INSTITUTIONS, RESOURCES, AND ENTRY STRATEGIES IN EMERGING ECONOMIES

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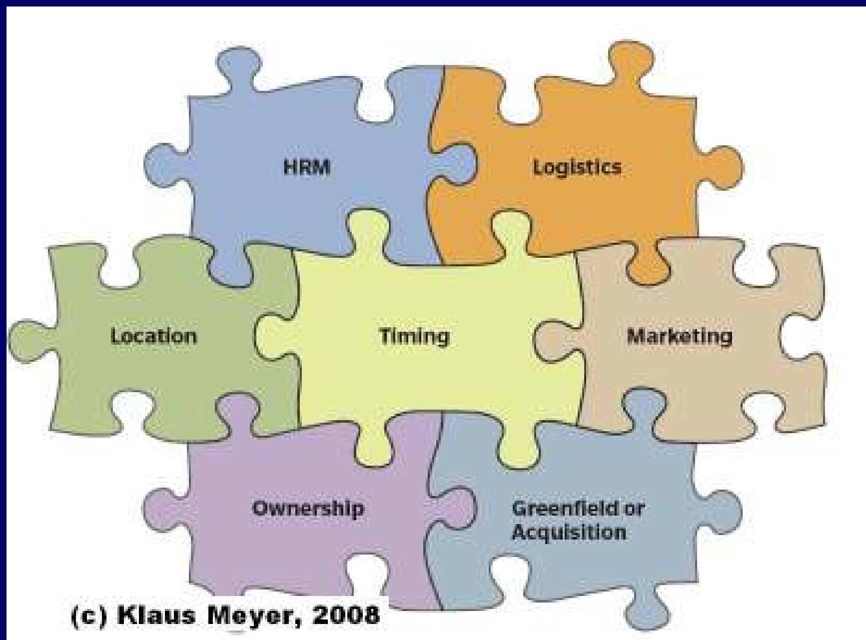
Institutions

Business Strategies

The Building Blocs of an Entry Strategy



Entry Strategies

Greenfield

Acquisition

Joint-Venture

Equity Entry Modes: Key considerations

- Resources
  - Who has the required resources?
  - How can we develop new resources?
  - How can we best transfer resources between businesses?
- Control
  - How tight control do we need over the foreign operation?
  - What costs are incurred by using market mechanism vis costs of using internal coordination mechanisms?

Dimensions of Mode Choice?

- **Access to local resources**

  → JV or acquisition
  - Lower cost of obtaining e.g. brand names or distribution networks if the local partner firm can provide them (Hennart & Park 1993, Anand & Delios 2002).
- **Control over local operation**

  → greenfield or acquisition
  - reduces the costs associated with sharing ownership with a local partner, and the associated potential for unauthorised diffusion of information and coordination problems between co-owners (Buckley & Casson, 1976; Anderson & Gatignon, 1986; Hennart, 1988).

An Economics Perspective
(North, Williamson, Casson, …)

Institutions

“the humanly devised rules and regulation that govern economic activity” (North) “rules of the game”

Efficiency of Markets

e.g. information asymmetry, contract enforcement meachnisms, uncertainty

Transaction Costs

Costs associated with finding partners, negotiating and enforcing contracts, measuring quality of products, etc.

Business Strategies

Design of organizational forms that minimize opportunity costs (or maximize revenues)

Emerging Economies: Weaker market-supporting institutions

- less extensive legal framework,
- less effective law enforcement,
- Less available info systems and intermediaries
- Less effective bureaucracy, and wide-spread corruption

