comparatively less resources from the foreign investor. This remarkable finding has substantive implications as it suggests that PAs may be at a substantial operational disadvantage compared to other modes. On both items, Greenfield projects seem to receive most support from the foreign parent.

Resources transfers tend to be low in both JVs and PAs, which support the argument that shared ownership would reduce investors' incentives to share knowledge with a new affiliate.

Investment in human capital is on average lower in PAs compared to any other mode. This is likely to be the consequence of the combination of organisational inertia in an inherited organization and adverse incentives arising from shared ownership.

Employment effects

A similar concern arises with respect to foreign investors' willingness to invest in risky organizational change processes if they do not have full control (Meyer & Estrin, 2007). Table 4.6 reports the relationship between change in employment and entry mode choice, the first is a simple means test reporting the mean change in employment per year⁹ viz. the choice of entry mode. The ANOVA test on the difference of means suggests that PAs would tend to destroy jobs. However, when controlling for the initial size of the operation, using our two step approach, the results change substantially. PAs are no longer associated with employment destruction, but surprisingly show a small though insignificant propensity to create or preserve jobs. Finally we investigate the absolute value of the change in employment across entry modes. The results again do not indicate significant deviation across entry modes when corrected for initial size.

The job destruction in PAs thus arises from the much larger size of PAs at the outset; it is not caused by the choice of PA as an entry mode per se. Many state owned firms in CEE employed before privatisation a substantially larger work force than what was required. A reduction of employment in large enterprises may thus be a necessary part of the restructuring (Estrin, 2002), and PA is chosen as an organizational form to implement this aim.

The propensity of PAs to create or destroy jobs after controlling for size is not significantly different from other modes. If it was true that local co-owners obstruct restructuring that involves lay-offs, we would see a positive coefficient after controlling for size, and a negative coefficient when considering the absolute value of the change. The coefficients are both positive – but the F-

⁹ This variable has been defined as [(employment at the time of survey – employment in first year of operations) / age of subsidiary in years].

Table 4.6 Employment effects by entry mode

Entry Mode	Change in employment per year		Change in employment per year (with control for size)		Absolute change in employment per year (with control for size)	
	Mean	SD	Mean	SD	Mean	SD
Greenfield	18,34	65,70	-1,05	70,54	2,59	61,23
Joint Venture	6,90	18,60	-10,05	23,52	0,97	122,24
Acquisition	-2,23	154,64	-1,09	136,08	-9,89	17,34
Partial Acquisition	-171,80	634,67	29,35	296,67	9,38	262,19
F	8,025***		0,915		0,345	
Eta	0,248		0,086		0,053	

Notes: Poland, Lithuania and Hungary only, levels of significance: P<0.01 ***, P<0.05 **, P<0.10 *.

statistic shows that this effect is clearly not statistically significant.

Thus, the impediments to full control may be offset by countervailing forces. As previously suggested, even in full acquisitions, employees or the government could potentially constrain the operational flexibility of the foreign owned subsidiary indirectly.

Another possibility is that there are some intrinsic advantages of partnering with local stakeholders. A partnership with local stakeholders may provide the subsidiary with a shield against adverse opportunistic activities by other stakeholders. Hence the operational freedom of a partial PA may in fact be comparatively larger. It is also possible that local co-owners may facilitate access to new business licences and permits, real estate etc, therefore contributing to new growth opportunities. Finally an alternative explanation is that co-ownership with employees could encourage smoother redeployment of resources into more productive uses.

Summary

We find that PAs are fairly commonly used across emerging economies, even in relatively advanced ones such as South Africa. The propensity for PAs varies across countries as for all modes of entry, which suggest that institutional, location and cultural aspects play an important role in the entry mode choice. Furthermore, our data indicate that PAs tend to be larger in terms of

employment than other foreign entries. Considering the fairly consistent use across a broad range of transition economies and their comparatively large economic impact on the host countries, PAs clearly merit scholarly attention. Our exploratory analysis of the characteristics of PAs shows distinct features. Some of these features appear to the size differences, while others are not:

- We find indirect evidence of increased government influence in large enterprises pointing to the possibility that firms chose PAs to align the host countries interests with that of the investor or as a shield against possible adverse government interference.
- We find lower transfers of resources from the foreign investor and less investments in human resource development in PAs, pointing to a combination of lower incentive to transfer resources and organisational friction or inertia
- We find no evidence to suggest that PAs are organisationally more rigid. Retention rates and overall organisational change is not significantly affected by the limited control, suggesting a series of possible countervailing forces facilitating growth opportunities.

These results should however be treated as preliminary. Even though we control for size of the affiliate, rigorous analysis would call for multivariate techniques. Our exploratory analysis thus mainly services to outline challenges for future research.

MOTIVES: ACQUIRER'S PERSPECTIVE

What advantages and disadvantages does a PA offer? Unlike a JV, the advantages derived from a local co-owner is unlikely to be related directly to market knowledge, managerial skills etc. Similar to a full acquisition we may expect these to reside within the acquired organisation. However there may still be a unique set of advantages that makes a partial acquisition an attractive entry mode.

Reduced ex-ante contracting costs

The process of acquiring a local firm in a transition economy can be a slow and difficult exercise (Artisien-Maksimenko & Rojec, 2001) that runs the risk of being hijacked by various groups of stakeholders (Antal-Mokos, 1998). As suggested above, ownership of assets in transition economies is often in the hands of stakeholders that have other primary interests than profit maximization, most notably protecting jobs. Even when stakeholders are not directly involved in the negotiation process they may still successfully exert indirect pressure. Antal-Mokos (1998) and Meyer (2002) provide several examples of ex-ante negotiations that have failed or been drawn out due to intervention by other stakeholders in the process.

It is also common in transition economies that an acquirer contractually commits to undertake a certain level of investment, or, for instance, not to close plants or lay off employees within a certain period. For example, Rieber & Søn a Norwegian operator in the food retail industry acquired Delecta SA, an employee owned firm in Poland, and contractually obliged not to make changes within a three year period (Dale, 2006). We have no way of segmenting acquisitions that are contractually restricted from acquisitions that are not, however anecdotal evidence suggest that this has been fairly frequent. Consequently the relative level of operational freedom enjoyed by full acquisitions should not be overestimated.

Local ownership participation may ease some of hurdles and thus speed up the negotiation process. For the foreign investor, a partial acquisition may be the fastest way to gain access to a market and secure early mover advantages. Thus, Jakobsen (2007) finds that early entry through partial acquisition enhances the performance of a new operation. Hence a key advantage of partial acquisitions may be to reduce the ex-ante contracting costs.

Legitimacy

Retaining a local partner may also enhance the legitimacy of the venture in the host country. Even in developed market economies, public opinion may perceive the acquisition of a local firm by a foreign enterprise with some misgivings (Crystal, 2003). This is particularly important in transition economies where governmental agencies often have indirect means to influence the prosperity of a business. An ownership stake by the state in the local firm is thus a potential mean to align the interests of the foreign partner and the government (Meyer, 2002). Doh et al. (2004) found a curvilinear relationship between the level of government sponsored investment hazards and private ownership, suggesting that high levels of government sponsored investment hazards induce firms to partner with the state to avoid state sponsored rent seeking activities. Our study suggests that PAs may enjoy certain advantages in gaining access to new growth opportunities on account of local ownership participation. Even when the partner is not a state or employee owner, the presence of a local partner may deflect some of the misgivings in the host country.

Increased governance cost

However, there are also disadvantages associated with joint ownership. Retaining a local partner raises the governance costs of the venture (Luo, 2002). In uncertain environments that require frequent strategic and operational adaptation, the need to negotiate changes with a local partner may significantly affect the enterprise's ability to speedily affect changes consequently increasing the governance cost. This may especially be a problem when the local partner has different objectives which will often be the case with employee or state owners.

