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#### Citation

YIU, Daphne W. and MAKINO, Shige. The choice between joint venture and wholly owned subsidiary: An institutional perspective. (2002). *Organization Science*. 13, (6), 667-683.

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# The Choice Between Joint Venture and Wholly Owned Subsidiary: An Institutional Perspective

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## Abstract

The study of foreign entry-mode choice has been based almost exclusively on transaction-cost theory. This theory focuses mainly on the impacts of firm- and industry-specific factors on the choice of entry mode, taking the effects of country-specific contextual factors as constant or less important. In contrast, the institutional perspective emphasizes the importance of the influence of both institutional forces embedded in national environments and decision makers' cognitive constraints on the founding conditions of new ventures. Still, this theoretical perspective has yet to provide insights into how institutional factors influence the choice of foreign entry mode. The primary goal of the present study is to provide a unifying theoretical framework to examine this relationship. We synthesize transaction-cost and institutional perspectives to analyze a sample of 364 Japanese overseas subsidiaries. Our results support the notion that institutional theory provides incremental explanatory power of foreign entry-mode choice in addition to transaction-cost theory. In particular, we found that multinational enterprises tend to conform to the regulative settings of the host-country environment, the normative pressures imposed by the local people, and the cognitive mindsets as bounded by counterparts' and multinational enterprises' own entry patterns when making foreign entry-mode choices.

*(Institutional Theory; Subsidiary Ownership; International Entry Mode; Multinational Enterprise)*

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## Introduction

The study of foreign entry-mode choice has proliferated in international business and strategic management research. Theoretical approaches used in previous studies include the transaction-cost theory (Anderson and Gatignon 1986, Hennart 1988), the corporate strategy perspective

(Caves and Mehra 1986, Contractor 1990), and the learning perspective (Barkema and Vermeulen 1998, Kogut 1988). Although these studies look at the determinants of entry-mode choice from different aspects, they commonly posit that the decision is based on firms' deliberate, conscious efforts to enhance their competitiveness, efficiency, and control over critical resources.

In this study, we introduce an institutional perspective on foreign entry-mode choice. The institutional perspective proposed in this article suggests that the choice of organizational structure can be viewed as the consequence of organizational responses to isomorphic pressures arising from both a firm's external environment and its internal organizational practices and routines (DiMaggio and Powell 1983, Meyer and Rowan 1977, Scott 1995). Unlike the conventional perspectives that focus on economic rationales for entry-mode choice decisions, the institutional theory posits that firms choose organizational practices and structures such as entry mode primarily to gain legitimacy from both internal and external claimants. Meanwhile, from an institutional perspective, economic rationales such as achievement of organizational efficiency and competitiveness are thought of as less pervasive concerns (DiMaggio and Powell 1983, Martinez and Dacin 1999).

Building on the institutional literature, we argue that decision makers' choices of foreign entry mode are significantly influenced by isomorphic pressures embedded in foreign national environments, as well as by their cognitive limits regarding this choice. In this study we focus on one type of foreign entry-mode decision: The choice between a joint venture and a wholly owned subsidiary. Traditionally, the distinction between the two has been considered a matter of equity control. However, from the institutional perspective, it could be argued that entry mode represents an organizational form appropriate for

the firm's motivation to gain legitimacy in the relevant environments under the conditions of uncertainty.

Building on the above arguments, we suggest that institutional theory can make important contributions to the understanding of the determinants of foreign entry-mode choice decisions. First, it provides a new conceptual foundation for studying entry mode choice decisions. Most previous studies based on transaction-cost theory have tended to understate the significance of contextual factors in the choice of entry mode (Erramilli 1996, Shane 1994), and such a neglect of contextual factors is a significant drawback in past research (Henisz 2000, Kostova and Zaheer 1999, Westney 1993). Although some studies have pinpointed the effects of the host-country elements on foreign entry decisions (Contractor 1990, Davis et al. 2000, Delios and Beamish 1999, Delios and Henisz 2000, Gomes-Casseres 1989, Makino and Neupert 2000), a unifying framework is lacking so far. Accordingly, this paper aims to provide a unifying framework that integrates the diverse elements of the host-country institutional environment proposed as influence on foreign entry-mode choice in the aforementioned studies.

Second, institutional theory provides a new perspective of ownership strategy for foreign expansion. The conventional international business literature tends to view the distinction between wholly owned and shared ownership as a matter of the alignment of control between partners (Makino and Beamish 1998). Institutional theory suggests ownership may be a means of conformity to the institutional environment. In the arena of international expansion, firms face a dual pressure of conformity: to the national environment of the host country, and to the organizational practices within the multinational enterprise (Rosenzweig and Singh 1991). A great pressure from the parent to conform indicates that preference will be given to a particular entry mode that is consistent with the parent organizational practice. Pressure from host-country institutions may induce firms to trade their ownership for legitimacy in the local environment, and hence, joint venturing with local partners is likely to be the preferred mode.

In this study, we are going to examine three general propositions:

**PROPOSITION 1.** *Foreign firms are more likely to form a joint venture with local partners than establish a wholly owned subsidiary as the degree of regulative and normative pressures in a host country increases.*

**PROPOSITION 2.** *Foreign firms tend to choose the entry mode that is most frequently used by their competitive counterparts in the same host country.*

**PROPOSITION 3.** *Foreign firms tend to choose the entry mode that they have chosen in preceding foreign market entries.*

The first hypothesis is based on the argument that foreign firms form a joint venture with local partners to conform to isomorphic pressures in a host-country environment. The second and the third hypotheses are based on the argument that foreign firms tend to choose a particular entry mode as taken for granted when other alternatives are unavailable or unknown.

We examine these general institutional hypotheses together with some derived from the transaction-cost theory. Transaction-cost theory posits that the choice of organizational structure, including the mode of foreign entry, is based on "efficiency" criteria: Firms choose organizational structures that will economize on transaction costs. Most previous studies of entry-mode choice use this perspective. The institutional theory posits that the choice of organizational structure is based on "legitimacy" criteria: Firms choose organizational structures as a way to respond to isomorphism in both external and internal environments (DiMaggio and Powell 1983). In the empirical model, we use transaction-cost variables as baseline determinants and examine how institutional factors add incremental explanatory power to the prediction of foreign entry-mode choice decisions.

## **Transaction-Cost Theory and Foreign Entry-Mode Choice**

The transaction-cost perspective of foreign entry-mode choice explains why a joint venture is chosen as an efficient governance form over other modes of entry such as the establishment of a new venture, full or partial acquisition of a going firm, or another alliance and contractual agreement with another firm. The transaction-cost perspective suggests that a joint venture would be chosen over other modes of entry when the following conditions are simultaneously satisfied (Buckley and Casson 1988, Hennart 1988). First, the firms have a bilateral need to gain access to complementary assets owned by the partners, which can neither be replicated nor acquired through market transactions. Second, full or partial acquisition of the needed complementary assets owned by other firms is difficult or costly due either to their indivisibility and tacit nature, or to the difficulties of integrating the acquired assets.

