

Kawai, Norifumi; Jonas, Manja

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Ownership strategies in post-financial crisis Southeast Asia: The case of Japanese firms

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**Ownership Strategies in Post-Financial Crisis
Southeast Asia:
The Case of Japanese Firms**

Norifumi Kawai, Manja Jonas

Institut für Ostasienwissenschaften (Institute of East Asian Studies)
Universität Duisburg-Essen
Campus Duisburg
D-47048 Duisburg, Germany
Tel.: +49-203-379-4191
Fax: +49-203-379-4157
e-mail: in-east@uni-duisburg-essen.de

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Norifumi Kawai, Manja Jonas

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Abstract/Zusammenfassung

Existing research on entry mode determinants is firmly grounded in the transaction cost and resource-based literature while location-and institution-specific characteristics lack attention. The primary goal of this article is to address the determinants of entry mode by Japanese manufacturing firms in Southeast Asia after the financial crisis on the basis of a theoretical framework that integrates firm-specific, industry-specific, location-and institution-specific factors. Results show that locational factors make significant contributions to the understanding of the entry mode selection of MNEs and partly override the effect of firm-specific factors.

Keywords/Schlagwörter

Entry mode; transaction costs; resource commitment; location factors; country risk; Japanese manufacturing firms; Southeast Asia

Universität Duisburg-Essen
Campus Duisburg
Institut für Ostasienwissenschaften, Geschäftsstelle
D-47048 Duisburg

Ownership Strategies in Post-Financial Crisis Southeast Asia: The Case of Japanese Firms

Introduction

The selection of a multinational's ownership structure abroad is one of the most important strategic decisions affecting both corporate performance and the speed of its internationalization process (Palenzuela and Bobillo 1999; Chang and Rosenzweig 2001; Zhao and Luo 2002; Woodcock, Beamish et al. 1994; Makino and Beamish 2001; Douma, George et al. 2006). To date, empirical research on ownership structure is skewed toward Japanese or European multinational enterprises (MNEs)' entry into the US (Hennart 1991; Hennart and Park 1993; Hennart and Reddy 1997; Hennart and Larimo 1998; Chen and Hennart 2002; Nisbet, Thomas et al. 2003), into Europe (Somlev and Hoshino 2005; Cleeve 1997) and into China (Shi, Ho et al. 2001; Tsang 2005; Claver and Quer 2005). Despite the importance of Japanese firms' production activities in Southeast Asia, there are few studies done pertinent to Japanese MNEs' ownership strategy in the region in the post-crisis period in particular. This gap should be narrowed for two reasons: First, Japanese MNEs need a clear understanding of the factors to be taken into account, when planning a new investment project. The pattern of ownership behaviour of their peers provides valuable guidance to follower firms in such a difficult setting as post-crisis ASEAN, where the crisis destroyed many received truths about what might constitute an appropriate strategy. And second, host governments often take a keen interest in the ownership structure of their foreign investors. It is not by chance that many ASEAN governments share a history of restricting foreign ownership some way or other. They believe that FDIs tend to be more beneficial for host countries, e.g. in terms of technology transfers, if local equity partners are involved. Thus, they should be very interested in the determinants of ownership preferences by MNEs in order to align their economic policies accordingly.

The objective of this paper is to shed light on the current set of determinants of the ownership decision of Japanese foreign direct investments (FDIs) in Southeast Asia. Japan has been an important source of FDI in the region for many years. Between 1995 and 2004 it accounted for 14% of the inflows, second only to the US with 18% (ASEAN-Japan Centre 2006). It even topped the list for the Philippines, Thailand and Vietnam in the period. We focus on a single home country, since MNEs have been shown to retain many factor

endowments, which are specific to their home country (for a typology see Borrus 1996: 30; for Japanese MNE, e.g. Hatch and Yamamura 1996).

The paper proceeds as follows. The second section provides an overview of recent trends in FDI and investment policy in Southeast Asia. The third section presents our theoretical framework based on a review of the literature on FDI ownership structures. After specifying our econometric model in section four, the fifth section presents the empirical results. The findings are discussed in section 6, and section 7 concludes.

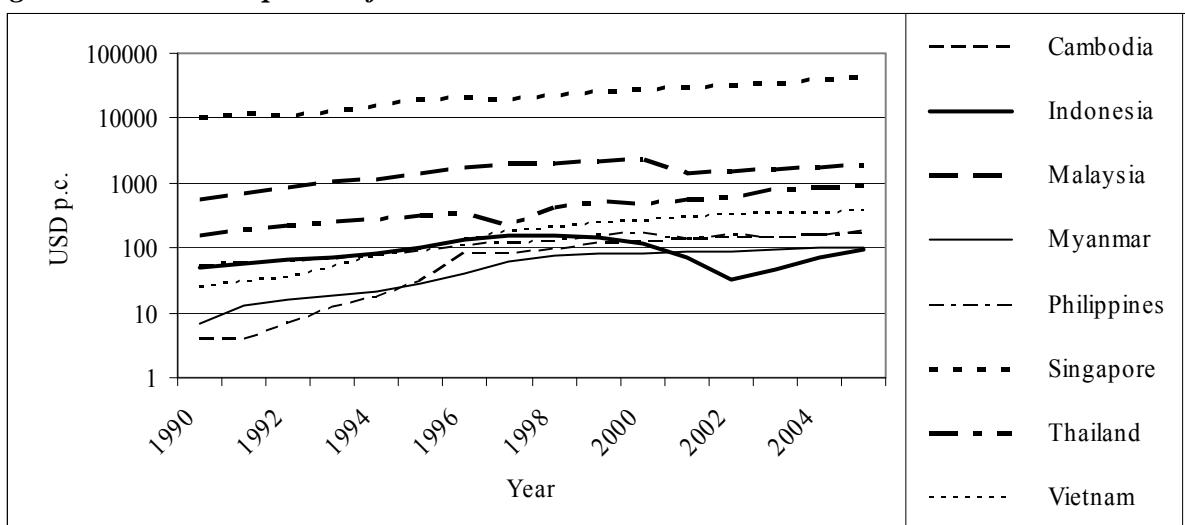
Recent trends of FDI and investment policy in Southeast Asia

This section highlights a number of key features of investment policy and recent FDI flows into the region.

Trends in FDI flows

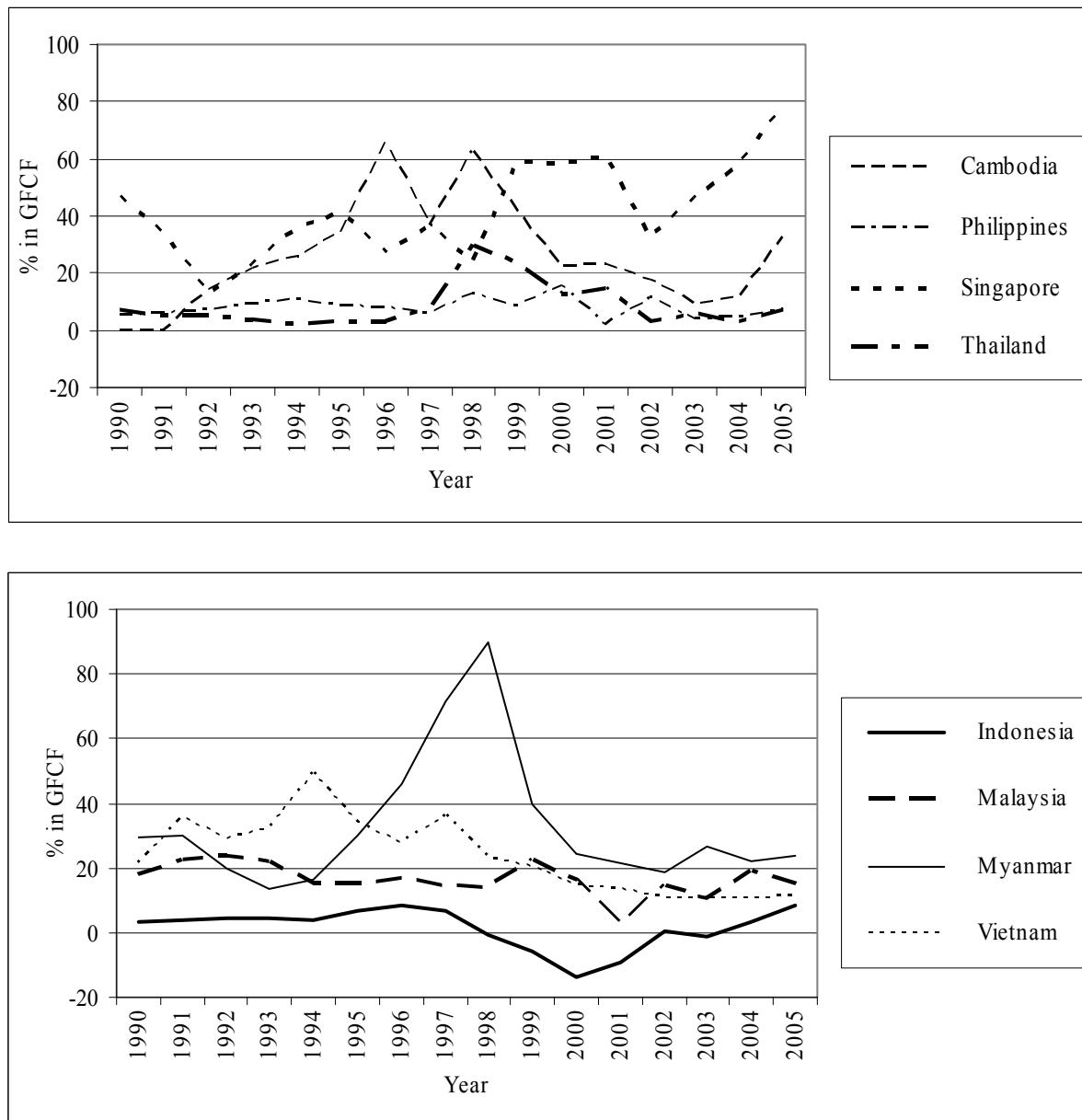
In the early 1990s Southeast Asia emerged as a core investment location for FDI in the developing world. In 1996 the share in developing country FDI stock reached a maximum of 23% before declining relatively to 14% in 2005. In this year, of the 35% of world total FDI flows targeted at developing countries, 11.5% still came to the region. Absolute stocks were rising almost continuously over the period, standing at 375 billion USD in 2005 (UNCTAD 2007). However, while total stocks have been soaring, the distribution among individual countries is markedly uneven. Figure 1 illustrates on a logarithmic scale the leading role of Singapore. Malaysia and Thailand follow at a large distance, while Indonesia has clearly fallen behind.

