Chinese Multinationals and Entry Mode Choice: Institutional, Transaction and Firm-Specific Factors

Abstract  Foreign direct investment (FDI) ownership decision is one of the most researched topics in the international business literature. However, little is known about the extent to which this knowledge can be applied to emerging-economy multinationals. Building on the institutional, transaction cost and resource-based view perspectives, this paper analyzes the determining factors of FDI mode choice between wholly-owned subsidiary (WOS) and joint venture (JV) by Chinese firms. From a sample of 139 outward FDI decisions made by large Chinese firms between 2002 and 2009, our results show certain characteristics that differ from the conventional wisdom of the multinational enterprise (MNE). Host country political risk and cultural distance do not affect FDI ownership decisions of Chinese MNEs, while firm size is negatively related with WOS. However, from a more conventional point of view, technological intensity of the industry is positively associated with WOS.

Keywords  FDI ownership decision, Chinese firms, determining factors

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1 Introduction

Entry mode choice is one of the most important decisions in the internationalization process, because of its implications for performance and its long-term consequences for the firm. Indeed, entry mode decisions have been ranked as the third most researched field in the international management literature (Werner, 2002). Predictors of entry mode choice or level of equity ownership include host country factors (such as restrictiveness or cultural distance), firm-specific factors (such as financial factors, experience or organizational capabilities), home country factors, transaction costs, and industry. Numerous empirical studies have addressed the entry mode decision and some recent papers have provided a thorough review of entry mode research (Brothers and Hennart, 2007; Canabal and White, 2008; Morschett, Schramm-Klein and Swoboda, 2010; Zhao, Luo and Suh, 2004). For over half a century, internationalization has been associated with western MNEs. However, internationalization of firms from emerging economies is on the rise (Yang et al., 2009). Over the recent years, many Chinese companies have made major investments in other
countries. Chinese outward FDI multiplied by four between 2005 and 2009, accounting for 4.4% of the world’s total (UNCTAD, 2010). It is also estimated that by the end of 2009 there were around 13,000 businesses with Chinese capital in 177 countries (MOFCOM, 2010).

The search for resources (particularly natural resources), markets (in many cases, trying to avoid export restrictions) or strategic assets (particularly advanced technology, managerial know-how or internationally recognized trademarks) are the main reasons behind such growth of Chinese outward FDI (Deng, 2004; Hong and Sun, 2006; Wong and Chan, 2003; Wu and Sia, 2002). It is helped by the huge foreign currency reserves accumulated from exports, the knowledge acquired by co-operating with foreign companies in China and, of course, by the Chinese government, which sees the international expansion of Chinese companies as a key element to ensuring the country’s continued economic growth (Child and Rodrigues, 2005; Hong and Sun, 2006; Zhang and Van den Bulcke, 1996).

International business research has not been unaffected by this phenomenon. After an initial few years when eminently descriptive works predominated, recent studies have sought to explore further into certain specific topics, such as the factors that determine Chinese outward FDI (Buckley et al., 2007; Child and Rodrigues, 2005; Deng, 2009; Kolstad and Wiig, 2012; Liang, Lu, and Wang, 2012; Liu, Li, and Xue, 2011; Lu, Liu, and Wang, 2011; Luo and Tung, 2007; Quer, Claver, and Rienda, 2012; Rui and Yip, 2008), or the applicability of traditional theoretical frameworks (Boisot and Meyer, 2008; Dunning, 2006; Liu, Buck, and Shu, 2005; Mathews, 2006; Zhang, Zhou, and Ebbers, 2011).

However, there are still certain gaps in the literature, and more work is needed to extend our knowledge of Chinese MNEs. In particular, we still know very little about the factors that influence key strategic decisions in their internationalization process, such as the choice of FDI entry modes. Only few papers have addressed this issue so far (Cui and Jiang, 2009a, 2009b, 2010; Xu, Hu, and Fan, 2011). Therefore, the aim of this paper is to bridge this gap by analyzing the influence that various institutional, transaction, and firm-specific factors have on FDI ownership decision of Chinese MNEs. From a sample of the largest Chinese companies, we study how factors such as political risk, cultural distance, industrial technological intensity, firm size and firm international experience affect this decision. In doing so, this paper makes a contribution to the international business literature as an emerging economy case study.

First, we present our theoretical framework and establish various hypotheses regarding the influence of the above-mentioned factors on FDI ownership decision. We then test these hypotheses with firm-level data from a sample of large Chinese companies listed on the Fortune Global 500. After a discussion of the results, this paper concludes by suggesting future research avenues on this topic.

2 Theoretical Background and Hypotheses

A large number of theories have been used to explain the entry mode choice decision. We build on three of the most commonly applied theories: institutional theory, internalization theory and the resource-based view (Brouthers and Hennart, 2007).

