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## Article

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## Article

# Cultural Distance and Entry Modes in Emerging Markets: Empirical Evidence in Vietnam

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**Abstract:** Cultural distance is acknowledged as a crucial factor that significantly affects the entry mode selection of multinational enterprises. The purpose of this article is to analyze the relationship between cultural distance and entry mode choice by exploring a novel dataset of 5236 firms in Vietnam with foreign investment during the period 2005–2016. Although many studies were conducted about the cultural distance and entry mode nexus, most of the research mainly focuses on developed and developing countries, where a market economy is already established. It is important to expand the research to a transition economy such as Vietnam, where the government is committed to attracting foreign investment. The results indicate that, when the cultural difference between Vietnam and their home country is high, foreign-invested firms prefer wholly-owned subsidiaries (WOS) over equity joint ventures (EJV). The study contributes to the general understanding about cultural distance and entry mode decision of foreign-invested firms in emerging markets.

**Keywords:** cultural distance; entry mode; equity joint venture; wholly owned subsidiary

## 1. Introduction

Multinational companies invest in foreign markets for a variety of reasons: Some may find new markets for their goods and services, while others are attracted by the cheap and abundant resources of the host country (Dunning 2002). During the pre-investment stage, the choice of market entry mode is the essential strategy that will affect the survival and development of firms in the future (Anderson and Gatignon 1986). Many scholars believe that the cultural distance between the investing and host countries is one of the most important factors that influences the entry mode choice by investors (Kogut and Singh 1988; Agarwal and Ramaswami 1992; Erramilli 1996). However, the way in which cultural distance affects the entry mode is still controversial among scholars. According to transaction cost theory, there are two opposing arguments about the impacts of cultural distance on entry mode selection. The first argument states that cultural distance influences the perception of costs and uncertainty of the investing firm (Kogut and Singh 1988). A larger cultural distance between home and host countries encourages multinational corporations to select equity joint ventures (EJV) over wholly owned subsidiaries (WOS) to limit their exposure to uncertainty and risk. The second argument states that it is difficult for foreign firms to acquire accurate information about the local partners, as well as understand the behavior of these partners in an environment with a large cultural distance (Chang et al. 2012). Therefore, foreign firms would select WOS to gain full control of their business and avoid opportunistic behaviors by the partners (Sutcliffe and Zaheer 1998). However, most studies

on the entry mode and cultural distance focus on developed economies. Many researchers (Meyer and Nguyen 2005; Dikova 2012) state that the entry mode strategy is totally different in transition countries and developed countries due to different institutional frameworks.

The question of whether the WOS or EJV can be selected in a transition country when the cultural distance between an investing country and a host country is large, remains unanswered. Our research in the context of a transition country contributes to the body of knowledge about entry mode selection.

To address the research gap, we aim to explore the impact of cultural difference on entry mode selection using a novel dataset of 5236 foreign-invested firms in Vietnam in the period 2005–2016. This research objective is achieved by adopting the transaction cost theory. The transaction cost approach contributes new insights into how the cultural distance influences the entry mode choice of foreign-invested firms into a transition economy. Theoretical argument about the role of cultural distance and entry mode selection is developed in a transition country context. As suggested by Michailova (2011) about the importance of context-specific theory development in international business research, we believe that our theoretical argument can contribute a new knowledge in international business literature.

Vietnam is a suitable country for this study for many reasons. First, Vietnam is an emerging country with a high economic growth rate in recent years, and continues in transition with commitments from the government for important reforms, such as attracting foreign direct investment (FDI), so it is a good case for research on the entry mode. Vietnam's Investment Law 2015 introduces positive change, but the cultural distance between the home and host countries is still the main obstacle, in addition to restrictions on investors who are considering investment in Vietnam (Van Dut et al. 2018). Therefore, comprehensive research on the relationship between cultural distance and entry mode choice to promote foreign investment in Vietnam is needed. Second, little research about entry mode selection in emerging countries covers Vietnam. Most research on this topic mainly discusses developed or developing countries, where a market economy is already formed (Kogut and Singh 1988; Agarwal and Ramaswami 1992). It is important to expand the research to a transition economy such as Vietnam, and it makes a contribution to the theory development in a specific context, as suggested by Michailova (2011).