Weak incentives

Moreover, the absence of full ownership and the lower residual claim this implies reduces the attractiveness of finding opportunities for the transfer of resources from the foreign parent to the

local subsidiary. In essence the partial acquisition mode lacks the high powered incentives of a wholly owned subsidiary. Evidence from this study suggests that both the transfer of resources from the foreign parent and investments in human resource development may be impaired in PAs.

MOTIVES SELLERS PERSPECTIVE

A PA is the outcome of an agreement between an investor and the previous owner(s) of the firm. While the entry modes choice literature has largely focused on investors, it is essential to also understand the seller's perspective to explain why PAs emerge as the mutually agreed outcome.

Retain stakeholder influence

Possibly the strongest motive for local owners to prefer a partial divestment (a PA seen from the seller's perspective) is the desire to retain some influence in the enterprise. Sellers in transition economies often have other stakes in the enterprise apart from their equity stakes. Hence they are naturally reluctant to completely turn over control to an outside owner, even when this is necessitated by the need for external financial, managerial and technological resources.

In order to protect their interests they may turn to contractual provisions. However this type of contracting is likely to be extremely cumbersome in high uncertainty environments, like transition economies, and in organizations that require extensive restructuring. A partial divestment is thus a deal structure that balances the need to protect the interests of the stakeholders while ensuring that ex-ante contracting costs stays within acceptable limits. The evidence in this study does suggest that partial acquisitions are larger in terms of employment, which again would suggest that the mode choice is motivated by labor concerns.

Rent appropriation

Foreign direct investors are motivated by their desire to exploit their ownership advantages in another country (Dunning, 1992). They may enter by acquisition if they are confident that they

can create more value from the acquired organization than the previous owners. In competitive markets for corporate governance, we would expect some of this additional value to accrue to the seller through the acquisition premium. However local owners in rapidly changing environments are often poor at pricing their own assets, let alone estimating their potential value in their first best use - a reverse asymmetric information problem (Jakobsen & Meyer, 2007). Local owners may therefore prefer to retain a stake in the enterprise to ensure that they get a share of the increased value of the firm.

Incompatible investment time horizons

There are of course also disadvantages to retaining an ownership stake. Often, foreign investors take a long term investment horizon, and focus on expanding and consolidating their market position, which means the free cash flows generated by the enterprise, will usually be reinvested in the business. In contrast, local owners may prefer that some of the free cash flow is released as dividends. They may also risk that the discrepancy in the investment horizon could lead the foreign owner to deliberately depress dividends with the implicit aim of forcing them to sell out.

Governance concerns

Another potential source of discomfort for a local minority partner is the often poor minority shareholder protection offered in transition economies. While low dividend pay outs may strain the minority partner, the MNC may pursue business practices that are directly harmful to the minority partner. Particularly transfer pricing policies may be a source of contention between the partners.

CONCLUSION AND DIRECTIONS FOR FUTURE RESEARCH

Public Policy implications

Policy makers in governments see partial divestment as a means to privatize state-owned enterprises. This form of attracting FDI, however, has some unique characteristics, and thus impact

on the host economy. Contrary to journalistic opinions, PAs are not associated with the destruction of jobs; rather this effect is attributable to the large size of many PAs in transition economies. However, we find that PAs are associated with fewer resource transfers from the investor, and less investment in human capital in particular.

Policy makers may consider PAs useful to soften the economic and social impact of the transfer of ownership in large firms subject to significant structural changes in the industry. However, this softened social impact of necessary economic restructuring may come at the cost of slower efficiency gains and delayed upgrading of the resources and capabilities of the firm. It would thus be ill advised to pursue such a policy indiscriminately; hence general legislation promoting or limiting the choice of entry modes is likely to be economically suboptimal.

Future directions for the study of partial acquisitions

Our analysis suggests that the existing literature fails to capture essential aspects of PAs. Firstly, we argue that the assertion by Brouthers and Hennart (2007), that the method of remunerating the input providers is the main determinant of both JVs and PAs is insufficient to explain PAs. Secondly, we argue that Chen and Hennart's (2004) asymmetric information view on PAs fails in transition economies because of probably important reverse asymmetric information effects.

We argue that PAs are preferred when the seller wish to protect upstream resources from harmful autonomous adaptation (Williamson, 1975). Consequently the preference for a PA is at least in part motivated by the seller's desire to *influence* the decisions made by the jointly owned economic unit. Evidence to support this argument was found in relation to the employment in PAs. This argument provides an alternative view to the remuneration of input providers argument (Brouthers & Hennart, 2007), which holds that partial ownership *aligns* the interests of the owners, hence effectively eroding the scope for self-serving opportunism.

Future research on entry mode choices should therefore take a more nuanced approach. In particular, future studies should recognize that mode choices are rarely unilaterally but rather the outcome of a bilateral negotiation process. Furthermore, the underlying assumptions of many traditional approaches may fail to capture the motives of the entry mode choice in emerging economies. Hence, studies in these economies promises to produce results that may broaden our understanding of the nature and boundaries of the firm.

Challenges for theorizing in international business research

Our analysis of PAs raises major concerns with respect to the dominant avenues for theory building in international business research, especially with respect to foreign entry modes (cf. Brouthers & Hennart, 2007). In particular, our digging deeper in the character of this particular mode reveals that theories often make implicit assumptions about the nature of entry mode that do not represent a close depiction of the real world.

Firstly, the (often implicit) assumption that decisions on ownership and on acquisition-versus-greenfield are independent clearly does not hold. Hence, the assumption that decisions are separate, or at least analytically separable, has to be re-examined. There is little empirical evidence of such a separation. Hence, Figure 4.1 serves to classify modes, but it is insufficient to build explanatory models on these two dimensions only, as PAs are subject to influences that cannot be explained by combining these two perspectives. Moreover PAs share with both JVs and acquisitions the access to resources held by local firms, albeit under different legal and organizational arrangements. Since the question of whether or not such local resources are needed is a key starting point for planning an FDI project, it is more likely that the initial decision is between Greenfield and modes-providing-resource-access, and in the second stage the appropriate mode is selected for accessing these resources (Jakobsen & Meyer, 2007; Meyer, Estrin & Bhaumik, 2005).

Second, the (often implicit) assumption that entry modes are clearly delimited using the logic of Figure 4.1 is challenged by the observation from case research (Meyer & Estrin, 2007; Meyer & Tran, 2006; Estrin & Meyer, 2004) that certain projects are in fact hard to classify. Specifically, where are the boundaries between (a) JV and PAs in the case of JV Type II, and (b) partial and full acquisitions in the case of staged acquisitions or contractually restrained acquisitions?

Third, the (often implicit) assumption that mode choice is primarily decided by the investor based on costs and benefits of alternative arrangements does not hold. Rather, PAs are the outcome of a bilateral bargaining process between buyer and seller – and similar bargaining with local partners occurs in the case of JVs (Harrigan, 1988) and acquisitions.

Fourth, the (often implicit) assumption that initial ownership arrangements are fairly stable clearly does not hold for PAs (Meyer & Tran, 2006), nor does it hold for JVs (Buechel, 2002; Harrigan, 1988). Rather, PAs are often transitory arrangement aimed at full acquisitions in form of staged acquisitions. Future research thus may need to focus more on dynamic processes of entry and the post-entry development, rather than at entry mode as a cross-sectional phenomenon.

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Appendix: Selected items from the CEE survey instrument

Government influence

Single item measure on the following statement (scale: 1 = agree not at all, 5 = fully agree)

"In our industry, it is important to maintain close personal contact with key officials at the national level"

Availability of resources

Three item measure on the following statements (scale: 1 = not at all, 5 = to a large extent)

"Your firm can readily obtain financial resources from the parent firm to finance its expansion"

"Your firm can readily obtain managerial resources from the parent firm"

"Your firm can readily obtain technological resources from the parent firm"

Human resources

Three item measure on the following statements with respect to the last three years (scale: 1 = not at all, 5 = to a large extent)

"The firm has invested in training and education of its full-time employees"

"There are formal training programs to teach new hires the skills needed to perform their jobs"

"Formal performance appraisals are used to facilitate promotion decisions or to develop employees"

5. Negotiating entry modes: Partial Acquisitions in Transition Economies

ABSTRACT. Multinational enterprises often acquire stakes in an existing enterprise when entering emerging economies. This paper examines the determinants of entry mode choices with a special focus on these partial acquisitions, which have received little attention in the scholarly literature.