2.1 Institutional Theory

Institutional theory makes it possible to establish solid grounds to explain the internationalization of companies from emerging economies entering other emerging economies and the markets of more developed countries alike (Wright et al., 2005). In the first case, it is more likely that they are seeking to exploit their assets, which may be more easily applicable in an environment with similar institutional characteristics to those found in
the country of origin. Indeed, when competing in these emerging countries, companies from emerging economies may have lower transaction and co-ordination costs than companies from developed economies do. On the other hand, companies from emerging economies tend to enter developed economies looking to explore assets in order to acquire new technological capabilities that will allow them to be more competitive in the global market.

Institutional differences are particularly important for MNEs operating in more than one institutional context (Meyer et al., 2009). The formal and informal rules affect not only how a company chooses to enter an economy, but the very decision on whether or not to set up in a particular country as well as the entry mode. According to the institutional theory, companies make their strategic choices based on interaction between institutions and the organization itself, and attempt to obtain institutional legitimacy in terms of the host country’s rules and regulations (Cui and Jiang, 2010). Institutional factors alter the cost of doing business in one nation rather than another, which affects every aspect of the MNE’s behaviour (Henisz and Swaminathan, 2008): choosing the location, technology, capital or staff, as well as organizing the local subsidiary or investment sequence. From an institutional perspective, the choice of an entry mode is a result of the organization’s responses to isomorphic pressures arising from both firm’s external environment and internal organizational practices and routines (Ge and Ding, 2009).

Host country political risk is one of the most researched institutional factors in the entry mode literature. Political risk can be considered as an external influence that affects the company’s operations, whether that means the possibility of expropriation or nationalization of the investment, or other government actions or changes in the political and social situation that could have a negative effect on economic activity (Kobrin, 1979; Simon, 1984).

The conventional wisdom suggests that higher political risk will be negatively associated with entry modes involving full ownership, this being the relationship that has traditionally received the greatest empirical support (Azofra and Martínez, 1999; Brouthers, 2002; Gatignon and Anderson, 1988; Kim and Hwang, 1992; Luo, 2001; Pak and Park, 2004). Faced with conditions of political instability and uncertainty, foreign enterprises will be reluctant to commit many resources through FDIs. In addition, when the political risk is high, the firm must find a flexible position that allows it to modify its decisions if environment conditions change, and even to leave the country without incurring substantial losses. For this reason, the firm will prefer non-ownership-based or low investment modes. Finally, to enter a high-risk country successfully, the firm may need the help of a local partner that can provide it with access to knowledge about the target country, thus sharing the risk. In view of these arguments, we propose that:

**Hypothesis 1:** Host country political risk is negatively related to the likelihood that Chinese firms will choose WOS entry mode.

Cultural distance is another traditional factor in the literature on entry mode choice. Culture can be considered part of the environment’s informal institutions, which underpin formal institutions (Peng, Wang, and Jiang, 2008). Some arguments support the view that greater cultural distance will be associated with the adoption of an entry mode that implies lower resource commitment. Cultural distance may generate additional costs related to information collection and disturb communication processes, which require a common ground in order to code and decode the information (Pak and Park, 2004). Consequently, being less familiar with the target country makes integration more difficult and increases internalization costs, which is why the enterprise will prefer a lower resource commitment level (Randoy and Dibrell, 2002). On the other hand, it can be considered, as we previously pointed out in relation to political risk, that low ownership modes which improve the firm’s flexibility to move away from the target market if it does not succeed in becoming acclimatized to an
unfamiliar location (Kim and Hwang, 1992). Additionally, the greater cultural distance may force the firm to look for local support with the aim of facilitating product adaptation, sharing risks and avoiding mistakes (Azofra and Martínez, 1999; Chen and Hu, 2002), and also to acquire management skills on a local level and even to delegate culturally sensitive tasks (Contractor and Kundu, 1998; Hennart and Larimo, 1998; Pak and Park, 2004). Finally, when it comes to exploiting a competitive advantage, the firm must take into account the specific context knowledge, that is, the peculiar way to do business in a specific country. Thus, cultural distance hinders the applicability of the firm’s own routines, which is why the firm may prefer entry modes based on collaboration with local agents (Madhok, 1997).

Therefore, all the above would lead us to expect an inverse relationship between cultural distance and WOS entry modes. Nonetheless, there are also arguments that question this hypothesis. Cultural distance may not only make it difficult to find an appropriate local partner, but also generate costs when transferring know-how to that partner. This is why the firm will probably prefer high-ownership entry modes (Contractor and Kundu, 1998). Moreover, the little familiarity with the host country’s culture and with local managers gives investors incentives to choose WOSs so that subsidiaries can be more efficiently controlled (Chen and Hu, 2002). Therefore, a positive relationship between cultural distance and full-ownership could be also expected.

