

FDI Entry Mode Choice of Chinese MNCs:  
An Integrated Framework and Empirical Evidences

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**ABSTRACT**

Based on an integrated theoretical framework comprising the perspectives of strategic behaviour, transaction costs, organizational capabilities, and institutional influence, we first conducted a pilot investigation of ten Chinese multinational corporations (MNCs) with the aim of validating the framework. This was followed by a survey of 138 Chinese MNCs which examined the factors that affected those firms' FDI entry mode choice between wholly owned subsidiary (WOS) and joint venture (JV). The results suggest that the FDI entry mode choices of Chinese MNCs do not differ from those of Western or developed country MNCs from either an institutional or transaction cost perspective. However, there are major differences between Chinese and Western MNCs from an organizational capability and some aspects of a strategic behaviour perspective. The implications of these findings are discussed with a focus on the decomposition and rationalization of decision-making process of FDI entry mode choices.

## INTRODUCTION

The popularity of inward foreign direct investment (FDI) to China over the past two decades or so has been mirrored by outward FDI (ODI) from China in recent years. The growth trend of China's ODI has been steadily upwards since the mid-1990s (Deng, 2004, Liu et al., 2005). The annual flow of China's ODI recorded an increase of 528 per cent from US\$1.8 billion in 2004 to US\$11.3 billion in 2005. As a result, by the end of 2005, China's ODI stock volume ranked third among developing countries, after Russia and Brazil (UNCTAD, 2006). Despite the increasing prominence of China's ODI in global business, modest research attention has been paid to this area. Most existing studies have focused on explaining the growth of China's ODI from an economic perspective, revealing the linkage between macroeconomic development level and FDI outflow (Cai, 1999, Deng, 2004, Liu et al., 2005). A limited number of studies have been conducted at the firm level, mainly focusing on the determinants, motivation, and location choice of Chinese MNCs' FDI activities (Young et al., 1996, Wu and Chen, 2001, Liu and Li, 2002, Wang, 2002). However, little is known about how Chinese MNCs' choose an international market entry mode, especially between wholly owned subsidiary (WOS) and joint venture (JV). This is despite the fact that the FDI entry mode choice between WOS and JV is one of the most important and challenging decisions for any MNC seeking to enter foreign markets.

The hierarchy model of market entry mode (Pan and Tse, 2000), posits that once a firm decides to enter foreign markets through equity mode (FDI), the next decision is to choose an entry mode from two alternatives – WOS and JV. The decision is multifaceted and complex as it influences the level of control, the resource commitment, and the risk involved in the overseas operation of the entrant firm (Anderson and Gatignon, 1986), and therefore has significant and far-reaching consequences on its performance and survival overseas (Davidson, 1982, Gatignon and Andersen, 1988, Root, 1994, Terpstra and Sarathy, 1994, Ekeledo and Sivakumar, 2004). While the theory of FDI entry mode choice is well developed for Western MNCs, there are significant questions about whether this theory applies equally to MNCs from developing countries such as China which are now emerging as important players. In view of this significant theoretical gap, this paper sets out to investigate the FDI entry mode decision making of Chinese MNCs, focusing on the major factors impacting the choice between WOS and JV entry modes.

## RESEARCH PROPOSITIONS

FDI entry mode choice has been extensively researched in relation to developed countries for decades and has resulted in an abundant literature. Various theories have emerged from this work, such as the transaction cost approach (Anderson and Gatignon, 1986, Gatignon and Andersen, 1988), strategic behaviour approach (Harrigan, 1988, Kogut, 1988, Buckley, 1990), organizational capability perspective (Aulakh and Kotabe, 1997, Madhok, 1998) and institutional perspective (Lu, 2002, Yiu and Makino, 2002), among others. These four theories have been widely adopted and generally supported by empirical studies, and their complementarity to each other has also been proven (Kogut, 1988, Aulakh and Kotabe, 1997, Madhok, 1998, Mutinelli and Piscitello, 1998, Lu, 2002, Yiu and Makino, 2002). To provide a more comprehensive - and thus more powerful theoretical framework - efforts have been made by researchers to integrate these complementary theories. Dunning's (1988) eclectic theory was applied in an entry mode study by Agarwal and Ramaswami (1992:4) whose framework incorporated firm ownership, location, and internalization factors in the entry mode choice but did not include firm strategic factors and institutional factors. Hill et al. (1990:4) proposed an eclectic framework that incorporated strategic variables into the transaction cost framework which was tested and supported by Kim and Hwang (1992). Aulakh and Kotabe (1997:150) further specified this framework to include strategic factors, organizational capability factors, and transaction cost factors. In addition to these factors, Bell's (1996:59) eclectic model includes locational factors derived from internalization theory which shares the same theoretical roots with transaction cost theory (Teece, 1986). Institutional perspective variables, however, have been largely neglected or incompletely included in these "eclectic" frameworks. For example, instead of addressing the normative institutional impact from both host country cultural ethnocentricity and home-host cultural distance aspects (Yiu and Makino, 2002), the eclectic frameworks only focus on the cultural distance issue (e.g. Bell, 1996) and have therefore led to different empirical results from institutional perspective theory. Therefore, a more comprehensive framework that fully incorporates the four complementary theories may serve as a basis for examining Chinese MNCs' FDI entry mode decisions.

The compatibility of the existing theories within the current research context is also challengeable. The existing literature is mainly developed from and for the practice of developed country firms whilst this study investigates the FDI practices of firms from the world's largest developing country. Based on Dunning's investment

development path (IDP) theory (Dunning, 1993, Dunning and Narula, 1996), China is now in a transition phase from the second to the third IDP stage, where some domestic firms have established a certain level of capability for international competition and are starting to seek possibilities to exploit and enhance their ownership advantages overseas (Liu et al., 2005). Previous studies have been conducted on firms from developed countries – countries in the fourth or fifth IDP stage where highly advanced technology and high living standards are the major characteristics. Country of origin effect, firm capability, FDI motivation and many other factors differ between Chinese MNCs and firms studied in the literature, and such differences require adjustment to the entry mode predictions of transaction cost, organizational capability, and strategic behaviour theories. In addition, the institutional environment of Chinese MNCs is also different from that of developed country firms. For example, the government's influences on business are considerable in China, and the relationship- and network-centered business culture imposes extra normative institutional barriers on Chinese FDI firms when they seek to integrate with the global business system (Zhan, 1995). Such differences suggest that a simple synthesis of existing theories may not be able to capture all the major factors impacting upon Chinese MNCs' FDI entry mode decisions, especially those associated with special features of Chinese MNCs and their institutional environment.