The transaction-cost implications of foreign entry-mode choice are complicated under conditions of uncertainty. Uncertainty in a transaction takes two forms: Behavioral or contextual (Root 1988, Shan 1991). Behavioral uncer-

tainty entails the opportunistic behavior of transacting parties. In the presence of behavioral uncertainties and given that a transaction is recurrent, where the assets involved are highly specific to the transaction, foreign firms have an incentive to choose a wholly owned subsidiary over a joint venture. This is because by doing so they can avoid the risk of the unwanted dissemination of their proprietary assets to the joint venture partners and of the failure to fully appropriate the rent generated by the assets transferred to their subsidiaries (Teece 1981). Although the formation of an equity joint venture can attenuate these transaction hazards by holding the partners in a mutual hostage position (Kogut 1988), the theory generally suggests that a wholly owned subsidiary provides better monitoring systems for such hazards than a joint venture (Ramanathan et al. 1997, Williamson 1991).

Contextual uncertainty entails bounded rationality of decision makers and arises from changes in institutional conditions such as political and economic stability, legal ground rules, and cultural and social relations embedded in national environments. In the transaction-cost perspective of multinational enterprises, researchers have not clearly specified what country-specific conditions and attributes might influence entry-mode choice decisions (Erramilli 1996, Kogut and Singh 1988, Ramanathan et al. 1997, Shane 1994), and contextual uncertainty simply refers to the volatility (unpredictability) of the firm's external environment that makes it difficult to write complete contracts (Anderson and Gatignon 1986). In principle, the transaction-cost perspective suggests that because contextual uncertainty is usually beyond the control of the firm (Root 1988), firms are, *ceteris paribus*, better off accepting low-control entry-modes (e.g., joint venture) or even avoiding ownership in order to retain flexibility against environmental changes and shift the risks to outsiders (Anderson and Gatignon 1986, Williamson 1975). However, once transactions involve behavioral uncertainty and the assets concerned become highly specific to the transactions, firms are more likely to adopt high-control entry-modes (e.g., wholly owned subsidiary) than low-control modes (e.g., joint venture), irrespective of the level of contextual uncertainty (Anderson and Gatignon 1986, Williamson 1991). Thus, in the transaction-cost perspective, the effects of contextual uncertainty and other contextual factors on entry-mode choice tend to be specified as moderators rather than direct effects.

Previous studies of entry-mode choice have used a variety of proxies to measure transaction costs and conditions in which transaction costs are likely to arise. In this study, we focus on two firm-specific variables that have frequently been used in previous studies.

*Parent's Firm- and Product-Specific Knowledge.* Research of entry-mode choice based on the transaction-cost

theory has used R&D intensity as a proxy for asset specificity. Asset specificity refers to durable investments that cannot be redeployed to alternative uses and by alternative users without a sacrifice of productive value (Williamson 1991). Williamson suggests that as asset specificity increases, bilateral dependence between transacting partners increases, and more coordinated efforts are required to resolve self-interested bargaining and disagreements between them. Due to the increased costs associated with the coordinated efforts, a hybrid form of governance becomes less efficient compared to a hierarchy form. Thus, the transaction-cost theory suggests a positive relationship between the degree of asset specificity and the likelihood that a hierarchy such as a wholly owned subsidiary is chosen over a hybrid form of governance such as a joint venture. Consistent with the transaction cost logic, previous studies have suggested that as the degree of parent firm R&D intensity (as a proxy for asset specificity) increases, the propensity for firms to form a wholly owned subsidiary, rather than a joint venture, increases (Delios and Henisz 2000, Erramilli and Rao 1990, Gatignon and Anderson 1988, Kim and Hwang 1992). We therefore propose the following hypothesis:

**HYPOTHESIS 1.** *The higher the R&D intensity of the parent firms, the less likely the multinational enterprise will choose a joint venture over a wholly owned subsidiary.*

*Parent's Host-Country-Specific Experience.* Firms entering a new host-country market suffer from disadvantages over local firms with regard to market-specific knowledge and access. Such knowledge is often tacit, and therefore its acquisition is subject to high transaction costs (Hennart 1988, 1991). Consequently, at the early stage of entry, foreign firms' dependence on local firms with regard to local knowledge and access is relatively great, and they tend to acquire local knowledge and access from their local joint venture partners. However, once foreign firms have accumulated local experience and obtained the necessary local knowledge and access in a host country, their dependence on local partners becomes less critical, and hence, they may exercise full control over the new subsidiaries (Gatignon and Anderson 1988). Thus, we predict that foreign firms are more likely to choose a wholly owned subsidiary over a joint venture as they accumulate local experience in a host country.

**HYPOTHESIS 2.** *The longer the multinational enterprise's parent experience in the host country, the less likely the multinational enterprise will choose a joint venture over a wholly owned subsidiary.*

Although transaction-cost theory is useful in providing an economic account of organizational actions and practices, the pure pursuit of efficiency may not entirely explain certain organizational actions (Robins 1987). It is suggested that the usefulness of transaction-cost theory in explaining dynamic organizational actions can further be enhanced if it is considered in conjunction with institutional theory (Martinez and Dacin 1999).

## The Institutional Environment and Foreign Entry Mode

The central premise of institutional theory is that organizations adopt structures and practices that are “isomorphic” to those of the other organizations as a result of their quest to attain legitimacy. Researchers have identified several factors that give rise to isomorphic pressures. Scott (1995), for example, suggested that there are three pillars of the institutional environment. The regulative pillar refers to rules and laws that exist to ensure stability and order in societies; the normative pillar refers to the domain of social values, cultures, and norms, and the cognitive pillar refers to the established cognitive structures in society that are taken for granted. Organizations choose a particular form of structure and practice either because it would receive regulative and normative approbation as is necessary due to their reliance on resources from these environments, or because it is taken for granted that doing so is the proper way to organize (DiMaggio and Powell 1983, Meyer and Rowan 1977).

Institutional theory differs from transaction-cost theory in at least two important areas. First, it pays greater attention to contextual variations in institutional environments. Although transaction-cost economists have made some attempts to incorporate institutional constraints into their conceptual models (Williamson 1991), their focus has been limited to certain aspects of regulative institutions. The other two institutional pillars, the normative and cognitive domains of the institutional environment, do not yet figure into their work (Roberts and Greenwood 1997).

Second, key determinants considered to have an impact on the choice of organizational structure differ between transaction-cost and institutional theories. While the former focuses on “efficiency” as the primary determinant of the choice of organizational structure, the latter regards “legitimacy” as the primary criterion. Institutional theorists (Dacin 1997, DiMaggio and Powell 1983, Oliver 1991, Scott 1995) suggest that organizations are motivated to enhance their legitimacy by conforming to other organizations in the environment, even in the absence of evidence that such actions increase internal efficiency.

Although conformist organizations are not guaranteed to be more efficient than their more deviant peers, they are rewarded for being similar to other organizations. That similarity makes it easier for them to transact with each other (DiMaggio and Powell 1983) and increases the likelihood of their founding success (Dacin 1997, Singh et al. 1986).

Following the institutional-based logic, we examine the premise that multinational enterprises choose an entry mode that will help them gain legitimacy in and conform to the host-country environment. We specifically hypothesize that: (a) multinational enterprises are more likely to choose a joint venture over a wholly owned subsidiary when regulative and normative institutional pressures in the host country are great; (b) multinational enterprises choose the entry mode (either joint venture or wholly owned subsidiary) that has been predominantly adopted by previous foreign counterparts in the same host country; (c) multinational enterprises choose an entry mode (either joint venture or wholly owned subsidiary) that has been most frequently adopted in the past as a taken-for-granted organizational practice.

Building on Scott’s (1995) three institutional pillars, we examine how the regulative, normative, and cognitive domains of the institutional environment influence firms’ decisions on foreign entry-mode choice.