As a result, the predicted effect of cultural distance on entry mode choice is ambiguous (Morschett et al., 2010). Indeed, Tihanyi, Griffith and Russell (2005), after a meta-analysis from 66 independent samples, failed to provide statistical evidence of significant relationships between cultural distance and entry mode choice. Hence, their conclusion is that cultural distance is not directly related to entry mode choice. As a result, we propose that:

**Hypothesis 2:** Cultural distance is not related to the likelihood that Chinese firms will choose WOS entry mode.

2.2 Internalization Theory

Internalization theory, building on transaction cost economics, suggests that high ownership is more likely when the transaction involves products and processes with high proprietary content that may suffer from potential free-riding problems. These assets are difficult to transfer in an imperfect market. The high transaction costs of transferring proprietary assets incurred by companies lead them to internalize markets (Anderson and Gatignon, 1986; Buckley and Casson, 1976; 1998; Hill and Kim, 1988; Rugman, 1981).

Market transactions involving technological know-how imply costs (specifying the agreement conditions, the likelihood of disclosing key knowledge, the difficulty to codify such knowledge, etc.) which may constitute a clear incentive for FDI (Teece, 1986). Such entry mode proves more efficient when transferring tacit or non-codifiable knowledge enjoying little legal protection (Hennart, 1989). Furthermore, to safeguard specific assets from potential opportunism problems, firms may use high control governance structures, such as WOSs (Tahir and Larimo, 2004).

Kumar (1984) argued that firms operating in sectors with a high technological intensity may be expected to use entry modes allowing them a more efficient control of all the tasks to be carried out in the host country. Similarly, Chen and Hu (2002) observed that WOSs were more likely than contractual JVs when the foreign firm belonged to a high-technology industry. Thus, we propose:

**Hypothesis 3:** The technological intensity of the industry is positively related to the likelihood that Chinese firms will choose WOS entry mode.

2.3 Resource-Based View
The resource-based view suggests that firms develop unique resources that they can exploit in emerging markets or use foreign markets as a source for acquiring or developing new resource-advantages (Brouthers and Hennart, 2007). The resource-based view is compatible with traditional MNE theory. In fact, Dunning (1988) suggests that ownership factors relate to the MNE’s ability to compete in foreign markets and that these advantages derive from unique country, industry, and firm-specific variables. Thus, ownership advantages are conceptually similar to firm-specific resources, in that they are the unique internal factors that generate competitive advantages (Fladmoe-Lindquist and Tallman, 1994).

One of the most influential ownership advantages is firm size. Larger firms may be in a better position to successfully compete with host country firms, especially in host countries, and absorb the high costs and risks in international operations (Pangarkar and Yuan, 2009). Besides, greater size implies greater availability of financial and managerial resources, which makes it easier to set up WOSs (Tallman and Fladmoe-Lindquist, 2002). In keeping with this, empirical research supports that firm size correlates positively with high-commitment entry modes (Agarwal and Ramaswami, 1992; Brouthers, Brouthers and Werner, 2003; Campa and Guillén, 1999; Rialp, Axinn and Thach, 2002; Stopford and Wells, 1972; Trevino and Grosse, 2002; Yu, 1990). Thus, we propose that,

Hypothesis 4: Firm size is positively related to the likelihood that Chinese firms will choose WOS entry mode.

Another influential ownership advantage related to FDI is the firm’s international experience. Experience-based knowledge plays an outstanding role in the internationalization process (Eriksson et al., 1997). Indeed, this is one of the basic tenets of the Uppsala Model (Johanson and Wiedersheim-Paul, 1975; Johanson and Vahlne, 1977, 1990). This approach underlines that, as firms progressively gain experience, they tend to decide on more committed strategies. If the firm has already been involved in FDIs in several countries, the firm will have accumulated capabilities and know-how concerning such a mode of entry, which may be used in other destinations and even, allows the firm to bypass intermediate stages (Welch and Luostarinen, 1988).

Furthermore, firms with more FDIs also possess a higher level of accumulated distinctive competencies, which allow them to overcome what Zaheer (1995) called “the liability of foreignness”, i.e. the additional costs incurred by firms operating in foreign markets. Various empirical studies have identified a positive relationship between the scope of a firm’s international operation (number of FDIs in different countries) and high-commitment entry modes (Contractor and Kundu, 1998; Randoy and Dibrell, 2002). As a result, we propose that:

Hypothesis 5: Firm international experience is positively related to the likelihood that Chinese firms will choose WOS entry mode.

3 Methodology

3.1 Data Collection

The sample for this study is made up of all the outward FDIs made from 2002 to 2009 by the mainland Chinese companies listed on the Fortune Global 500. The year 2002 was chosen because it was when Chinese companies first started to conduct important international operations. This followed a major boost in 2001 when China joined the World Trade Organization (WTO), and particularly when the Chinese government announced its “go out” policy, which aimed to boost the international competitiveness of Chinese companies by
reducing the obstacles to outward FDI. Since then, the Chinese government has continued to provide incentives for the process, as it considers that forming large MNEs will help China to become a key player in the global economy. Helping Chinese companies get onto the Fortune Global 500 list has thus become an objective in itself (Hong and Sun, 2006).