Figure 1: The Development of FDI Stocks in Southeast Asian Countries



Source: UNCTAD (2007)

Figure 2: The Importance of FDI for Gross Fixed Capital Formation in Southeast Asian Countries

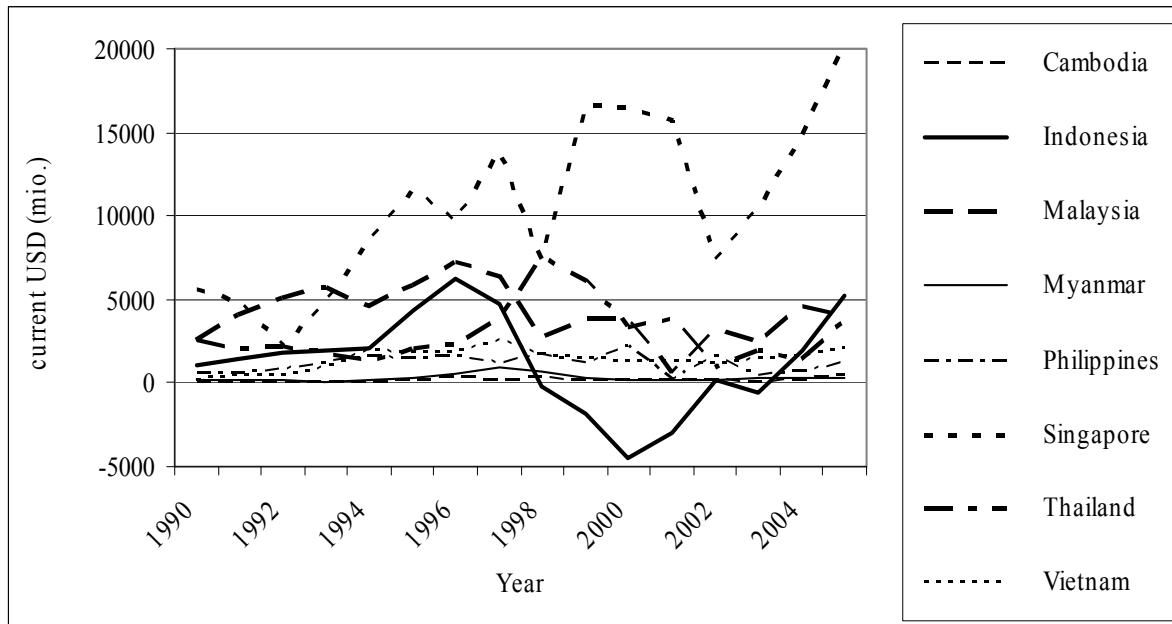


Source: UNCTAD (2007)

FDI dependency, measured as the share of FDI in the Gross Fixed Capital Formation, also varies widely. Singapore is now almost completely depending on foreign capital for its economic accumulation. In many countries dependency has been dropping in recent years, showcasing a widespread policy reorientation with the aim to reduce vulnerability from globalized financial markets. But interestingly, the data in Figure 2 suggests that FDI actually helped stabilizing the capital formation during the Asian crisis in a number of countries, such as Myanmar, Cambodia and Thailand. Even if there obviously have been cases of swift divestments, such anecdotal evidence is hardly supported by the macro figures.

A sketch of absolute annual FDI inflows (Figure 3) supports the emerging picture. Singapore is - and has been for many years - the largest receiver of FDI inflows in the region. In many countries the development seems to stagnate, with two noteworthy exceptions: While Vietnam has been emerging as a new investment location during the 1990s and levelling off in recent years, the period between 1998 and 2003 marked intense fluctuations in Indonesia, even leading to net investment outflows.

Figure 3: The Development of FDI Flows into Southeast Asian Countries in Absolute Figures



Source: UNCTAD (2007)

Of Japan's 5 trillion Yen of FDI outflows in 2005, 11% have gone to Association of Southeast Asian Nations (ASEAN). Japanese outward investment is generally dominated by the manufacturing sector (57% of total FDI flows in 2005), in ASEAN it accounts for 45% followed by financial services at 30% and trade/commerce at 6% (Statistics Bureau 2007; ASEAN-Japan Centre 2006). The distribution across manufacturing industries and host countries is highlighted by Figure 4. It shows that resource-based industries concentrate investment in Indonesia and Thailand, while process industry investments tend to cluster in Malaysia, the Philippines, Singapore and Thailand. Japanese firms investing in the textile industry are concentrated in Malaysia, Thailand and Vietnam.

Figure 4: The Industrial Distribution of Japanese Manufacturing FDI in Southeast Asia across Host Countries (in 2004)

| | Total | ASEAN | Brunei | Indonesia | Laos | Malaysia | Myanmar | Philippines | Singapore | Thailand | Vietnam |
|-------------------------------|---------|-------|--------|-----------|------|----------|---------|-------------|-----------|----------|---------|
| Manufacturing | 2,886.6 | 432.0 | 0.1 | 111.5 | 0.1 | 35.0 | 2.0 | 61.3 | 69.3 | 132.8 | 20.2 |
| Food | 187.3 | 78.8 | | | | | | | | | |
| Textile | 45.5 | 8.9 | | | | | | | | | |
| Lumber and Pulp | 95.3 | 67.7 | | | | | | | | | |
| Chemicals and Pharmaceuticals | 375.5 | 44.8 | | | | | | | | | |
| Petroleum | 55.2 | -42.5 | | | | | | | | | |
| Rubber and Leather | 92.5 | 21.1 | | | | | | | | | |
| Glass and Ceramics | 27.0 | 25.7 | | | | | | | | | |
| Metals | 148.0 | 23.8 | | | | | | | | | |
| General Machinery | 145.4 | 26.8 | | | | | | | | | |
| Electric Machinery | 480.9 | 30.0 | | | | | | | | | |
| Transportation Equipment | 946.1 | 111.4 | | | | | | | | | |
| Precision Machinery | 155.2 | 23.4 | | | | | | | | | |

Notes:

In billion Yen

Shaded fields refer to sector-country combinations accounting for more than 10 % of investment in respective categories

 country

 sector

 country and sector

Source:

ASEAN-Japan Centre (2006)

According to the *Toyo Keizai Kanigai Shinshutsu Kigyo Sōran* there have been a total of about 450 new manufacturing investments of Japanese firms in Southeast Asia in the period between 1998 and 2004 (Toyo Keizai Inc. 1998-2004). With only a few exceptions, these investments are concentrated in only 6 countries. Available ownership information, which refers to 318 establishments, shows an absolute majority of wholly-owned subsidiaries and a roughly equal distribution of the remainder between Joint ventures with and without local company participation (see Table 1).

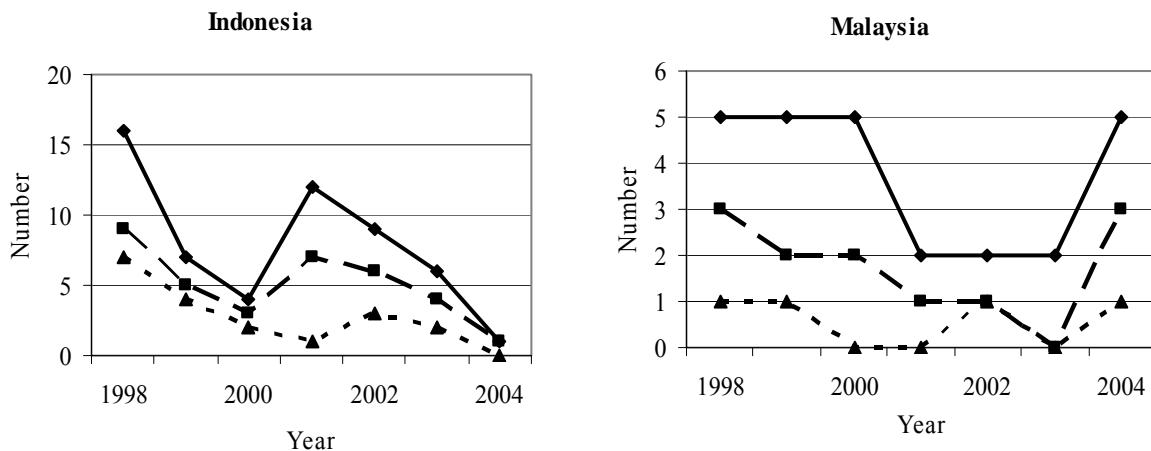
Table 1: Distribution of Japanese Manufacturing Investments in Southeast Asia

| | Wholly-owned subsidiaries | Wholly foreign-owned Joint Ventures | Local-foreign Joint Ventures | Total |
|--------------------|------------------------------|--|---------------------------------|-------|
| Cambodia | 0 | 0 | 1 | 1 |
| Indonesia | 20 | 17 | 18 | 55 |
| Malaysia | 14 | 8 | 4 | 26 |
| Myanmar | 0 | 0 | 2 | 2 |
| Philippines | 31 | 1 | 8 | 40 |
| Singapore | 16 | 4 | 2 | 22 |
| Thailand | 69 | 23 | 39 | 131 |
| Vietnam | 22 | 8 | 11 | 41 |
| Total | 172 | 61 | 85 | 318 |