The structure of the paper is as follows: In the next section we present a brief review of the literature. We then present the methodology in Section 3, followed by a discussion of the results in Section 4. Section 5 concludes our paper.

## 2. Literature Review

When conquering new markets, multinational enterprises need to select an entry mode as their important internationalization strategy (Agarwal and Ramaswami 1992). Entry mode is defined by Sharma and Erramilli (2004, p. 2) as “a structural agreement that allows a firm to implement its product market strategy in a host country either by carrying out only marketing operations (i.e., via export modes) or both production and marketing operations there by itself or in a partnership with others (contractual modes, joint venture, wholly owned operations).” The choice of entry mode has a significant impact on the survival and development of firms in the future (Porter 1987). In the past two decades, researchers identified different types of entry modes, mainly divided into two groups: Equity mode and non-equity mode. The equity mode group includes joint venture and wholly owned subsidiaries (Root 1994). The non-equity mode group includes exporting, licensing/contractual agreement, R and D contracts, franchising, and strategic alliance (Root 1994). Different types of entry modes have different levels of control, resource commitment, and risk (Hill et al. 1990). In this research, we consider two important modes of entry in Vietnam: Equity joint ventures (EJV) and wholly-owned subsidiaries (WOS) (Tsang 2005). Another reason for only considering EJV and WOS in this study is the nature of the data that we collected. Our sample consists of 4070 WOS projects (77.27%), 1116 EJV projects (22.14%), six build-operate-transfer (BOT), build-transfer (BT) and build-transfer-operate (BTO) projects (0.11%), and 25 business cooperation contract (BCCs) projects (0.47%). We omit the

data on BOT, BT, BTO and BCCs from the sample because they are small in number, and have special characteristics.

Based on previous empirical research, scholars divide the determining factors of entry mode into three groups: Country-specific factors, firm-specific factors and industry factors (see [Luo 2001](#); [Tsang 2005](#); [Shieh and Wu 2012](#)). Country-specific factors represent the characteristics of investing and recipient countries such as the country risk, market potential and cultural distance. Industry-specific factors refer to characteristics of the industry. Lastly, firm-specific factors are concerned with the characteristics of foreign-invested firms, and this study examines investment amount, project orientation, investment duration and year of investment. When we move from macro to micro determinant factors, the role of transaction cost theory is increasingly more important.

Prior research often emphasizes that cultural distance (a country-specific factor) has significant impacts on entry mode choice ([Yiu and Makino 2002](#)). Cultural distance is defined as “the degree to which shared norms and values differ from one country to another” ([Hofstede 2001](#)). In order to explore the cultural distance and entry mode relationship, international business scholars tend to rely on transaction cost theory ([Anderson and Gatignon 1986](#); [Kogut and Singh 1988](#)). Transaction cost theory was first articulated in the seminal work of Ronald [Coase \(1937\)](#), who was awarded the Nobel Memorial Prize in economics for his research on the nature of the firm. In addition, [Williamson \(1975\)](#) also received the Nobel Prize in economics for his research on transaction costs economics theory (TCT), and the concept of transaction cost was first applied to entry mode by [Anderson and Gatignon \(1986\)](#). TCT is the most widely-adopted and applied in international business on market entry mode choice ([Canabal and White 2008](#)). The theory states that the selection of market entry mode by foreign firms is affected by the desire to minimize transaction costs ([Anderson and Gatignon 1986](#)). Transaction costs occur when firms do business with their partners. These costs include the cost of compiling a contract and negotiating with business partners, as well as cost of monitoring contract performance. The theory suggests two opposing arguments about the impacts of cultural distance on entry mode selection. The first argument states that cultural distance influences the perception of costs and the uncertainty of the investing firm ([Kogut and Singh 1988](#)). A larger cultural distance between home and host countries encourages multinational corporations to select equity joint ventures (EJV) over wholly-owned subsidiaries (WOS) to limit their exposure to uncertainty and risk. Empirical evidence from [Kogut and Singh \(1988\)](#), [Erramilli and Rao \(1993\)](#), and [Pak and Park \(2004\)](#) support this argument. The second argument states that it is difficult for foreign firms to acquire accurate information about the local partners, as well as understand the behavior of these partners in an environment with a large cultural distance ([Chang et al. 2012](#)). In this case, the cost of negotiating, monitoring, and enforcing contracts with local firms is even higher. Therefore, foreign firms would select WOS to gain full control of their business and avoid opportunistic behaviors by the partners ([Sutcliffe and Zaheer 1998](#)). Empirical studies by [Shane \(1994\)](#), as well as [Chen and Hu \(2002\)](#), provide evidence that supports the hypothesis of choosing WOS when the cultural difference is large. However, most studies on the entry mode and cultural distance focus on developed economies. Given the debate, we argue that the role of cultural distance on entry mode selection cannot be ignored in the context of the transition economy. In transition countries, the main difficulty faced by foreign-invested firms is the selection between WOS or EJV. The reason is that foreign-invested firms first need to select between employing local resources or conquering the transition country on their own ([Van Dut et al. 2018](#)). When the cultural distance between host country with a transition economy and the home country is large, firms need the local knowledge and local resources to overcome the risk and uncertainty ([Van Dut et al. 2018](#)). Adopting the transaction cost approach, we expect a large cultural difference and inefficient cooperation with local counterparts to encourage foreign investors to select WOS. The discussion leads to the hypothesis:

**Hypothesis 1 (H1):** *WOS are preferred to EJV when the cultural distance between Vietnam and investing countries is large.*

### 3. Methodology

#### 3.1. Data

The study explores the linkage between entry mode choice and the cultural distance of foreign firms in Vietnam, a developing country in the transition process with reform commitments by the government to attract FDI. The data, from 2005 to 2016, were compiled by the Ministry of Planning and Investment of Vietnam, totaling 4070 wholly-owned subsidiaries (WOS) (77.27%), 1116 equity joint ventures (EJV) (22.14%), six build-operate-transfer (BOT), build-transfer (BT), and build-transfer-operate (BTO) (0.11%), and 25 business cooperation contract (BCCs) (0.47%). The data on BOT, BT, BTO, and BCCs were omitted from this study because of their small number and special characteristics. These foreign-invested projects came from 78 countries in the world. The sample consisted of 1064 foreign-invested projects from Korea, 876 from Europe, 792 from Singapore, 654 from Chinese regions (mainland China, Hong Kong, Macau, and Taiwan), and 274 from the US.

#### 3.2. Variables

##### 3.2.1. Dependent Variable

The dependent variable is the entry mode choice of foreign investors when entering Vietnam. This is a dummy variable that takes a value of 1 if foreign investors establish EJV, and 0 for WOS (Slangen and Hennart 2008).

##### 3.2.2. Independent Variable

Cultural distance is the most important variable in this study. We measure cultural distance between Vietnam and investing countries along the six cultural dimensions developed by Hofstede (1980): Power distance, individualism, masculinity, uncertainty avoidance, long-term orientation and indulgence. Hofstede's cultural metrics are used because they enable us to conduct international comparisons between cultures. These data are widely employed in international business and cross-cultural psychology studies (Shenkar 2001). These data are adjusted and computed from 0 to 100 (percentage), and are available at Hofstede's website, <https://geerthofstede.com>. Based on the equation of Kogut and Singh (1988), we calculate a cultural distance index between Vietnam and other countries. Because culture is a multidimensional concept, using cultural distance data at an aggregate level can fully measure all aspects of culture. In addition, if we use data from each dimension, some of them may be incompatible with Vietnam.

$$CD_j = \sum_{i=1}^6 \left\{ \frac{(I_{ij} - I_{iv})^2}{V_i} \right\} / (6)$$

where  $CD_j$  is the cultural distance between investing countries and Vietnam,  $I_{ij}$  is the cultural aspect  $i$  of home countries  $j$ ,  $I_{iv}$  is the  $i$ th cultural aspect of Vietnam,  $v$  is Vietnam, and  $V_i$  is the variance of the  $i$ th cultural aspect. The larger the value of this indicator is, the larger the cultural distance between Vietnam and the investing countries.