## **THEORETICAL FRAMEWORK AND HYPOTHESES**

The theoretical framework for this study is based on the four complementary FDI entry mode theories. With the aim of testing those existing theories and in order to reveal any factors specific to Chinese MNCs associated with their FDI entry mode choice decisions, a pilot study was conducted in 2005 using in-depth interview and qualitative data analysis methods. Executives from ten Chinese MNCs in a variety of industries were interviewed, focusing on the motivation, strategies, and FDI entry mode decision factors related to their FDI projects. Global strategic motivation, resource constraints, technology seeking, and home and host government influences emerged as the major themes from the interview data. The pilot study findings provided evidence to adjust and integrate the four complementary theories in a unified comprehensive framework. Figure 1 is the theoretical framework depicting the relationship between independent and dependent variables. The hypotheses derived from the framework are formally stated below.

Place Figure 1 here

### *Strategic Behaviour Approach*

From a strategic perspective, firms choose an FDI entry mode to optimize their strategic position in a global and local business context. The firm's global strategy, generic competition strategy, first mover advantage strategy, and global catching up strategy are all relevant to the entry mode decision.

A **global strategy** is theoretically opposite to a multidomestic strategy (Roth et al., 1991) and emphasizes the strategic arrangements by which an MNE coordinates its global business network, maximizes the synergistic effect from it, and makes strategic moves in reaction to its global competitors. Chinese MNCs have been pursuing strategic FDI for global synergy effects, especially in relation to technological learning and the R&D sector. They also pursue other global strategic motivations such as setting up global expansion outposts and global sourcing sites. The pilot study showed that Chinese MNCs expanding overseas through FDI with global strategic motivations prefer high levels of control and integration. This preference has also been identified in prior studies and has been explained in terms of it being easier for a MNE to implement global strategy when the individual business units are fully controlled than when they are jointly controlled by the headquarters (Hill et al., 1990, Kim and Hwang, 1992, Zhan, 1995, Aulakh and Kotabe, 1997, Makino and Neupert, 2000), because fully controlled business units constitute a more integrated global business network whereas jointly controlled business units involve one or more business partners who may apply different or even contradictory international business strategies.

*Hypothesis 1 (H1): The global strategic motivation behind the FDI of a Chinese MNC is positively related to it choosing a WOS entry mode*

Severe **host industry competition** encourages foreign entrant firms to adjust their FDI entry strategy and entry mode choice in accordance with the most effective competition strategy in that host industry. However, previous studies have been inconclusive about the direction of the impact. Gomes-Casseres's (1990) study found a negative relationship between this variable and the likelihood of choosing a WOS entry mode, supporting the argument that a JV enables an entrant firm to avoid host-country firm retaliation and retain strategic flexibility in a competition-intensive host industry (Hennart and Larimo, 1998). Bell (1996), however showed that a foreign

entrant survives and wins against severe local competition by adopting a differentiation strategy (Teece, 1981, Hennart and Park, 1994) through solo operation. Other studies, however, have found no significant impact of host-industry competition level on FDI entry mode choice (Kogut and Singh, 1988, Hennart, 1991, Kim and Hwang, 1992, Larimo, 1993). Our pilot study findings reveal that Chinese MNCs have a preference for a high level of control over their foreign ventures in competition-intensive host industries such as manufacturing and service industries in developed countries. JVs are usually not preferred by Chinese MNCs because the strategic fit between Chinese MNCs and developed country local firms is low, as Chinese MNCs generally adopt cost leadership and niche-market competitive strategies, whilst developed country local firms usually focus on the development of high value-adding technology and product differentiation competitive edge. When the host-industry competition level is high, a Chinese entrant firm is most likely to enter the industry alone as maintaining its low-cost and niche-market focused competitiveness is the most effective way to survive the competition. It needs to be noted, however, that this argument is only valid in greenfield FDI, as in the case of acquisition no additional capacity is added to the host industry and its competitive situation is not immediately affected.

*Hypothesis 2 (H2): The competition level in the host industry is positively related to the likelihood that a Chinese firm will choose the WOS entry mode in a greenfield FDI.*

**Host industry growth** reflects the attractiveness of a local industry and the importance for a foreign entrant firm to establish an advantageous competitive position in this market before its competitors. In order to obtain first or early mover advantages in fast growing markets, a foreign entrant firm will prefer an entry mode that enables rapid establishment in order that it can profit from the fast growth and large growth potential and so that it can build up a local competitive edge in advance of its competitors (Kogut and Singh, 1988, Hennart, 1991). A large portion of China's outward FDI has targeted developing economies and emerging markets with high growth rates and large growth potential, such as countries in Eastern Europe and Southeast Asia, where a quick entry is usually considered as a key to success. The JV entry mode, either in a greenfield or by acquisition, provides a fast track for establishment compared to a WOS entry mode which demands more preparation and processing time and other resources.

*Hypothesis 3 (H3): Host industry growth is negatively related to the likelihood that a Chinese firm will choose the WOS entry mode.*

**Resource seeking motivation** plays an important role in the FDI decision making of firms that use FDI as a catch-up mechanism to enhance their capabilities, especially firms from developing countries (Moon and Roehl, 2001). Lack of technological capability may compel a firm to seek technological opportunities overseas, usually in technologically advanced industries in developed countries (Gomes-Casseres, 1989, 1990, Bell, 1996, Brouthers et al., 1996, Lu, 2002). It can also be related to the product and activity diversification strategies of a firm where the investing firm lacks prior experience in the new business and will require complementary know-how from other firms (Hennart, 1991, Madhok, 1998, Mutinelli and Piscitello, 1998). Firms can acquire complementary resources by acquiring assets of other firms, setting up joint venture with them, or through local purchasing and local hiring by their foreign subsidiaries. From our pilot study, it appears that Chinese MNCs prefer full ownership when technology and know-how seeking possesses a high strategic priority in their FDI projects because it gives an investing firm unrestricted access to its acquired resources and allows it to freely relocate them within its global business network to fully utilize their strategic and business value. However, this preference for full ownership in resource-seeking FDI is moderated by the mutual complementarity of firm resources between entrant and host-country firms. If resource-seeking Chinese MNCs enter a host country where local business sees inward FDI as a source of complementary resources, the resource-seeking motivation applies to both entrants and locals and can only be mutually fulfilled in a JV operation. In such situations, a full ownership entry mode is perceived as hostile by local business and government as it does not necessarily benefit their development.