### Regulatory Institutions

Organizations are embedded in their political environment (Zukin and DiMaggio 1990). Foreign entry-mode choice reflects the extent to which the foreign subsidiary conforms to the regulatory domain of the host-country environment. The elements of the regulatory domain include laws and rules that construct and constitute the grounds of organizational and industry action as well as ensure stability and order in societies (North 1990, Scott and Meyer 1994; Williamson 1975, 1991). Compared to indigenous organizations, foreign subsidiaries in the host countries are under discriminative institutional pressure from the native governments (Poynter 1985). Multinational enterprises’ organizational forms and their capacities to operate as networks of affiliates are also affected by cross-national variations in political institutions (Murtha and Lenway 1994). Hence, the foremost concern of a multinational enterprise when entering a foreign market is to gain market legitimacy: to establish the right to do business in the new market.

Past research suggests that the capacity of a foreign firm to establish legitimacy through allying with local partners may be indispensable to its success (Beamish 1985, Makino and Delios 1996, Shan and Hamilton 1991). When the regulatory domain of the host country

is unfavorable to foreign investors, there are two reasons for multinational enterprises to mitigate threats and gain market legitimacy by joint venturing with local partners. First, the foreign parent can mitigate the liability of foreignness by venturing with local partners. As regulatory constraints are levied on foreign rather than indigenous firms, joint venturing with local partners can lessen some of the regulatory requirements more than if the subsidiary is owned by the foreign parents alone. Second, multinational enterprises can benefit from “spillover effects” of their local partners. Not only do multinational enterprises benefit from local partners’ knowledge about and skills for dealing with the local government and other institutional infrastructure, they can also gain a “free ride” on the reputational capital of their genuine local partners. In other words, these local advantages spill over to the foreign subsidiaries. Multinational enterprises can then signal legitimate rights to conduct business in the new market to the host-countries’ regulatory constituents. Past empirical studies have found that more joint ventures are formed than wholly owned subsidiaries when the host government is more restrictive (Contractor 1990, Fagre and Wells 1982, Gomes-Casseres 1990, Lecraw 1984). With both theoretical and empirical support, we hypothesize that:

**HYPOTHESIS 3.** *The more restrictive is the regulatory domain of the host country, the more likely the multinational enterprises will choose a joint venture over a wholly owned subsidiary.*

### **Normative Institutions**

Economic activities are also embedded in the institutional context of societal norms and expectations that define socially acceptable economic behavior (Zukin and DiMaggio 1990). Foreign entry-mode choice reflects the extent to which the foreign subsidiary conforms to the normative domain of the host-country environment. The normative domain refers to shared understandings and meanings, or the “logic of appropriateness” (March 1981), that are embodied in the form of national culture, value, norms, and belief systems in a given country. Multinational enterprises are more vulnerable to attack from local interest groups and face more stereotypes and different standards from the host country constituents than do local firms (Kostova and Zaheer 1999). The failure of Matsushita and MCA’s merger due to cultural clashes (McGarvey 1997), and the anti-Japanese “hysteria” that occurred during Nintendo’s acquisition of the U.S. professional baseball team, the Seattle Mariners (National Review, 1992), are typical examples of how normative pressures and social culture pose threats to foreign direct investment. Therefore, when entering an institutional

context with a different normative system, multinational enterprises must accommodate institutional expectations and conform to social expectations to demonstrate their social responsibility (D’Aunno et al. 1991, DiMaggio and Powell 1991). In short, multinational enterprises need to build social legitimacy in host countries.

However, such social legitimacy is not easily obtained. One of the barriers is cultural distance. The more culturally distant the host country is from the home country, the more difficult it is for the multinational enterprises to tap into the collective understanding of the local people. Another barrier is cultural ethnocentricity. If the local culture is very ethnocentric and against foreigners, it is hard for the multinational enterprises to be perceived as socially acceptable. In these socially restrictive institutional environments, one way to overcome the normative impediments is entering through a joint venture with socially legitimate local partners. Joint venturing with local partners can reduce downside costs, as the multinational enterprises can benefit from the social reputations of local partners at no expense. Moreover, it can increase the upside benefits because the multinational enterprises can accrue social capital, an intangible resource, from the social structuring of relations between actors (Coleman 1988). Taken together, a joint venture mode can help foreign parents overcome immediate normative impediments such as stereotypes and provide them a means to strategically leverage relationships, acquire social legitimacy; and facilitate access to economic resources, institutional constituents, and business relationships. Empirical evidence has also found that multinational enterprises are more likely to enter the host country through a joint venture than through a wholly owned subsidiary when the cultural distance between home and host countries is large (Agarwal 1994, Kogut and Singh 1988).

**HYPOTHESIS 4.** *The more restrictive the normative domain of the host country, the more likely the multinational enterprises will choose a joint venture over a wholly owned subsidiary.*

### **Cognitive Institutions**

Decisions regarding entry-mode choice are limited by the cognitive mindsets of organizational decision makers. The cognitive domain refers to the widely shared cognitive structures by which actors of a given organizational field or societal entity interpret and make sense of their world, and is regarded as the “internalized symbolic representations of the world” (Scott 1995, p. 40). Research in cognitive psychology shows that individuals make sense of social events by categorizing them on the basis of such cognitive structures as schemas and stereotypes (Markus and Zajonc 1985). Tversky and Kahneman

(1974) also bring up a phenomenon known as “representativeness heuristic,” which refers to the situation in which individuals’ judgments about particular events are affected by their judgments about similar events that fall into the same cognitive category. Over time, the judgments are institutionalized and become taken-for-granted beliefs and values about appropriateness in those contexts. As a result, organizational decision makers are unaware of the full range of known alternatives (DiMaggio and Powell 1991, Greenwood and Hinings 1996) and are in favor of only those with high levels of cognitive legitimacy. Fligstein (1991) found that strategic issue definitions and operating practices such as the conceptions of control are moored in industry macrocultures and historical functional sources. In our study, we propose that there are two ways in which firms can acquire and maintain cognitive legitimacy: external mimicry and internal mimicry.

*External Mimicry–Mimetic Entry.* Mimetic isomorphism (DiMaggio and Powell 1983) results from the behavior of organizations that seek guidance from the experiences of other organizations in comparable situations when facing uncertainty. When entering a new institutional environment, multinational enterprises may form efficiency expectations by observing the overall performance of other organizations and infer the efficiency of their own organizational designs (Roberts and Greenwood 1997). For example, in their study of alliance formation in Latin America, Gimeno and Hoskisson (1997) found that organizations considering alliance-based foreign expansion in the telecommunication industry may, due to environmental uncertainty, follow the actions of other successful similar ventures. Although following the prevalent mode may not necessarily guarantee the greatest efficiency, firms can at least gain cognitive legitimacy when making decisions under uncertainty.

Moreover, local constituents make sense of new foreign entrants by referring to past entry patterns. When local constituents evaluate the legitimacy of a particular foreign subsidiary, they may refer to the legitimacy of others that belong to the same cognitive category, for instance, foreign subsidiaries of the same organizational field or from the same country. This is referred to as external legitimacy spillover (Kostova and Zaheer 1999). The density-dependent legitimacy dynamics argument (Aldrich and Fiol 1994, Fligstein 1991) suggests that if a particular organizational form is institutionalized over time, continuous adoption may further increase the legitimacy associated with this organizational form. Hence, we postulate that multinational enterprises pursue mimetic behavior in choosing the mode of entry. They are

likely to choose the entry-mode that is more widely adopted by competitors from the same home country. Considerable empirical evidence has found support for the fact that firms imitate the practices adopted by a large number of firms, which is termed frequency-based imitation; and that firms base their choices of role models upon firms’ traits such as firm size and status, which is termed trait-based imitation (Amburgey and Miner 1992, Haunschild and Miner 1997, Haveman 1993, Korn and Baum 1999).

