

# Entry Mode of MNEs in Vietnam: An Eclectic Model of The Choice Between International Joint Ventures and Wholly Owned Subsidiaries

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## **Abstract**

*The purpose of this article is to analyze and explain foreign investors' entry mode choices between Wholly Owned Subsidiaries (WOS) and International Joint-ventures (IJV). Research hypotheses have been established and verified over a sample of 6603 foreign firms who made investments in Vietnam during the period from 1988 to 2010. The results of the study were in agreement with the eclectic model (Dunning, 1980, 1995). We found the significant impact of almost of components of OLI advantages, in the exception of MNEs' size and cultural distance. The results indicate that: "O" advantages such as (experience and asset specificity) are positively associated with MNEs' WOS choice, so negatively its IJV choice; "L" advantages such as investment risk, GDP growth and "I" advantages such as currency risk influence positively the MNEs' IJV choice; so negatively its WOS choice.*

**Keywords:** Entry modes, international joint ventures, wholly owned subsidiaries, FDI, eclectic model, Vietnam

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## 1. Introduction

Multinational enterprises (MNEs) invest abroad for several reasons: some try to pursue an internationalization strategy or to reduce competition, while others are motivated by resources and costs (transaction and/or production costs) (Anderson & Gatignon, 1986; Hennart, 1988; Hennart & Reddy, 1997; Tsang, 2000, Brouthers *et al.*, 2003; Sharma & Erramili, 2004). But in their nature, “*companies become committed to international markets only when they no longer believe that they can attain their strategic objectives by remaining at home*” (Root, 1987, p.1). In the case of the internationalization process, the enterprise initially favors investment modes that make quick profits, such as exports, then co-operative contracts; and finally it establishes abroad foreign direct investment (FDI) that concerns two entry modes of IJV and WOS.

In the literature on international business, there are a certain number of theoretical approaches, supported by empirical studies, which focus on the foreign investors’ choice between IJV and WOS for an entry mode into a new market. But each one of these approaches can only partially explain one point of view of the reality. For example, two dominant ones: the resource based view (Barney, 1991; Grant, 1991; Kogut & Zander, 1992) explains the investors’ choice that is motivated by the maximization of profits; as a complementary approach, transaction cost economics (Williamson, 1979) stresses the minimization of transaction and production costs that influences the investors’ choice.

Despite the success of previous theories, Dunning (1995) analyzes the international

business and argues that these theories are individually incomplete and do not fully explain the foreign investor’s choice of entry mode abroad. Therefore, the author proposes an eclectic theory, which is in fact a multi-theoretical approach for entry mode decisions. In this perspective, the current research aims to apply the eclectic paradigm for explaining the MNEs’ choice between IJV and WOS as entry mode into Vietnam - “an emerging tiger in Asia”.

Our current study was encouraged by several reasons. *First*, existing empirical studies, which focus on the entry mode choice, concentrate mostly on developed countries or developing countries, where the market economy is established (Beamish, 1993; Tsang *et al.*, 2004). It is necessary to expand the geographical research champ to other countries by generalizing results obtained and for exploring new circumstances. In this perspective, Vietnam has apparently the most potential. *Secondly*, despite its potential as a multi-theoretical approach, among the empirical studies above, there are a few that mobilize the eclectic theory for explaining MNEs’ choice of IJV or WOS as entry mode. *Thirdly*, Vietnam represents some relevant characteristics to our current research: the transition process of this country, after the fall of the socialist regime, was developed with specific endogenous elements (monetary and fiscal policies controlled, out-of-date technologies, poor managerial capacity), which were different from East European countries (Kelly *et al.*, 2002; Nguyen, 2003); Vietnam is continuing a process of developing into an industrialized country, which was initiated by the famous

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reform “Đổi Mới” in 1986. Foreign investors have to face various problems coming from all internal and external aspects of subsidiary such as the local legal systems, fast changes of local legislations, lack of local knowledge, cultural distances between Vietnamese and western managers etc. (Lai and Truong, 2005). These elements discussed above motivated us to undertake this study.

The paper is organized into three sections. In the first and second section, we will develop respectively the theoretical framework and research hypotheses, then methodology. And, in the final section, the research results and discussions will be represented.