Recent research suggests that a buyer prefers partial acquisitions, when a seller possesses asymmetric information advantages. However, other studies have suggested that partial acquisition result from sellers' preference for partial divestment. We propose a different perspective that is grounded in the influence of stakeholders on the transfer of ownership rights and find that partial acquisitions are preferred when negotiations are subject to significant stakeholder interference.

INTRODUCTION

Emerging economies create different sorts of challenges for multinational enterprises (MNE) as they adapt their strategies to the local context (Meyer & Peng, 2005; Wright et al., 2005; Hoskisson et al., 2000), and indeed develop entirely new business concepts and strategies to take advantage of business opportunities in these contexts (Meyer & Tran, 2006; London & Hart, 2004; Dawar & Chattopadhyay, 2002).

An important part of the adaptation is the choice of entry mode, which establishes the basis for the development of the local subsidiary (Meyer, 2001; Brouthers & Brouthers, 2000; Hennart & Park, 1993). Entry modes are commonly segmented into equity based and non-equity based modes (Pan & Tse, 2000). The former are considered to be irreversible (Elango & Sambharya, 2004), which has important implications for the trade off between, among other factors, control,

investment risk (Luo, 2001) and legitimacy in the host country (Lu & Xu, 2006). We thus investigate these equity based entry modes, in particular the probably least analyzed form of equity-based mode, partial acquisition (PA).

MNEs face two important decisions when they wish to enter with an equity-based mode; the level of equity control and whether to acquire an existing enterprise or build a new start up (Brouthers & Brouthers, 2000). Scholars have analyzed these decisions using a variety of conceptual models: Some studies focus on the relationship between control and commitment by studying the choice between a joint venture (JV) and full ownership (Brouthers & Hennart, 2007; Luo, 2002; Andersen & Gatignon, 1986). Others investigate the make or buy decision inherent in the choice between greenfield and acquisition (Harzing, 2002; Brouthers & Brouthers, 2000; Hennart & Park, 1993) or the choice between an acquisition and a JV (Hennart & Reddy, 1997). A small number of integrative studies simultaneously study the choice between acquisition, JV and greenfield (Elango & Sambharya, 2004; Chang & Rosenzweig, 2001; Kogut & Singh, 1988).

Partial acquisitions in turn have received comparatively little attention in the literature, with only three empirical studies (Chen & Hennart, 2004; Duarte & Garcia-Canal, 2004; Barkema & Vermeulen, 1998). Of these, only Barkema and Vermeulen (1998) model the choice between all four equity-based modes; acquisition, greenfield, JV and partial acquisitions. This omission of the specific features of partial acquisitions in entry mode research may affect the validity of past empirical studies (Chen & Hennart, 2004) and may explain some of the mixed empirical findings. By lumping together partial acquisitions and acquisitions the important role of ownership control is ignored. Similarly, the failure to distinguish between partial acquisitions and JVs ignores the critical aspects involved in the choice between building a new venture and acquiring an existing established enterprise.

In previous studies partial acquisitions are found to be associated with more risky and

culturally distant countries (Duarte & Garcia-Canal, 2004; Barkema & Vermuelen, 1998). We therefore investigate PAs, using a unique original survey dataset of foreign entrants in Poland, Hungary and Lithuania, taking into consideration the specific contextual issues when developing our arguments.

In particular, recent studies in transition economies suggest that partial acquisitions are an important entry mode in its own right (Meyer & Tran, 2006; Tsang, 2003). Partial acquisitions are particularly important in these contexts because stakeholders other than owners continue to play an important role, and governments continue to interfere in private business affairs in order to serve perceived public interests. Therefore, we explicitly considering the mode choice outcome a result of a bargaining process rather than an endogenous decision by the foreign entrant, when we seek to answer the question; what is the role of partial acquisitions in transition economies?

Moreover, the study of partial acquisitions may shed new light on an important theoretical debate in the entry mode literature, namely the relative merits of the digestibility motive and the asymmetric information motive on entry mode choice (Chen & Hennart, 2004; Hennart & Reddy, 2000; Reuer & Koza, 2000; Reuer & Koza, 2000b; Hennart & Reddy, 1997; Balakrishnan & Koza, 1993). We contribute to this debate by exploring the role of asymmetric information in a transition economy context; we argue that the nature of the information asymmetry may be different than what is assumed in prior empirical research, which leads to different outcomes. We therefore suggest that cautious sellers, rather than buyers, motivate partial acquisitions.

It is our view that a partial acquisition is the response to the contractual difficulties involved in protecting the interests of local owners and stakeholder and therefore, the aim of this study is to contribute to the existing literature by taking into account the influence of sellers and stakeholders on the entry mode bargaining process.

Figure 5.1 Ownership control and the make or buy decision

	New organization	Existing organization
Full equity control	Greenfield	Acquisition
Shared equity control	Joint venture	Partial acquisition

Theoretical framework

For clarity, we define a greenfield operation as a wholly owned new venture (Figure 5.1). An acquisition is defined as obtaining full ownership control (>95%) of an existing local firm. A JV is defined as the establishment of a new venture between a foreign owner with no less than 10% of the equity stake and a local Co-owner, while a partial acquisition is defined as the acquisition of a stake in an existing local firm of at least 10% but less than 95% of equity.

Firms engaging in FDI may have to augment their existing resources and capabilities to the needs of the host market (Anand & Delios, 2002; Caves, 1996). This can be done by internally developing the resources or capabilities needed, by buying them in factor markets or in the market for corporate control. From a resource based view a firm would prefer to enter by greenfield operation, when it is possible to develop the necessary resources or capabilities internally or acquire them through factor markets. When this is not possible, either because organizational routines inhibit the development of new capabilities (Anand & Delios, 2002; Teece, 1987) or because factor markets are saddled with asymmetric information and opportunism problems (Williamson, 1975),

firms would use the market for corporate control.

The most straightforward use of the market for corporate control is to fully acquire another firm that has the resources required to successfully operate in the host country. However, Hennart and Reddy (1997) argue that firms tend to be complex organizations with a broad range of resources. Often the acquirer desires only selected resources that are commingled with a range of undesired resources. A full acquisition would burden the acquirer with a bundle of resources that may have little value to the acquirer or even have a detrimental effect on the acquirer's performance. To overcome this "digestibility" problem, Hennart and Reddy (1997) argue that firms could effectively establish a jointly owned new venture with resource contributions from both parent companies. This would allow the transfer of desired resources that cannot easily be separated from the organisational boundaries and at the same time create an effective hostage in the form of asset specific investments to safeguard against opportunistic behaviour. JVs then serve as a vehicle to reduce the ex-post integration costs when desired resources are highly commingled with undesirable resources.

An alternative argument by Reuer and Koza (2000); Balakrishnan and Koza (1993) suggest that JVs are primarily motivated by ex-ante valuation problems caused by asymmetric information and adverse selection between the buyer and the seller. They argue that sellers would be more able to estimate the true value of an asset in their possession than potential buyers. However, it is difficult for sellers to credibly convey information on the value to a buyer, because they may lack incentives to be truthful and conversely the buyer has no reason to trust them (Akerlof, 1970). An agreement by the parties to enter into a JV may alleviate the asymmetric information problem. The willingness to undertake asset specific investments in the JV serves as a signalling device, conveying to the buyer the seller's commitment and belief in the value of its resources. Moreover, JVs *"enable the two firms to combine resources in a piecemeal fashion such that the learning that*

follows allays the adverse selection problem that can arise from initial valuation uncertainties in an outright acquisition" (Reuer & Koza, 2000). Moreover, they suggest that both arguments are valid, but they maintain that a preference for JV can exist without indigestibility, but not without asymmetric information.