*HYPOTHESIS 5. Multinational enterprises will use a follow-the-leader approach and follow the dominant entry-mode chosen by their home-country incumbents in the same host country.*

*Internal Mimicry–Historical Norm.<sup>1</sup>* The multinational enterprise itself constitutes a microinstitutional environment in which organizational information and practices are transferred between the parent and the subsidiaries and among the subsidiaries themselves. Organizational practices, being institutionalized, become ceremonial artifacts (Meyer and Rowan 1977). Habitualized behavior patterns may elude the conscious awareness of decision makers (Oliver 1996). Like external legitimacy, internal legitimacy can also spill over vertically between a parent and subsidiaries and horizontally between different subsidiaries (Kostova and Zaheer 1999). If a subsidiary attains high legitimacy in a particular host country, the parent will incorporate this successful experience into the cognitive structure of the multinational enterprise as a whole. Consequently, subsidiaries in the same host country are likely to adopt the same organizational practices. For example, using Japanese firms as their sample, Padmanabhan and Cho (1999) empirically found that firms tend to select ownership structures and establishment modes based on their experiences with similar decisions in the past. Furthermore, historical factors come into play. North (1990) argues that institutions are shaped by historical factors that limit the range of options open to its decision makers. Also, organizational inertia literature (Romanelli and Tushman 1986) posits that high-performing firms institutionalize established activity patterns so that the likelihood of any alternation becomes remote. Organizations may conform to a previously established mode and the sequence of decision making will become institutionalized as an organizational artifact (Romanelli and Tushman 1986, Tallman and Shenkar 1994). Combining the theories of organizational routines and competencies and the theories of management cognition, Amburgey and Miner (1992) empirically found that repetitive momentum occurred in firm merger activity. In all, historical and inertia factors lead to institutional

persistence; that is, firms repeat what they have been doing in the past.

**HYPOTHESIS 6.** *Multinational enterprises will follow the mode of entry that has been used most frequently in the same host country in the past.*

## Research Methodology

### Sample

The sample was selected from Kaigai Shinshutsu Kigyo Soran (Toyo Keizai 1996). The data were based on a questionnaire survey of all Japanese companies listed on the Japanese stock exchanges, as well as of some unlisted firms. The database lists about 15,300 subsidiaries of 3,600 Japanese parents with 5% or more equity ownership all over the world. Our sample consists of foreign subsidiaries established by the five largest (in terms of sales as of March 1996) Japanese home-electronics companies (Matsushita, Hitachi, Toshiba, NEC, and Mitsubishi Electric), and the five largest Japanese automobile companies (Toyota, Nissan, Mitsubishi Motors, Honda, and Mazda).

The 10 companies were found to be involved in extensive foreign activities, with the combined total of 751 foreign subsidiaries formed, 500 in the home-electronics industry and 251 in the automobile industry. Of the original 751 cases, 659 cases were wholly owned subsidiaries or joint ventures. The remainder consisted of subsidiaries established through acquisitions or capital participation, and these were removed from the sample. We further removed cases of joint ventures formed with no local partners and those with missing information regarding either country or subsidiary attributes. The final sample included 364 cases of overseas subsidiaries, with 262 in the home-electronic industry and 102 in the automobile industry. We performed a chi-square test to check possible sample selection bias and did not find any biased results.

Parent company information as of 1996 was obtained from the Analysts' Guide (Daiwa Institute of Research 1997), which provides major financial information on all Japanese listed companies. Host-country information was obtained from the *World Competitiveness Report* (WCR)—IMD International and World Economic Forum 1995. In the original data, the score for each item was measured by the average value of respondents' ratings (0–10), with 0 indicating the highest and 10 the lowest value. The scale was reversed in our study so that higher (lower) score represents higher (lower) value of institutional restrictiveness.

## Measures

### Dependent Variables

The dependent variable represents foreign entry mode, defined as a dummy variable, and coded 0 for a wholly owned subsidiary and 1 for a joint venture. The distinction between wholly owned subsidiary and joint venture has been a controversial issue. Some may argue that a wholly owned subsidiary should be owned by only one parent, and that if a subsidiary's equity is owned by two or more parents, it should be considered a joint venture irrespective of the size of equity share owned by the parents. In previous studies, however, many researchers (Anderson and Gatignon 1986, Gomes-Casseres 1989, Hennart 1991, Padmanabhan and Cho 1996) have adopted a 95% equity ownership as the cutoff point to differentiate between a wholly owned subsidiary and a joint venture. Other researchers have used an 80% cutoff, following conventional accounting practices that define the minimum necessary equity level to confer control as 20% (Makino and Beamish 1998). In this study, we used 100, 95, and 80% cutoff points, respectively, to differentiate between a wholly owned subsidiary and a joint venture.

### Independent Variables

#### 1. Transaction-Cost Variables

*Parent's Firm- and Product-Specific Knowledge.* R&D intensity, the parent firm's research and development expenditure as a percentage of total annual sales, is used to measure this construct.

*Parent's Country-Specific Experience.* Parent experience in the host country is measured by the number of years since the establishment of the Japanese parents' first subsidiary in a host country. The same measure has been used in the previous studies on mode of foreign entry (Hennart 1991, Makino and Delios 1996).

#### 2. Institutional Variables

##### a. Regulatory Institutions

*State Influences.* State influence is measured in terms of the extent to which local regulative forces influence foreign firms' activities in a host country. In this study, we measured this variable based on seven items derived from the WCR 1995. These items include state interference (the extent to which state interference hinders the development of business); state control (the extent to which state control of enterprises distorts fair competition); investment restriction (the extent to which investment in the economy is directed by the local government);



bureaucracy (the extent to which bureaucracy hinders business development); protectionism (the extent to which national protectionism prevents foreign products and services being imported); policy (the extent to which fiscal policy treats enterprises in an unequal manner); and ownership restrictions (the extent to which foreign firms have difficulties in acquiring control in a domestic company). Since these items were found to be highly correlated with correlation coefficients greater than 0.60, we used the mean score of the items to measure the degree of state influences.

### b. Normative Institutions

*Cultural Influences.* Cultural influences represent the normative institutional forces of a host country. Two variables were used to measure the degree of cultural influences: ethnocentricity and cultural distance. Ethnocentricity (ETHNO) was measured using two items from the 1995 *WCR*: unequal treatment (the extent to which foreigners are treated unequally compared to native citizens in all respects) and cultural confinement (the extent to which national culture is closed towards foreign cultures). Since the scores of these items were found to be highly correlated, we measured ethnocentricity by the mean score of the two items. Cultural distance (CULTDIST) is defined as the difference between the national culture of Japan and those of the host countries in which their subsidiaries are located. Cultural distance has been measured in different ways in previous studies (Kogut and Singh 1988, O'Grady and Lane 1996, Ronen and Shenkar 1985). In this study, we adopted Kogut's and Singh's (1988) measure of cultural distance, as it has been most frequently used in past studies.<sup>2</sup>

One critical weakness of the use of these variables is that they were measured based on the *WCR* scores of 1995 and might not precisely capture the institutional characteristics of host-country environments at the time of subsidiary establishment. To examine this possibility, we performed correlation analyses, using the scores of the same survey items reported in different yearly versions of the *WCR*. Due to the inconsistent content of survey questions, we were able to use only the survey items of national culture, protectionism, bureaucracy, and ownership restrictions reported in several years' versions of the *WCR* (1991, 995–1,999). The results showed that all the scores were significantly correlated, with the value of correlation coefficients being greater than 0.70 for all the items. With this evidence, we assume that there were no critical institutional changes in host countries throughout the period that our sample subsidiaries were established.