*Hypothesis 4 (H4): The resource-seeking motivation in a Chinese MNC's FDI is positively related to the likelihood that it will choose a WOS entry mode. This positive relationship weakens when firm resource mutual complementarity is high between the Chinese entrant firm and host country local firms.*

### *Organizational Capability Perspective*

From a firm-capability perspective, FDI entry mode choice is constrained and affected by the endowment and configuration of tangible and intangible firm assets represented by firm size, international experience, and goodwill capital.

**Firm size** is commonly used as a proxy of the overall tangible resource capability of a firm. The large resource requirement of integration has led researchers to believe that firm size is positively related to a WOS entry mode (Kogut, 1988, Gomes-Casseres, 1990, Agarwal and Ramaswami, 1992, Erramilli and Rao, 1993, Aulakh and Kotabe, 1997). However, when the size of the firm exceeds a certain point, it tends to avoid adding more fully controlled foreign affiliates into its global business network, because the cost of maintaining and managing an oversized system will exceed the benefits of control (Hennart and Larimo, 1998, Lopez-Duarte and Garcia-Canal, 2002, Lu, 2002). Our pilot study findings, as well as the statistical evidence, suggest that, at the current stage of their internationalization, Chinese MNCs are generally small sized in comparison with their foreign counterparts, and that, therefore, it is not the oversize consideration but rather the size constraint that is of concern to Chinese managers in their FDI entry-mode decision making.

*Hypothesis 5 (H5): The size of a Chinese MNC is positively related to the likelihood for it to choose a WOS entry mode.*

A firm's **international experience** is the experience accumulated from its prior overseas business operations. A positive relationship between experience and degree of control in foreign ventures has been found in many prior studies (Gatignon and Andersen, 1988, Agarwal and Ramaswami, 1992, Brouthers et al., 1996, Aulakh and Kotabe, 1997, Mutinelli and Piscitello, 1998, Meyer, 2001), supporting the argument that experienced firms perceive less uncertainty in overseas operations and are more aggressive in committing resources and assuming control than inexperienced firms (Erramilli, 1991). Our pilot study shows that those Chinese managers who perceived high levels of unfamiliarity and risk due to inexperience in international operations preferred a collaborative entry mode (JV) instead of solo operation (WOS).



*Hypothesis 6 (H6): The international experience of a Chinese MNC is positively related to the likelihood for it to choose a WOS entry mode.*

**Goodwill capital** refers to the asset value of a firm's reputation and its brand name (Mueller and Supina, 2002). In the existing literature, this variable has been mostly discussed in transaction cost theory which suggests that distinct firm reputation and brand value is subject to a partner free-riding threat (Anderson and Gatignon, 1986) which may result in degradation and substantial loss of firm goodwill capital (Bell, 1996). Therefore, when investing overseas, a firm with high value goodwill capital will tend to avoid partnership in its foreign ventures (Gatignon and Andersen, 1988, Gomes-Casseres, 1990, Brouthers et al., 1996, Ekeledo and Sivakumar, 2004). However, the linkage between firm goodwill capital and free-riding risk is challenged in the pilot study on Chinese FDI firms. As late participants in global business, Chinese MNCs are in the process of building their global brands. Their current business reputation is regional and not globally distinct, which does not generate extra value for their products and services, and therefore does not necessarily cause free-riding risk. Accordingly, it is more theoretically appropriate to define goodwill capital as a firm capability but not as a source of transaction costs. In fact, as suggested by the pilot study, Chinese MNCs with relatively higher reputations are more accepted by host country local firms in forming joint ventures because they are regarded as more trustworthy and reliable business partners by their foreign counterparts.

*Hypothesis 7 (H7): The goodwill capital of a Chinese firm is negatively related to the likelihood for the firm to choose a WOS entry mode.*

#### *Transaction Cost Approach*

From a transaction cost perspective, a firm should choose a FDI entry mode that minimizes the transaction cost caused by the transfer of proprietary assets and the risk of free-riding on the positive reputation of the firm.

**Proprietary assets** refer to highly differentiated and hard to imitate production technologies and know-how which generates "quasi-rent" (Hill et al., 1990) for the firm who owns such specific assets. Investments that involve highly specific assets are not easily transferable to alternate uses without significant loss of value (Williamson, 1975, Klein et al., 1978, Williamson, 1985) which increases the investing firm's vulnerability to opportunism.

Accordingly when both asset specificity and partner opportunism levels are high, the investing firm will prefer the transfer of specific assets through internal channels, as in the context of FDI, a preference for a WOS over a JV entry mode (Erramilli and Rao, 1993, Bell, 1996, Madhok, 1998). Although Chinese MNCs have often lacked high-value proprietary assets, this cannot be generalized to all Chinese MNCs, especially those leading firms that actively participate in outward FDI. Our pilot study findings show that in industries where Chinese MNCs possessed highly specific "quasi-rent" generating assets, such as in the oriental pharmaceutical industry, the investing firms prefer to expand to foreign markets through integrated entry modes in order to exercise their control and to protect their proprietary assets.