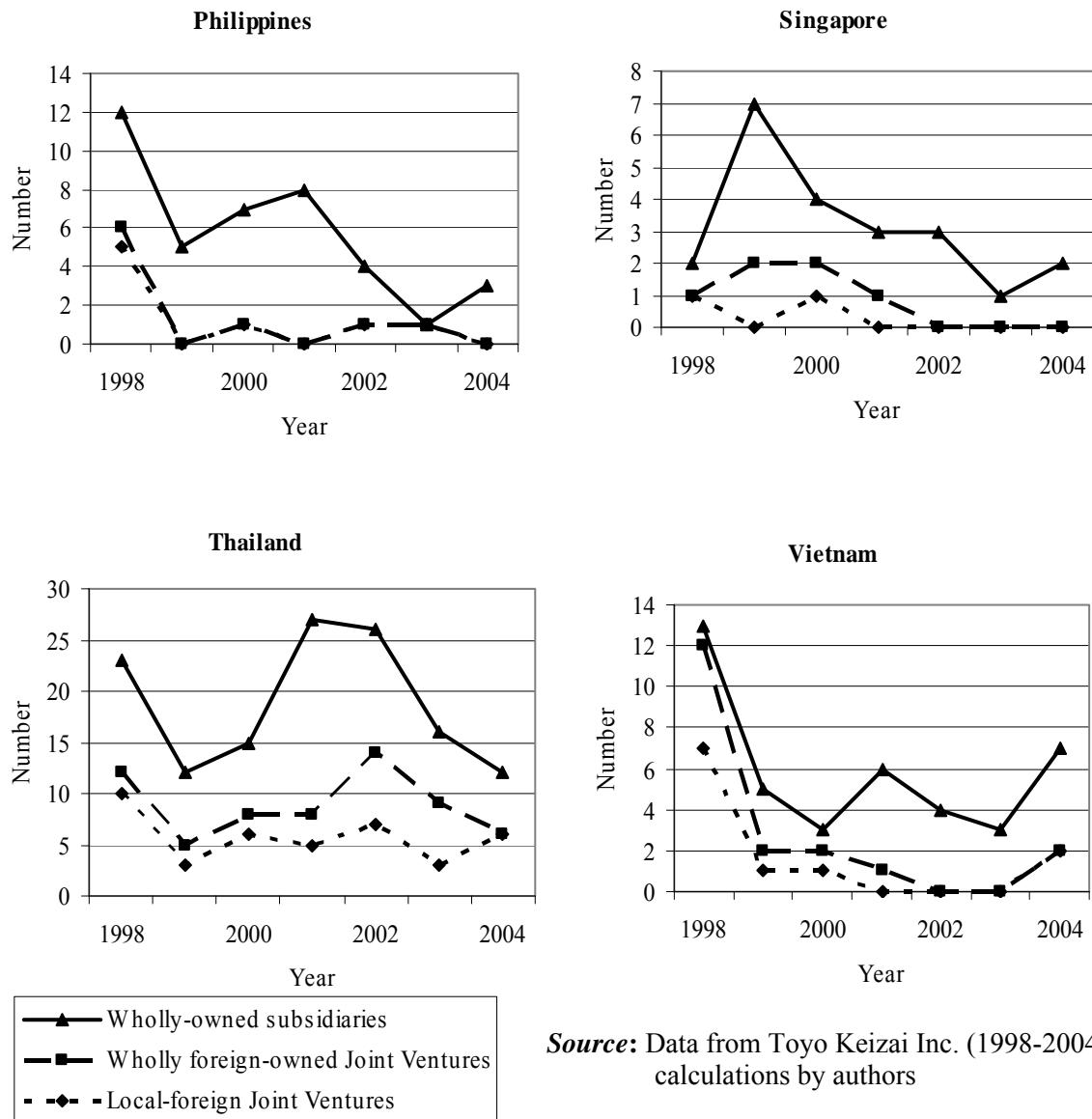
Source: Toyo Keizai Inc. (1998-2004), calculations by authors

Figure 5 illustrates that there is no clear tendency over time towards any of the investment modes, even if wholly-owned subsidiaries were briefly dominant around the year 2001. There are differences according to country, however. Vietnam experienced a significant shift towards the wholly-owned investment mode and towards wholly-foreign-owned modes in general¹. Indonesia, Thailand, Cambodia and Myanmar show a consistently high ratio of investments with local equity participation, and Indonesia as well as Malaysia have disproportionately many foreign equity joint ventures (JVs).

Figure 5: Distribution of Investment Modes 1998-2004 (stacked)



¹ ANOVA analysis of establishment year of investments with a certain entry mode yields $p=0.0001$ and $p=0.0549$ respectively.



Source: Data from Toyo Keizai Inc. (1998-2004), calculations by authors

A number of locational factors have been discussed as potential determinants of entry mode choice. Prominent among them are the investment policies and public institutions bearing on the local investment climate. The following paragraphs provide an overview over a number of the policy and institutional characteristics of the ASEAN countries.

Investment policy and climate

A general perceptive picture of the business and investment climate in ASEAN countries can be gleaned from the Heritage Foundation Economic Freedom Index and its components (see Table 2). What strikes about most of the component indices is their high correlation with the overall score, which indicates either the existence of an underlying variable such as administrative capacity, or a bias introduced with the methodology of subjective measures.

The only exception is the business freedom sub-index, where Vietnam and Laos perform much better than their overall score.

Table 2: Investment Freedom

| Country | World Rank | Overall score | Business Freedom | Investment Freedom | Property Rights | Freedom from Corruption | Labour Freedom |
|-------------|------------|---------------|------------------|--------------------|-----------------|-------------------------|----------------|
| Singapore | 2 | 85.7 | 94.6 | 80 | 90 | 94 | 99.3 |
| Malaysia | 48 | 65.8 | 68.6 | 40 | 50 | 51 | 89.5 |
| Thailand | 50 | 65.6 | 76.1 | 30 | 50 | 38 | 90.4 |
| Philippines | 97 | 57.4 | 54.2 | 30 | 30 | 25 | 60.7 |
| Cambodia | 102 | 56.5 | 37.1 | 50 | 30 | 23 | 67.7 |
| Indonesia | 110 | 55.1 | 45.7 | 30 | 30 | 22 | 67.5 |
| Vietnam | 138 | 50 | 62 | 30 | 10 | 26 | 59.3 |
| Laos | 140 | 49.1 | 51 | 30 | 10 | 33 | 53.5 |
| Myanmar | 153 | 40.1 | 20 | 10 | 10 | 18 | 20 |

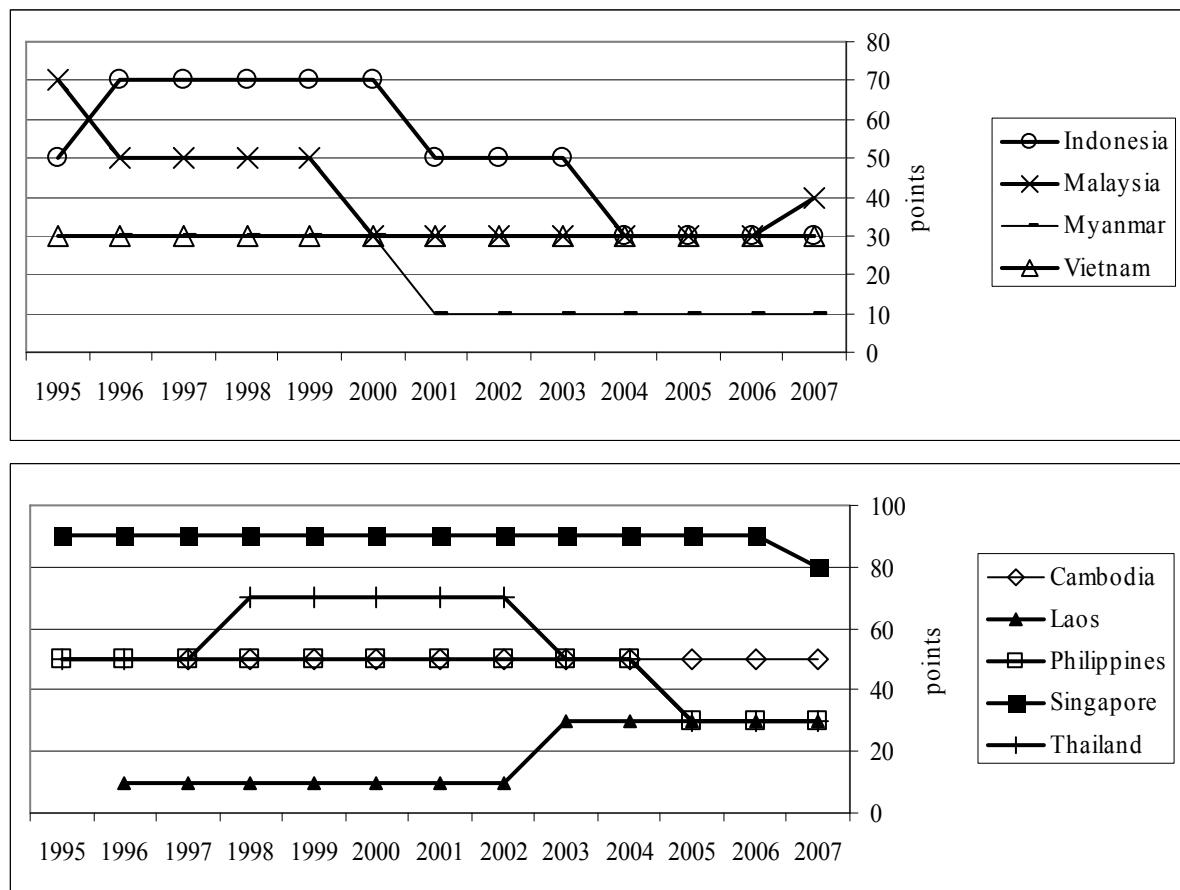
Notes: The business freedom and labour freedom scores are calculated from the World Bank's objective Doing Business Indicators. The Freedom from corruption indicator equals the tenfold Corruption Perception Index of Transparency International.