##### 3.2.3. Control Variables

To account for country-specific factors that might affect entry mode choice, we included variables for country risk and market potential. Anderson and Gatignon (1986) define country risk as unpredictable changes in the business environment in a particular country (cited in Shieh and Wu 2012), and these risks decrease the profitability of firms conducting business in this country. In high-risk host countries, foreign investors often avoid committing to investment in large projects to minimize losses in case they want to withdraw from the market (Kim and Hwang 1992). Previous empirical studies predict



that in an unpredictable business environment FDI firms prefer a joint venture, rather than a WOS (Agarwal and Ramaswami 1992).

This is because when investment risks increase, multinational corporations (MNCs) seek information and knowledge through joint ventures with local companies. Joint ventures allow firms to enjoy lower long-term costs due to having better information (Beamish and Banks 1987). We follow Manh Chien and Tu (2012) in using the political risks of Vietnam as a proxy for country risk. The data can be obtained from the website of Political Risk Services at [http://www.prsgroup.com/ICRG\\_Methodology.aspx](http://www.prsgroup.com/ICRG_Methodology.aspx).

Market potential is a crucial factor in entry mode selection. A country with a rapid and stable economic growth rate encourages foreign-invested firms to commit all their financial resources to development, and thus establish a company with 100% foreign capital (Agarwal and Ramaswami 1992). We employ Vietnam's GDP growth rate in the year that an investment project is initiated as a proxy for market potential. This is the one-year GDP growth rate, and the data come from the General Statistics Office of Vietnam, at <https://gso.gov.vn>.

We also add a dummy variable to distinguish between manufacturing (coded as 1) and services (coded as 0) (Brouthers and Brouthers 2003). According to Erramilli and Rao (1993) (cited in Brouthers and Brouthers 2003), manufacturing firms often require higher capital investment than service firms. Investing in manufacturing requires a large amount of capital to build factories and buy equipment when entering a foreign country (Gatignon and Anderson 1988). Manufacturing firms that make large capital-intensive investment are assumed to prefer WOS to EJV because doing so helps them protect their business secrets better and avoid opportunistic behavior by joint venture partners.

Firm-specific factors include investment amounts, duration, project orientation and investment year as crucial factors in entry mode choice. Investment amount represents the financial commitment of a parent company to its subsidiaries (Wei et al. 2005). According to transaction cost theory, the level of financial commitment has a significant impact upon the market entry mode of foreign firms. When a small amount of capital is invested, WOS is a preferred option because it allows the parent company to control the subsidiary and retain the profits (Luo 2001). However, when the company participates in a large project and requires a large amount of investment capital, EJV can provide solid financial support, as well as share the risks with the local partners (Luo 2001). Therefore, a higher investment amount increases the likelihood that EJV is chosen for entry in Vietnam. Investment capital is calculated by total investment in a project (USD). The data come from the Ministry of Planning and Investment. We take the natural log of this variable to reduce the variable scale.

Investment duration is the period during which a foreign company commits to investment in the host country, and it is a source of bargaining power (Pan 1996). When the duration is short, foreign companies do not earn the necessary profits or exploit the full potential of the business. Therefore, foreign-invested firms with shorter investment duration are reluctant to choose WOS because they cannot obtain higher returns (Shan 1991). In this paper, investment duration is measured by the number of years that the project lasts. The data come from the Ministry of Planning and Investment.

Project orientation (exporting or serving the domestic market) affects the distribution strategy, marketing capability and performance of MNCs, and this affects the company's governance structures, as well as the entry mode selection (Luo 2001). If a project is set up to serve the domestic market, it interacts with the domestic environment more deeply than an export project. Partnering with local companies can reduce the risk of change in the domestic business environment. Most business transactions in emerging economies are based on relationships with individuals or organizations, and consumers tend to be loyal to businesses that have long experience (Xin and Pearce 1996) (cited in Luo 2001). Collaboration with local companies is necessary for MNCs seeking local market expansion. However, when a project is export-oriented, contributions by local companies become less important. Instead, MNCs can choose 100% foreign capital to facilitate business processes (Luo 2001). This variable is a dummy variable. It takes a value of 1 if the investment project is for exporting purposes, and 0 if the investment project only serves the domestic market.