*Hypothesis 8 (H8): The level of proprietary assets involved in the FDI transaction of a Chinese firm is positively related to the likelihood that the firm will choose a WOS entry mode.*

Another source of transaction costs is the **free-riding risk** which is associated with a firm's positive reputation that generates extra value for its products or services. As discussed above, since Chinese MNCs are currently building, not exploiting, their goodwill capital in FDI, the linkage between firm reputation and free-riding risk cannot be assumed. This argument suggests a separation of free-riding risk from firm reputation but is not a rejection of the theoretical rationale of the transaction cost approach. Chinese FDI firms can still be exposed to partner free-riding risk; however, it is decided not only by the reputation of the entrant firm, but also many other contingency factors related to the specific host-country location, industry and product. For example, a Chinese electric home appliance manufacturing firm with a good regional reputation and brand recognition can be subject to partner free-riding when it enters neighboring developing countries; but free-riding will not be its major concern when the firm enters European or North American markets for global brand building. The difference between prior studies and this study, therefore, lies in the measurement of free-riding risk but not its impact on FDI entry mode choice. When measured separately from firm reputation, the positive relationship between free-riding risk and a firm's preference for WOS entry mode should also stand in the FDI entry mode choice of Chinese MNCs

*Hypothesis 9 (H9): The free-riding risk of a Chinese MNCs' positive reputation and brand value is positively related to the likelihood that the firm will choose a WOS entry mode.*

### *Institutional Perspective*

From the institutional perspective, firms choose FDI entry mode to attain institutional legitimacy with regard to host country regulatory and normative systems and the firms' internal institutional environment.

Host country regulatory institutions refers to the **host government's restrictions** due to which foreign investing firms must adjust their entry mode to attain regulatory institutional legitimacy. In a host country with a high level of regulatory institution restrictiveness, foreign investing firms are subject to discriminatory host government policies on foreign ownership in local business, access to local resources, mandate for exporting, and many other policies that will constrain the foreign investing firm's operation. Hence, the foremost concern of a firm entering a restrictive foreign country is to gain market legitimacy, namely, to establish the equal right as local firms in the local operation. A JV entry mode is preferred because restrictive local policies have less impact on a jointly-owned foreign-domestic business than they have on a purely foreign-owned business (Gomes-Casseres, 1989, 1990, Erramilli, 1996, Padmanabhan and Cho, 1996, Tse et al., 1997, Mutinelli and Piscitello, 1998, Brouthers, 2002, Yiu and Makino, 2002). Chinese executives interviewed during the pilot study also emphasized that a JV entry mode enabled them to avoid disadvantageous market positions caused by restrictive host government policies and the general country risk associated with restrictive host-country regulatory institutions.

*Hypothesis 10 (H10): The level of host government restrictions is negatively related to the likelihood that a Chinese firm will choose a WOS entry mode.*

Host country normative institutions impose a certain level of **cultural barrier** to foreign firms operating in the host country. When entering an institutional context with a different normative system, a firm must accommodate institutional expectations and conform to social expectations to demonstrate their social responsibility, in other words, to build social legitimacy in host country. The level of pressure from the host country normative institutional environment is affected by the ethnocentricity of local culture (Yiu and Makino, 2002). In an ethnocentric cultural environment, a foreign firm will find it hard to be socially accepted, and therefore it may feel the need to form a JV, as a JV is more socially and culturally acceptable than a purely foreign owned business (Yiu and Makino, 2002). The difficulty in obtaining local socio-cultural legitimacy is also related to the cultural

distance between the home and host country. By forming a JV, the investing firm can learn how to adapt to local cultural norms from its partner and can utilize the partner's social network to shorten the cultural distance (Gomes-Casseres, 1989, Hennart, 1991, Yiu and Makino, 2002). Chinese MNCs also prefer a JV entry mode in host countries where the ethnocentric local culture and cultural differences impose significant disadvantage on operating solely as foreign firms.

*Hypothesis 11 (H11): Cultural barriers are negatively related to the likelihood that a Chinese firm will choose a WOS entry mode.*

The internal institutional environment of a firm influences the cognitive mindset of FDI entry mode decision makers in favor of previous successful and commonly adopted entry modes. Chinese FDI firm managers, at the current stage, are free from such institutional impacts because their firms have not formed an historical norm of FDI entry mode choice, as their experiences of prior FDI entry are still very limited and not yet institutionalized. For Chinese MNCs, a more significant internal institutional impact arises from **home government support** as a result of their already established home country institutional legitimacy which entitles them to a certain amount of additional resources to conduct FDI. As noted by Aggarwal and Agmon (1990), home governments play an important role in the competitive advantage of these firms when they expand overseas. The resource constraints faced by Chinese MNCs in FDI can be partially relieved by home government support in the form of government funding, national bank loans with preferential terms, tax breaks, and others which enable them to commit more resources to the FDI entry.

*Hypothesis 12 (H12): Home government support is positively related to the likelihood that a Chinese firm will choose a WOS entry mode.*

Figure 1 summarizes the theoretical framework and the hypothesized causality between the variables discussed above, as well as the FDI entry mode choice of Chinese MNCs between WOS and JV. A positive sign indicates that an increase in the variable will increase the likelihood that WOS is chosen as the FDI entry mode.

## METHODS

### *Data*

A sample frame of 588 Chinese MNCs was constructed for the data collection phase of this study, which accounted for 14.6 per cent of the population of Chinese MNCs as at the end of 2005 (population size 4021, MOC, 2006). This sample frame included Chinese outward investing firms listed in the last three issues of 'Statistical Bulletin of China's Outward Foreign Direct Investment' published by the Chinese central government, as well as other Chinese MNCs revealed in provincial Chinese government publications, the Chinese stock market database, and newspaper articles. A questionnaire was then designed by which to collect FDI entry-mode decision-related information from senior executives of these Chinese MNCs at their headquarters in China. Data was collected between July 2006 and November 2006. A telephone pre-screen procedure was initiated to identify potential respondents and to seek initial commitment to participate. Such an approach has also been applied successfully in previous studies using surveys (Pahud de Mortanges & Vossen, 1999). After eliminating those unable or unwilling to participate, 189 potential respondents remained in the final survey list and were sent the questionnaire via facsimile. Usable questionnaires were returned by 138 firms before the completion of the survey, constituting a 75.1 per cent response rate. The 138 responding firms included firms from a wide range of industries in the resource, manufacturing, and service sectors. 58 of the cases related to JVs while the other 80 related to foreign entries by WOS.