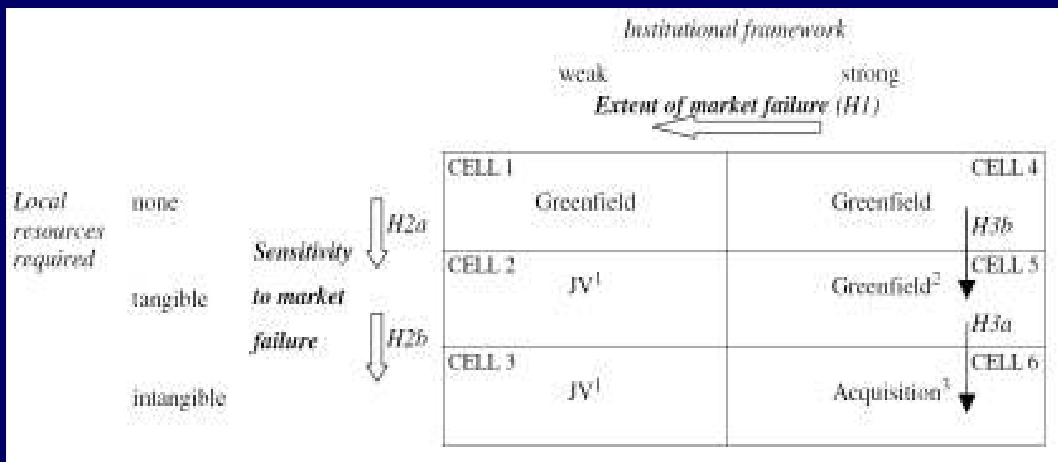
≈ ‘institutional voids’ (Khanna & Palepu)

High transaction costs in markets, and thus

➔ entrants would design alternative organizational forms or means to access resources/firms.

➔ entrants need different types of capabilities, e.g. networking capabilities, strategic flexibility

- Combining institutional and resource perspectives:
  Likelihood of market failure v. Sensitivity to market failure



[Meyer, Estrin, Bhaumik & Peng, SMJ 2009]

Market-supporting Institutions: Extent of Market Failure

- *High costs in local markets*
  - →*High degree of network based interaction*
    - → *foreign investors need to tap into local networks*
- *Idiosynractic local institutions*
  - → *need to build local capabilities through learning*
    - → *best way of learning is through direct interaction*
- *Certain forms of business may not be permitted*

Hypothesis 1(H1): The stronger the market-supporting institutions in an emerging economy, the less likely foreign entrants are to enter by joint venture (as opposed to greenfield or acquisition).

Resource Needs: Sensitivity to Market Failure

- Foreign investors need local resources
  - Often organizationally embedded
  - Especially in emerging economies where ideosycratic institutions are required to attain competitiveness
- Hard to do on your own, yet local partners as help accessing such resources
- *Acquisitions require transactions on markets for corporate control – which are particularly sensitive to market failure due to weak institutions*
  - *Equity markets: stock exchange*
  - *Supporting institutions such as information systems (accounting & auditing systems) and specialized intermediaries.*
  - *Relevant at medium/high levels of institutional development*

Resource Needs: Sensitivity to Market Failure

Hypothesis 2a (H2a): The stronger the need to rely on local resources to enhance competitiveness, the less likely foreign entrants are to enter an emerging economy by greenfield (as opposed to acquisition or joint venture).

Hypothesis 2b (H2b): The effect of Hypothesis 2a is stronger when requiring intangible assets compared to tangible assets.

Interaction between Institutions and Resources

Literature: Investors <u>transfering</u> intangible assets prefer greenfield

How are they <u>accessing</u> different types of local resources?

- Intangible assets (e.g. brands, networks):
  → hard to specify assets and their uses → desire to control them
  → acquisition
- Tangible assets (e.g. real estate):
  → shared use of assets, less integration with global operations, less uncertainty over their value
  → joint ventures is good enough, no need to internalize

Hypothesis 3a (H3a): Under conditions of strong institutions, the greater the need of foreign entrants for intangible resources, the more likely they are to use acquisition or joint venture rather than greenfield.

Hypothesis 3b (H3b): Under conditions of strong institutions, the need for local tangible resources will not influence the choice of entry mode.