Investment year has a significant impact on the entry mode choice of the firms. In 2008, after it became a member of the World Trade Organization (WTO), Vietnam increased its socio-economic achievements and created a favorable business environment for domestic and foreign investors. For example, Vietnam's GDP growth rate in 2018 was 7.08%, the highest since 2008, making Vietnam one of the fastest-growing countries in the region and the world (GSO 2018). In addition, the introduction of an Investment Law in 2014 has contributed to an improvement in the investment climate in Vietnam. Therefore, investors are more confident about choosing WOS as an entry mode. This variable is also a dummy variable. It takes a value of 1 for the period after 2008, when Vietnam joined the WTO; otherwise, 0.

### 3.3. Analytical Methodology: Logit Regression Model

Based on the measurement of dependent variable described in Section 3.2, we employ the Logit (logistic unit) regression model to examine the impacts of cultural distance between Vietnam and investing countries on the entry mode selection of FDI firms. The Logit regression model allows us to explain the actual coefficients in the model. The estimation model can be described with the equation:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 + \beta_7 X_7 + \beta_8 X_8 + \varepsilon$$

where

Y is the entry mode choice of foreign-invested firms (Y = 1 for EJV, and Y = 0 for WOS)

$\beta_0$  is the intercept

$\beta_1$  is the regression coefficient of cultural distance

$X_1$  is the value of the cultural distance variable

$\beta_{2 \rightarrow 8}$  is the regression coefficients of other control variables (country risk, market potential, investment capital, duration, project orientation, industry, WTO)

$X_{2 \rightarrow 8}$  is the value of control variables

$\varepsilon$  is the error term

## 4. Results and Discussion

### 4.1. Descriptive Statistics

Table 1 describes the means, standard deviation (SD) and correlations for the entry mode choice of foreign-invested firms in Vietnam. The average capital investment of a project is USD 5.1 million, and the average project duration is 22 years. About 2% of foreign-invested projects in Vietnam are for exporting. About 83% of projects in Vietnam with foreign investment post-date Vietnam's WTO membership.

**Table 1.** Mean, Standard Deviation, and Correlation ( $n = 5236$ ).

	VIF	Mean	Std. Dev	1	2	3	4	5	6	7	8	9
1. Entry mode		0.22	0.41	1								
2. Culture distance	1.02	0.89	0.58	−0.03	1							
3. Country risk	1.72	0.80	0.03	−0.004	−0.02	1						
4. Market potential	2.45	6.18	0.64	−0.03	−0.01	0.4	1					
5. Investment Capital	1.10	5.1	6.55	0.07	−0.09	0.1	0.04	1				
6. Duration	1.23	22.11	16.67	0.02	−0.05	−0.02	0.33	0.17	1			
7. Project orientation	1.13	0.02	0.15	−0.07	0.03	0.18	0.26	0.001	−0.0006	1		
8. Industry	1.12	0.239	0.42	−0.08	−0.06	0.23	0.15	0.18	0.02	0.15	1	
9. WTO	3.08	0.83	0.375	0.01	−0.004	−0.62	−0.72	−0.10	−0.13	−0.31	−0.23	1

In terms of market potential, Vietnam's economic growth rate in the period 2005–2016 was 6.18%. Vietnam is considered a country with low political risk, and the average level of political risk in that period was 0.8.

Regarding the cultural distance between Vietnam and the investment country, Vietnam has the lowest cultural difference (minimum value is 0.07) with countries in Southeast Asia, such as Brunei, Cambodia, Myanmar and Indonesia. The cultural gap increases in the sample with European countries and the US. Vietnam has the largest cultural gap (2.34) with Nigeria.

#### 4.2. Results of Regression Models

The findings in our research contribute to a general understanding of the entry mode selection in emerging countries.

In cross-sectional data regression, heteroskedasticity may be a serious problem that we need to address. To deal with heteroskedasticity, we use a White heteroskedasticity consistent covariance matrix for each coefficient standard error. In addition, the variance inflation factor (VIF) test provides no evidence of multicollinearity in our model (Hair et al. 2016). We include four regression models to examine the impacts of country-specific factors, firm-specific factors, and industry factors on entry mode choice. The estimates remain robust in term of significant level and sign. The Pseudo- $R^2$  has improved from 0.0022 in model 1 to 0.0230 in model 4. Therefore, we choose model 4 as our final model to interpret the results.