On the other hand, Hennart and Reddy (2000) suggest that asymmetric information can explain the use of partial acquisitions. Moreover, Chen and Hennart (2004) argue that despite increased management costs associated with co-ownership and control (Luo, 2002; O'Connor, Luo & Lee, 2001) partial acquisitions may be preferred over full acquisition when asymmetric information and adverse selection problems leads both seller and buyer to price opportunistically. They argue that ex-ante valuation problems may be resolved if the current owner retains a share in the firm that effectively functions as a hostage. Only owners that are confident in the future prospects of their company would be willing to retain a share. Even if the ex-ante valuation problems could be resolved the current owner may engage in ex-post opportunistic behaviour that could adversely affect the performance of the acquired firm (Chen & Hennart, 2004). This could be done either through neglect e.g. by withholding important information or by engaging in competing business. By retaining the seller as a co-owner, the two parties align their interests, thus curbing the incentive to act opportunistically.

Similarly, Meyer (2002) suggests that partial acquisitions may be a means to align the interest of an MNE and the host government in acquisitions related to the privatization of state enterprises. Governmental agencies often have indirect means to influence the prosperity of a business. Aligning their interests with the private sector interests of a foreign investor would thus reduce the likelihood of surprise adverse interferences. Thus, partial acquisitions can facilitate the trade-offs in markets for corporate control that are plagued by asymmetric information and adverse selection problems, and at the same time discourage ex-post opportunistic behaviour by the seller

(Chen & Hennart, 2004).

From these perspectives joint ventures or partial acquisitions substitutes a full acquisition either as a consequence of ex-ante valuation problems or ex-post operational problems. Since sharing control raises governance costs (Luo, 2002) it is clear that in the absence of digestibility and asymmetric information problems, the preferred mode choice would be a full acquisition. While a JV may resolve ex-ante valuation problems caused by asymmetric information, this does not necessarily make this mode the optimal choice. Without digestibility problems the preferred long-term solution should be full integration of the companies in question.

In a partial acquisition, the acquirer takes control of some shares and may, as valuation problems are resolved, venture on to fully integrate the acquired firm. Arguably it would be more costly to coordinate the two parent companies and a JV operation between them, which may develop its own distinct organizational culture. This suggests that a preference for JV may exist without asymmetric information, but not without digestibility problems.

Hence the asymmetric information argument would appear to offer the best available explanation for partial acquisitions. Yet, it is not without problems. The notion that local sellers understand the value of the assets better than the potential acquirer is tentative. This issue is of particular concern in transition economies. These economies typically lack effective market mechanisms for the transfer of ownership rights, which limits local owners' ability to gauge the value of their assets. Moreover, the local owners only truly know the value of their assets in their current use. They may not know the potential value of their brand or product line when placed in its first best use and supported by sophisticated marketing techniques. Similarly, the value of a dominant market position or an extensive distribution network may be unknown to the owners of an inefficient firm. This may particularly be a problem when the seller is a privatization agency. Tsang and Yip (2007) argues that local governments and managers may even deliberately under price

assets in order to gain personal advantages from a sale, thus accelerating the pricing problem. Consequently, local owners' concern of selling 'too cheap' may motivate partial acquisitions rather than the MNE's fear of paying too much. In other words, the sale of assets may be subject to a "reverse" information asymmetry problem, as buyers possess superior information of the value of the target firm's assets.

A related challenge in transition economies is the influence of stakeholders during the negotiation process. Meyer (2002); Antal-Mokos (1998) provide several examples of ex-ante negotiations that have failed or been drawn out due to intervention by other stakeholders in the process. Contractual conditions often include a non-financial component, such as guarantees not to close plants or to lay off employees, which may later create impediments to restructuring. Moreover, in JV contracts the partners agree in detail the rights and duties of each party to the venture, while partial acquisition agreements may be less clear. This can be an advantage in situations where powerful rent-seeking stakeholders are able to derail the ex-ante negotiations. By opting for a partial acquisition, sensitive issues may be postponed, thus avoiding prolongation or even failure of the negotiations.

Similarly, partial acquisitions tend to be easier to label as a beneficial arrangement, e.g. strategic alliance, which reduces the risk of intervention by rent-seeking stakeholders. This is particularly important for project of high public visibility or where a governmental agency is a partner to the negotiations because the latter may be subject to political pressures (Antal-Mokos, 1998). On the other hand, public opinion may perceive a full acquisition by a foreign firm with some misgivings, even in developed market economies (Crystal, 2003). Therefore, foreign investors may consider partial acquisitions the fastest way to gain access to a market and to secure early mover advantages. Thus, Jakobsen (2007) finds that early entry through partial acquisition enhances the performance of a new operation.

Postponing agreements on critical business aspects allows the parties to settle details when uncertainty and information asymmetries have been reduced, which facilitates agreement. Foreign investors generally enter transition economies with the expectation that the institutional environment will improve over time; hence they expect that future negotiations are conducted in a less uncertain environment. Moreover, the interests and bargaining power of stakeholders is expected to change over time. At the same time, foreign investor in a partial acquisition may gain legitimacy in the local context and gather allies, which help neutralizing politically motivated opposition.

We therefore proceed to develop our hypothesis based on the view that owners and stakeholders seek to protect their interests. Since the transition economy environment is often highly uncertain it is costly to protect these interests by means of contractual measures (Williamson, 1975) and therefore retaining some influence through local ownership would be optimal.

HYPOTHESES DEVELOPMENT

The theoretical discussion above suggests that asymmetric information between buyer and seller, and the resulting bilateral bargaining situation, are core to an explanation of why firms choose partial acquisitions rather than more conventional modes of investment. Large asymmetries of information between buyers and sellers with respect to the value of the assets of the firm can inhibit acquisition deals. Alternatively, firms may design specific strategies, such as a partial acquisition, to protect their interests.

In an acquisition, two types of information asymmetries emerge. The seller has superior knowledge concerning the actual operations of the firm (Chen & Hennart, 2004). On the other hand, the buyer has superior knowledge concerning the potential contribution of the firm's resources to the buyers operations. The literature has focused on the former effect, yet the latter may also be

important. If the buyer wants to use the resources of the acquired firm in ways that create higher rents than their current usage, e.g. by creating synergies with existing operations, the buyers maximum price may be substantially above the sellers minimum price. Thus, a substantial scope for negotiation emerges.

This situation is likely in transition economies, especially if the acquisition is related to the privatization process (Meyer, 2002). Foreign investors are often in a better position to assess the value of a firm under conditions of a modern market economy than for instance privatization agencies with the legacy of state-ownership and central planning. While traditionally the market mechanism in advanced economies may be good at capturing rent derived from perceived synergies for the existing shareholders through high acquisition premiums, emerging markets lack the fundamental market supporting institutions, and hence the sellers must device alternative means to secure a share of the rent. Sellers would thus prefer an acquisition arrangement that gives them a stake in the firm's future revenues, such as a partial or staged sale. Consequently, this reverse information asymmetry would lead sellers to prefer partial acquisitions.

Hence, in the presence of reverse asymmetric information advantages, the acquirer's past commercial experiences in the host country does not reduce the asymmetric information problem but rather signals to the current owner(s) the acquirer's superior capacity to value the target, thus inducing the current owner(s) or a group of owners not to sell outright, in the hope that they can free ride on the acquirer's efforts. Hence we propose that:

Hypothesis 1: Previous host market knowledge is positively associated with entry by partial acquisition rather than full acquisition.

For MNEs that have already established foreign investment operation, an additional

consideration becomes paramount. Any new operation would normally aim to extend the existing one, for instance by increasing market share or by deepening the local supply chain. Therefore, for investors undertaking follow-up investments, the interaction between the existing and the new operations is essential.