Chinese companies listed on Fortune Global 500 provide and appropriate research setting because they have made some of the China’s biggest overseas investments to date. For instance, China Petroleum and Chemical Corporation (Sinopec)’s acquisition of Addax Petroleum, Industrial and Commercial Bank of China (ICBC)’s partial acquisition of the Standard Bank of South Africa, China National Petroleum Corporation (CNPC)’s takeover of Petrokazakhstan or Lenovo’s acquisition of IBM’s PC division.

Overall, 35 different mainland Chinese firms were listed on the Fortune Global 500 between 2005 and 2009. The data on each FDI were obtained from news items published on the website of China Daily (www.chinadaily.com.cn), the largest English-language newspaper in China. Having searched all news items covering international operations by each of the 35 firms between January 2002 and December 2009, we obtained 139 FDI ownership decisions, these being the sample for our study. Table 1 provides descriptive data on our sample.

Table 1 Sample Descriptive Data

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>Sinopec 中国石化</td>
<td>9</td>
<td>207,814</td>
<td>11</td>
</tr>
<tr>
<td>CNPC 中国石油天然气集团公司</td>
<td>13</td>
<td>181,123</td>
<td>22</td>
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<tr>
<td>State Grid 国家电网</td>
<td>15</td>
<td>164,136</td>
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<td>ICBC 中国工商银行</td>
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<td>70,568</td>
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<tr>
<td>China Mobile 中国移动通信</td>
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<td>65,015</td>
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<tr>
<td>China Construction Bank 中国建设银行</td>
<td>125</td>
<td>57,977</td>
<td>4</td>
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<tr>
<td>China Life Insurance Company 中国人寿保险</td>
<td>133</td>
<td>54,534</td>
<td>1</td>
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<tr>
<td>Bank of China 中国银行</td>
<td>145</td>
<td>51,317</td>
<td>8</td>
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<tr>
<td>Agricultural Bank of China 中国农业银行</td>
<td>155</td>
<td>48,063</td>
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<tr>
<td>Sinochem 中国中化集团公司</td>
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<td>44,457</td>
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<tr>
<td>China Southern Power Grid 中国南方电网</td>
<td>185</td>
<td>41,083</td>
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<td>Baosteel 上海宝钢集团公司</td>
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<td>35,517</td>
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<tr>
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<td>32,538</td>
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<td>China Telecom 中国电信</td>
<td>263</td>
<td>31,814</td>
<td>6</td>
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<tr>
<td>CSCEC 中国建筑工程总公司</td>
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<td>29,807</td>
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<tr>
<td>CNOOC 中国海洋石油总公司</td>
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<td>28,027</td>
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<tr>
<td>COSCO 中远集团</td>
<td>327</td>
<td>27,430</td>
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<tr>
<td>China Minmetals 中国五矿集团公司</td>
<td>331</td>
<td>26,667</td>
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<tr>
<td>COFCO 中粮</td>
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<td>26,446</td>
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<td>China Communications Construction 中国交通建设</td>
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<tr>
<td>SAIC 上海汽车工业(集团)总公司</td>
<td>359</td>
<td>24,882</td>
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<tr>
<td>Sinosteel 中国中钢集团公司</td>
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<td>24,164</td>
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<tr>
<td>Hebei Iron and Steel Group 河北钢铁集团</td>
<td>375</td>
<td>24,034</td>
<td>0</td>
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<tr>
<td>China Metallurgical Group 中国冶金科工集团公</td>
<td>380</td>
<td>23,767</td>
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<tr>
<td>Company</td>
<td>Rank</td>
<td>Sales (in 10s)</td>
<td>Rank</td>
</tr>
<tr>
<td>-------------------------------</td>
<td>------</td>
<td>---------------</td>
<td>------</td>
</tr>
<tr>
<td>China FAW Group</td>
<td>385</td>
<td>23,664</td>
<td>2</td>
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<tr>
<td>CITIC Group</td>
<td>415</td>
<td>22,229</td>
<td>3</td>
</tr>
<tr>
<td>China Unicom</td>
<td>419</td>
<td>21,981</td>
<td>3</td>
</tr>
<tr>
<td>China Huaneng Group</td>
<td>425</td>
<td>21,781</td>
<td>2</td>
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<tr>
<td>Aviation Industry of China</td>
<td>426</td>
<td>21,738</td>
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<tr>
<td>China South Industries Group</td>
<td>428</td>
<td>21,675</td>
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<tr>
<td>Jiangsu Shagang Group</td>
<td>444</td>
<td>20,897</td>
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<tr>
<td>Bank of Communications</td>
<td>494</td>
<td>18,677</td>
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<tr>
<td>Chinalco</td>
<td>499</td>
<td>18,579</td>
<td>5</td>
</tr>
<tr>
<td>Lenovo</td>
<td>499*</td>
<td>16,788</td>
<td>8</td>
</tr>
<tr>
<td><strong>Total outward FDIs</strong></td>
<td></td>
<td><strong>139</strong></td>
<td></td>
</tr>
</tbody>
</table>