### *Measurement*

#### **Dependent Variable**

This study focused on the FDI entry mode choice between WOS and JV, making the dependent variable dichotomous and categorical. JV was coded as '0', and WOS '1'. Following prior studies of FDI entry mode choice (Erramilli and Rao, 1993, Hennart and Larimo, 1998, Madhok, 1998), in this study, the dependent variable was measured by a single question that asked the respondents to select their chosen FDI entry mode from the two alternatives.

## **Independent Variables**

The twelve independent variables incorporated in the theoretical framework of this study are all latent constructs which are linked to the empirical world through indicators. Variable constructs containing multiple psychometric indicative items have been developed and adopted in previous entry mode studies to measure the FDI entry mode factors impacting on managerial perceptions (Agarwal and Ramaswami, 1992, Kim and Hwang, 1992, Erramilli and Rao, 1993, Bell, 1996, Aulakh and Kotabe, 1997, Davis et al., 2000, Brouthers, 2002, Ekeledo and Sivakumar, 2004). In this study, the independent variable measures were developed mainly from established indicative items in these prior studies. For those variables not investigated in prior studies, new indicator items were developed based on theoretical concepts in the literature and the findings of the pilot study.

The initial variable constructs included multiple indicator items for each variable and were subject to a scale reliability test, and a refining procedure was then followed. The indicative items with low item-to-total correlation ( $r < 0.25$ ) were eliminated from their corresponding constructs to ensure satisfactory scale reliability ( $\alpha > 0.60$ ) for each construct (a list of the indicators can be supplied on request). Except for firm size which is measured on the sales volume range of firms, all other variables are measured on 5-point scale and their variable scores were calculated based on a unit weighing scheme (Einhorn and Hogarth, 1975). Correlation tests were then performed on the independent variables where no significant large correlation ( $r > 0.45$ ) was found between the independent variables (see Table 1).

Place Table 1 here

## **Control Variables**

An FDI entry mode decision involves two levels of choice – the choice of foreign venture ownership structure (WOS or JV) and the choice of FDI establishment method (greenfield or acquisition). Kogut and Singh (1988) argue that the degree of ownership is usually determined in conjunction with the mode of establishment whereas in some other studies these two decisions are generally treated as independent of each other (Caves and Mehra, 1986, Hennart, 1991, Hennart and Park, 1993, Padmanabhan and Cho, 1996, Hennart and Larimo, 1998). A *greenfield* dummy variable was included in this study to control for the possible effect of different establishment

methods on the FDI entry mode choice between WOS and JV. Prior studies that sampled FDI firms from multiple home countries also found that differences in home country cultural and economic characteristics had a significant impact on the firm's entry mode preference (Erramilli, 1996). Although the firms which were the focus of this study are of the same nationality, one may argue that regions within a nation can also vary if distinctive subcultures exist in the nation (Goodman, 1992, Robertson, 1993). To control for any possible effect of regional and subcultural difference on Chinese manager's decision making with respect to FDI entry mode choice, a *subculture* control variable denoting the affiliation of the responding firms to the three principal subcultural regions in mainland China – Beijing, Shanghai, and Guangdong - was included in this study. Finally, being a Chinese State-owned enterprise (SOE) may impose certain political and diplomatic liabilities on Chinese FDI firms, especially when they enter ideologically conflicting host countries. A SOE dummy variable was included to examine and control for any possible impact of such liability on an SOE firm's FDI entry mode decision.

#### *Empirical Test*

The logistic regression method has been the most frequently adopted empirical test method in FDI entry mode studies (Gomes-Casseres, 1989, Hennart, 1991, Makino & Neupert, 2000). Arregle, Hebert, and Beamish (2006) proposed a multilevel method in challenge to the logistic regression method, however it was also noted that this method could be less effective if the firms under research only engaged in one or a few FDI entries (Arregle, Hebert, & Beamish, 2006). As Chinese MNCs generally fall into this category, in this study, the hypotheses were tested using binomial logistic models. Such a technique is oriented to estimating the probability that one event occurs rather than another - as in this study, the choice of a WOS entry mode rather than a JV entry mode. The probability of a Chinese MNC choosing a WOS entry mode in preference to a JV entry mode can be modeled as a function of the independent variables and control variables as follows:

$$\pi = \frac{e^Z}{1 + e^Z}, \text{ where } Z = b_0 + b_1X_1 + b_2X_2 + \dots + b_nX_n$$

$\pi$  is the probability of choosing WOS as the mode of FDI entry and Z is a linear combination of explanatory variables. A positive regression coefficient ( $b_i$ ) means that an increase in its associated variable ( $X_i$ ) will increase

the likelihood of WOS as the selected FDI entry mode. The parameters are estimated using maximum likelihood, employing the binomial logistic regression procedure of SPSS 13. The overall efficacy of the model is assessed using the likelihood ratio Chi-square, which is twice the difference in log likelihoods for the estimated model and the base model (a model only including constant). The predictive ability of the model can be gauged by comparing the correct classification rate of the estimated model with that of the random model. A 25 per cent improvement in correct classification rate from the random model is generally regarded as significant (Hair, Black, Babin, Anderson, & Tatham, 2005). A statistically significant parameter indicates the extent to which the corresponding variable contributes to the utility of WOS entry mode to JV entry mode by a Chinese MNC in its FDI entry.

Six different models were tested in this study. Model 0 had a Z function that included only the three control variables. This is to test, before the framework is introduced, how well the choice of FDI entry mode can be explained by categorizing firms based on their FDI establishment method, subculture affiliation, and state ownership structure. Models 1 to 4 included the control variables and the independent variables from each of the four individual theories separately to test the effectiveness of each individual theory before they were integrated. Models on individual theories without inclusion of control variables were also tested and similar results were generated. To avoid redundant information, only the results of models of individual theories with control variables are reported in this paper. Model 5 aims to test the integrated framework which incorporates variables from all four complementary theories. Based on model 5, model 6 further includes control variables into its test. The test results of these six models are shown in Table 2.