### c. Cognitive Institutions

*Mimetic Entry.* Mimetic entry was measured by the rate of joint venture over wholly owned subsidiary established by the other Japanese competitors in the sample in the same host country at the time of the focal multinational enterprise's entry. In this study, we focused on 10 Japanese firms in our sample. We calculated this variable separately for each industry in order to control for possible industry effects on the mimetic investment behavior of the parent firms. A similar frequency-based measure of mimetic entry has been used in past studies (e.g., Fligstein 1985, Haveman 1993). A recent study by Haunschild and Miner (1997) moved beyond the frequency-based measure to incorporate the outcome-based measure of mimetic behavior. However, we used only the former measure of mimetic entry due to the limited information in our dataset.

*Historical Norm.* Historical norm is measured by the rate of joint venture over wholly owned subsidiary established by the same parent firm in the same host country at the time of entry. The greater the value of the measure, the more frequently a firm follows the momentum of having formed joint ventures in the past. The rationale here is similar to the count method of the same type of acquisition events by Amburgey and Miner (1992).

### 3. Control Variables

*Subsidiary Type.* Subsidiary type is defined by a dummy variable, coded 0 when the subsidiary was engaged in the manufacture of the parent's core product and 1 when it was engaged in nonmanufacturing business activities such as sales, service, holding, R&D, finance, or planning. The establishment of different types of subsidiaries may involve varying degrees of resource commitment and risks (Johanson and Vahlne 1977), which may or may not influence the firms' entry-mode choice decisions. We therefore included this variable in our analyses to control for possible effects of subsidiary type on entry-mode choice.

*Relative Size of Subsidiary to Parent.* The size of the subsidiary relative to its parent is defined as the ratio of the relative subsidiary's assets to those of its parent. The effect of size on entry-mode choice is somewhat unclear. When the size of foreign investment is relatively large, foreign firms may choose a joint venture in order to disperse financial risks of investment. However, even when the size of investment is small, the firms may still choose in the same way to achieve minimum efficient scale of economies. With the mixed implications of the effect of size on entry-mode choice, in our analyses we used this

variable as a control rather than as an independent variable.

*Parent Firm Dummy.* In this study, we used limited numbers of parent-firm-specific variables (i.e., parent R&D intensity, experience, and historical norm) which might proxy for other unobserved strategic factors that incline the firms to prefer one entry mode over another. To capture this variance, a set of firm-level dummy variables was used in our analyses.

### Analysis

We examined two sets of logistic regression analyses. Models 1A, 2A, and 3A were the base models that included control variables (subsidiary type and relative size) and transaction-cost variables (i.e., R&D intensity and parent firm experience). Other models included control variables, transaction-cost variables, and institutional variables. Because the state influences variable, the mimetic entry variable, and the historical norm variable were significantly correlated, we examined four separate models for each of the three dependent variables. That is, we inserted the state influences variable in the first model (Model B); the two normative institutions variables, cultural distance and ethnocentricity, in the second model (Model C); the mimetic entry variable in the third model (Model D); and the historical norm variable in the fourth model (Model E). Hierarchical regression analyses were conducted to examine whether the inclusion of institutional variables would significantly increase the incremental explanatory power of entry-mode choice.

Table 1 provides a summary of the parent firms' equity ownership and the entry mode of the sample subsidiaries used in our analyses. Table 2 provides the results of the variance component analyses of the parent equity ownership. The results in the left column in the table indicate that 37.7% of the total variance in Japanese equity ownership is explained by country effects, and 2.4% by parent firm effects. Similar results were obtained for the sample of different industrial sectors (electronics and automobile) and that of subsidiary types (manufacturing and non-manufacturing subsidiaries). These results provide preliminary support to our assertion that country-specific institutional effects explain a significant portion of subsidiary ownership decisions.

### Results

Tables 3 and 4 provide the descriptive statistics and correlation matrix of the variables in this study. Table 5 provides the summary of the results of the logistic regression analyses. The fit of the models looks good, as the model chi-squares were significant at the  $p < 0.01$  level. For all

Nagelkerke's  $R^2$ , which is analogous to  $R^2$  in OLS regression, was also satisfactory, ranging from 0.17 (Model 3A) to 0.45 (Model 2D). The effectiveness of classification was satisfactory with the positive values of Lambda- $\rho$  in all the models, ranging from 0.7 (Model 3A) to 0.42 (Model 2D).

Turning to hypotheses testing, the results generally supported the hypotheses for both the transaction-cost and the institutional perspectives. Consistent with Hypotheses 1 and 2, the results suggested that both R&D intensity and parent experience variables had a significant and negative impact on the choice of joint venture over wholly owned subsidiary in all the base models (Models 1A, 2A, and 3A). These results support the transaction-cost perspective and suggest that parent firms are less likely to choose a joint venture over a wholly owned subsidiary when they have a greater R&D intensity and a longer operational experience in a host country prior to the establishment of the subsidiary.

With regard to the hypotheses for the institutional perspective, we predicted that the extent of state influences, ethnocentricity, and cultural distances would have a positive impact on the choice of joint venture over wholly owned subsidiary. Consistent with Hypothesis 3, the state-influences variable had a significant and positive impact on the choice of joint venture over wholly owned subsidiary in all the models. Consistent with Hypothesis 4, two normative variables, ethnocentricity and cultural distance, had a significant and positive impact on the choice of joint venture over wholly owned subsidiary in all the models except Model 3C. These results strongly support our hypotheses and suggest that the parent firms were more likely to choose joint venture over wholly owned subsidiary when they entered the host countries in which regulative and normative restrictions were relatively strong.

We also predicted that two cognitive variables: mimetic entry, measured by the rate of joint venture over wholly owned subsidiary established by other firms in a host country; and historical norm, measured by the rate of joint venture over wholly owned subsidiary previously established by parent firms in the same host country, would have a positive impact on the choice of joint venture over wholly owned subsidiary. Consistent with Hypotheses 5 and 6, the results suggested that both the mimetic entry and the historical norm variables had a significant impact on the entry-mode choice in all the models. These results suggest that the more frequently other firms' past entries were through a joint venture, and the more frequently the parent firms' past entries were through a joint venture, the more likely it is that the