* Global 500 Rank (2008)

3.2 Dependent Variable

The dependent variable in this study represents the dichotomous choice of FDI entry mode between a WOS (including both greenfield and full acquisition) and a JV. We adopt Brouthers and Hennart (2007) position that JVs are joint hierarchies and that they include both shared greenfields and partial acquisitions.

3.3 Independent Variables

Based on Buckley et al. (2007), host country political risk was proxied by the political risk rating of the International Country Risk Guide (PRS, 2010). This rating assigns risk points to a pre-set group of factors, termed political risk components. In every case the lower the risk point total, the higher the risk, and the higher the risk point total the lower the risk. In order to take into account institutional differences, we calculated a political risk distance by subtracting the target market risk value from the home market value (Brouthers, Brouthers, and Werner, 2008).

Cultural distance was measured by the Kogut and Singh (1988) index, based on Hofstede’s cultural dimension scores (Hofstede, 1980). This index has been extensively used in previous literature on entry mode choice (Chen and Hu, 2002; Contractor and Kundu, 1998; Hennart and Larimo, 1998; Luo, 2001; Pak and Park, 2004; Xu, Hu and Fan, 2009, 2011).

We proxied the technological intensity of the industry by classifying the industries of the companies into various technology levels (Chen and Hu, 2002; Chen, Hu, and Hu, 2002; Claver and Quer, 2005; Dikova and Van Witteloostuijn, 2007; Hu and Chen, 1993; Pangarkar and Yuan, 2009; Tahir and Larimo, 2004). We used the OECD proposal (2001) which, based on the International Standard Industrial Classification (ISIC-revision 3) establishes four categories in manufacturing sectors and two categories in service sectors. Thus, we classified the sectors in our sample into three categories: (1) low technology manufacturing sectors and services not based on know-how; (2) medium-low and medium-high technology manufacturing sectors; (3) high technology manufacturing sectors and knowledge-based services.

Firm size was measured by total sales (Campa and Guillén, 1999; Contractor and Kundu, 1998; Pangarkar and Yuan, 2009; Randoy and Dibrell, 2002; Tahir and Larimo, 2004). International experience was proxied by the number of FDIs the firm had carried out in other countries at the time of entry (Randoy and Dibrell 2002; Tahir and Larimo, 2004). We used a log transformation of these two variables.

3.4 Control Variables
By using data from the UN Statistics Division (2010), we considered a control variable regarding host-market size (proxied by host-country GDP). We used log transformation to normalize the distribution of this measure (Buckley et al., 2007). Finally, we included a dummy variable regarding the objective of each outward FDI decision: 1 if resource-seeking, and 0 otherwise. The FDI decision was classified into the resource-seeking category if the investing company belonged to a mining-quarrying industry and its aim was to access a local resource, usually in a country rich in raw materials.

4 Results and Discussion

To test the above hypotheses we conducted a binary logistic regression. It is a statistical model that makes it possible to estimate the effect of an increment of each independent variable on how likely the dependent variable (entry mode) is to take value 1 (WOS) as opposed to value 0 (JV).

Table 2 reports descriptive statistics and bivariate correlations. Before conducting the regression analysis, we performed a multicolinearity diagnosis, examining the variance inflation factor (VIF) for all the variables. This test measures the extent to which the variances of the coefficients estimated in a regression are inflated when compared to the cases in which the independent variables are not linearly related. High VIF values can become indicators of the existence of multicolinearity. The highest VIF was 2.25, which is well below 10, the cut-off point recommended by Neter, Wasserman and Kutner (1985). This allows us to rule out the presence of multicolinearity in our data.

Table 3 shows the regression analysis results. As can be seen, we used two models. Model 1 performs the regression of the dependent variable on the control variables. Model 2 also includes independent variables relating to the hypotheses1.