If foreign investors obtain full control over new operations, they would be able to proceed with the integration of the old and the new operation. If however they have to share control, as in a partial acquisition, they would find it considerably more difficult to integrate the two operations. Thus, subsequent investments are less likely to be with shared ownership, as found for instance by Kogut and Singh (1988).

Moreover, MNEs often undertake subsequent investments to increase their market share with the aim to attain market leadership in previously fragmented markets. They may thus pursue a strategy of multiple acquisitions to reach a desired level of market coverage and power (Meyer & Tran, 2006) and to realise economies of scale in production, marketing and distribution. Such a strategy, however, requires operational integration of the acquired units, which is easier without residual outside shareholders. Therefore we expect partial acquisitions to be less relevant for follow-up investments compared to full acquisitions:

Hypothesis 2: *If the foreign parent already has direct investment in the host country, subsequent investments are less likely to be partial acquisitions rather than full acquisitions.*

A different form of international experience has attracted considerable scholarly attention, namely experience in international business as such (rather than specific to a country). Theoretical arguments suggest that inexperienced investors would more often use JVs as means to learn international business practices, and to access complementary resources. Moreover, a JV provides a

local partner who would help to adapt to local conditions and to gain local legitimacy (Lu & Xu, 2006). While some empirical studies support the notion that less experienced foreign investors prefer shared ownership (Meyer, 2001; Gomes-Casseres, 1990), Barkema and Vermuelen (1998) found no direct link between international experience and the propensity to choose full acquisition over partial acquisition. In general the overall evidence from this literature is highly inconclusive (Harzing 2002).¹⁰

In part the mixed evidence may be due to the failure to distinguish between JVs and partial acquisitions, which both have shared ownership. Since partial acquisitions may be chiefly motivated by the interests of the local owners and stakeholders, this learning argument may only apply to JV where both partners contribute resources and share the running of the company. Thus we predict:

Hypothesis 3a: *The greater the international experience of the parent company the less likely it will choose to enter by Joint Venture versus Greenfield or acquisition.*

Hypothesis 3b: *The international experience of the parent company does not affect the propensity to enter via partial acquisition versus Greenfield or acquisition.*

Entry strategy research has paid considerable attention to the size of the envisaged local operation. Greenfield operations take more time to grow, as foreign investors have to recruit staff and build operations from scratch, which is a time-consuming process. Thus, investors are more likely to use acquisitions rather than greenfield entry when aiming to establish large operations (Harzing, 2002; Brouthers & Brouthers, 2000; Hennart & Park, 1993) or large plants (Elango & Sambharya, 2004).

¹⁰ Harzing (2002) provides a thorough review of empirical results on this issue.

The acquisition of large targets may be particularly important for investors seeking to build a leadership role in local markets, which is a particularly important motive in transition economies (Meyer & Tran, 2006; Meyer 2002). Acquisitions offer faster and easier market access than greenfield entries (Gil et al., 2006). Large new ventures may experience high costs, as they have to invest aggressively in marketing to build volume turnover and to fill production capacities. Moreover, leaving behind a large local firm also leaves a window of opportunity for late movers to enter the market and gain a substantial market position thereby negating potential first mover advantages (Lieberman & Montgomery, 1998). Thus, for multiple reasons, we would expect foreign investors aiming for a substantial operation to prefer acquisition or partial acquisition as an entry mode.

Full acquisitions of large firms however face distinct obstacles, especially in highly politicized contexts. Firms owned fully or in part by the state or by employees may attach greater importance to employment guaranties, or other commitments that would ensure the long-term continuation of the firm. In order to secure a full acquisition a foreign acquirer would often have to surrender a significant degree of strategic flexibility through contractual arrangements. Even when this is not the case, external stakeholders such as the national government, local municipalities or the media may aim to influence and/or slow the negotiation process (Antal-Mokos, 1998). They may insist that a local co-owner retains an equity stake to secure local interests, and thus obstruct full acquisitions (Meyer, 2002). In this respect we can also view the legal restriction on full acquisitions as the extreme manifestation of a generally held belief, that the transfer of ownership and control to a foreign entity carries with it a hazard to the public good. The larger the local firm, the higher would be the profile of the takeover negotiations in the host community and the greater the likelihood that stakeholders would intervene. Consequently, we expect that the larger the local firm the more likely the deal will be structured as a partial acquisition.

Hypothesis 4: The larger the new subsidiary, the more likely it has been established by partial acquisitions rather than any other mode of entry.

THE SURVEY AND METHODOLOGY

We use data from a questionnaire survey of foreign owned firms in three transition economies: Poland, Hungary and Lithuania. The survey has been conducted as a joint project in cooperation with a team of local researchers in each of the three countries in 2003. Where appropriate the survey was translated into local languages.

The base population was constructed by combining local databases. The questionnaire was then sent to the chief executive of firms where contact information was available, which in most cases was followed up by phone contact and personal interviews to achieve a desired rate of response. Relative to the base population of all foreign investors, the sample includes 10 percent for Poland, 11 percent in Hungary and 22% in Lithuania. After eliminating observations with missing values, a total sample of 322 foreign owned subsidiaries remains.

While common method bias always remains a potential source of problems in a questionnaire based studies we employed techniques suggested by Podsakoff et al. (2003) to mitigate such biases. In particular, the dependent variable, mode choice, is a factual classification that is not sensitive to subjective perceptions as for instance Likert scale data are.

The firms included were primarily established during the period 1990-2000 and had at least 10 employees and a foreign ownership participation of no less than 10%. These criterion was selected to eliminate administrative or representation offices and ensure that only fully operating firms are in the sample. The majority, 62 percent of the local subsidiaries reported that they had less than 100 employees in 2001, 31 percent reported between 100 and 1000 and the remaining 7

percent reported that they had more than 1000 employees. The sample is thus broadly representative for both smaller and larger enterprises. The survey includes firms in a wide range of industries and reflecting the main countries of origin in the region, namely Germany, the Nordic countries, other Western European countries and North America.

The sample contains a substantial proportion of all four entry modes, which allows empirical analysis of the four-way choice: Greenfield operations represent 44 percent of all observed entries, acquisitions 23 percent, JVs 21 percent and partial acquisitions 12 percent. This pattern differs from earlier studies of entry mode. Most studies of entry mode choice in the US report a dominant share of acquisitions, for instance in the Elango and Sambharya (2004) study 210 out of 336 observations were acquisitions. On the other hand, studies on China data have observed a large majority of shared ownership modes (Luo, 2001 & 2002), though this may have diminished in recent years.

Dependent variables and statistical methods

To test our hypotheses we model the entry mode choice as a multi nominal logistic regression (M-Logit) with entry mode as a dependent variable. The entry mode variable takes the values greenfield, acquisition, JV and partial acquisition respectively.

Independent variables

To test hypotheses 1 we include a dummy variable previous *host market knowledge*. Similarly, hypotheses 2 is tested by the dummy *follow-up investments*, which indicate whether or not the subsidiary was the parent companies first FDI in the host country. Both dummies are derived from yes-no questions in the questionnaire survey.

To test hypotheses 3a and 3b we include a measure for the international experience of the foreign parent firm. Similar to Barkema and Vermeulen (1998), we proxy *international experience*

using the natural logarithm of the number of countries the parent company had affiliates in at the time of the investment. A large number of foreign affiliates indicate that the parent has considerable experience with foreign market entry.

Following Kogut and Singh (1988), we proxy *subsidiary size* by the natural logarithm of the number of employees. We choose the number of employees for the last year of operation reported, to eliminate a potential problem that a new venture might have little or no activities in its first year of operation. A simple means test indicate that partial acquisitions on average have been laying off employees consistent with restructuring needs, whereas greenfields and JVs tend to have grown over time. The last year is thus more useful to measure persistent size differences. This measure is used to test hypothesis 4 in the M-Logit analysis.