**Table 1 Equity Ownership and Entry Mode of Sample Subsidiaries**

Country of Entry	Equity Ownership Mean (std)	N	Number of JVs (%)			Parent Firm	Equity Ownership Mean (std)	N	Number of JVs (%)		
			100%	95%	80%				100%	95%	80%
China	59.0 (20.7)	49	44 (88%)	44 (88%)	42 (84%)	Matsushita	85.5 (21.3)	100	33 (33%)	33 (33%)	30 (30%)
Taiwan	91.0 (14.8)	13	4 (30%)	4 (30%)	3 (23%)	Hitachi	77.8 (26.9)	52	22 (42%)	22 (42%)	17 (32%)
Hong Kong	77.1 (26.8)	8	2 (25%)	2 (25%)	2 (25%)	Toshiba	87.5 (20.0)	48	14 (29%)	13 (27%)	12 (25%)
Thailand	60.2 (24.6)	31	21 (67%)	20 (64%)	18 (58%)	NEC	83.1 (25.6)	42	14 (33%)	14 (33%)	12 (28%)
Singapore	92.4 (16.3)	20	5 (25%)	5 (25%)	3 (15%)	Mitsubishi Electric	87.1 (24.0)	20	5 (25%)	5 (25%)	5 (25%)
Malaysia	86.8 (22.4)	22	6 (27%)	6 (27%)	4 (18%)	Electronic Industry total	84.0 (23.2)	262	88 (33%)	87 (33%)	76 (29%)
Philippines	85.4 (25.9)	4	1 (25%)	1 (25%)	1 (25%)	Toyota	79.6 (27.6)	19	4 (21%)	4 (21%)	3 (15%)
Indonesia	81.0 (19.5)	5	3 (60%)	3 (60%)	2 (40%)	Nissan	90.5 (21.4)	37	7 (18%)	7 (18%)	7 (18%)
India	40.0 (0.0)	3	3 (100%)	3 (100%)	3 (100%)	Mitsubishi Motors	99.5 (1.1)	5	1 (20%)	0 (0%)	0 (0%)
UK	99.4 (3.6)	31	1 (3%)	1 (3%)	1 (3%)	Honda	76.5 (29.5)	31	7 (22%)	7 (22%)	6 (19%)
Netherlands	91.8 (20.0)	6	1 (16%)	1 (16%)	1 (16%)	Mazda	63.9 (32.3)	10	5 (50%)	5 (50%)	5 (50%)
Belgium	100.0 (0.0)	3	0 (0%)	0 (0%)	0 (0%)	Automotive Industry total	82.0 (27.0)	102	24 (23%)	23 (22%)	21 (20%)
France	89.0 (20.5)	6	2 (33%)	2 (33%)	1 (16%)	Total	83.5 (24.4)	364	112 (30%)	110 (30%)	97 (26%)
Germany	95.0 (14.4)	17	2 (11%)	2 (11%)	2 (11%)						
Switzerland	60.0 (n.a.)	1	1 (100%)	1 (100%)	1 (100%)						
Spain	94.5 (13.6)	6	1 (16%)	1 (16%)	1 (0%)						
Italy	100.0 (0.0)	3	0 (0%)	0 (0%)	0 (0%)						
Canada	100.0 (0.0)	7	0 (0%)	0 (0%)	0 (0%)						
USA	89.5 (22.7)	102	10 (9%)	9 (8%)	8 (7%)						
Mexico	67.2 (36.8)	6	3 (50%)	3 (50%)	3 (50%)						
Peru	100.0 (n.a.)	1	0 (0%)	0 (0%)	0 (0%)						
Brazil	91.3 (18.3)	8	1 (12%)	1 (12%)	0 (0%)						
Australia	95.8 (14.4)	12	1 (8%)	1 (8%)	1 (8%)						
Total	83.5 (24.4)	364	112 (30%)	110 (30%)	97 (26%)						

**Table 2 Variance Components of Japanese Ownership**

	Percent of Total Variance (%)				
	Total (N = 364)	Parent Industry		Subsidiary Type	
		Electronics Industry (N = 262)	Automobile Industry (N = 102)	Manufacturing Subsidiary (N = 221)	Nonmanufacturing Subsidiary (N = 143)
Country	37.7	44.1	31.4	40.0	36.0
Parent firm	2.4	0.7	10.6	2.4	-1.2
Country-parent covariance	-0.4	-2.0	-6.8	-1.1	2.7
Model	39.8	42.8	35.2	41.3	37.5
Error	60.2	57.2	64.8	58.7	62.5
Total variance	100.0	100.0	100.0	100.0	100.0

**Table 3 Descriptive Statistics**

			Mean	Standard Deviation
1	MODE (100% cutoff)	Entry mode	0.31	0.46
2	MODE (95% cutoff)	Entry mode	0.30	0.46
3	MODE (80% cutoff)	Entry mode	0.27	0.44
4	SUBTYPE	Subsidiary type	0.39	0.49
5	RSIZE	Relative size	0.19	0.64
6	P_RDRATE	Parent firm RandD intensity (%)	6.8	1.8
7	P_EXP	Parent firm experience	15.4	9.3
8	CULTDIST	Cultural distance	4.2	1.6
9	ETHNO	Ethnocentricity	3.0	0.61
10	STATE	State influences	3.6	1.0
11	MIMETIC (100% cutoff)	Mimetic entry	0.31	0.35
12	MIMETIC (95% cutoff)	Mimetic entry	0.29	0.32
13	MIMETIC (80% cutoff)	Mimetic entry	0.26	0.32
14	HISTORY (100% cutoff)	Historical norm	0.31	0.40
15	HISTORY (95% cutoff)	Historical norm	0.29	0.39
16	HISTORY (80% cutoff)	Historical norm	0.26	0.38
17	Matsushita	Parent dummy	0.27	0.45
18	Hitachi	Parent dummy	0.14	0.35
19	Toshiba	Parent dummy	0.13	0.34
20	NEC	Parent dummy	0.12	0.32
21	Mitsubishi Electric	Parent dummy	0.05	0.23
22	Toyota	Parent dummy	0.05	0.22
23	Nissan	Parent dummy	0.10	0.30
24	Mitsubishi Motors	Parent dummy	0.01	0.12
25	Honda	Parent dummy	0.08	0.28
26	Mazda	Parent dummy	0.02	0.16

parent firms would form a joint venture in subsequent entries.

As for the effects of control variables, the results

showed that the subsidiary-type variable had a significant and negative impact on the choice of joint venture over wholly owned subsidiary, suggesting that manufacturing