Data: Methodological Notes

- Four Host Country Survey (48 home countries)
  - India, Vietnam, Egypt, South Africa
- Common questionnaire
- Base population: all FDI fulfilling the following criteria
  - ❑ established 1990-2000
  - ❑ Minimum foreign equity 10%
  - ❑ Minimum employment 10

❑ Random sampling

❑ Questionnaires were filled in interviews (in most cases)

❑ Return: > 600

- ❑ ca 150 per country
- ❑ Return rate 10% (IN, EG) to 30% (SA) of firms contacted

Operationalization of variables

- Dependent Variable:
  - Categorical Variable based on Q
    - 1 = Greenfield, 2 = JV, 3 = acquisiton
    - M-Logit Model
- Institutions: based on secondary data
  - ”Transparency”
    - Corruption Perceptions from Transparency International
  - ”Economic Freedom”
    - Economic Freedom Index; aggreagte of multiple indices (inverted)

Note: we selected these proxies of institutions because they are available time-varying

Operationalization of variables

- Need for local resources
  - Weighted index: importance of local tangible / intangible resources for competitiveness.
  - Two step question
    - Which resources are most important for competitiveness?
    - For these resources, where were they obtained: from MNE, locally, or elsewhere?
- Control variables
  - MNE parent: R&D, diversification-dummy, relative size
  - Experience: two dummies
  - Quality & quantity of local firms (two Likert-scale based constructs)
  - Home country GDP
  - Home country clusters: dummies based on Ronan and Shenkar (1985)
  - Industry dummies

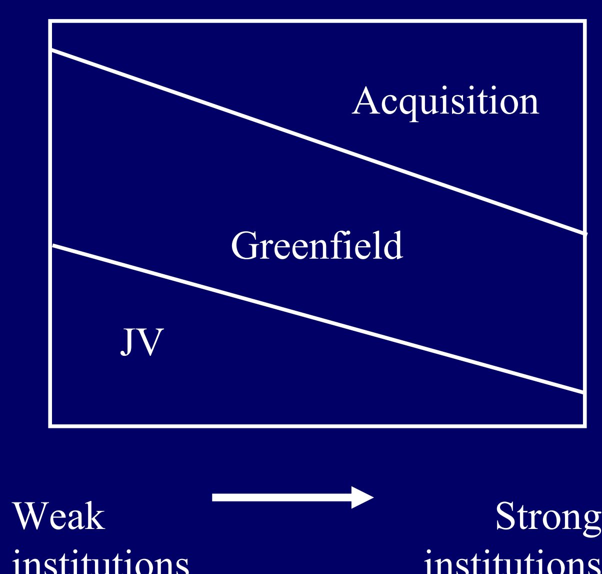
Multinomial Regression

Table 3. Multinomial regression (marginal effects)