Source: Heritage Foundation (2007)

The investment policy in ASEAN countries is assessed by the Heritage Foundation indicator on investment freedom (see Figure 6). The values of this perceptive measure are relatively stable over time. While providing for convenient comparisons, as a one-dimensional measure it clearly suffers from over-simplicity. So, it is not able to capture many of the detailed reforms in the investment regimes of FDI host countries. We will therefore complement presentation of the measure with a verbal treatment of the individual country cases.

Myanmar maintains the most restrictive policies towards FDI in ASEAN. While there is a Foreign Investment Law since 1988, and either the cabinet or the Trade Policy Council occasionally issues investment permissions, an informal ban on the issuance of new business licenses has virtually brought FDI to a halt in 2002. Moreover, all operations are subject to ubiquitous corruption. On the other hand, corruption opens a pathway for a few well-connected investors to dodge regulations. Overall, Japanese firms have a total of only 22 FDI projects permitted by the Myanmar government, the number of actual investments being unpublished (U.S. Commercial Service 2007a; Heritage Foundation 2007).

Figure 6: Investment Freedom



Source: Heritage Foundation (2007)

Laos has improved its policies towards foreign investors in recent years, but it still remains an overtly socialist country with strong regulation of private business. 163 days and 8 different procedures to open a business put a large burden on interested foreign investors. Gradual improvements result from the 2004 Law on the Promotion of Foreign Investment, which in principal opened non-strategic sectors to FDI. But still intellectual property rights (IPR) legislation and the overall investment climate are rated as being poor. The main institutional obstacle seems to lie in inconsistent and arbitrary implementation of existing laws and regulations in combination with serious corruption. (U.S. Commercial Service 2005; Heritage Foundation 2007).

Vietnam is another socialist one-party state, but it has shown improvements in regulation and deregulation during the last decade. The fundamental difference to the above countries may be that Vietnam has started to consciously embrace FDI as a possible conduit for economic development. Since the country implemented its Enterprise Law in 2000, the number of days needed to start a business has been brought down to 50. In 2005, a common Investment Law was passed levelling the playing field for domestic and foreign investment. Still, large-scale

FDI projects (above app. 19 mil. USD) and investments in specific sectors have to be approved by the Ministry of Planning and Investment and other government bodies. With a larger number of involved parties, the severe corruption problem makes itself felt more by enterprises. At least, smaller projects in non-restricted sectors can be licensed on the provincial level since 2006. On the positive side, proactive provincial governments have significantly streamlined their procedures, while on the flipside uncertainty may have increased through decentralization. Taken together, Vietnam has clearly improved its institutional environment for FDI, which, surprisingly, is not yet reflected by the investment freedom sub-index so far (U.S. Commercial Service 2007f; Heritage Foundation 2007).

Indonesia's track record with regard to investment conditions is rather mixed. Generally, it is open to foreign investment, except for 19 industries, which were closed for investments in 2000. Administrative procedures to obtain necessary permits remain time-consuming and complex. In 2003 a copyright law took effect, which improved IPR protection to a point, where improvements were recognized by the US government. This does not mean, however, that the problem is solved, as long as producers still claim that the majority of CDs, for instance, continues to be pirated. Indonesia's tradition of vaguely formulated laws and regulations has always offered opportunities for rent seeking and arbitrary bureaucratic action. The situation has even worsened with the IMF-induced decentralization drive following the Asian financial crisis. Before, government behaviour was said to follow a roughly predictable pattern. Decentralization has then multiplied the number of agencies with some sort of authority, leading to a situation, where corruption became partly deinstitutionalized intensifying business risk (U.S. Commercial Service 2007b; Heritage Foundation 2007).

Cambodia's law on investment dates back to 1994. Since then a largely free investment climate offered near-unlimited access for foreign capital, only in a few sectors have minor restrictions been subsequently put in place. Liberal laws as such do not, however, guarantee smooth and efficient administrative procedures. Low administrative capacity leads to lengthy procedures of around 97 days when registering a new company. While intellectual property rights protection is still in its infancy, physical property rights are usually honoured, even though the judicial system is judged to be too corrupt to provide adequate protection, . (U.S. Commercial Service 2003; Heritage Foundation 2007).

Much of what has been said on Cambodia equally applies to the *Philippines*. The Foreign Investment Act from 1991 is similarly non-discriminatory. Two extensive negative lists pose notable restrictions on FDI, but around 40 bilateral investment agreements remove many

obstacles. Unfortunately, just as in the case of Cambodia, this advantage is set off by high levels of corruption and an ineffective judicial system. An intellectual property codes is in effect since 1997 but enforcement remains relatively weak (Heritage Foundation 2007; U.S. Commercial Service 2007g).

Thailand used to follow a generally open investment policy with foreign ownership restrictions limited to 32 professions as well as extra-industrial estate land. Investment in five technology-intensive priority sectors in recent years even became encouraged through provision of special incentives. Procedures for opening a business are taking just over a month and are therefore relatively swift. The Foreign Business Act from 1999 is now under revision to introduce constraints on more sectors and on foreign ownership above 50% of equity. The judiciary system is independent and functioning satisfactorily, even in the field of IPR protection (U.S. Commercial Service 2007e; Heritage Foundation 2007).

Malaysia is similar to Thailand in its investment regime and administrative as well as judicial capacity. However, it should be noted that the main difference between the two countries is that in Malaysia the affirmative action in favour of the Bumiputera (or indigenous) population penetrates all areas of economic policy. FDI used to be affected most by a requirement for Bumiputera equity participation of 30 percent. Since the strict requirement was loosened in 2003, Bumiputera participation has been important for the evaluation of licence applications. The foreign investment conditions have always been managed through administrative procedures instead of laws. Many investment projects, especially those with high technological content or location in remote areas benefit from substantial incentives, which are not transparently spelled out subject to negotiations with the Malaysia Industrial Development Authority and the decision-making high-level government committees. The judicial and bureaucratic system is generally effective, with some problems of corruption or insufficient implementation (Heritage Foundation 2007; U.S. Commercial Service 2007c).

Singapore undisputedly has the most advanced systems in place to govern FDI. The administration has a reputation of being highly effective, and all sub-systems are conducive to foreign investment. FDI generally benefits from equal status as local investment (U.S. Commercial Service 2007d; Heritage Foundation 2007).

In sum, the ASEAN countries represent a diverse range of investment regimes, which renders the region an ideal object of analysis of the locational characteristics influencing entry mode strategies of Japanese firms. We now turn to the existing literature in order to highlight earlier findings on what characteristics may exert significant influence.

Analytical Framework of Entry Mode Selection

It is not unreasonable to say that MNE perspectives (transaction cost theory and resource-based view) have dominated over location-and institution-specific variations when discussing entry mode selection in a given location (Yiu and Makino 2002; Meyer and Nguyen 2005). Traditionally, proprietary assets (Hymer 1960) and internalization advantages (Rugman 1980) are emphasized in entry mode theory. However, since Dunning (1998) raised the concern that locational factors are neglected in entry mode research, location-and institution-specific factors have also been drawing increasing attention in recent years. In this section we review the literature with regard to two major entry modes: (1) full ownership and (2) shared ownership. We report on received views and - sometimes - offer alternative interpretations of existing theories concerning the impact of location-and institution characteristics.

One of the most important theories on entry mode selection is the transaction cost theory, from which the logic of internalization advantages is derived. Williamson (1985) claims that MNEs are likely to internalize technological knowledge, marketing skills and managerial know-how within their hierarchical organizations because transactions at arm's length tend to be costly and uncertain. We choose transaction cost theory as the basic foundation of our conceptual framework for the entry mode selection of MNEs. Entry in the form of wholly-owned subsidiaries (WOSSs) reduces the MNE's transaction costs of engaging in new ventures. Full ownership modes allow the parent to protect its intangible assets from market inefficiencies and failure while a high level of control over its new venture helps the parent company to implement desired strategies and achieve its goals. The advantages of a full ownership strategy are derived from notions of free-riding by project partners (Chang and Rosenzweig 2001; Madhok 2005), monitoring costs (Anderson and Gatignon 1986), and the issue of shirking (Gomes-Casseres 1989). To be more specific, full ownership modes enable the parent to independently dictate value systems, technological innovation, resource networks, organizational patterns, financial leverage and managerial methods of its local affiliates at a lower cost although it requires the longest time to establish the venture (Anderson and Gatignon 1986; Newburry and Zeira 1997; Chang and Rosenzweig 2001). Empirically, it is confirmed by previous scholarship (Delios and Beamish 1999; Yiu and Makino 2002) that contributed assets, as measured by advertising intensity and R&D intensity, exert a positive effect on Japanese firms' preference for full ownership.