Table 4 Correlation Matrix

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26
1 MODE (100% cutoff)	1.00																									
2 MODE (95% cutoff)	0.98**	1.00																								
3 MODE (80% cutoff)	0.90**	0.91**	1.00																							
4 SUBTYPE	-0.24**	-0.23**	-0.21**	1.00																						
5 RSIZE	0.00	-0.01	0.00	-0.03	1.00																					
6 P_RDRATE	0.03	0.05	0.04	-0.23**	-0.14**	1.00																				
7 P_EXP	-0.25**	-0.25**	-0.12**	-0.04	0.04	-0.02	1.00																			
8 CULTDIST	0.08	0.08	0.04	0.02	-0.30	-0.01	-0.30	1.00																		
9 ETHNO	0.12	0.12	-0.12	-0.13	0.04	0.05	0.07	-0.20**	1.00																	
10 STATE	0.50**	0.51**	0.50**	-0.22**	-0.08	0.14**	-0.32**	-0.20**	0.24**	1.00																
11 MIMETIC (100% cutoff)	0.50**	0.50**	0.49**	-0.22**	-0.11	0.17**	-0.30**	0.21**	0.08	0.71**	1.00															
12 MIMETIC (95% cutoff)	0.58**	0.58**	0.56**	-0.26**	-0.11	0.21**	-0.32**	0.20**	0.18**	0.76**	0.88**	1.00														
13 MIMETIC (80% cutoff)	0.60**	0.60**	0.58**	-0.27**	-0.10	0.19**	-0.30**	0.13**	0.17**	0.78**	0.87**	0.97**	1.00													
14 HISTORY (100% cutoff)	0.54**	0.54**	0.49**	-0.21**	-0.11	0.15**	-0.27**	0.19**	0.10	0.63**	0.74**	0.83**	0.82**	1.00												
15 HISTORY (95% cutoff)	0.54**	0.54**	0.50**	-0.23**	-0.10	0.17**	-0.28**	0.19**	0.15**	0.62**	0.74**	0.84**	0.83**	0.95**	1.00											
16 HISTORY (80% cutoff)	0.52**	0.52**	0.51**	-0.21**	-0.09	0.16**	-0.27**	0.12	0.13**	0.63**	0.73**	0.83**	0.84**	0.88**	0.93**	1.00										
17 Matsushita	0.03	0.03	0.04	-0.20**	-0.11	0.69**	0.06	-0.00	0.11	0.09	0.10	0.17**	0.15**	0.10	0.12	0.14**	1.00									
18 Hitachi	0.10	0.10	0.05	-0.13**	-0.09	-0.11	0.02	0.06	-0.01	0.03	0.10	0.12	0.13	0.25**	0.20**	0.12	-0.25**	1.00								
19 Toshiba	-0.01	-0.02	-0.01	0.13**	-0.04	0.40**	-0.10	0.07	0.06	-0.01	0.00	-0.02	-0.05	-0.09	-0.11	-0.12	0.24**	-0.15**	1.00							
20 NEC	0.02	0.02	0.01	0.09	-0.02	0.23**	-0.14**	-0.00	-0.00	0.00	0.02	0.03	0.03	0.06	0.09	0.09	0.22**	-0.14**	-0.14**	1.00						
21 Mitsubishi Electric	-0.03	-0.02	-0.00	-0.02	-0.03	-0.13	-0.00	0.01	0.02	-0.02	0.00	0.00	0.01	-0.01	-0.00	0.01	-0.14**	-0.09	-0.09	-0.08	1.00					
22 Toyota	-0.04	-0.04	-0.05	0.01	0.01	-0.24**	0.10	-0.04	-0.13	-0.06	-0.10	-0.11	-0.10	-0.07	-0.06	-0.01	-0.14**	-0.09	-0.09	-0.08	-0.05	1.00				
23 Nissan	-0.08	-0.08	-0.05	0.21**	0.04	-0.39**	0.09	-0.03	-0.05	-0.11	-0.21**	-0.22**	-0.21**	-0.24**	-0.23**	-0.21**	-0.20**	-0.13**	-0.13	-0.12	-0.08	-0.07	1.00			
24 Mitsubishi Motors	-0.02	-0.07	-0.07	0.09	0.20**	-0.28**	-0.02	-0.05	0.01	-0.06	-0.08	-0.08	-0.07	-0.09	-0.09	-0.08	-0.07	-0.04	-0.04	-0.04	-0.02	-0.02	-0.04	1.00		
25 Honda	-0.05	-0.05	-0.05	-0.04	0.12	0.27**	-0.01	-0.06	-0.09	0.04	0.01	-0.05	-0.05	-0.10	-0.13	-0.12	-0.18**	-0.12	-0.11	-0.11	-0.07	-0.07	-0.10	-0.03	1.00	
26 Mazda	0.07	0.07	0.08	0.00	0.24**	-0.29**	0.00	0.01	0.01	-0.02	-0.00	-0.01	-0.00	0.07	0.08	0.10	-0.10	0.06	-0.06	-0.06	-0.04	-0.03	-0.05	-0.02	-0.05	1.00

N = 364.

\*Correlation is significant at the 0.05 level. \*\* Correlation is significant at the 0.01 level.

**Table 5 Logistic Regression Results**

Variables	Predicted														
	100% cutoff			95% cutoff			80% cutoff								
Sign	Model 1A	Model 1B	Model 1C	Model 1D	Model 1E	Model 2A	Model 2B	Model 2C	Model 2D	Model 2E	Model 3A	Model 3B	Model 3C	Model 3D	Model 3E
Subsidiary type	-1.32***	-0.97***	-1.28***	-1.00***	-1.17***	-1.23***	-0.87***	-1.19***	-0.76***	-0.98***	-1.21***	-0.79***	-1.16***	-0.9***	
Relative size	0.01	0.14	-0.01	0.19	0.20	-0.02	0.10	-0.05	0.15	0.14	-0.01	0.13	-0.03	0.15	0.15
R&D intensity	-0.31*	-0.38**	-0.29**	-0.33**	-0.13	-0.32**	-0.38**	-0.30**	-0.29**	-0.07	-0.34**	-0.42***	-0.34**	-0.34**	-0.11
Parent experience	-0.07***	-0.03**	-0.07***	-0.03***	-0.03***	-0.07***	-0.03**	-0.07***	-0.02**	-0.03***	-0.06***	-0.01	-0.06***	-0.01	-0.02*
State influences		1.03***			1.02***							1.08***			
Cultural distance		0.12**			0.11*								0.04		
Ethnocentricity		0.50***			0.51***								0.46**		
Mimetic entry				3.14***					4.12***					4.28***	
Historical norm					3.02***					3.04***					2.92***
Constant	2.79*	-1.55	0.67	1.00	-0.22	2.84***	-1.46	0.75	0.54	-0.43	2.72**	-1.90*	1.11	0.477	-0.42
Model $\chi^2$	57.8***	118.0***	64.4***	119.1***	129.6***	59.5***	119.2***	66.3***	142.8***	127.8***	46.3***	109.9***	50.9***	132.9***	108.5***
d.f.	12	13	14	13	13	12	13	14	13	13	12	13	14	13	13
$\Delta\chi^2$	—	60.2***	6.6**	61.3***	71.8***	—	59.7***	6.8**	83.3***	68.3***	—	63.6***	4.6*	86.6***	62.2***
Nagelkerke $R^2$	0.20	0.39	0.22	0.39	0.42	0.21	0.39	0.23	0.45	0.41	0.17	0.38	0.19	0.44	0.37
Cases correctly classified															
Wholly owned															
subsidiary	224 (88%)	231 (91%)	226 (89%)	229 (90%)	226 (89%)	228 (89%)	236 (92%)	228 (89%)	232 (91%)	232 (91%)	254 (95%)	252 (94%)	254 (95%)	245 (91%)	244 (91%)
Joint venture	54 (48%)	60 (53%)	58 (51%)	67 (59%)	70 (62%)	52 (47%)	59 (53%)	58 (52%)	69 (62%)	66 (60%)	20 (20%)	51 (52%)	30 (30%)	60 (61%)	55 (56%)
Total	279 (76%)	291 (79%)	284 (78%)	296 (81%)	296 (81%)	280 (76%)	294 (81%)	286 (78%)	301 (82%)	298 (81%)	274 (75%)	303 (83%)	284 (78%)	305 (83%)	299 (82%)
Lambda-p	0.23	0.34	0.28	0.39	0.39	0.23	0.37	0.27	0.42	0.40	0.07	0.37	0.17	0.39	0.32

Note. Parent firm dummies are included in all the models but not presented in the table.

N = 364.

\*\*\*p < 0.01; \*\*p < 0.05; \*p < 0.10 (one-tail test).