Place Table 2 here

Model 0 had an insignificant model chi-square ( $p=0.120$ ), indicating that the control variables alone cannot effectively differentiate the two FDI entry modes. The greenfield dummy variable had a positive coefficient and was significant at the .01 level which showed an association between a greenfield investment method and a WOS entry mode. The other two control variables were insignificant in all models, and the greenfield investment dummy variable was also insignificant in the models where strategic behaviour variables were included. Individual models of the strategic behaviour approach (model 1), the organizational capability perspective (model 2) and the



transaction cost approach (model 3) all showed significant model chi-squares with most of the independent variables significant and supporting their corresponding hypotheses. The individual model of the institutional perspective obtained a marginally significant model chi-square and no significant coefficient on its independent variables. This indicated that the institutional perspective must be considered complementary to other theories but not an independent FDI entry mode framework. One common weakness of the four individual models was that their model classification hit-rates were all below 70 per cent, while a 25 per cent improvement from random model (where in this study a hit-rate higher than 76.3 per cent) is regarded as significant (Hair et al., 2005).

Single theories, as evidenced by the low classification hit rate of models 1 to 4, did not show sufficient predictive ability; however, when integrated, model 5 benefited from the complementarity of the individual theories and achieved a satisfactory model fit on all assessment criteria. The model chi-square was 69.884 with a degree of freedom of 13 and was significant at the .001 level ( $p=.000$ ). This result indicated a significant reduction of -2LL (-2 times the log likelihood) from the base model, showing a good fit of the model. Furthermore, the Hosmer and Lemeshow Goodness-of-fit Chi-square test returned an insignificant result ( $p=.223$ ) as expected, indicating that there is not sufficient evidence to reject the null hypothesis that the actual and predicted values of dependent variable are equal. Lastly, the overall hit rate percentage (percentage of correct prediction) was 79.0 per cent which was a 27.7 per cent improvement from the random model. A slight increase in model hit rate from model 5 was observed in the test results of model 6, where the three control variables were included. However, the inclusion of the control variables did not change the significance of independent variables and the control variables themselves were all insignificant. When effectiveness (model fit) and efficiency (proportion of significant explanatory variables) are both taken into consideration, model 5, which is the exact transformation of the theoretical framework proposed in this study, appears to be the best model among all alternatives. This suggests that it is reasonable to base the hypothesis testing on the test results of model 5.

As shown in the test results of model 5 in Table 2, all of the four strategic behaviour hypotheses were supported. The hypothesized positive impacts of global strategic motivation and host industry competition on the choice of WOS entry mode were both highly significant. Host industry growth had a negative impact on the choice of WOS entry mode as expected and was significant at the .05 level. Resource seeking motivation had a positive impact

on the choice of WOS entry mode which was significant at the .05 level, while this positive impact was negatively moderated by mutual complementarity of firm resources with the moderating effect significant at the .01 level; this supported the hypothesis on resource seeking motivation and the moderating effect on it. With regard to the three organizational capability hypotheses, while the hypothesized positive impact of firm size and negative impact of goodwill capital on the choice of WOS entry mode were significant at the .01 and .05 levels, respectively, no significant impact of international experience was evidenced in the test results. Both transaction cost hypotheses were supported but to various degrees. The positive impact of proprietary assets on the choice of WOS entry mode was marginally significant (at the .10 level), while a higher significance level (at the .01 level) was evidenced on the positive impact of free-riding risk. Model estimation of the three institutional variables received different results. The expected negative impact of cultural barriers on the choice of WOS entry mode was supported as evidenced by a negative coefficient of the variable which was significant at the .05 level. The negative impact of host government restrictions was marginally significant (at the .10 level) whereas home government support showed no significant impact on the choice of FDI entry mode.

While the focus of this study is on the FDI entry mode choice between JV and WOS, the structural differences among different types of joint venture discussed in many prior studies (Gatignon and Andersen, 1988, Levary and Wan, 1999, Pan and Tse, 2000, Jiang, 2001) call for an in-depth investigation on the effects of the independent variables on the choice of different types of JV entry mode, as against WOS entry mode. A multinomial logistic regression model was tested where the categorical dependent variable had four values representing WOS, majority JV (largest ownership share), equal JV (equal ownership share with largest partner), and minority JV (less ownership share than largest partner) entry mode, respectively. The multinomial logistic regression technique is oriented to estimating the probability that a certain state of an event occurs compared to a reference state of the event, as in this study, the choice of one of the three JV entry modes against a WOS entry mode. To obtain comparable results with the hypothesis tests based on model 5 of binomial logistic regression, the twelve independent variables were entered in this multinomial logistic test model as explanatory variables, and the results are shown in Table 3 below.

Place Table 3 here

Two independent variables, international experience and home government support, that were insignificant in the binomial tests remained insignificant in the multinomial test, which confirmed that neither factors have a significant impact on the choice of FDI entry mode. Unexpectedly, host government restrictions which was marginally significant in the binomial test showed insignificant results in the multinomial test. Accordingly, it was JV entry mode in general, but not any of its particular forms, that was preferred by entrant firms in highly restrictive host countries. The other nine independent variables were all significant with their impacts on the choice of a JV as against a WOS entry mode consistent with the binomial test results. The fact that none of these independent variables was significant for any of the three types of JV entry mode simultaneously confirmed that to FDI entry mode decision makers, the three types of JV were not considered as homogenous but, indeed, different entry modes options. The overall model fit of the multinomial logistic regression model was satisfactory, as evidenced by a significant reduction in -2LL and insignificant test results of Pearson and Deviance's goodness of model fit as expected.