Compared to full ownership, the form of JV places constraints on a firm's flexibility in coordinating and arranging local operations in the quest for the formation of global value chains (Meyer and Nguyen 2005). Such coordination problems become more difficult to solve

over time because business interests of one partner in the joint venture may gradually diverge from those of another (Palenzuela and Bobillo 1999; Chang and Rosenzweig 2001). Yiu and Makino (2002: 668-671) posit that the cost of integrating contributed assets by local partners into a new venture may exceed the benefit from “a free ride on their reputational capital” when their assets are intangible. MNEs wish to obtain local firms’ private information while local partners aim at absorbing proprietary assets from MNEs. Such diverging agendas appear to trigger the dissolution of JVs because both actors may suffer from the agency problem.

From the resource-based view, it is often discussed that a firm with poor international experience and regional networks is less likely to undertake full ownership entry because of insufficient knowledge on foreign operations, weak bargaining capabilities with local government officials, and cultural differences. Given these resource disadvantages, shared ownership can be more profitable because it acts as a strategic FDI device to overcome the liability of foreignness (Gatignon and Anderson 1988). Davidson (1980) buttresses the argument that cumulative experience gives rise to learning, which explains FDI behaviour of foreign firms. Delios and Beamish (1999) also found that more internationally experienced Japanese firms tend to choose higher equity ratios. Shared ownership allows foreign firms to benefit from synergetic effects through combining their own organizational and managerial capabilities with required resources, such as extensive local distribution networks and knowledge of consumer preferences in local markets, which lie in the hands of potential partners. In financial terms, shared ownership is generally preferable since each JV parent only has partial financial responsibility over the venture (Newburry and Zeira 1997) while profit sharing ensures the necessary incentives to abstain from opportunism. For example, if MNEs, which suffer from cumulative debt problems, invest abroad to meet strong requests from their close business clients, JVs serve as an optimal way of minimizing operational costs while tapping quickly into local markets. In sum, the decision to opt for JV may be motivated by the internalization of financial resources among partners.

From a behavioural perspective, experience again plays a crucial role in determining the entry mode choice of MNEs. Chang and Rosenzweig (2001) confirmed that firms tend to undertake entry modes used already in previous foreign market entries.

According to institutional theory, political stability, FDI ownership restrictions, cultural affinity, social capital and legal rules can be influential variables explaining the level of ownership when investing abroad. Past research (Anderson and Gatignon 1986; Yiu and Makino 2002) confirms the importance of socio-cultural distance for the relative value of local partners. The argument is that operations in a dissimilar culture raise information costs.

While we believe this to be true, we would add that socio-cultural distance equally complicates negotiation and cooperation with JV partners. It remains therefore theoretically unclear, whether JV formation is more or less appropriate in a culturally distant investment location.

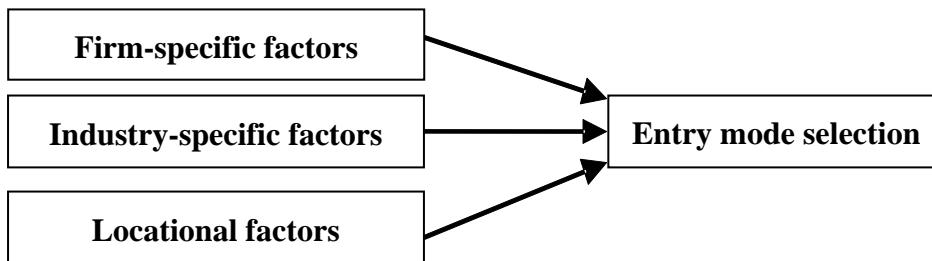
Shared entry modes are one of the means to mitigate unfavourable locational factors, especially, if institutional barriers are high. Bhaumik and Gelb (2005) suggest that the form of JV or acquisition will be more profitable in countries with insufficient institutional systems and lacking government support. He (2003: 402) stresses that JVs facilitate access to marketing channels and knowledge creation with regard to local policies, business practices and operating conditions embedded in unknown business environments. The creation of strategic alliances with local partners may enhance the adaptability to local markets and attenuate political hazards and institutional uncertainty by taking advantage of local partners' social networks. JVs play a role in obtaining legitimacy and recognition from local communities (Yiu and Makino 2002; Meyer and Nguyen 2005). A countervailing influence originates from deficiencies in IPR protection, which are often going hand-in-hand with other institutional shortcomings. A lack of IPR protection aggravates threads of shirking by local partners, thus tremendously increasing transaction costs of JV operation. Accordingly, Lee and Mansfield (1996) associate JV formation with effective IPR protection. It is hard to decide theoretically, which mechanism is more decisive.

On a different note, full ownership modes may be less susceptible to institutional uncertainties and volatile economic structures in indigenous markets when economic activities of subsidiaries are embedded into the parent's global strategy. Therefore, industries predominantly characterized by global value chains may show comparatively higher ratios of full ownership modes.

Empirical evidence on the influence of locational and institutional characteristics remains inconclusive. While Brouthers (2002) found that economic and political risks affect the entry mode choice in a survey research based on 105 European firms, Tsang (2005) failed to support the conjecture that the ownership patterns of foreign manufacturing firms in Vietnam are affected by the level of country risks. Delios and Beamish (1999) confirmed that host country restrictiveness exerts a negative impact on the degree of equity control. Yiu and Makino (2002) and Sanchez-Peinado and Pla-Barber (2006) find that a higher level of country risk is associated with a hierarchical form of governance, while numerous scholars (Gatignon and Anderson 1988; Palenzuela and Bobillo 1999) report an inverse relationship between country risk and ownership.

To sum up, firms face trade-offs between the level of control, the cost of resource commitment and the degree of location- and institution-specific hazards when choosing between JV and WOS ventures in the expansion of offshore activities. The previous studies (Anderson and Gatignon 1986; Yiu and Makino 2002) insist that full control modes allow the firm to enjoy higher returns and proprietary knowledge protection at the expense of suffering from gaining social and market legitimacy in local environments. On the other hand, the cost of economic, political and institutional hazards in developing countries can be minimized by an integrated form of equity control although coordination problems place constraints on the efficiency of operations. Finally, it should also be noted that a firm may not have any alternatives to WOS, if there are no adequate and capable partners who may contribute to the returns on investment in local markets (Zejan 1990). Figure 7 exhibits a conceptual foundation for understanding the entry mode selection mechanism incorporating three different aspects: firm, industry, and locational factors.

Figure 7: Proposed Model



Model Specification

To decide on the ownership structure when a firm enters a new market environment – with a hierarchical form of control (full ownership) on the one hand and a hybrid form of control (partial ownership) on the other – is a rather qualitative choice (Kogut and Singh 1988). According to Toyo Keizai (1999, 2000, 2001, 2002, 2003, 2004, 2005 and 2006), there are more than 330 Japanese manufacturing subsidiaries in Southeast Asia in the aftermath of the financial crisis. After excluding Japanese MNEs, whose entry mode is not clarified yet, which took the form of M&A, or whose financial data is not publicly obtainable, 318 observations are available for our study. We use a binomial logit model for the new venture ownership choice variable, where a wholly foreign-owned subsidiary is defined as one, while a foreign-local JV is zero. The binomial logit regression model is given as

$$P_{ij} = \exp(\beta_j X_{ij}) / \sum \exp(\beta_j X_{ij}),$$

where P_{ij} is the probability that firm i will select entry mode j , X_{ij} corresponds to a marginal effect of independent variables which exert an effect on the ownership strategies of firm i . β_j refers to the coefficients of the explanatory variables. We test the entry mode choice for factors, which represent complex multidimensional concepts in accordance with the complexity of determinants in the transaction cost and resource-based theories. We now turn to discussing the rationale for inclusion of individual explanatory variables and specifying them in detail.

Operationalization of Explanatory Variables

In line with our theoretical framework the explanatory variables constitute groups of firm-specific variables, location-specific factors, and industry dummy variables.

Firm-Specific Factors

The MNE characteristics of interest here are those, which determine the application of technology to the FDI project.

Firm size: Previous studies have associated the size of the firm with its accumulation of competitive knowledge and technologies (Andersson and Svensson 1994; Chang and Rosenzweig 2001). From a resource-based perspective, size can be taken as a proxy for the managerial resources, such as capable expatriates and tested routines, available to apply technological knowledge to new projects. Less need for complementary external resources should thus lead to a greater propensity to opt for full ownership. On the other hand, Meyer (1998) argues that the formation of a JV requires MNEs to restructure the organization of a local partner's venture and to integrate it into their global production value chains. Thus, a MNE undertaking a JV should possess strong core competencies. He postulates that small firms on average possess more limited core competencies so that the size of firms should be positively related to the ability to undertake JVs. A small firm may prefer full ownership to partial ownership since the cost of coordination with local partners may be higher due to its on average comparatively poor international experience. The results of Claver and Quer (2005) and Delios and Beamish (1999) support this proposition, while other previous scholarship (Brouthers 2002; Chang and Rosenzweig 2001; Palenzuela and Bobillo 1999) shows that firm size does not exert a significant influence on the international entry mode choice. Consistent with Horaguchi (1992) we use the number of employees of parent

companies measuring the size of the firm (**SIZE**). Data are obtained from Toyo Keizai Shinpōsha's *Kaisha Zaimu Karute* (2007).