Table 2 Descriptive Statistics and Correlations

<table>
<thead>
<tr>
<th>Variables</th>
<th>Mean</th>
<th>SD</th>
<th>VIF</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
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</thead>
<tbody>
<tr>
<td>1. Host market size</td>
<td>5.49</td>
<td>0.88</td>
<td>1.75</td>
<td></td>
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<tr>
<td>2. Resource-seeking</td>
<td>0.55</td>
<td>0.50</td>
<td>1.74</td>
<td>-0.45</td>
<td></td>
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<tr>
<td>objective</td>
<td></td>
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<td></td>
<td></td>
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<tr>
<td>3. Political risk</td>
<td>4.08</td>
<td>13.7</td>
<td>2.25</td>
<td>0.56</td>
<td>-</td>
<td>0.33</td>
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<td></td>
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<tr>
<td>4. Cultural distance</td>
<td>1.93</td>
<td>1.18</td>
<td>2.05</td>
<td>0.56</td>
<td>-</td>
<td>0.16</td>
<td>0.67</td>
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<tr>
<td>5. Industry technological</td>
<td>2.36</td>
<td>0.54</td>
<td>1.30</td>
<td>0.19</td>
<td>-</td>
<td>0.53</td>
<td>0.18</td>
<td>0.03</td>
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</tr>
<tr>
<td>intensity</td>
<td></td>
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<td></td>
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<tr>
<td>6. Firm size</td>
<td>4.60</td>
<td>0.34</td>
<td>1.75</td>
<td>-0.28</td>
<td>0.32</td>
<td>-</td>
<td>0.30</td>
<td>0.15</td>
<td>-0.22</td>
</tr>
<tr>
<td>7. International</td>
<td>0.81</td>
<td>0.34</td>
<td>1.73</td>
<td>-0.20</td>
<td>0.36</td>
<td>-</td>
<td>0.25</td>
<td>0.13</td>
<td>-0.17</td>
</tr>
<tr>
<td>experience</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: 1.Correlations above 0.17 are significant at 0.05 level.
      2.Correlations above 0.22 are significant with at 0.01 level.
      3. Significance levels are based on two-tailed test.

Table 3 Binary Logistic Regression Results

1 Because large-sized firms may go international earlier and accumulate sufficient international experience, we controlled for the possible redundancy of these two independent variables: firm size and international experience. Thus, we performed the regression by alternatively removing each variable. However, in doing so, we did not find any significant improvement in coefficients.
<table>
<thead>
<tr>
<th>Dependent variables</th>
<th>Model 1</th>
<th>Model 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Host market size</td>
<td>0.07 (0.05)</td>
<td>0.47 (0.34)</td>
</tr>
<tr>
<td>(control)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Resource-seeking objective</td>
<td>$-1.76^{***}$ (0.39)</td>
<td>$-0.99^*$ (0.58)</td>
</tr>
<tr>
<td>(control)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Political risk</td>
<td>0.03 (0.03)</td>
<td></td>
</tr>
<tr>
<td>(Hypothesis 1)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cultural distance</td>
<td>0.23 (0.28)</td>
<td></td>
</tr>
<tr>
<td>(Hypothesis 2)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industry technological intensity</td>
<td>0.93* (0.47)</td>
<td></td>
</tr>
<tr>
<td>(Hypothesis 3)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Firm size</td>
<td>$-1.46^{**}$ (0.52)</td>
<td>1.28 (0.91)</td>
</tr>
<tr>
<td>(Hypothesis 4)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>International experience</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Hypothesis 5)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Overall chi-square</td>
<td>32.52$^{***}$</td>
<td>53.77$^{***}$</td>
</tr>
<tr>
<td>Overall % correct</td>
<td>72.1%</td>
<td>81.4%</td>
</tr>
<tr>
<td>$-2$ Log likelihood</td>
<td>136.61</td>
<td>109.81</td>
</tr>
<tr>
<td>Nagelkerke $R^2$</td>
<td>0.31</td>
<td>0.49</td>
</tr>
</tbody>
</table>

Note: 1. The dependent variable is WOS (= 1) or JV (= 0).
2. † indicates $p < 0.1$; * indicates $p < 0.05$; ** indicates $p < 0.01$; *** indicates $p < 0.001$.

The regression equation in Model 1 is statistically significant (Chi-Square = 32.52, $p < 0.001$), which suggests that control variables explain entry mode choice. More precisely, the resource-seeking objective has a negative impact on the choice of a WOS ($\beta = -1.76$, $p < 0.001$). This effect is maintained when the explanatory variables are included, although with lower statistical significance (Model 2). The regression equation in Model 2 is also statistically significant (Chi-Square = 53.77, $p < 0.001$), and the independent variables explain 81.4% of the entry modes selected.

Our results show that political risk is not related with WOS entry mode. Thus, H1 is not supported. This goes against some findings of previous studies on MNEs from other countries—particularly developed countries—which reported a negative relationship. Thus, our finding contradicts this conventional influence of political risk on entry mode choice. Although Xu, Hu and Fan (2009) reported that the smaller the host country political risk is, the larger ownership percentage the Chinese firm will choose, other studies did not find a significant relationship between political risk and FDI decisions of Chinese firms. Therefore, empirical evidence exists in line with our result, suggesting that the risks of the host country do not affect Chinese MNEs in a conventional way. Cui and Jiang (2009a) found that country risk did not have a significant impact on FDI entry mode of Chinese firms, whereas Buckley et al. (2007) did not confirm that Chinese outward FDI was negatively associated with high levels of political risk in the host country.