In H1, we assume that the greater the cultural distance between Vietnam and the investing countries is, the more likely it is that foreign investors will choose WOS over EJV as an entry mode. Regression results in Table 2 support this hypothesis: When cultural difference increases by one percentage point, the probability of selecting WOS increases 1.8%. The finding is consistent with transaction cost theory, which emphasizes that the structure chosen by a firm with foreign investment is affected by a desire to minimize the transaction costs (Anderson and Gatignon 1986; cited in Luo 2001). These transaction costs include the cost of drafting contracts, negotiating with business partners, and monitoring the partner (Luo 2001). When the transaction costs are high, firms are more likely to select WOS as an entry mode because it enables them to operate independently and to avoid opportunistic behavior by their local partners. For example, in Vietnam, in the era of doi moi, foreign investors preferred joint ventures to WOS because this investment form helped them to overcome inefficient government bureaucracy and gain more market information from their local partners and it also had a lower sunk cost for new entrants (Simonet 2012). However, joint ventures have many disadvantages, such as lacking flexibility, and many joint venture companies ended up in litigation. For example, Sapharco bought the share of its French partner to change Roussel Vietnam into a 100% locally-owned enterprise in 2002 (Simonet 2012). In this kind of situation, great cultural difference and inefficient cooperation with local counterparts encourages foreign investors to select WOS to ensure a lower failure rate. According to Simonet (2012), the overall failure rate of foreign-invested firms from 1988 to 1997 was 16% (694 out of 4514 projects were dissolved), and the failure rate of joint venture projects is twice as high as the overall rate. New foreign investors in Vietnam hear stories about unsuccessful EJV from previous investors. Therefore, they prefer WOS for entry. In 2015, the share of WOS in investment in Vietnam was high, comprising 70.5% of investment projects compared to 3.8% that were EJV (Ministry of Planning and Investment 2015).<sup>1</sup> The same was seen in China, where in 2004, WOS made up 65% of investment projects, whereas EJV accounted for 30% (Simonet 2012). Our findings suggest that the cultural distance between home and host transition country is an important factor to consider when foreign-invested firms want to invest in a transition country with a high level of uncertainty. The study contributes to the discussion of entry mode selection in transition countries.

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<sup>1</sup> This information comes from <http://www.mpi.gov.vn/en/Pages/tinbai.aspx?idTin=38605&idcm=109/>.



**Table 2.** The Effect of Cultural Distance on the Entry Mode Choice of Foreign-Invested Firms in Vietnam (Marginal Effect of the Logit Model).

	Model 1	Model 2	Model 3	Model 4
<b>Country-Specific Factors</b>				
Cultural distance	−0.022 *** (0.01)			−0.018 *** (0.009)
Country risk	0.107 (0.15)			0.146 (0.18)
Market potential	−0.025 ** (0.009)			−0.032 ** (0.013)
<b>Industry-Specific Factors</b>				
Industry sector		−0.08 * (0.01)		−0.09 * (0.01)
<b>Firm-Specific Factors</b>				
Investment amount			0.015 * (0.003)	0.017 * (0.003)
Duration			0.0003 (0.0003)	0.0005 (0.0003)
Project orientation			−0.192 * (0.017)	−0.182 * (0.02)
Year of investment			0.006 (0.01)	−0.048 *** (0.02)
No. of obs.	5194	5236	5236	5194
Wald chi-square (Prob. > chi-square)	12.10 (0.0070)	40.48 (0.0000)	43.91 (0.0000)	93.95 (0.0000)
Pseudo chi-square	0.0022	0.0079	0.0118	0.0230

Notes: \* significant at 1%, \*\* significant at 5%, \*\*\* significant at 10%. White heteroskedasticity consistent standard errors are reported in parentheses. Industry sector: Manufacturing (coded as 1) and services (coded as 0).

As hypothesized, we find that manufacturing firms prefer WOS to EJV, and service firms are more likely to select EJV over WOS. This is because manufacturing firms often require greater capital investment than service firms (Erramilli and Rao 1993). Selecting WOS allows foreign-invested firms to enjoy lower transaction costs and avoid opportunistic behavior by joint venture partners (Brouthers and Brouthers 2003).

These findings support Shieh and Wu (2012), who find that investors in Vietnam in the Greater Chinese Economic Region were more likely to select WOS when investing in manufacturing, and EJV in services.