Firm age: The argument on firm age (**AGE**) is similar to that on firm size, since firms tend to accumulate their knowledge and experience over time. Data are obtained from Toyo Keizai Shinpōsha's *Kaisha Zaimu Karute* (2007).

R&D intensity: Technological capabilities are one important intangible asset to be applied to foreign investment projects but at the same time to be protected from unintended spillovers. The higher control associated with full ownership allows more effective knowledge protection than what may be feasible in a JV. R&D expenditure is a widely used variable for measuring technological capabilities of developed country firms. We use a ratio of R&D expenditure relative to total sales (**RD**) in order to distinguish this type of resources from the size effect. The predicted impact of **RD** on full ownership according to the above argument is a positive one. Data are obtained from Toyo Keizai Shinpōsha's *Kaisha Zaimu Karute* (2007).

Human capital intensity: The impact of human capital (**HUMAN**) on the entry mode of Japanese firms should be the same as that of R&D. Following Belderbos and Sleuwaegen (1996: 216), we use a ratio of human capital expense relative to total sales. Data are obtained from Toyo Keizai Shinpōsha's *Kaisha Zaimu Karute* (2007).

Regional network: The literature on the influence of international experience is still inconclusive. Anderson and Gatignon (1986) point to the role of experience for the capability to efficiently manage foreign subsidiaries. From this line of argument the inclination of the MNE to form JVs should fall with experience. The opposite argument assumes that managerial expertise is scarce and not easily replicated. Under such conditions, a large network would require the MNE to spread its managerial resources thinly over the network (Davidson and McFetridge 1984). A third argument concerns the social capital being locally built by earlier subsidiaries (**NETWORK**). When they operate in a market they start to build connections to local actors and probably make those connections available to the newcomer as well. This would diminish the advantage of local partners. From the above, it is impossible to define clear expectations on the impact of the variable. For estimation, we used the number of subsidiaries in Southeast Asia obtained from Toyo Keizai Shinpōsha's *Kaishabetsu Kaigai Shinshutsu Kigyo Sōran* (2005).

Financial debt: The common argument is that a firm, which has a higher debt-to-equity ratio, is likely to partner with others in order to diversify and minimize the risk of failure due to increased operational risks in incomplete developing markets. The predicted sign would be

negative. On the other hand, the partner chosen by the MNE does not necessarily have to be a local one, so that this prediction has to be question-marked. In our study, we use a debt-to-equity ratio (**DEBT**) as an adequate proxy for financial performance. Data are obtained from Toyo Keizai Shinpōsha's *Kaisha Zaimu Karute* (2007).

Financial performance: In parallel to financial debt, financial performance is considered as a strong determinant of ownership structure (Claver and Quer 2005). But the same caveat with regard to equity participation of local partners mentioned above applies here as well: other Japanese or foreign partners could provide complementary financial assets just as effectively. The definition of performance can be twofold. One is profitability whereas another is productivity. Productivity is partly captured by our technology-related variables, so we apply return on assets (**ROA**) as a profitability measure here. Data are obtained from Toyo Keizai Shinpōsha's *Kaisha Zaimu Karute* (2007).

Industry-Specific Factors

We include industry dummy variables so as to evaluate the magnitude of variations in industrial organization patterns across industries. Three industries are tested as follows: food (**FOOD**), consumer electronics and electronics components (**ELECTRO**) and car assembly and transport equipments (**AUTO**).

Food industry: The food industry is often strongly embedded in the local environment, since it tends to rely on local inputs and often targets local consumer. Gomez-Casseres (1989) asserts this relationship for all resource-based industries. The food industry is usually also subject to strong health and safety regulations. Therefore, the local regulatory environment is relatively important in this industry. We can expect more joint ventures than in other industries.

Electronic industry: The electronic industry can be taken as an opposite case to the food industry. Electronics are usually produced in global value chains, which tend to locate low-value added intermediate processes in ASEAN countries. Vulnerability by local institutional shortcomings should therefore be much lower here, leading to a higher propensity to choose a full ownership mode.

Car assembly and transport equipment: In this industry global value chains also prevail. The main difference to the electronic industry lies in the political interest the automotive industry is often attracting. At least four ASEAN countries have or used to have national car projects with all the associated protection. It has hence been crucial for global suppliers to build strong connections to local regulators in order to get access. Sometimes wholly foreign-owned

subsidiaries were outright forbidden. Taken together, we can expect the ownership choice to be tilted towards the JV mode.

Locational Factors

Locational characteristics can be interpreted as host country assets or liabilities, which influence the level of transaction costs. Such costs may come as both the predetermined cost of doing business and the costs from the risks associated with an investment location (Tornell and Velasco 1992). The former can be captured by measuring the regulatory quality in general and the business freedom in particular.

Regulatory quality: Improved regulatory quality has been associated with better functioning markets and increased FDI flows (Alfaro, Kalemli-Ozcan et al. 2005). Under such conditions the assistance and mediation by local equity partners is less crucial for efficient transactions with the bureaucracy as well as suppliers and customers. As a measure of regulatory quality (**REGUL**) we apply the Worldbank governance indicator (Kaufmann, Kraay et al. 2006) on regulatory quality because it presents the most comprehensive evaluation available. The index is a secondary index calculated from expert assessments and surveys from up to 12 different sources per country. Among the sources are much used indicators such as the Heritage Foundation Economic Freedom Index, the Political Risk Services International Country Risk Guide and the World Economic Forum Global Competitiveness Report. Since perception by managers is formed over time and the development of an investment project is also time-consuming, we use the average score for the three years prior to investment. Better regulatory quality is expected to be associated with a higher inclination to form wholly foreign-owned subsidiaries. Therefore, the predicted sign is positive.

Business freedom (BUSFREE) is a measure to assess the average costs of regulatory requirements in connection with the basic operation of the individual business. These include, among others, regulations on the establishment of new enterprises, the access to loans, the contracting of workers and the eventual shut-down of operations. Since it is not possible to extract ratings on individual aspects of regulatory quality from the Worldbank index, we use data from one of its contributing sources. The Business Freedom Index published by the Heritage Foundation (Heritage Foundation 2007) is most appropriate here, since it attempts to define variables as objectively as possible. For instance, the regulatory burden is measured in terms of number of required licenses, average time and cost as a share of per capita income necessary to process the licenses. Even narrower than the business freedom measure is its

component indicator for investment freedom (**FDIFREE**), which focuses on the investment conditions for foreign MNEs. For both the expected sign is again positive.

Country risk, on the other hand, is composed of complex factors (Anderson and Gatignon 1986), many of which can be subsumed under the headings of rule of law, volatility of the economy and socio-cultural distance. According to Tsang's argument (2005: 445), "foreign investors would avoid WOS [wholly-owned subsidiaries; the authors], which represents the highest degree of internalization when they enter a risky host country".

Rule of law: An important source of institutional risk for an investor consists of the difficulties encountered when invoking the judicial system to enforce his property rights. Equally, discrepancies between formal laws and regulations and actual bureaucratic procedures pose a risk to those who have to rely on them for their business operations (DeHart-Davis and Bozeman 2001). Corruption is one possible expression of such discrepancies. Some authors have argued that inconsistent rule of law is more risky in a JV structure, where property rights tend to be more contested by the equity partners (Asiedu and Esfahani 2001), while others contend that JVs with local participation may leverage the latter's social capital to mitigate external threats to property rights (Bhaumik and Gelb 2005; Tsang 2005). It is not easy to decide theoretically, which mechanism is more relevant. We use the World Bank governance indicators (Kaufmann, Kraay et al. 2006) on the rule of law (**INSTQLY**) as our measure of the rule of law because it may be taken as an expression of the state of international knowledge on the issue. It combines up to 19 different sources of mostly perceptive assessments of the extent of the rule of law in different countries. Again, we use the average score for the three years prior to investment.

Economic risk: An important objective and outcome of institutional infrastructure is to achieve general economic stability in a country, which is assumed to be a precondition for sustainable development. We proxy economic stability and its adversary – economic risk (**ECONRISK**) – by the inflation rate. The inflation rate is a well-understood, straight-forward and in general well-publicised measure, which managers are likely to take into account to define their risk perception of an investment location. We use the three year average prior to investment of inflation rates as published by the IMF (2006) and expect a negative sign, meaning that a higher inflation rate contributes to JV mode choices.

Socio-cultural distance: The socio-cultural distance (**CULTDIST**) is a measure, which proxies the expected difficulty to communicate and build relationships between foreign investors and local actors. The theoretical discussion provides no clear direction as to whether

large socio-cultural distance rather necessitates or complicates local equity participation. Meaningful quantification of the concept of culture has also proven to be extremely difficult. In the absence of agreed measures of socio-cultural distance, we have to rely on the contested Hofstede dimensions (Hofstede 2003). Our proxy is formed by adding the differences in value of the four dimensions – the higher/lower the indicator value the greater/narrower the socio-cultural distance.