Chinese MNEs show certain characteristics that challenge the conventional view that political risk is negatively related to full-ownership entry modes. Although many Chinese companies do not have asset advantages such as technology and branding, they do have a transaction advantage: the ability to manage relationships within a complex environment such as China. This gives them an edge over MNEs from developed countries when it comes to investing in markets with these institutional characteristics (Malhotra and Zhu, 2009; Morck, Yeung and Zhao, 2008). Similarity in the institutional environments of two countries may allow for the management to organize an internal market more effectively than in two countries with highly differentiated institutional environments (Henisz, 2003).

The very idiosyncrasy of China’s own institutional framework may provide some additional arguments (Buckley et al., 2007). Because of imperfections in the Chinese capital market, the cost of capital is very low for state-owned Chinese companies. Furthermore, because they are conditioned by the institutional influences of the Chinese government, they may not be behaving purely as profit maximizers. Moreover, an important part of the Chinese
outward FDI has been directed at countries with which China has close political and ideological ties, many of which have a high political risk.

Furthermore, many of the Chinese FDIs included in our sample belong to regulated industries such as oil and gas, banking, telecommunications or utilities. Overall, these regulated industries share three characteristics (Henisz, 2003): the central role of government as either a provider or a monitor; the need for foreign capital, which forces host country governments to open the sector to private participation; and institutional idiosyncrasies that hamper credit assessment by international financial institutions and investors’ ability to hedge their exposure using financial instruments. These conditions create the potential for MNEs to generate rents through the management of their relationships with the government.

Recent research on the international expansion of firms in regulated industries challenges the notion that countries with high levels of policy instability are unattractive to foreign firms (García-Canal and Guillén, 2008). While the foreign firm would prefer a constrained executive branch during the operational phase of the investment, that is, a government or regulator that cannot easily change the rules of the game, at the time of entry the foreign firm would prefer to deal with a politically unconstrained executive branch in the host country so as to obtain preferential treatment. In such institutional environments, firms may develop broader meta-level routines both to identify the institutional idiosyncrasies and to lobby or influence the actors who can best prevent an adverse policy change or promote a favourable policy change (Henisz, 2003). Therefore, the Chinese firm would be in a better position to impose its preference for a WOS, if it considers it the most appropriate entry mode in order to control foreign operations (Taylor, Zou, and Osland, 2000).

Regarding cultural distance, the regression results show that it is not related to the likelihood that Chinese firms will choose WOS entry mode, thus supporting H2. This finding goes against observations made by Cui and Jiang (2009a, 2009b, 2010) and Xu, Hu and Fan (2011) who found that cultural barriers had a negative impact on a Chinese firm’s choice of WOS entry mode. When developing this hypothesis, we offered arguments regarding both a positive and a negative influence of cultural distance on the choice of a WOS. In addition, it must be pointed out that the influence of cultural distance may depend on the Chinese firm’s objectives. While investments that sought markets might well have been initially aimed at countries in which this distance was smaller, investments that seek know-how have been mainly aimed at developed countries in North America and Europe, which are culturally more distant (Young, Huang and McDermott, 1996). Also, many Chinese companies do not seem to shy away from cultural distance, perhaps aided by the alliances they have made in China with MNEs from developed countries (Luo and Tung, 2007).

We find support for H3, as the positive relationship between the technological intensity of the industry and the likelihood of a WOS entry mode is significant ($\beta = 0.93$, $p < 0.05$). Thus, following the conventional wisdom of the internalization theory, Chinese firms belonging to high-technology industries seem to use high control entry modes in order to avoid opportunism problems. This finding is in line with the case study of Cui and Jiang (2009b), who reported that the level of asset specificity and the possibility of partner opportunism are positively related to the likelihood that the Chinese firm will choose WOS entry mode. They also argued that these transaction costs were contingent on the industry and product characteristics of the Chinese firm.

Contrary to expectation, our results show that firm size does have a significant negative impact on WOS ($\beta = -1.46$, $p < 0.01$). Thus, H4 is rejected. This contradicts the result of Cui and Jiang (2009a) who found that firm size showed a positive impact on the choice of WOS entry mode by Chinese firms. However, there is also empirical evidence suggesting that firm size has no effect on the decision by Chinese firms to engage in outward FDI (Lau, Ngo and Yiu, 2010). It should be pointed out that there are some arguments suggesting that size, as a
strategic factor, is not necessarily correlated to the propensity to use high-ownership entry modes (Contractor and Kundu, 1998). This supports the conclusion of Gatignon and Anderson (1988) that “higher control modes are less likely for large foreign operations”. This argument is based on the idea that the size of global operations in many industries will force even large firms to accept partners to share in the large total investment and large coverage of a global network. In other words, the path to becoming a global player could require Chinese firms to accept a lot of partners and use shared-ownership entry modes.