## **2. Theoretical framework and research hypotheses**

By definition, “a joint venture occurs when two or more firms pool a portion of their resources within a common legal organization” (Kogut, 1988, p.319). One special characteristic of joint venture is that it has several parent firms with their own identity who own capital jointly and share its control (Hennart, 1988; Inkpen & Beamish, 1997). On the other hand, a Wholly Owned Subsidiary (WOS) is an entity which belongs totally to a sole foreign enterprise. It represents the residual economic and cultural values of its parent enterprise. Moreover, the parent enterprise can impose its management system to the WOS. This contributes positively to the organizational process of problem solving and to the functioning of the subsidiary (Killing, 1983).

In the perspective of eclectic theory, the choice of MNEs between IJV and WOS depends three elements: “O” - Ownership advantages, “L” - Location advantages and “I”

- Internalization advantages. This is the reason why this theory is also called “OLI” model. “To compete with host country firms in their own markets, firms must possess superior assets and skills” (Agarwal et Ramaswami, 1992, p.4). The MNEs’ ownership advantages are so associated with (1) the specificity of their assets contributed to the subsidiary, with (2) their experiences in terms of knowledge of the host country and (3) their size (Dunning, 1980). MNEs that possess a great “O” may favors a WOS as entry mode, because they are less influenced by the local government due to the effect of its size; because its experiences and its specific assets could support all its contractual and investment risks. On the other hand, WOS choice may permit MNEs to protect their specific assets against opportunism learning of other firms (Hill *et al.*, 1990; Agarwal et Ramaswami, 1992; Bell *et al.*, 1997). So, we suppose that:

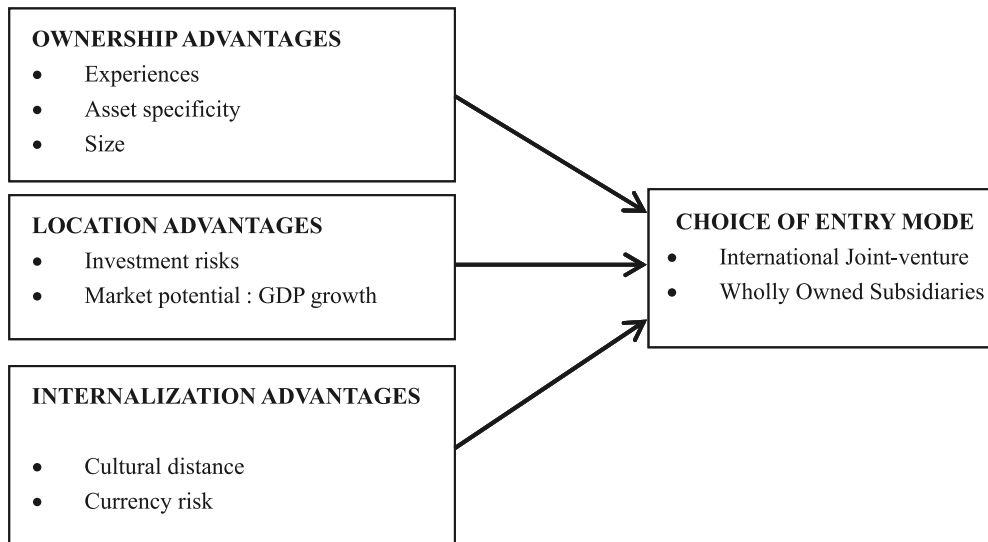
H1: *Firms that have higher experience are more likely to choose a WOS versus IJV for entry in emerging economy.*

H2: *The transfer of highly specific assets increases the likelihood of using a WOS versus IJV for entry in emerging economy.*

H3: *Firms that have larger size are more likely to choose a WOS versus IJV for entry in emerging economy.*

With the “O” obtained, the MNE then decides where it will invest. It will choose a specific location that permits it to have additional advantages, eg the exchange rate, reduction of competition, lower taxes ... what Dunning (1980) calls the location advantages “L” which involves different costs through the different locations and countries. Agarwal and

**Figure 1: Research Model**



Ramaswami (1992) specify the “L” in terms of the attractiveness of the market that reflects the market potential and investment risk. The market potential is formed by the growth of this market, while the investment risk involves uncertainty about the continuation of present economic and political conditions, in other words, the changes of local governmental policies. In such conditions, the market potential encourages MNE to choose OWS for maximizing the profits, in contrast, MNE seeks an JVI as entry mode in order to avoid or reduce the risks (Hill *et al.*, 1990; Bell *et al.*, 1997). We suppose that:

H4: *Higher market potential increases the likelihood of using a WOS versus IJV for entry in emerging economy.*

H5: *Higher investment risk increases the likelihood of using an IJV versus WOS for entry in emerging economy.*

The “O” and “L” advantages are the necessary conditions but not sufficient for the choice

of WOS or IJV as entry mode. MNE’s choice must be justified by the “I” - internalization advantages, which are defined as “contractual risks”. These imply risk of deterioration of quality of services and currency, and costs of writing and enforcing contracts (Dunning, 1980). For MNEs’ entry mode choice, it involves essentially the cultural risk or distance and the currency risk that influence directly respectively the functioning and value of subsidiary (Agarwal et Ramaswami, 1992; Bell *et al.*, 1997). We suppose that:

H6: *Foreign firms that have larger cultural distance from the host country are more likely to choose an IJV versus WOS for entry in emerging economy.*

H7: *Higher currency risk increases the likelihood of using an IJV versus WOS for entry in emerging economies.*

Based on the reasoning above, we establish a research model as shown in Figure 1.

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### 3. Methodology

#### 3.1. Research field and data collection

Based on the deductive approach, we will test the seven research hypothesis proposed by an empirical study of foreign firms investing in Vietnam - “an emerging tiger in Asia”. Data was collected from FIA (Foreign Investment Agency) – a government agency belonging to the Ministry of Planning and Investment which manages FDIs in Vietnam from 1988 to 2010. During this period, 6223 projects under IJV and WOS as entry mode were realized. These projects implied 6603 entry mode decisions made by 5802 foreign investors coming from 12 countries in the world. Our database based on these choices was established.

#### 3.2. Dependent variables

The dependent variable corresponds to the choice of an investment mode in Vietnam. It encodes by the binary system. For analyzing foreign investor’s IJV choice as entry mode, *firstly* the value 0 is given to the foreign investor’s WOS choice, and the value 1 is given to the foreign investor’s IJV choice. The binary variable is represented by the following:

$$y_i = \begin{cases} 0 & \text{if the invesment is a WOS } \forall i \in [1, N-934] \\ 1 & \text{if the invesment is IJV} \end{cases}$$

In order to analyze foreign investor’s WOS choice as entry mode, *secondly*, the value 0 is given to the foreign investor’s IJV choice, and the value 1 is given to the foreign investor’s WOS choice. The binary variable is represented by another model that is contrast to the one above.

#### 3.3. Independent variables

MNEs’ experiences measure the number of

years spent by the foreign investor in the investing country until the targeted investment decision (Delios & Beamish, 2001; Lowen & Pope, 2008). The specificity of assets contributed by MNEs is measured the ratio of the amount of R&D and the total turnover of subsidiary (Kogut & Singh, 1988; Jinyu & Heli, 2009). Size of the MNEs is coded in 1 for the ones giving no information on their turnover, between 0 and 20 million dollars; in 2 for a turnover between 20 and 200 million dollars, 3 for a turnover of between 200 and 400 million dollars; 4 for a turnover of more than 400 million dollars.

The investment risks represent the host country environmental instability which determines the investor’s choice. (Yan & Gray, 1994; Meschi, 2004). It is measured by Vietnam political risk for the year when the investment decision in Vietnam is made. This risk is provided by the Political Risk Services<sup>1</sup>. The market potential is associated with the Vietnam’s GDP growth for the year when the investment decision in Vietnam was made.

The cultural distance between the MNEs’ home country and Vietnam is calculated according to Kogut & Singh’s research results (1988) which is referred to by a number of researchers (Lowen & Pope, 2008; Meschi & Riccio, 2008). It is a deviation of four cultural references (Hofstede: power distance, individualism, masculinity and uncertainty avoidance)<sup>2</sup> of the foreign investor’s country of origin compared to Vietnam. The deviations are corrected dividing the square values by the deviance of each cultural refer-