The regression results show that markets with greater potential have a higher likelihood that investors will select WOS over EJV. A country with a fast and stable economic growth rate encourages foreign investors to commit resources toward its development. In this context, market potential stimulates investors to establish WOS in order to maximize profits (Agarwal and Ramaswami 1992). The finding is consistent with those in previous empirical studies (Hill et al. 1990).

As expected, foreign-invested enterprises with high investment capital are more likely to choose EJV over WOS to share the risks with domestic partners. When capital investment increases by 1%, the likelihood that a foreign-invested firm will choose EJV as its entry mode increases by 1.7%. Investment capital represents the financial commitment of the parent company to the subsidiary (Wei et al. 2005). According to transaction cost theory, financial commitment has a significant impact on the market entry mode of foreign-invested enterprises. When a relatively small amount of capital is being invested, WOS is the preferred option, as this form of investment allows the parent company to fully control the subsidiary and retain all of the profit (Luo 2001). However, when the company participates in a large project and requires a large amount of capital investment, EJV can provide solid financial support and help to share risks with local partners (Luo 2001). This result is similar to those in previous studies (Kogut and Singh 1988; Tsang 2005; Shieh and Wu 2012).

The coefficient of the project orientation variable is negative and statistically significant at 1% with the entry mode choice. This means that if the project is established for the purpose of exporting, foreign-invested firms choose WOS. If a project is set up to serve the domestic market, it will certainly interact more intensively and extensively with the domestic environment than an export project (Luo 2001). Partnering with local companies can help reduce the risks of change in the domestic business environment and explore business potential. However, when a project is export oriented, the contributions of local companies will become less important. Instead, MNCs choose WOS to facilitate business processes.

We conjecture that foreign investors would be more likely to choose WOS over EJV after Vietnam joined the WTO. Regression results in Table 1 support this hypothesis. After becoming an official WTO member, Vietnam had great socio-economic achievements and created a favorable business environment for domestic and foreign investors. Thanks to significant changes in the investment environment, foreign investors feel more secure when investing in Vietnam and selecting WOS.

However, we do not find a statistically significant relationship between country risk and entry mode choice in Vietnam. This is because Vietnam has low investment risk (especially political risk). The political risk index fluctuates over a range of only 0.76–0.86. Therefore, the investors do not consider political risk an important factor when choosing their entry mode in Vietnam.

We expect that if the investment duration is long, the likelihood that investors will choose WOS is higher than that of EJV. Our regression results do not support this hypothesis. The duration variable is not statistically significant in the model.

## 5. Conclusions

This study broadens our knowledge of the entry mode choice of foreign-invested firms in a transition economy, in this case, Vietnam. The study is based on transaction cost theory to explore the link between cultural difference between Vietnam and investing countries and their entry mode selection. We employ a novel dataset of 5236 foreign-invested firms in Vietnam from 2005 to 2016, and our empirical results indicate that foreign-invested firms prefer WOS over EJV when the cultural difference between Vietnam and their home country is large. The study contributes to a general understanding of the investment strategy of foreign-invested firms and academic discussion of the entry mode in many ways. First, although cultural distance is widely accepted as having a significant influence on the entry mode choice, the question of whether a high level of cultural difference is connected with the choice of WOS or EJV in Vietnam remains unanswered. Our paper fills the research gap.

Our findings are consistent with transaction cost theory, which emphasizes that the structure chosen by a foreign-invested firm is affected by a desire to minimize the transaction cost. When the cultural distance and transaction costs are high, firms are more likely to select WOS as their entry mode because it enables them to operate independently, and to avoid opportunistic behavior by their local partners. Second, our findings have practical implications for the Vietnamese government. Given that a larger cultural distance leads to more WOS selection by foreign investors, this investment form hinders the positive spillover effects of transferring advanced technology, as well as good management practices. This is because the establishment of WOS makes it easy for MNCs to engage in production and minimize the risk of technology exposure to domestic firms. In fact, for many years, Vietnam has encountered many difficulties in promoting technology transfer, as well as learning advanced technology from foreign firms (Ministry of Planning and Investment 2015). The Vietnamese government should improve the investment climate and the quality of governance if it wishes to attract foreign firms to establish EJV with domestic firms.

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