Control variables

Equity based entry modes other than greenfields are generally associated with augmenting the foreign parents resource base (Anand & Delios, 2002). We therefore include a measure of *foreign parent resources* reliance as a control variable. The respondents where asked to report the three most critical resources for the subsidiary success during its first years of operation. This question was followed up with another asking the respondent to rate on a percentage scale the contribution of these resources from various sources e.g. a local partner, the foreign parent or other local sources. A weighted measure of the parent's relative contribution of resources was created, attaching the greatest weight to the most important resource and subsequently less importance to secondary and tertiary resources.

$$\underline{\sum (r1)*0.5 + (r2)*0.3 + (r3)*0.2}$$

Similarly, firms that pursue efficiency oriented FDI will usually rely on host country factor

endowments as well as their own resources in efficient management and production technology. They will rarely need country specific resources like local market knowledge or access to distribution networks. Furthermore, host governments generally look more favourably on export oriented FDI, which tend to give efficiency seeking MNE's greater leverage in the choice of entry mode (Luo, 2001). To control for this effect, we coded all firms that received more than 80 percent of their revenues from export as *export intensive*.

Furthermore, we include control variables for the host country, home region of the parent and industry. To avoid singularities in the Hessian matrix we reduced the number of industry groups and home regions. The industry of the affiliate is coded as *Manufacturing, Utilities and mining, Trade, Financial services* or *Other services*. We divided the home region of the parent companies into *Nordic countries, Germany, other Western European countries, North America* and all *Other countries*.

Since transition economies are undergoing rapid changes in the institutional environment, it

Table 5.1 Descriptive Statistics and Correlation Table

		Mean	s.d.	X1	X2	X3	X4	X5	X6	X7	X8	X9	X10
X1	Foreign parent resources	38.43	33.72	1									
X2	Export intensity	0.20	0.40	0.07	1								
X3	Subsidiary Size(LN)	0.00	1.65	-0.03	0.02	1							
X4	Hostmarket knowledge	0.41	0.49	-0.04	-0.01	-0.00	1						
X5	Follow up investment	0.26	0.44	-0.07	-0.11**	0.14***	0.45***	1					
X6	International experience(LN)	0.00	1.32	0.04	-0.08*	0.14***	0.12**	-0.07	1				
X7	Affiliate age	7.67	3.08	0.09*	-0.13***	0.15***	-0.05	0.12***	0.06	1			
X8	Poland	0.38	0.49	0.07	-0.13***	0.24***	0.08*	-0.04	0.21***	0.08*	1		
X9	Lithuania	0.20	0.40	-0.11**	0.09**	-0.07	-0.21***	-0.06	-0.15***	-0.26***	-0.39***	1	
X10	Hungary	0.42	0.49	0.02	0.05	-0.18***	0.09**	0.09**	-0.10*	0.12***	-0.67***	-0.43***	1

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

is to be expected that there may be time trends in the entry mode choice (Estrin, Ionascu & Meyer, 2004). Moreover, past experiences of other entrants from the same home country might affect the MNE's choice of entry mode. To control for these time effects we interact the number of years since the affiliate was established with the host country and the home region of the parent company. This procedure generates multiple time trends that control for all other factors that are time or country specific.

Table 5.1 reports descriptive statistics and the correlation matrix of the variables in this analysis. The table shows that, with a few exceptions, the pair wise correlations between the variables are quite low (<0.3). Since firms with past FDI in the host country is expected to have host market knowledge the pair wise correlation between previous *host market knowledge* and *follow up investments* is relatively high (<0.5). None of the pair wise correlations are so high that we would expect a serious multi-collinearity problem though.

RESULTS AND HYPOTHESES TESTS

The results of the M-logit regression on the determinants of entry mode choice are presented in Table 5.2 and 5.3. A positive sign in Table 5.2 indicate a greater likelihood of choosing the entry mode in question compared to the base mode Greenfield. The same regression is reproduced in Table 5.3 with acquisitions as the base case such as to extract information on the significance of effects viz. acquisitions as well. The overall model fit is good with a pseudo R^2 of 0,52. The model correctly classified 61.50 percent of the observations. For our hypotheses, it is particularly relevant that the model is also good at classifying partial acquisitions with 42 percent correctly classified, which is more than three times that which could be predicted by a random choice model.

Table 5.2 Multinomial logit with Greenfield as the base

	Acquisition	Joint venture	Partial acquisition
Intercept	-4.07*** (0.95)	-2.69*** (1.00)	-4.91*** (1.24)
Foreign parent resources	-0.02*** (0.01)	-0.03*** (0.01)	-0.03*** (0.01)
Export intensity	-0.91* (0.48)	-1.78*** (0.57)	-1.14* (0.66)
Subsidiary size	0.67*** (0.14)	0.21** (0.16)	0.98*** (0.18)
Host market knowledge	-0.22 (0.40)	-1.60*** (0.46)	1.08** (0.55)
Follow up investments	0.92** (0.45)	1.05* (0.54)	-0.75 (0.63)
International experience	-0.09 (0.14)	-0.44*** (0.17)	0.01 (0.19)
Hungary	0.99** (0.41)	-0.06 (0.45)	0.53 (0.56)
Lithuania	0.99 (0.65)	0.96 (0.65)	1.33 (0.91)
Industry Dummies**	Yes	Yes	Yes
Home region Dummies*	Yes	Yes	Yes
Host country*Affiliate age	Yes	Yes	Yes
Home region*Affiliate age	Yes	Yes	Yes
N	322	Correct classifications	61.50
Chi Square	211.78	Nagelkerke R ²	0.52

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

In support of hypothesis 1, we find that prior *host market knowledge* is positively associated with entry by partial acquisitions. We argue in hypothesis 1 that buyers may benefit from *reverse* asymmetric information advantages. Sellers in transition economies had little experience with valuation of assets and lacked effective market institutions e.g. stock markets. Previous commercial experience in the country may signal to the seller that the buyer has a good understanding of the

Table 5.3 Multinomial logit with Acquisition as the base

	Greenfield	Joint venture	Partial acquisition
Intercept	4.07*** (0.95)	1.38 (1.09)	-0.84 (1.23)
Foreign parent resources	0.02*** (0.01)	-0.01 (0.01)	-0.01 (0.01)
Export intensity	0.91* (0.48)	-0.87 (0.60)	-0.23 (0.65)
Subsidiary size	-0.67*** (0.14)	-0.46*** (0.15)	0.31** (0.16)
Host market knowledge	0.22 (0.40)	-1.38*** (0.49)	1.30** (0.55)
Follow up investments	-0.92** (0.45)	0.13 (0.52)	-1.67*** (0.60)
International experience	0.09 (0.14)	-0.34** (0.18)	0.10 (0.19)
Hungary	-0.99** (0.41)	-1.04** (0.50)	-0.45 (0.57)
Lithuania	-0.99 (0.65)	-0.02 (0.69)	0.34 (0.89)
Industry Dummies**	Yes	Yes	Yes
Home region Dummies*	Yes	Yes	Yes
Host country*Affiliate age	Yes	Yes	Yes
Home region*Affiliate age	Yes	Yes	Yes
N	322	Correct classifications	61.50
Chi Square	211.78	Nagelkerke R ²	0.52

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

true value of the asset. Consequently, the seller(s) will be more reluctant to divest its entire stake in the firm preferring to wait and see how things develop. An alternative or complementary argument for the observed effect could be that foreign firms with local experience are more likely to recognize the potential for ex-ante conflicts and may be more willing to accept partial ownership.

On the other hand, prior *host market knowledge* is found to be negatively associated with

JVs. In line with the digestibility argument, this suggests that firms enter by JV when they desire access to local market knowledge and resources related to the management of business activities in the local context, without being burdened by undesirable resources that would be obtained through a full merger.

