

## Entry Mode Selection by Korean FDI Firms

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### <Abstract>

This research was started with the assumption that the entry mode selection by the FDI firms from developing countries will differ from those of the firms from developed countries. Two hypotheses concerning the entry mode selection were empirically tested by using the data collected from 36 subsidiaries of Korean parents

According to the test result, the firms that have the motivation to acquire new resources through foreign direct investment were seem to prefer joint-venture or acquisition mode, and the firms that do not have the motivation to acquire new resources through foreign direct investment seem to prefer new venture mode. Further analysis using the data set comprised of the firms with the motivation to acquire new resources through FDI showed that the firms with no willingness to expose their core resources preferred acquisition mode, and firms with the willingness to expose their core resources preferred joint-venture mode.

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## 海外直接投資 企業의 進入戰略 選擇에 관한 研究

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### <요 약>

본 연구에서는 한국기업들의 해외직접투자시 진입전략의 선택은 신규자원의 확보동기 및 핵심자원의 공개의지에 따라 다를 것이라는 가정하에 출발하였고, 보다 구체적으로는 해외시장 진입전략의 선택에 관한 신이론의 틀을 이용하여 한국기업의 해외시장 진입전략 선택에 관한 세가지 가설을 36개 해외직접투자 기업을 대상으로 설문조사한 자료를 이용

하여 검증하였다. 교차분석법에 의한 실증분석 결과 신규자원 확보동기의 유무가 해외시장 진입방식의 선택과 무관하지 않은 것으로 나타났으며, 신규자원의 확보 동기가 있는 경우에는 합작투자 또는 기존 기업 인수방식을 택하는 경우가 많고, 신규자원의 확보 동기가 없는 경우에는 신규설립방식을 선호하는 것으로 나타났다. 또한 새로운 자원의 확보 동기가 있는 기업집단을 대상으로 한 교차분석 결과에 의하면 이미 축적해 놓은 핵심자원의 공개 의지가 없는 기업들은 인수방식에 의한 단독투자를 선호하는 것으로 나타났고, 핵심 자원에 대한 공개 의지가 있는 기업들은 합작투자를 선호하는 것으로 나타났다

## INTRODUCTION

Foreign direct investment(FDI) firms can select one of the ownership-based entry modes such as Joint Venture(JV) and Wholly Owned Subsidiary(WOS) The latter can be classified into New Venture(NV) mode and Acquisition(AQ) mode. The definitions of the modes are as follows the NV is defined as an entry mode that involves only one parent, which built and operationally equipped the plant the AQ is defined as an entry mode that involves only one parent whose plant and equipment are purchased from the previous owner and the JV is defined as an entry mode that involves more than one parent whose plant was built and operationally equipped by these parents(Woodook, et al., 1994)

The decision to select an entry mode among those three alternatives is very important because of the resource commitment If one firm made the wrong decision, it would suffer from a lot of losses in time and money Therefore, many researchers have examined the contingent relationship between firm characteristics, environment and selected entry mode

Stopford and Wells(1972) suggested the first model of entry mode selection arguing that entry mode selection was contingent upon the firm's international experience and product diversification Caves and Mehra(1986) found that entry mode selection was influenced by a variety of industry and firm specific factors, including firm size, advertising intensity, research intensity, industry growth, and industry concentration Anderson and Gatignon(1987) have compared JV and WOS and found that locational factors, the degree of multinationality, and research and advertising intensity influence the selection decision. Kogut and Singh(1988) found that industry, firm, and country-specific factors influence the selection decision among JV, AQ, and NV More recently, Kim and Hwang(1992), and Agarwal and Ramaswami(1992) have found that locational, ownership and internationalization advantages contingently influenced all of the various entry modes

Most of the above studies premise that ownership advantage is a necessary

condition for a firm to enter foreign market by FDI. However, we could hardly find any study which examines entry mode selection decision by the firms from developing countries, which do not have any distinct ownership advantage

They supposed these firms do not enter foreign market or select low risk mode like export. But some firms were observed to enter foreign country with large market potentiality through JV or Licensing mode(Talaga, Chandran & Phatak, 1985).

We have also found that many Korean firms, which seem to have no distinct ownership advantage, entered developed countries as well as less developed countries through JV or WOS.

The purpose of this study is to examine the entry mode selection decision by Korean firms with no significant ownership advantage from the view point of resource commitment.

They seem to enter foreign country to acquire some resources which they lack or are in weak position. In this case of resource-building FDI, how can we explain their entry mode selection decision?

## LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

### *Literature Review on Entry Mode and Resource Requirement*

Recently, Woodcock, et al.(1994) developed a resource requirement contingency decision matrix illustrated in table 1. They developed this matrix by reviewing various studies concerning the entry mode selection based on resource requirements. It seems necessary to introduce their model first, because we accepted their model and developed our hypotheses based on their model.

Resource commitment has been used widely to contingently differentiate between joint ventures and wholly owned entry modes. Many studies have used the degree of ownership control as proxy for resource commitment. The greater the degree of ownership in the entry mode, the larger the resource commitment. For example, in a joint venture, a firm's resource commitment is minimized relative to a wholly owned entry mode because of the shared resource commitment between firms(Anderson and Gatignon, 1986). A firm not having the resources, and wishing to share the risks associated with having such resources is, thus, compelled to enter the market through a JV mode.

TABLE 1  
RESOURCE REQUIREMENT CONTINGENCY DECISION MATRIX

Entry Mode	New Resources Are Deemed Necessary for Entry Mode	Concern over Exposure to, or Sharing of, Core Resources
New Venture	No	Not Applicable
Joint Venture	Yes	No
Acquisition	Yes	Yes

Source Woodcock, Beamish and Makino(1994 p 261)

The resource commitment concept can also be used to differentiate between the WOS entry modes. Firms that use the AQ entry mode are procuring a new set of resources, while firms using the new venture mode are relying on their historic and previously developed set of resources. This concept suggests that firms having suitable resources will use the acquisition mode and trade financial resources for the required resources. The necessary and appropriate resources may range from tangible resources such as product characteristics to intangible resources such as market experience.

The important difference between the AQ and JV modes is that firms in a joint venture share and provide access to some of their internal resources, while no such access is provided in the AQ mode. A firm will use the JV mode to rectify a resource deficiency only if it is willing to take a risk of providing access to such resources, and can find a willing and suitable partner(s) having appropriate resources to share or provide access(Hill, Hwang and Kim, 1990)

A firm will tend to favor an AQ entry mode if it cannot find a suitable partner predisposed to providing access or sharing the required resources, or if it is not itself predisposed to providing access to internal resources.

The critical element is the perceived risk of either exposing or sharing the resources, and the resulting loss of future competitive advantage, given the benefits of the JV mode. If firms want to protect these vital core resources and the perceived risks of having them transferred to the second firm are high, then they should procure the needed resources through an AQ.

### *Hypotheses Development*

This study accepts the resource requirement contingency decision matrix of table 1, which suggests that entry mode selection is dependent on both the new resources that are deemed necessary and the concern over exposure to(or sharing) core resources. But, Woodcock et al (1994) didn't examine those relationship empirically.

This study developed the following hypotheses and tested empirically those

relationship based on the decision matrix by using the data set collected from Korean FDI firms.

HYPOTHESIS I (H1): NV entry mode will be preferred to JV or AQ entry mode by the FDI firms without resource-building motivations.

Because the FDI firms without resource-building motivations are more likely to exploit their ownership advantages which they already accumulated, they will prefer NV entry mode by which they can have more control power.

HYPOTHESIS II (H2) JV(AQ) entry mode will be preferred to AQ(JV) entry mode by the FDI firms with resource-building motivation and with the willingness (not) to expose or share their core resources

Because the FDI firms with resource-building motivations are more likely to seek a partner which has already accumulated the resources that the FDI firms want to build, they will prefer JV or AQ to NV. If the FDI firm does not concern over exposing to, or sharing of their core resources, they will prefer JV to AQ. Otherwise they will prefer AQ to JV.

## EMPIRICAL ANALYSIS

The database used in this study was collected from survey on Korean subsidiaries all over the world by 14 scholars of International Business Studies in Korea, in summer 1996.

Each scholar interviewed two or three subsidiaries in the host countries. A total of 36 cases was collected. Table 2 shows a description of the sample. Business areas are mostly manufacturing sectors, except for a few of trading companies. As for the host country, 17 cases are in DCs(Developed Countries) and 19 cases are in LDCs(Less Developed Countries)

The motivations of FDI could be classified as resource-building(17 cases) and reduction of production cost(6 cases), market penetration(10 cases), detour of trade barriers(3 cases). The entry mode they used was distributed as JV(13 cases), NV(15 cases), AQ(8 cases)