Dependent variable: 0 = wholly owned subsidiary; 1 = joint venture.

subsidiaries were more likely than nonmanufacturing subsidiaries to be established through a joint venture. Another control variable, relative size, had no significant impact on the choice of joint venture over wholly owned subsidiary in all the models. Finally, the parent firm dummies did not have a significant impact on the choice of entry mode, suggesting that the likelihood of the choice of joint venture over wholly owned subsidiary did not significantly vary among the 10 Japanese firms in our sample.

Hierarchical logistic regression was used to examine whether the inclusion of the institutional variables would have incremental explanatory power of entry-mode choice decisions. The improvements in chi-square were significantly larger when the institutional variables were entered with the transaction-cost variables in the regressions than when only the transaction-cost variables were used. These results suggest that a significant portion of entry-mode choice decisions can be explained by institutional factors. In particular, the improvement in chi-square was much weaker for the normative institutional variables (cultural distance and ethnocentricity) than for the regulative institutional variable (state influences) and cognitive institutional variables (mimetic entry and historical norm). These results suggest that the impact of regulative and cognitive forces on the entry-mode choice might be more critical than that of normative forces.

## Discussion and Conclusion

The present study examines the effects of institutional factors and transaction-cost factors on foreign entry-mode choice. Our results show that both factors are important determinants for foreign entry-mode choice. While most previous studies have used transaction-cost theory as a conceptual basis for hypothesis development and testing, our evidence suggests that models that only consider transaction-cost variables may be underspecified, and institutional factors have a significant incremental contribution in explaining entry-mode choice decisions.

Our findings have two major implications regarding the institutional perspective of foreign entry-mode choice. First, our evidence suggests that institutional forces may influence the choice of entry mode at different levels. While regulative and normative institutions may account for the cross-national variations in the choice of entry mode, cognitive institutions may account for the cross-firm variations in the choice of entry mode. On the one hand, multinational enterprises need to conform to isomorphic pressures in individual host countries. On the other hand, they need to conform to the isomorphic patterns pervasive across subsidiary units within their organization. These conflicting conformity pressures pave

ways for future studies to explore the issues of what mechanism is being used by multinational enterprises to resolve country-firm tensions of conformity and what role entry mode plays in resolving these tensions (Gooderham et al. 1999, Westney 1993). The call for multilevel studies is important, as it comes back to the fundamental premise that the institutional environment is multifaceted.

Second, institutional forces may influence the choice of foreign entry mode in different magnitudes. Our results show that the regulative forces (state influences) and cognitive forces (mimetic isomorphism and historical norm) have a stronger influence on entry-mode choice decisions, compared to the normative forces (cultural distance and ethnocentricity). One possible explanation for this is that normative institutional pressures are less codifiable and take more time to be recognized. Unlike regulative institutional forces that are codified in formal legal restrictions and sanctions, and cognitive institutional forces that are reflected in observable industry or organizational historical patterns, normative institutional pressures might not be easily identified before local operations start. Also, when making the entry-mode decision, market legitimacy and cognitive legitimacy may be the most immediate legitimacy that multinational enterprises need to attain, while normative legitimacy takes a longer time to be established in the value systems of the host-country nationals.

Future research should attempt to overcome the limitations of the present study. First, more effort could be made to devise new measures. The variables used in the present analyses may not actually measure the transaction costs and isomorphic pulls themselves. For instance, there is a debate as to whether cultural distance is able to represent normative institutional forces in a host country. Some researchers use cultural distance as a key institutional variable (Kogut and Singh 1988, Kostova 1999), whereas others (e.g., Hennart and Larimo 1998) argue that it can be used as a transaction-cost variable because it infers miscommunications and misunderstandings between joint venture partners. We cannot preclude the possibility that our results may suffer from critical measurement errors.

Second, future studies could examine whether and when the same results are obtained in different contexts. Our study could be extended to other contexts in terms of the country of origin of the parent firms (non-Japanese parents), industries in which the parent firms operate (nonmanufacturing sectors and manufacturing sectors other than home electronics and automobiles), and other modes of foreign entry (acquisition and capital participation).

Third, longitudinal studies are called into effect. Due

to the cross-sectional nature of analysis, we are not able to control for the state of firm- and country-specific factors at the time of each entry. Given that firms' entry-mode choice decisions may involve an incremental learning process (Barkema et al. 1996), future studies should conduct longitudinal analysis of entry-mode choice to confirm the findings of our study.

Finally, there is a concern about whether the entry-mode decisions are subject primarily to corporate effects or to subsidiary-specific effects.<sup>3</sup> The theory and data in this study treated entry-mode decisions at the corporate level, and we controlled for subsidiary effects by inserting two subsidiary variables in the analysis. However, our cross-sectional data, as well as limited subsidiary-level information in the analyses, cannot fully examine the subsidiary effects on the choice of entry mode. Future studies need to adopt a multilevel analysis using the longitudinal panel data with more subsidiary-level information (e.g., subsidiary-level R&D intensity) and examine how much subsidiary-specific effects matter on the entry-mode choice decisions.

In conclusion, this study examines both the transaction-cost and institutional perspectives on the choice of foreign entry mode. The results of the analyses suggest that both perspectives are robust in explaining foreign entry-mode choice decisions, thereby highlighting the insufficiency of the transaction-cost theory and the need to incorporate the institutional perspective in the studies of foreign entry mode. We propose that the choice of organizational structure (including entry-mode) cannot be viewed only as a level of control, but also as a consequence of organizational responses to isomorphic pressures arising from both external environments in which the firm operates and internal organizational practices within the firm. Entering a different institutional environment, firms tend to conform to the regulative settings of the host-country environment, the normative pressures imposed by the local people, and the cognitive mindsets as bounded by counterparts' entry pattern in the industry as well as past foreign entry pattern within the multinational enterprise.

### Acknowledgments

This paper is based on the first author's M. Phil. thesis at the Chinese University of Hong Kong and was completed when the first author was at the University of Oklahoma. The authors thank Tina Dacin and the anonymous reviewers for their helpful comments. They also thank David Ahlstrom, Chris Baughn, Lowell Busenitz, Michael Harvey, Mark Sharfman, David Tse, and Lu Yuan for their comments on the earlier versions of this paper. The authors especially thank Bob Hoskisson for his comments and continuous support. The work described in this article is partially supported by the Research Grants Council of the Hong Kong Special Administrative Region (Project No. CUHK4304/02H).

### Endnotes

<sup>1</sup>Historical norm is related to, but distinct from, the transaction-cost variable, "parent experience." In our study, parent experience refers to the amount of local knowledge a parent firm accumulates through its subsidiary in a host country. Historical norm goes beyond this amount of experience and captures the cognitive constraint imposed upon the organizational decision maker once such past experience is institutionalized (Leonard-Barton 1992, Levinthal and March 1993).

<sup>2</sup>The cultural distance variable was created by the following formula:

$$CD_{jk} = \ln \sum \{D_{ij} - D_{ik}\}^2 / V_i / 4$$

where  $CD_{jk}$  stands for the cultural difference between countries  $j$  and  $k$ ,  $D_{ij}$  is the score for parent country  $j$ , i.e., Japan, on the  $i$ th cultural dimension,  $D_{ik}$  is the score for subsidiary host country  $k$  on the  $i$ th cultural dimension, and  $V_i$  stands for the variance of the index for the  $i$ th cultural dimension.

<sup>3</sup>We thank one of the reviewers for pointing out this limitation.

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