The results indicate that follow up investments are less likely to be by partial acquisition, thus supporting hypothesis 2. As expected, firms are less willing to accept partial control when they engage in subsequent acquisitions. Subsequent acquisitions tend to be motivated by a desire to strengthen and consolidate a market position in the host country. The presence of other owners in the individual subsidiaries complicates the foreign parent's ability to integrate activities in the host country, thus limiting the scope for positive synergies. Furthermore, the local owners may be more willing to sell their holdings when faced with intensifying foreign competitive pressure.

We find that internationally experienced firms were less likely to enter by JV compared to any other entry mode, thus supporting hypothesis 3a. On the other hand, in line with hypothesis 3b international experience did not affect the likelihood of firms choosing partial acquisition over Greenfield or full acquisition. Therefore, the results also suggest a fundamental difference in the underlying motivation for the choice of JV and partial acquisitions. Whereas the choice of a JV is motivated by the desire to gain a local partner to help compensate for the foreign parent's lack of international experience, this is not the case for partial acquisitions. The choice of partial acquisition is thus not motivated by a deficiency within the MNC in terms of resources or capabilities, but rather by deficiencies in the contracting environment.

As predicted in hypothesis 4, *subsidiary size* is strongly positively associated with partial acquisitions. As expected, both acquisitions and partial acquisitions are on average significantly larger than Greenfield projects (Table 5.2) and in addition partial acquisitions are larger than full acquisitions (Table 5.3). Our study thus presents strong evidence that firms prefer to acquire large

enterprises rather than to build them from scratch. The process of building a large organization from scratch may be too slow and difficult for many investors. It tends to be easier to buy into a new market, particularly when local assets are available for sale, which was mostly the case due to the extensive privatization campaigns undertaken by the host countries in the period.

Moreover the positive relationship between *subsidiary size* and partial acquisition we link to a tendency by stakeholders such as the state, municipal government and employees to intervene with the object of derailing, slowing down or otherwise affecting the outcome of ex-ante ownership transfer negotiations (Meyer, 2002). The probability of stakeholder intervention is greater the larger their perceived interest, which would often be closely connected to the number of jobs involved. In such cases foreign firms may have a clear interest in limiting ex-ante negotiations and postponing negotiations on sensitive issues like layoffs.

The pattern of control variables is in line with our expectations. We find that the relative resource contribution of the parent company is positively and significantly associated with greenfield operations. Similarly, exporters were more likely to enter by greenfield operations. This generally supports the resource-based view that firms will seek to utilise or develop resources in-house and to the extent that this is not possible they will pursue complementary (local) resources through acquisition or a partnership with a local firm. Contrary to the WOS versus JV/PA division argued by Brouthers and Hennart (2007) this suggests that a more appropriate segmentation would be between greenfields and resource seeking modes.

Overall the joint effects of the time trends were not significant. For the home region dummies (not reported) North America stands out with a rather clear aversion against partial ownership. This result is generally similar to previous findings that have studied the impact of culture on the choice of entry mode.

DISCUSSION

This study offers several contributions to the literature. It is one of the first studies to empirically investigate the factors that determine the choice to enter by partial acquisitions, and thus establishes that partial acquisitions have distinct features. Moreover, this study considers the influence of local owners and stakeholders in shaping the entry mode decision. These influences have important implications for the factors that govern the choice to enter by partial acquisition in transition economies, but also the direction of these. Consequently, we argue that information asymmetries may run counter to that which has previously been suggested (Chen & Hennart, 2004). Our results support this by showing that better informed foreign acquirer's does not contribute to reducing information asymmetries problems, but rather enhance them. We also explain the previously inconclusive evidence of the effect of international experience on shared versus full ownership. The theoretically expected effect applies only to joint ventures, and empirical studies that muddle the difference between partial acquisitions and joint ventures may thus fail to identify this effect.

It is one of the first studies in transition economies that simultaneously examine the factors that determine the choice of ownership level *and* the decision to make or buy. We demonstrate that it is fruitful to consider the choice of entry mode as a simultaneous choice along multiple dimensions. It is important to distinguish between not only levels of ownership control, but also whether the subsidiary should be acquired or build from scratch. A division between wholly owned and partially owned subsidiaries fails to capture the choice between acquiring existing assets and building new assets. Similarly a failure to separate acquisitions and partial acquisitions ignores the important issue of control and governance. Yet, even combining the two sets of arguments may be insufficient to explain the choice of partial acquisitions.

Thus, our study suggests a clear distinction in the underlying pattern of entry mode choice,

which is perhaps particularly important between joint ventures and partial acquisitions. We see that the lack of context specific “host market knowledge” and general business experience in an international context are key drivers for the choice of JV. Thus, JVs are primarily motivated by the operational concerns of the foreign investors regarding their ability to manage a cross border subsidiary in the specific host country context. Yet partial acquisitions are not driven by the same factors. They appear to be formed on the basis of comparative strength, i.e. the foreign investors in partial acquisitions are more likely to have previous host market. It is thus not the operational aspect that governs the choice of a partial acquisition, but rather partial acquisition emerges as a means to acquire a bundle of resources when there are forces at work that resists the transfer of these resources.

The study has some important limitations. Some entry mode choices may not be relevant in other countries because of legal constraints on e.g. full acquisition. In these regions, it may be especially important to distinguish between partial acquisitions and JV greenfields.

Some of the results may be specific to transition economies and cannot be generalized. The reverse asymmetric information motive might be particularly strong in transition economies. Likewise, if a positive relationship between size and partial acquisitions is mainly attributable to a desire to avoid or postpone negotiations on non-financial contractual clauses, then this would be of less importance in more advanced economies where these are less common. Hence the transition economy context might explain the difference in the results between this study and the study by Barkema and Vermuelen (1998), which found that JVs were on average larger than full acquisitions and that the parents had greater international experience.

Future research is hoped to provide a more differentiated treatment of entry modes, recognizing the unique features of partial acquisitions. In particular, we propose to investigate a similar set of hypotheses on different countries. A further possibility for future research may be to

re-estimate bimodal Logit regression equations presented in the literature on the same data, but replacing the Logit with an M-Logit model that incorporates partial acquisitions as a separate option. Another line of inquiry may investigate whether buyers or sellers are the principal motivators for the choice of partial acquisitions.

CONCLUSION

A partial acquisition is the outcome of a negotiation between an acquirer and a group of seller(s) and stakeholders that seek to retain some influence on the future of the enterprise. The main implications for managers are that they should not confuse the motives for establishing a JV and those for establishing a partial acquisition. Firms can advantageously choose a joint venture greenfield operation with a local partner, when they need to upgrade their capabilities to conduct business in the local context. On the other hand, a partial acquisition is not a means to enhance operational efficiency by joining up with a partner that possesses superior context specific managerial capabilities. For all practical purposes these capabilities reside at the level of the acquired subsidiary's management, not its owners. Rather, the key purpose of a partial acquisition is to facilitate an acquisition deal in situations where powerful stakeholders resist turning over full managerial flexibility to the acquirer. By pursuing, or perhaps more appropriately accepting, a partial acquisition the acquirer can limit the ex-ante negotiations and avoid or reduce the severity of long-term concessions.

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6. Conclusion

The object of this study has been to investigate the role of entry timing on firm performance, the use of partial acquisitions and the relationship between these in a transition economy setting.

From a firm strategy perspective we would want to be able to provide some form of concrete managerial recommendations in regard to entry timing. One of the problems in this respect is the possible interrelatedness of entry timing, firm resources and performance. This study seeks to account for this endogeneity issue through several means. Most importantly, I use a sample of Central and Eastern European firms which I reason is most likely to exhibit competitive entry behavior on account of (1) the geographical and cultural proximity to many of the large foreign investor countries in Europe and (2) the scope of the structural changes in terms of the sheer number of industries effected. I will therefore claim, with a certain degree of confidence, that this dissertation offer one of the best available studies of competitive entry timing effects.