## **DISCUSSION AND IMPLICATIONS**

Both similarities and differences exist between the strategic behaviour of Chinese MNCs and Western firms in their FDI. Consistent with previous studies (Kim and Hwang, 1992, Aulakh and Kotabe, 1997), this study supported the proposition that Chinese MNCs expanding overseas for global strategic reasons prefer a WOS entry mode, especially as against equal and minority JV entry modes, as full ownership provides the entrant firms with greater control over their overseas affiliates. With regard to host industry competition levels, Chinese MNCs prefer the WOS entry mode when entering a competition-intensive host industry. Our result is consistent with Bell's (1996) study but contradicts the findings of Gomes-Casseres (1990). It suggests that the low cost and niche-market focused competition strategies of Chinese MNCs can be better implemented when they operate alone in highly competitive host industries. The negative impact of host-industry growth on the choice of a WOS entry mode that has been supported in many prior studies (e.g. Gomes-Casseres, 1990, Hennart, 1991, Bell, 1996, Brouthers et al., 1996) is also supported in this study. To establish first or early mover advantage and capture the benefit of fast-growing potential markets, Chinese MNCs prefer a JV entry mode, in either majority or minority form, which enables a quick entry into the host industry, while a WOS entry mode is considered too time consuming and therefore disadvantageous. In contrast to Western firms, a large proportion of the FDI activities of

Chinese MNCs are resource seeking rather than resource exploiting oriented. Chinese MNCs prefer WOSs, especially as against minority JVs in their resource seeking FDI in order to more effectively relocate and utilize the acquired resources. However, when mutual complementarity of firm resources is high between Chinese MNCs and host country local firms, the strategic merit of a WOS entry reduces relative to a JV entry mode as resource-seeking motivation applies to both parties, which can only be fulfilled simultaneously in a JV operation.

In terms of capability, Chinese MNCs differ from Western firms in both tangible and intangible aspects. Although the effect of size constraints on the choice of a WOS entry mode was supported, no significant impact of firms' international experience was found in the empirical results of this study. This is probably due to the fact that Chinese MNCs generally lack core knowledge of managing and operating assets overseas (as needed in FDI), although many of them have become very experienced in exporting or other types of international business activities. Also, in contrast to previous studies (e.g. Gatignon and Andersen, 1988, Bell, 1996), this study investigated the impact of firm goodwill capital (such as reputation and brand value) as a firm capability factor, not a source of transaction costs. It is confirmed that Chinese MNCs with relatively more goodwill capital can better attract foreign partners and therefore more frequently adopt a JV entry mode, especially with majority ownership share, when expanding overseas.

The institutional perspective and transaction cost approach focus on the external environment of FDI and the characteristics of the FDI transaction itself, which are largely independent of the characteristics of the entrant firm. Accordingly, the empirical test results on the transaction cost and institutional variables in this study are generally consistent with those of prior studies. A special feature of the Chinese MNCs investigated in this study is the level of home government support received by them. The results show that this factor has a positive but insignificant impact on their choice of FDI entry mode, which can be explained by two possible reasons. First, the level of home government support received by Chinese MNCs may not be adequate enough to significantly improve their investment capability or to influence their FDI strategy. Secondly, home government support may be related to a firm's decision to become engaged in FDI – the choice at the first hierarchy level of foreign market entry mode, where the decision is made between equity entry mode (FDI) and non-equity entry mode, rather than the FDI entry mode decision between a WOS and a JV. This suggests that firms that have already decided to enter

foreign markets by means of FDI can be largely homogeneous in terms of the level of government support they may be entitled to.

In general, Chinese MNCs do not differ from Western firms in terms of the institutional and transaction cost impacts on their FDI entry mode, while the major differences lie in firm capability and some aspects of firm strategic behaviour. Based on the integrated framework in this study, for Chinese managers facing the decision task of FDI entry mode choice, it is important to conduct an internal and external scanning process and a comparative rating process before making the decision. Internally, a firm needs to take into account its strategic mission vis-à-vis FDI and its capability status with the choice of the FDI entry mode. Resource seeking, strategic assets seeking, competition surviving missions, can be better accomplished in a solo operation given that the investing firm has sufficient assets power, while a JV is beneficial when the purpose is to gain first mover advantages in a potential market and can be relatively easy to establish when the investing firm has superior goodwill capital. Externally, transaction costs and institutional impacts need to be carefully measured. Western firm's experiences in assessing and counteracting partner opportunism in relation to specific assets, free-riding risks, host government restrictions, and cultural barriers are of great usefulness to Chinese MNCs. A WOS is preferable when it is important to minimize transaction costs while a JV is more effective in neutralizing the negative effects of a host government and the cultural environment. Finally, and more importantly, it is the joint effect of all of the internal and external factors that lead to the optimal FDI entry mode decision and, therefore, upon examining the impacting factors separately, it is necessary to rate the relative importance of these factors. Entry mode suggestions from individual factors can be contradictory to each other and priority should be given to the most important factors if tradeoffs need to be made. Many contingency issues may be involved in this comparative rating process which is beyond the scope of this study.

## **LIMITATIONS AND FUTURE RESEARCH**

This study shifts the focus of academic research on the FDI entry mode choice from Western firms (developed country MNCs) to developing country firms. As research in its early stage, this study is not without limitations. First, the data of this study was not adequate for an industry sector-specific analysis. This is mainly due to the lack of firm-level information for Chinese MNCs. For example, a complete list of Chinese MNC has been kept

confidential by the Chinese government and is not accessible to researchers. If resources allow, future studies should expand the sample frame, or focus on specific industry sectors. Secondly, this study investigates the impacts of strategic variables that lead to the FDI entry mode chosen by Chinese firms, but not the success of the chosen entry mode. One may argue that the most successful mode of entry will most likely to be chosen by decision makers. However, this argument is only valid under the assumption that decision makers are hyper rational. Future research should link the FDI entry mode choice with post hoc performance evaluations, as demonstrated in the study of Aulakh and Kotabe's (1997). Finally, this study investigates the FDI entry mode choice of firms from one single home country. National characteristics in economic and cultural terms should be incorporated into the framework when future research is conducted on firms from multiple developing countries.