**Table 1: Correlation between independent variables**

| Independent variables    | Means  | (1)      | (2)      | (3)      | (4)     | (5)      | (6)              | (7) |
|--------------------------|--------|----------|----------|----------|---------|----------|------------------|-----|
| <i>Experience</i>        | 1.549  | 1        |          |          |         |          |                  |     |
| <i>Asset specificity</i> | 0.991  | -0.025*  | 1        |          |         |          |                  |     |
| <i>Firm Size</i>         | 1.693  | 0.128**  | 0.059**  | 1        |         |          |                  |     |
| <i>Culture Distance</i>  | 1.722  | 0.035**  | 0.101**  | 0.148**  | 1       |          |                  |     |
| <i>GDP Growth</i>        | 7.832  | 0.036**  | -0.099** | 0.087**  | 0.060** | 1        |                  |     |
| <i>Currency risk</i>     | 7.573  | -0.039** | -0.061** | -0.037** | -0.001  | -0.373** | 1                |     |
| <i>Investment risk</i>   | 66.116 | 0.074**  | 0.016    | 0.088**  | 0.064** | 0.492**  | -0.514**         | 1   |
| * $p \leq 0.05$          |        |          |          |          |         |          | ** $p \leq 0.01$ |     |

ence. Finally, currency risk is the fluctuation of exchange rate VND/USD for the year when the investment decision in Vietnam is made.

### 3.4. Parametric analysis methodology: logistic regression model

Logistic regression is a way of analyzing empirical studies using a qualitative binary value, which can only have two values, 1 and 0 (Agresti, 2007). This method has been used to figure out the investor's tendency in Vietnam in choosing an entry mode (0 for a WOS, 1 for an IJV, or in contrast). The relationship between the probability of the investor's choice and independent variables is a linear function as follows:

$$\text{logit}(p) = a_0 + a_i \cdot x_i + \varepsilon \quad (i = 1, \dots, 8)$$

where  $\text{logit}(p)$  is the natural logarithm ( $\ln$ ) of the odds values of the investor's choice for a WOS

$a$ : variables evaluated coefficients

$x_i$ : independent variables

$\varepsilon$ : specification error

We continue to verify the research hypothe-

ses by using the SPSS statistic software. Results and analysis are presented in the next section.

## 4. Results and analysis

### 4.1. Research results

The table 2 indicates the final results of the logic regression mode used in the current study. Model 1 corresponds to scenario where IJV as entry mode is coded in 1; model 2 corresponds to scenario where WOS as entry mode is coded in 1. Before verifying the validity of the hypotheses, the quality of the adjustment and of the specifications of the regression model is evaluated using the Likelihood Ratio Chi-squared test (Agresi, 2007). The significant results with a maximum confidence level of 99.9% ( $p < 0.001$ ) validate the adjustment and specification qualities of all regression models.

We now verify the hypotheses. The first one stresses a positive association between the MNEs' accumulated experiences and the likelihood of using a WOS versus IJV in Vietnam. The accumulated experiences imply a good

**Table 2: Results of Logit regression**

| Independent variable        | Model 1: IJV versus WOS    |           | Model 2: WOS versus IJV     |           |
|-----------------------------|----------------------------|-----------|-----------------------------|-----------|
|                             | Odds Ratio                 | Std. Err. | Odds Ratio                  | Std. Err. |
| <i>Experience</i>           | -0.029 (0.971)*            | 0.013     | 0.029 (1.029)*              | 0.013     |
| <i>Asset specificity</i>    | -0.250 (0.779)***          | 0.016     | 0.250 (1.284)***            | 0.026     |
| <i>Firm Size</i>            | 0.046 (1.047) <sup>†</sup> | 0.028     | -0.046 (0.955) <sup>†</sup> | 0.025     |
| <i>Investment risk</i>      | 0.100 (1.105)***           | 0.007     | -0.100 (0.905)**            | 0.008     |
| <i>GDP Growth</i>           | 0.502 (1.652)***           | 0.055     | -0.502 (0.605)**            | 0.020     |
| <i>Culture Distance</i>     | 0.003 (1.003)              | 0.020     | -0.003 (0.997)              | 0.020     |
| <i>Currency risk</i>        | 0.050 (1.051)***           | 0.005     | -0.050 (0.952)***           | 0.005     |
| <i>_cons</i>                | 2.238                      | 0.518     | -2.238                      | 0.518     |
| <b>Goodness of Fit Test</b> |                            |           |                             |           |
| Observation number          | 6603                       |           | 6603                        |           |
| LR Chi-Square test          | 909.53***                  |           | 909.53***                   |           |

() Odds Ratio e coefficient

<sup>†</sup> $p \leq 0.1$  \* $p \leq 0.05$  \*\* $p \leq 0.01$  \*\*\* $p \leq 0.001$

understanding of the local environment that encourages MNE to choose a WOS as entry mode. These estimated coefficients respectively for two regression models are significant with 95% of confidence ( $p < 0.001$ ), and indicate that: every extra year spent or experiences accumulated by MNEs increases by 2.9% the chances for a MNE to choose WOS as entry mode in Vietnam. The first hypothesis is thus confirmed.