Overall, this dissertation does not find support for a *general* order of entry effect on performance in competitive foreign market entry. In line with previous literature (VanderWerf & Mahorn, 1998), support is found for a market share advantage, but this advantage does not translate into superior overall performance. Some support is found for a more general early mover advantage; however, this advantage is highly conditional on country and industry factors, and even mode choices. Therefore, we must conclude that the ability to derive performance advantages from moving first in competitive foreign market entry is largely situational.

Nonetheless, it is equally clear and puzzling that even some highly competitive industries do offer first movers substantial performance rewards. One such industry is the brewing industry, for which we find both substantial market share and financial performance advantages from moving first. In this dissertation it is suggested that the ability to command rent from moving first depends

crucially on the competitive environment and how this environment is shaped by first mover advantages. Hence, I argue that the combination of multi-market opportunities and strong first mover advantages lead competitors to shy away from confrontation and pursue alternative markets, effectively creating a state of competition for markets. It is not new that the market and competitive environment affect a firm's ability to derive rent from first mover advantages (Nakatari & Sivakumar, 1997); however, we need also consider how the existence of first mover advantages indirectly shapes this environment.

In regard to the use of partial acquisitions in transition economies, in this dissertation, I ultimately view the choice of entry mode in terms of the source of the resources that is needed to effectively undertake a business activity in a given host country. In this sense a Greenfield operation is a mode that relies predominantly on critical resource transferred from the parent company to the subsidiary. In contrast, firms enter by means of a Joint Venture, Acquisition or Partial Acquisition for the purpose of accessing a bundle of locally held resources. Effectively, Joint ventures, acquisitions and partial acquisitions serve as three organizationally and contractually different resource acquiring modes. As noted by Williamson (2005) "the upshot is that there is a place for each generic mode of organization, yet each should be kept in its place", hence the critical question is what is the place of each of these modes of organization and contracting?

This dissertation contributes by analyzing the factors that promote the use of partial acquisitions. In contrast to the remuneration perspective that sees the role of shared ownership predominantly from the perspective of aligning the interest of the local owners with that of the foreign partner, I advance the view that the ability to influence decisions is core to explaining the role of partial acquisitions in transition economies. Owners, governmental organizations, employees, local communities and other stakeholders will have vested interests in the operation of

the business unit which they will seek to protect from possible adverse unilateral adaptations by the foreign acquirer.

Seen from the perspective of these stakeholders, retaining influence through equity ownership, either directly or indirectly through other friendly stakeholders, offers some measure of protection against potentially harmful unilateral actions by the foreign investor. On the other hand, for the foreign acquirer a partial acquisition may offer the best or only alternative to a full acquisition of the assets when it is too difficult or costly to alleviate these concerns through contractual agreements.

It is particularly employment concerns that are likely to spark resistance to a takeover by a foreign company and thus we find that partial acquisitions are on average larger than other foreign owned subsidiaries in terms of number of employees.

This dissertation also advances the notion of a reverse asymmetric information problem. It is commonly assumed that the seller of an asset has the best knowledge of its true value. However, foreign acquirers typically seek specific asset that can be used to leverage their own ownership advantages. It is thus the synergies between the ownership advantages of the foreign parent and some of the local firm's assets that create value to the transaction, rather than the assets per se. In some cases only a single or few core assets have any value such as the case of brownfield entries (Meyer & Estrin, 2001). Consequently, the foreign acquirer may be in a much better position to estimate the true value of these synergies and correspondingly possess an information advantage over the seller; hence, promoting reluctance to fully divest by the seller.

A key observation that emerges from the overall dissertation is that I do not find a decrease in the likelihood of entering by means of a partial acquisition over time. What I do however find is that there are strong indicators that early entry through partial acquisitions has positive performance implications. This suggests that partial acquisitions are predominantly a tool to acquire

complementary local assets early in an institutional environment that does not support for instance contractual safe guards. The failure to use partial acquisitions in this capacity is thus likely to produce excessive governance costs.

Implications for future research

One of the key challenges for the timing and performance literature will be to effectively incorporate survival. However, there are some major empirical and technical constraints that need to be overcome in order to gain any conclusive results. Most pertinent will be the “quantification of implied failure”; firms simply exit markets for too many reasons and with too many degrees of relative failure for a simple binary variable to meaningfully capture this. While the primary objective of this study has not been to address survival I feel that it does provide some implications that could be of relevance to the study of entry timing and business failure. The implications of the chapter “Competition for Markets vs. Competition in Markets: The case of the brewing industry in Central and Eastern Europe” is that it is quite possible firms can be divided into “natural winners” and “losers” for lack of a more appropriate term. We may need to study the relationship between entry timing and performance separately for these groups. Or in other words, we probably need to consider entrepreneurial activity and strategic entry timing as two completely separate concepts especially in foreign market entry.

In terms of the pursuit of a conclusion to the general performance advantage question many methods have been applied with varying results. Possibly, the way forward is not the pursuit of the perfect method, but rather the perfect data (Lieberman & Montgomery, 1988 & 1998). However until we understand the role of the underlying competitive mechanism that exists in cross boarder entry better, I would suggest that the most likely way forward within the study of order of entry and performance effects in foreign market is to aim for more comprehensive industry studies with a

stronger focus on identifying how the environmental and competitive dynamics affect the ability to derive rent from moving first.

Finally, just as VanderWerf and Mahorn (1997) noted an industry selection bias effect, it is also worth noting that the study of foreign entry timing and performance is strongly biased in favor of certain comparatively successful countries, most notably China. The field could truly need some comparative studies from economies that have experienced shock effects such as South Korea, Russia and Mexico.

How to enter is not strictly a strategic choice by the foreign parent. Basically, a joint venture or a full/partial acquisition is the negotiated outcome between two or more parties. As such, it is important to understand the motivation that lead to the choice of one over the other from a broader perspective. We need to understand both the motivations of the acquirer and the seller. The entry mode literature has so far predominantly viewed the choice from the perspective of an acquirer; I suggest that scholars interested in the study of mode choices could advantageously focus on the influence of the seller on the mode outcome.

Another important implication of this study is that the ownership dimension alone is insufficient to explain mode choices. Consequently, the partial versus full ownership debate lack the richness to truly expand our knowledge of entry mode choices. If we are to broaden our understanding of mode choice, future studies should consider the entry mode decision a choice between multiple alternatives.

LIMITATIONS

The primary limitation of this study is grounded in the availability of suitable empirical material. For three of these studies I use a data set consisting of primary survey data collected in

Hungary, Poland and Lithuania by a team of researches headed by Klaus Meyer (Meyer & Estrin, 2007). This data set has some clear advantages in terms of size and the richness of material.

However, it also has some clear weaknesses. The respondents are at the subsidiary level which does impact on the quality of data describing the parent company. Some of the typical control variables like advertising and R&D intensity or the international experience of the parent company suffer from large number of missing observations.

Moreover, it is increasingly considered problematic to use a single source of data and as such the overall quality of the data and consequently the results would have been greatly improved, had we been able to combine the primary survey data with secondary data sources; Amadeus being the most likely candidate.

I did make an attempt to combine the survey data with data from Amadeus; however this attempt was abandoned after it became clear that we were unlikely to obtain a reasonable sample size. Firm names are neither a persistent nor distinct feature of a subsidiary. This was also a lesson that was made clear when I gathered the data on breweries in Central and Eastern Europe. Subsidiaries are frequently merged together or change names typically from a local name to some derivate of the parents global name and as such offer a poor measure to track firms.

While, I must recognize these shortcomings of the empirical basis of the dissertation, the choice to go with it anyway was a pragmatic one. The number of observations, the multi-country nature of the study and the scope of the material that the data provides are virtually unrivaled by any study I have thus far encountered within the entry timing and mode choice literature.

In terms of the brewing industry data I feel it could have been very useful to include the emerging markets of Asia in the study. Although it is not without problems, as argued by the paper we can almost certainly expect a regionalization of the Chinese market which might provide empirical problems of its own. It would have given the study a stronger and richer empirical

foundation. However, this would have required different sources of data which Copenhagen Business School does not have access to.

LITERATURE

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