The positive effect of firm international experience on WOS entry mode is not significant, which does not support H5. Types of international experience may provide some explanation for this result. Firm prior experience associated with a specific entry mode may be more influential than general international experience. However, lack of data prevented us from including this kind of specific experience in our model. In addition, Chinese companies, compared to their Western counterparts, could not require to go abroad to gain experience, since many of them gain international experience at home. Forming JVs with foreign firms, entering into a partnership with them through original equipment manufacturing or licensing their technology, is a route chosen by many Chinese companies (Child and Rodrigues, 2005). This kind of inbound internationalization is one of the distinctive characteristics of the internationalization process of Chinese firms, providing them with competencies and knowledge relevant to eventual outbound internationalization. Inbound internationalization is attractive for local firms, because learning from their foreign partners contributes to increase their competitiveness (Wan and Hoskisson, 2003).

Finally, we briefly discuss the significant control variable. The resource-seeking objective reveals a negative impact on the choice of WOS entry mode ($\beta = -0.99$, $p < 0.1$). As pointed out above, the search for resources, particularly natural resources, has been one of the traditional objectives of Chinese outward FDI. Depending on what the objective is for Chinese companies, the institutional factors linked to each location may play a very different role. For example, institutional restrictions that may arise when a Chinese company makes a FDI to access a resource considered strategic for the host country may not be applied when FDI is made in that same country for the purpose of accessing its market. For this reason, although the sole ownership would give the Chinese investing firm unrestricted access to resources, host country government restrictions may prevent them from using a WOS.

5 Conclusion

Compared to inward FDI in emerging markets, outward FDI from these emerging economies is a relatively new area of international business research. Despite the recent rise of Chinese outward FDI and the extensive research on entry mode choice, FDI ownership decision of Chinese firms remains an under-explored topic. The aim of this study was to fill this gap by analyzing some institutional, transaction and firm-specific factors affecting that decision.

Our paper contributes to the literature on entry mode choice of emerging economy firms in several ways. To our knowledge, along with the papers of Cui and Jiang (2009a, 2009b, 2010) and Xu, Hu and Fan (2011), this is one of the first attempts to analyze the determinants of FDI mode choice of Chinese firms. Thus, building on the institution, transaction, and resource-based views, our paper suggests that there are both similarities and differences between Chinese MNEs and traditional MNEs from developed countries.

From a transaction cost perspective, our results highlight the importance of the technological intensity of the industry as a determining factor of Chinese firms’ choice of WOS entry modes. High transaction costs of transferring technological know-how is the traditional argument for such relationship.
However, other findings from our paper seem to go against the conventional logic that has been observed in entry mode decisions made by MNEs from other, particularly Western, countries. A high political risk in the host country do not act as disincentive for Chinese MNEs to choose WOSs instead of JVs. Furthermore, we do not find evidence that cultural distance is an important institutional barrier for Chinese companies. In addition, from a resource-based perspective, firm size shows an unexpected negative impact on WOS, while general international experience seems not to affect FDI entry mode choice of Chinese firms.

Our findings also have several implications for practitioners. This paper provides Chinese managers with a framework to make decisions on FDI ownership choice. Although traditional host country institutional obstacles for Western MNEs seem not to influence that choice in the case of Chinese firms, managers must be aware that their choice could be constrained by industry’s technological intensity and they need to realize that the objective of the FDI also matters. Therefore, industry characteristics as well as firm objectives are key considerations for entry mode decision-making process of Chinese MNEs.

This research, though, is not without limitations. First, our empirical research is based on secondary data, a fact that influences the measurement of the variables. This prevented us from including managerial perceptions as well as other variables that might affect entry mode decisions, such as firm marketing capabilities or its experience with a specific entry mode.

These limitations suggest avenues for future research. First, future studies could achieve a more in-depth understanding of FDI ownership choices of Chinese firms by detailed surveys on managerial decision-making processes, including perceptions on institutional, transaction and firm-specific factors. Future work can also examine the interrelationship between entry mode choice (full vs. shared ownership) and establishment mode (greenfield vs acquisition), analyzing whether they are sequential or simultaneous decisions. It might also be interesting to analyze the influence of the different FDI ownership modes on the performance of Chinese firms, depending on whether the choice conforms or not to the theoretical models.

Finally, future research may also wish to focus on the interaction between target country institutional features and resources, including moderating effects (Brouthers et al., 2008; Meyer et al., 2009). As some resource-based advantages are context specific, differences in nations’ institutional environments may influence the applicability of such advantages. Thus, including other firm-specific resources not considered here and adding the moderating influence of national institutional environment to the resource-based view could help to better explain entry mode choice of Chinese MNEs.

References