Table 3: Summary of Explanatory Variables and the Expected Signs for the Wholly Foreign-owned Entry Mode

| Explanatory Variables | Description | Expected sign for WOS | N | Mean | SD | Min | Max |
|----------------------------------|--|------------------------------|----------|-------------|-----------|------------|------------|
| <i>Firm-specific factors</i> | | | | | | | |
| SIZE | Firm size as the log of the number of employees | +/- | 318 | 3,5 | 0,6 | 2,1 | 4,8 |
| AGE | Firm age in years at the time of establishment of the subsidiary | +/- | 318 | 64,9 | 19,1 | 1,0 | 185,0 |
| RD | R&D-intensity of the MNE (R&D-to-sales ratio) | + | 318 | 3,6 | 2,7 | 0 | 13,4 |
| HUMAN | Human capital (Labour expenses-to-sales ratio) | + | 318 | 4,9 | 3,3 | 0,3 | 21,2 |
| NETWORK | Number of foreign subsidiaries | +/- | 318 | 13,6 | 21,7 | 0 | 118,0 |
| DEBT | Financial vulnerability (Debt-to-equity ratio) | - | 318 | 156,9 | 135,2 | 15,5 | 936,4 |
| ROA | Financial performance (Return on assets) | - | 318 | 4,1 | 3,8 | -11,5 | 19,6 |
| <i>Industry-specific factors</i> | | | | | | | |
| FOOD | Dummy variable for food industry | - | 318 | 0 | 0,2 | 0 | 1 |
| ELECTRO | Dummy variable for electronic industry | + | 318 | 0,1 | 0,4 | 0 | 1 |
| AUTO | Dummy variable for automobile industry | - | 318 | 0,2 | 0,4 | 0 | 1 |
| <i>Locational factors</i> | | | | | | | |
| REGUL | Regulatory quality | + | 318 | 0,3 | 0,6 | -1,2 | 2,0 |
| BUSFREE | Business freedom | + | 318 | 43,3 | 20,0 | 10,0 | 90,0 |
| FDIFREE | Investment freedom | + | 317 | 20,7 | 1,1 | 19,3 | 23,2 |
| INSTQLY | Institutional quality (rule of law) | +/- | 318 | 0 | 0,8 | -1,3 | 2,1 |
| ECONRISK | Economic risk (inflation rate) | - | 318 | 6,0 | 7,1 | 0,3 | 34,3 |
| CULTURE | Socio-cultural distance | +/- | 318 | 142,2 | 20,2 | 95,0 | 287,0 |

Table 4: Correlation Matrix of Explanatory Variables

| Explanatory Variables | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 | 16 |
|--------------------------|----------|----------|----------|----------|---------|----------|---------|---------|----------|----------|----------|----------|----------|----------|--------|----|
| 1 SIZE | 1 | | | | | | | | | | | | | | | |
| 2 AGE | 0.1842* | 1 | | | | | | | | | | | | | | |
| 3 RD | 0.4104* | 0.1005 | 1 | | | | | | | | | | | | | |
| 4 HUMAN | -0.3012* | 0.0288 | 0.0445 | 1 | | | | | | | | | | | | |
| 5 NETWORK | 0.4482* | 0.0486 | 0.0783 | -0.1779* | 1 | | | | | | | | | | | |
| 6 DEBT | 0.1151* | 0.088 | -0.3075* | -0.3047* | 0.3730* | 1 | | | | | | | | | | |
| 7 ROA | 0.0264 | -0.1996* | 0.2343* | 0.049 | -0.0974 | -0.3797* | 1 | | | | | | | | | |
| 8 FOOD | 0.1094 | 0.0044 | -0.0521 | 0.1524* | -0.0359 | -0.1001 | 0.0683 | 1 | | | | | | | | |
| 9 ELECTRO | -0.0243 | -0.1146* | 0.1551* | 0.106 | 0.1494* | -0.0295 | -0.0196 | -0.0644 | 1 | | | | | | | |
| 10 AUTO | 0.1420* | -0.0699 | 0.1154* | -0.2857* | -0.0663 | -0.0712 | 0.1655* | -0.0759 | -0.1893* | 1 | | | | | | |
| 11 REGUL | -0.0227 | -0.0987 | -0.0653 | -0.0204 | -0.0473 | -0.0067 | -0.0661 | 0.0375 | -0.054 | -0.0944 | 1 | | | | | |
| 12 BUSFREE | 0.0172 | -0.0998 | -0.063 | -0.0149 | -0.045 | -0.0134 | -0.0556 | 0.0744 | -0.0896 | -0.0796 | 0.9213* | 1 | | | | |
| 13 FDIFREE | 0.0335 | -0.0613 | -0.0082 | 0.0954 | 0.01 | -0.024 | 0.0561 | 0.0935 | -0.0158 | -0.1318* | 0.6530* | 0.6868* | 1 | | | |
| 14 INSTQLY | 0.0054 | -0.11 | -0.0526 | 0.0363 | -0.052 | -0.0135 | -0.0329 | 0.0601 | -0.0406 | -0.1246* | 0.9013* | 0.9215* | 0.7748* | 1 | | |
| 15 ECONRISK | 0.0475 | 0.1399* | -0.0022 | -0.1380* | 0.0923 | 0.1409* | -0.0826 | -0.0598 | -0.0727 | 0.1133* | -0.3257* | -0.3833* | -0.5255* | -0.5487* | 1 | |
| 16 CULTURE | 0.0735 | 0.1021 | 0.0715 | 0.0691 | 0.0454 | -0.0402 | 0.0568 | 0.038 | -0.0278 | -0.0043 | 0.0831 | 0.0869 | 0.5354* | 0.1159* | 0.0104 | 1 |

N=318.

Note : * indicates significance at the 5% level. SD indicates standard deviation.

Table 5: The Logit Model: Determinants of Entry Mode for Japanese Manufacturing Firms in Southeast Asia, 1998-2006

| Independent variables | Dependent variable: Greenfield=1; JV=0 | | | | | | |
|------------------------------|--|--------------------|---------------------|---------------------|--------------------|---------------------|--------------------|
| | Model 1 | Model 2 | Model 3 | Model 4 | Model 5 | Model 6 | Model 7 |
| Constant | 3.78*** (2.83) | 3.52*** (2.61) | -4.85 (-1.56) | 2.94** (2.15) | 2.88*** (2.88) | 4.09*** (3.05) | 2.33 (1.45) |
| <i>Firm-specific factors</i> | | | | | | | |
| SIZE | -0.73** (-2.07) | -0.78** (-2.18) | -0.83** (-2.26) | -0.82** (-2.28) | -0.83** (-2.30) | -0.80** (-2.24) | -0.75** (-2.10) |
| AGE | -0.01* (-1.67) | -0.01 (-1.29) | -0.01 (-1.30) | -0.01 (-1.25) | -0.01 (-1.26) | -0.01 (-1.24) | -0.01* (-1.82) |
| RD | 0.04 (0.58) | 0.05 (0.68) | 0.04 (0.65) | 0.05 (0.77) | 0.05 (0.72) | 0.05 (0.79) | 0.04 (0.54) |
| HUMAN | 0.11* (1.65) | 0.11* (1.69) | 0.09 (1.44) | 0.11* (1.71) | 0.10 (1.60) | 0.10 (1.58) | 0.10 (1.61) |
| NETWORK | 0.01 (1.22) | 0.01 (1.39) | 0.01 (1.26) | 0.01 (1.38) | 0.01 (1.44) | 0.01 (1.36) | 0.01 (1.14) |
| DEBT | -0.002* (-1.73) | -0.002* (-1.64) | -0.002* (-1.75) | -0.002 (-1.57) | -0.002* (-1.69) | -0.002 (-1.53) | -0.002* (-1.68) |
| ROA | 0.01 (0.16) | 0.02 (0.35) | -0.002 (-0.03) | 0.02 (0.36) | 0.01 (0.23) | -0.002 (-0.04) | 0.004 (0.09) |
| <i>Industry-specific</i> | | | | | | | |
| FOOD | -2.24** (-2.45) | -2.36** (-2.48) | -2.58*** (-2.59) | -2.43*** (-2.56) | -2.36** (-2.49) | -2.27** (-2.49) | -2.34** (-2.47) |
| ELECTRO | 2.82*** (2.71) | 2.96*** (2.82) | 2.90*** (2.78) | 2.97*** (2.83) | 2.91*** (2.78) | 2.74*** (2.65) | 2.83*** (2.72) |
| AUTO | 0.15 (0.40) | 0.24 (0.65) | 0.34 (0.90) | 0.24 (0.66) | 0.27 (0.72) | 0.29 (0.76) | 0.14 (0.38) |
| <i>Locational factors</i> | | | | | | | |
| REGUL | | 0.62*** (2.61) | | | | | |
| INVESTFREE | | | 0.43*** (3.02) | | | | |
| BUSFREE | | | | 0.02** (2.45) | | | |
| INSTIQLY | | | | | 0.44** (2.26) | | |
| ECONRISK | | | | | | -0.05*** (-2.61) | |
| CULTURE | | | | | | | 0.01* (1.65) |
| Log likelihood | -160.50 | -157.33 | -154.62 | -157.33 | -157.78 | -157.07 | -159.04 |
| R-squared | 0.144 | 0.161 | 0.169 | 0.161 | 0.159 | 0.162 | 0.154 |
| Prob>Chi2 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |
| Observation | 318 | 318 | 317 | 318 | 318 | 318 | 318 |
| Correctly classified | 76.73% | 77.04% | 76.34% | 76.42% | 76.73% | 76.10% | 76.42% |

Note : z-values are reported in parentheses. z and P>z correspond to the test of the underlying coefficient being 0, *** Significant at the 1 percent level, ** Significant at the 5 percent level, * Significant at the 10 percent level. S.A. indicates Southeast Asia.