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Table 1 Independent Variable Correlation Coefficients

Constructs	Pearson Correlation Coefficients													
	1	2	3	4	5	6	7	8	9	10	11	12	13	
1. Global strategic motivation	1													
2. Host industry competition	.145	1												
3. Host industry growth	-.011	.109	1											
4. Resource seeking motivation	.235**	.131	.139	1										
5. Mutual complementarity	.066	.153	-.001	.205*	1									
6. Firm size	-.056	-.139	-.107	.149	.042	1								
7. International experience	.116	.063	.129	.139	-.005	.105	1							
8. Goodwill capital	.115	.144	.190*	.145	.172*	.094	.425**	1						
9. Proprietary assets	.193*	.095	.210*	.065	.014	.031	.056	.187*	1					
10. Free-riding risk	.007	.054	.095	.086	-.118	.005	.013	.041	.317**	1				
11. Host government restriction	-.192*	.052	.166	-.174*	-.334**	-.163	-.050	-.093	.087	.122	1			
12. Cultural barrier	-.018	-.055	.006	-.053	-.109	-.095	-.093	-.150	-.042	.086	.343**	1		
13. Home government support	.171*	.035	.101	.132	.273**	.089	.137	.207*	.150	-.126	-.037	-.067	1	

\*: p<.10; \*\*: p<.05; \*\*\*: p<.01; \*\*\*\*: p<.001 (2-tailed)

Table 2 Binomial Logistic Regression Tests Results

	Model Estimates and Model Fits						
	Model 0	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
Constant	-.773	-1.539	-.725	-2.729***	1.146	1.118	1.453
CV1: Greenfield investment dummy	1.295***	-.078	1.672***	1.360***	1.258**	1.118	1.453
CV2: Subculture dummy 1	.049	.222	-.223	-.134*	.122		-.504
CV2: Subculture dummy 2	.027	.338	-.106	.169	.057		-.059
CV3: SOE dummy	-.039	-.200	-.509	.009	-.151		.643
H1: Global strategic Motivation		.196***				.226***	-.880
H2: Host industry competition		.543*				.836***	.980***
H3: Host industry growth		-.401**				-.496**	-.589**
H4: Resource seeking motivation		.166**				.206**	.239**
H4 x Host government promotion		-.037**				-.064***	-.066***
H5: Firm size			.179***			.215***	.268***
H6: International experience			.372			.360	.405
H7: Goodwill capital			-.094			-.181**	-.199**
H8: Proprietary asset				.014*		.021*	.023*
H9: Free-riding risk				.509**		.712***	.783***
H10: Host government restriction					-.278	-.546*	-.608*
H11: Cultural barrier					-.093	-.202**	-.219**
H12: Home government support					-.037	.017	.006
Model Chi-square significance	.120	.000	.005	.003	.070	.000	.000
Model classification hit rate	63.8%	68.8%	69.6%	65.9%	60.1%	79.0%	81.9%

\*: p<.10; \*\*: p<.05; \*\*\*: p<.01; \*\*\*\*: p<.001 (2-tailed)

Table 3 Multinomial Logistic Regression Test Results

	Model Estimation		
	Reference Category: WOS entry mode MJV / WOS	EJV / WOS	IIV / WOS
Constant	-3.604	-4.443	.869
H1: Global stg motive	-.127	-.504**	-.394***
H2: Host industry compet	-.923***	-1.320***	-.284
H3: Host industry growth	.446*	.389	.927**
H4: Res seeking motive	-.182	-.258	-.381**
H4 × Host gov't promotion	.060**	.102**	.082
H5: Firm size	-.203**	-.288*	-.223
H6: Int'l exp	-.530	-.211	.012
H7: Goodwill capital	.285***	.222	-.120
H8: Proprietary assets	-.025*	-.051*	.003
H9: Free-riding risk	-.719**	-.879	-.661
H10: Host gov't restriction	.515	1.049	.598
H11: Cultural barrier	.208**	.535***	.109
H12: Home gov't support	-.006	.003	-.112
Chi-square	105.665		
df	39		
Significance	.000		
Goodness-of-fit			
Pearson (significance)	.945		
Deviance (significance)	1.000		

\*: p<.10; \*\*: p<.05; \*\*\*: p<.01; \*\*\*\*: p<.001 (2-tailed)

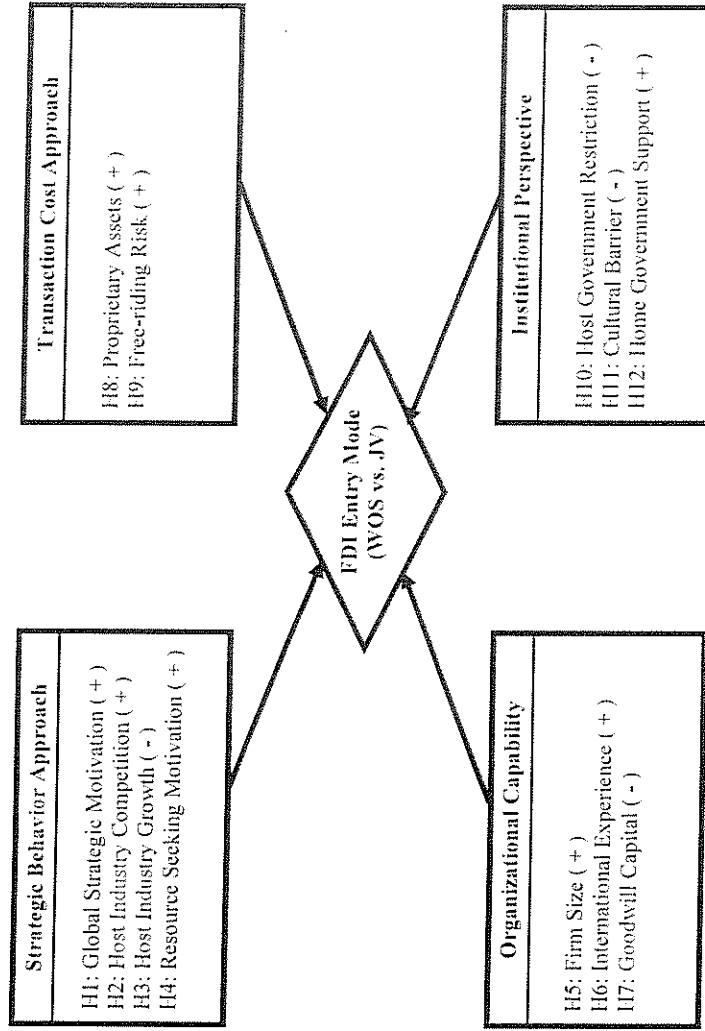


Figure 1 FDI Entry Mode Choice of Chinese Firms

A (+) sign indicates a greater likelihood that WOS will be chosen as the entry mode.