TABLE 2  
DESCRIPTION OF THE SAMPLE

Business Area	Host Country	FDI Motivation	Entry Mode
Electronics 20	DCs 17	Reduction of Production Cost	J V 13
Textiles 4	USA 4, UK 5, Germany 2,	6(16.7%)	WOS
Auto 3	Hong Kong 1, Japan 2,	Market Penetration 10(27.8%)	
Machinery 2	Australia 3,	Detour of Trade Barriers	NV 15
Chemicals 2	LDCs 19	3( 8.3%)	AQ 8
Trade 3	China 4, Peru 2, Indonesia 1,	Resource Building 17(47.2%)	
Metals 1	Malaysia 1, Philippines 3,		
Foods 1	Tailand 3, Vietnam 3, Mexico 2		
Total 36	36	36(100%)	36

*Crosstabulation for the test of Hypothesis I (H<sub>1</sub>)*

Table 3 shows the crosstabulation of entry mode and the motivation of FDI in terms of resource building. Among the FDI firms that had no motivation of resource-building, 15 out of 19 cases were shown to prefer NV entry mode, and this result generally support our Hypothesis I (H<sub>1</sub>)

TABLE 3  
CROSSTABULATION OF ENTRY MODE AND FDI MOTIVATION

		Entry Mode			Row Total
		NV	JV	AQ	Total
Have Resource Building Motivation	Yes		10	7	17 (47.2%)
	No	15	3	1	19 (52.8%)
Column Total		15 (41.7%)	13 (36.1%)	8 (22.2%)	36 (100%)

To test the above relationship between entry mode and FDI motivation, we used Pearson Chi-square which is a popular statistic to test the hypothesis that two variables of a cross tabulation are independent of each other. The statistical results are shown in Table 4.

For FDI motivations, the Pearson chi-square value is 23.54, and the observed significance level(00) is very small. For the chi-square distribution could be a good approximation, the data must be random sample and at least 75% or more cells must have the expected frequencies above the minimum expected frequencies. If these

conditions could not be met, Fisher's exact test is recommended as an alternative test. The statistical results show that the observed significance level(0.01) is also very low, even in the case of Fisher's exact test.

Therefore, the hypothesis that FDI motivations and entry mode selection are independent, is rejected.

TABLE 4  
STATISTICAL RESULTS

Chi-Square	Value	DF	Significance
Pearson	23.53846	2	.00001
Fisher's Exact Test			
One-Tail			.00980
Two-Tail			.00980
Minimum Expected Frequency - 2.889			

*Crosstabulation for the test of Hypothesis II(H<sub>2</sub>)*

Table 5 shows the crosstabulation of entry mode and the willingness to exposure core resources using the dataset comprised of the FDI firms with resource-building motivations.

TABLE 5  
CROSSTABULATION OF ENTRY MODE AND CORE RESOURCE EXPOSURE

		Entry Mode		Row Total
		AQ	JV	
Have the Willingness to Expose Core Resource	Yes	1	8	9 (52.9%)
	No	6	2	8 (47.1%)
Column Total		7 (41.2%)	10 (58.8%)	17 (100%)

Among the 9 cases, which had the willingness to expose and share their core resources, 8 cases were shown as preferring JV entry mode, and 6 cases out of 8 cases which had no willingness to expose or share their core resources were shown as preferring AQ entry mode. This result generally support our hypothesis II(H<sub>2</sub>)

Table 6 shows the statistical results to test the independence between the independent variable(willingness to expose core resources) and dependent variable(entry mode). For the willingness to expose core resources, the Pearson chi-square value is 6.74 and the observed significance level(0.00) is very low, and the Fisher's exact test shows also very small significance level(0.02). Therefore, the hypothesis that the willingness to expose core resource and entry mode selection are independent, is rejected.

TABLE 6  
STATISTICAL RESULTS

Chi-Square	Value	DF	Significance
Pearson	6.74074	1	0.00942
Fisher's Exact Test			
One-Tail			0.02098
Two-Tail			0.02098
Minimum Expected Frequency -		1.846	

## DISCUSSION AND CONCLUSIONS

The purpose of this paper is to examine the entry mode selection by the FDI firms from developing countries with no significant ownership advantage.

The statistical results generally support our hypotheses either at 1% or 5% significance level.

Therefore, it could be concluded that the FDI firms with resource-building motivations prefer JV or AQ to NV. And if the firms have willingness to expose or share their existing core resources, they prefer JV entry mode to AQ entry mode.

From the above analysis we can derive an implication that resource-building motivation as well as resource exploitation motivation could be an important factor for entry mode selection.

The control over core resources could be also an important decision factor for internalization of transactions in the case of the FDI firms from developing countries.

One of the important limitations of this study is that it uses a data set comprised of Korean parents, so this constraints the generalization of this study's result. Thus, further research based on a variety of data set concerning the firms from other developing countries is needed to generalize our findings.

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