Empirical Results

In this section, we present the estimation results using a binomial logit regression model on a sample of 318 Japanese manufacturing firms for the period from 1998 to 2004. Descriptive statistics provided in Table 3 include mean values and standard deviations of variables used. Table 4 demonstrates the Pearson correlation matrix of independent variables. It indicates that there is little multicollinearity except for the locational variables which are correlated with

each other (ex. r (REGUL, BUSFREE) = 0.913). To solve the issue of multicollinearity, separate regression analyses for each of the locational variables are carried out. We confirmed coefficient values and statistical significance by employing STATA/SE9.0. Table 5 displays the results of the binomial logit model. The two columns in each cell show the coefficients and z-values for the probability that a firm undertakes a full foreign ownership arrangement when investing in Southeast Asian countries. Each model has the ability to correctly predict the odds of full ownership at more than 75 percent.

The econometric analysis explores the impact of a set of factors predicted by existing theories such as ownership advantages theory, transaction cost theory, resource-based theory and location factors theory. The regression results point to some noteworthy aspects of the entry mode selection of Japanese MNEs entering Southeast Asia. We tested six location-specific variables at the country level while seven variables using unique firm-level data and three industry dummies are also incorporated at the same time.

The coefficients of **SIZE** are statistically significant and negative at the 5 percent significance levels. Our empirical results confirm that **SIZE** positively contributes to the choice of shared ownership. These results are consistent with the study of Meyer (1998), supporting the notion that a larger size is associated with competencies necessary for managing the risks and difficulties of cooperative ventures. The firm age variable (**AGE**) only shows a low statistical significance (in models 1 and 7) and small negative coefficients. This result is in line with the intuitive logic that firm survival is a much lesser predictor of firm capabilities than firm growth.

We find that other firm-specific variables, **RD**, **NETWORK** and **ROA** are not statistically significant in all the models presented, although they show the predicted signs. The absence of statistical significance for the **RD** variable implies that the overall technological intensity of the MNE plays no vital role in the choice of entry mode. This may be due to an extensively reported propensity of Japanese firms to establish manufacturing subsidiaries in Southeast Asia that specialize in non-critical low-technology or labor-intensive production activities. There, hence, exists no need to protect high-level proprietary technologies with a high-control mode of ownership when investing in Southeast Asia. With regard to **NETWORK**, the empirical relationship turns out to be just as ambiguous as the theoretical one. And financial performance, measured as **ROA**, does not tell us anything about the propensity to take in local JV partners.

In contrast, the other firm-specific variables, **DEBT** and **HUMAN** possess at least some explanatory power for the pattern of ownership arrangements by Japanese manufacturing firms in Southeast Asia. Consistent with our hypothesis, **HUMAN** is positive

and weakly statistically significant, while **DEBT** exerts a small negative influence on the probability that a firm chooses a full ownership entry. However, the **HUMAN** variable loses statistical significance and a little explanatory power in most of the models where locational variables are included. This suggests that there might be some self-selection of companies with higher human capital intensity into locations with better investment conditions.

The estimation results for the industry-specific variables are interesting. Our empirical findings support the hypothesis that industry-heterogeneity matters. While the **AUTO** dummy variable does not appear to play a significant role, the two industry dummy variables **FOOD** and **ELECTRO** are influential in explaining the choice of entry mode of FDI in Southeast Asia. Japanese firms investing in the food industry tend to form a joint venture while WOS is the most common mode for Japanese firms investing in the electronics industry. There are some clear implications. Japanese manufacturing firms operating in the food industry tend to target local markets and to acquire local raw materials, they are subjected to a host of health and price regulations, and they may also seek higher returns on investment in the short run so that they are more dependent on local partners who are familiar with market regulatory frameworks and have extensive marketing networks. In contrast, the electronic industry is organized along global value chains formed on the basis of comparative costs and capabilities. Due to limited local market size it is of little interest to Japanese manufacturing firms in the electronics industry to target local markets. Rather, their strategic aim is to export their locally produced products to the US and European markets. Their interactions with the investment locality can thus be much more limited with lesser need for local market and regulatory knowledge, and they indeed are. FDIs in the industry are sometimes even exempted from a number of foreign equity and other regulatory restrictions due to the competition among host countries for highly valued high-tech investments, under which electronics are often subsumed.

In our model estimations, locational characteristics are found to influence the entry mode selection of Japanese manufacturing firms. First, the coefficients for **REGUL**, **BUSINESSFREE** and **INVESTFREE** have the expected positive sign and are statistically significant at the 1 to 5 percent levels. These results suggest that the presence of favourable institutional environments accompanied by proactive FDI policy indeed affect the ownership structure of Japanese manufacturing firms. Overall, countries with developed institutional infrastructure systems facilitate Japanese firms' undertaking wholly foreign-owned ventures. High values diminish the need for forming a venture with local partners. The same holds for the rule of law (**INSTQLY**). It is however worth taking note of the fact that the regulatory

burden captured by **BUSINESSFREE** has a much lower impact than the risk associated with deficient rule of law.

Economic risk as measured by the inflation rate (**ECONRISK**) is statistically significant and has a negative relationship with the ownership structure as we predicted. It is Japanese manufacturing firms that prefer to undertake a shared entry mode when the state of local economies is financially fragile. Such market instability signals Japanese entrants to opt for a JV since financial commitments are shared by two partners. Our result thus contradicts the study of Sanchez-Peinado and Pla-Barber (2006).

Lastly, our empirical results lend only weak support for the hypothesis that socio-cultural distance (**CULTURE**) is positively associated with the entry mode selection. The coefficient is also very small. This can be interpreted as confirmation of the double-edged impact of socio-cultural distance discussed in the theoretical part.

In the following section, we summarize the empirical evidence and provide some proposals for future research.

Concluding Remarks and Future Research

It is of great interest to examine the entry mode selection of the Japanese manufacturing firms in Southeast Asia after 1997, since the aftermath of the Asian monetary crisis, the emergence of China and technological catch-up by other Asian firms put Japanese manufacturing firms under pressure to reconfigure their regional production networks. The appropriate choice of modal entry paves the way for Japanese firms to achieve a high level of profitability, efficiency, and stability of operations in an era of growing, uncontrollably mobile capital. The determinants of this choice are also of great interest to host governments, which consider investment policies as part of a broader development strategy. From a host government perspective, a transfer of cutting-edge technology, organizational skills and managerial knowledge from foreign firms to domestic firms is inevitable for the nation to further revitalize its economy in the post-crisis period. Our focus has been on the motives underlying the ownership choice of Japanese firms in Southeast Asia. In this paper, a binomial logit model was tested on a sample of 318 Japanese manufacturing firms in the period from 1998 to 2004 in Southeast Asia.

Some of our results are consistent with those of the previous scholarship that explored underlying factors influencing the entry mode strategies. First, regarding the effect of the firm-specific variables on entry mode selection, we have confirmed a negative relationship between firm size and the level of organizational commitments in accordance with prior studies (Meyer, 1998). This lends support to the resource-based view that core competencies have significant implications in predicting a firm's entry mode. We found that the higher the

human capital intensity is the higher is the probability of a full ownership mode, while higher debt exposure tends to be associated with a slightly lower level of resource commitment. However, the human capital intensity usually loses its statistical significance when tested together with locational variables. This suggests that locational variables in combination with self-selection of firms into different host-countries are partly responsible for the human capital effect. Effects of other firm-specific variables, such as the research intensity, network and performance on ownership governance, are not confirmed by our data.

Second, our empirical findings lend support to the conjecture that industry characteristics also play a role. Two industry dummy variables, food and electronics, are influential in explaining the structure of equity ownership when investing in Southeast Asia. Japanese firms in the food industry tend to form a JV while WOS is the most favoured entry mode for Japanese firms investing in the electronics industry. These results imply that between-industry variations of regulatory burdens in combination with industry-specific industrial organization patterns account for much of the variation in entry-mode choice. While firms in the food industry have a need to address comparatively strict regulatory environments through an integrated form of governance with indigenous firms, electronic MNEs tend to take advantage of the region independently, using it as an export platform without much regulatory interference.

Third, our results indicate that institutional characteristics of investment locations, such as investment freedom, business freedom, rule of law and regulatory quality exert a positive impact on the choice of full ownership. Among the different factors, business freedom shows the least impact. Such a result indicates that local partners are predominantly used to mitigate institutional risks and circumvent restriction on foreign investment rather than to tackle the overall regulatory burden. For host country governments the message could be that an improvement of the regulatory environment does not necessarily lead to a stark decrease in the number of the usually higher valued JVs.

Although our empirical results allow deep insights into the influential determinants of the initial choice of entry modes by Japanese manufacturing firms, they are still far from conclusive. We address some shortcomings and suggestions. First, we do not elaborate on the relationship of firms' negotiating power, market share, and reputation with the ownership arrangements, which are important in the bargaining framework. Second, it should be clarified more explicitly how the entry mode choice of Japanese MNEs in Southeast Asia varies by different investment motives such as resource-seeking, market-seeking, efficiency-seeking and strategic FDI. A hint on the importance of this point is given by the results for the industry dummies. Third, it would be interesting whether entry mode determinants are home-

country specific. Fourth, our research could be extended to examine whether the traditional transaction cost approach also takes account of dynamic changes in a MNE's ownership structure over time and to what extent the development of 'trust' and 'reciprocal commitment' shape Japanese firms' ownership strategies in Southeast Asia over time. Finally, a more refined approach is called for regarding the measurement of culture so as to allow more precise estimates of the influence of socio-cultural differences, even though our result already show a weak significance. All these puzzles take further the context-specific approach emphasized in this research.

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