	Model 1			Model 2		
	Greenfield	Acquisition	JV	Greenfield	Acquisition	JV
Main regressors						
Institutions ($\times 10^2$)	0.33 (0.25)	**0.13*** (0.04)**	**−0.45* (0.25)**	**0.84** (041)**	**0.12*** (0.04)**	**−0.95** (0.41)**
Intangible assets ($\times 10^2$)	**−0.25*** (0.09)**	**0.02** (0.01)**	**0.23*** (0.08)**	0.30 (0.28)	0.00 (0.03)	−0.30 (0.28)
Tangible assets ($\times 10^2$)	**−0.24*** (0.08)**	0.01 (0.01)	**0.24***** (0.09)	−0.46 (0.29)	0.05 (0.03)	0.42 (0.29)
Institutions $\times$ intangible ($\times 10^4$)	—	—	—	**−1.30** (0.70)**	0.00 (0.00)	**1.28** (0.70)**
Institutions $\times$ tangible ($\times 10^4$)	—	—	—	0.48 (0.70)	0.01 (0.10)	−0.40 (0.70)
Controls						
Local firm quality ($\times 10^2$)	−1.71 (2.93)	0.11 (0.24)	1.59 (2.93)	2.10 (2.96)	0.06 (0.18)	2.04 (2.96)
Local firm quantity ($\times 10^2$)	−0.39 (2.19)	0.22 (0.18)	0.17 (2.19)	−0.62 (2.19)	0.18 (0.15)	0.44 (2.19)
Experience country[#]	−0.01 (0.06)	0.00 (0.00)	0.01 (0.05)	−0.01 (0.06)	0.00 (0.00)	0.01 (0.06)
Experience EM[#]	−0.07 (0.06)	0.01 (0.01)	0.06 (0.06)	−0.07 (0.06)	0.01 (0.00)	0.07 (0.06)
Relative size	0.02 (0.02)	0.01 (0.13)	−0.02 (0.02)	0.02 (0.02)	−0.00 (0.00)	−0.02 (0.02)
R&D ($\times 10^2$)	0.96 (1.41)	0.01 (0.11)	−0.96 (1.40)	1.13 (1.42)	−0.00 (0.09)	−1.13 (1.42)
Conglomerate[#]	**−0.19*** (0.07)**	0.00 (0.01)	**0.18** (0.07)**	**−0.19*** (0.07)**	0.00 (0.01)	**0.19** (0.07)**
GDP host ($\times 10^2$)	−0.023 (0.003)	0.001 (0.003)	0.024 (0.025)	−0.026 (0.024)	0.001 (0.002)	0.024 (0.024)
GDP pc source ($\times 10^2$)	−0.015 (0.039)	0.003 (0.005)	0.011 (0.039)	−0.013 (0.039)	0.002 (0.004)	0.011 (0.039)
Clust Near-eastern[#]	−0.15 (0.18)	**−0.02** (0.01)**	0.16 (0.18)	−0.15 (0.19)	**−0.01** (0.01)**	0.16 (0.19)
Clust Nordic[#]	−0.11 (0.11)	−0.01 (0.00)	0.12 (0.11)	−0.13 (0.10)	−0.00 (0.00)	0.14 (0.10)
Clust Germanic[#]	**−0.21** (0.09)**	−0.00 (0.01)	**0.20** (0.09)**	**−0.22** (0.09)**	−0.00 (0.01)	**0.21** (0.09)**
Clust Latin-Europe[#]	−0.05 (0.10)	−0.00 (0.01)	0.05 (0.10)	−0.05 (0.10)	−0.00 (0.00)	0.05 (0.10)
Clust Far Eastern[#]	−0.03 (0.11)	−0.01 (0.01)	0.04 (0.11)	−0.02 (0.11)	−0.01 (0.01)	0.02 (0.11)
Clust Japan/Korea[#]	**−0.20** (0.09)**	0.01 (0.03)	**0.19** (0.09)**	**−0.20** (0.09)**	0.01 (0.02)	**0.19** (0.09)**
Clust Arab[#]	**−0.29*** (0.09)**	−0.02 (0.04)	**0.28*** (0.10)**	**−0.30*** (0.09)**	−0.01 (0.02)	**0.28*** (0.10)**
Clust other EMs[#]	**−0.29** (0.11)**	**−0.02** (0.01)**	**0.31*** (0.11)**	**−0.32*** (0.10)**	**−0.02** (0.01)**	**0.33*** (0.10)**
5 industry dummies	Yes**	Yes	Yes**	Yes**	Yes	Yes**
Log likelihood		−326.0			−322.3	
Wald chi-square		6281.1***			7223.2***	
Pseudo r-square		20.2%			21.1%	
Observations		421			421	

Notes to Tables 3 and 4: Levels of significance: *** = 1%, ** = 5%, * = 10%; standard errors in parentheses; # = dy/dx is for discrete change of dummy variable from 0 to 1.

Discussion:
Expected relationship of institutional development and entry modes



Conclusions

- Entry modes in EMs should be conceptualized as three-way choice
  - Theory builds bridges between seperate literatures e.g. acquisition versus greenfield
  - Empirical results suggest no ’order’ between the three modes
- Clear evidence for institutional effects on entry mode
  - acquisitions driven by institutional effects and experience,
  - JV are driven by need for local resources, which in turn depend on the institutional context.
- Provides a more differentiated analysis of the ’institutions → strategy’ relationship