In the same line, the second hypothesis on asset specificity is also validated. This result indicates a positive association between MNEs' asset specificity and its WOS choice in Vietnam. On the other hand, the third hypothesis is reversed but not significant. It seems that MNEs' sizes do not influence their entry

mode choices.

The fourth hypothesis concentrates on the positive relationship between investment risk and the IJV choice. The estimated coefficients are negative in model 2 and positive in model 1 with 99.9% of confident level ( $p < 0.001$ ). These results confirm our hypothesis: when investment risks increase by 1 unit, the probability to choose a WOS will decrease by 9.5%; and the probability to choose an IJV will increase by 10.5%. However, the regression results reject the fifth hypothesis; an association reverse is found. The GDP growth influences positively the likelihood of using an IJV in Vietnam.

Looking at the two last hypotheses, the sign of estimated coefficients is the same with those

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supposed, but the one of cultural distance is not significant. So, the results confirm only the seventh hypothesis concerning the positive association between currency risk and the likelihood of using an IJV in Vietnam.

#### **4.2. Discussion**

The results of the current study conform with the eclectic theory. We found the significant impact of almost all independent variables or components of OLI advantages, in the exception of MNEs' size and cultural distance. The results indicate that: "O" advantages such as experience and asset specificity are positively associated with MNEs' WOS choice, so negatively with its IJV choice; "L" advantages such as investment risk, GDP growth and "I" advantages such as currency risk influence positively the MNEs' IJV choice; so negatively its WOS choice. The OLI paradigm apparent suitable for analysis the MNEs' entry mode choice in the case of Vietnam.

These conclusions of the current research are also in agreement with the Resources theory (Barney, 1991; Grant, 1991; Kogut & Zander, 1992) and Transaction-Costs Economics (Williamson, 1979): asset specificity has a positive influence on the WOS choice as an entry mode. This choice is justified by: First, a WOS permit MNEs to maximize profits generated by its specific assets (Killing, 1983; Harrigan, 1985). Secondly, the specific assets can be well protected under WOS form of investment face on the opportunism of other firms (Anderson & Gatignon, 1986; Agarwal & Ramaswani, 1992; Errarnilli

& Rao, 1993).

#### **5. Conclusion**

The results of the current research confirmed the role of eclectic theory in international business: its three "OLI" components can imply a series of explanatory variables, fully explaining the MNEs' entry mode choice. Our study makes several positive contributions. Its major interest is to discuss the MNEs' entry mode decisions in the emerging country of Vietnam. The eclectic theory is a new approach in FDI literature; theoretically, it clarifies the preference of MNEs to choose an IJV or WOS as entry mode in such investment conditions. The managerial contributions are interesting for the MNEs' strategy, but also for local firms or local government to establish their cooperative strategy or to encourage the FDI into the country.

Our research represents a number of limits concerning the research field in Vietnam and the ignorance of interaction variables during the regression phase. In spite of such limits, the current study implies several perspectives for future research. It may be interesting to integrate other variables concerning the economic performance, competition, parent firms into the regression model. It may also be interesting to generate the results for other countries that have a similar profile with Vietnam such as Laos, Cambodia, China, and Thailand; also for other countries that have the same economic development level or the same historic political development such as Eastern European countries.

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## Notes:

1. Evaluation measures used by PRS Group: [http://www.prsgroup.com/ICRG\\_Methodology.aspx](http://www.prsgroup.com/ICRG_Methodology.aspx)
2. In countries where Hofstede's cultural index has not been defined, comparisons were made with neighbouring countries (Website <http://www.geert-hofstede.com>), for example Belarus, Slovenia, and Ukraine have been compared to Slovakia, Latvia to Estonia, etc.

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