



Influence of location factors on establishment and ownership of foreign investments: The case of the Japanese manufacturing firms in Europe

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Abstract

We test the hypothesis that location factors have strong predictive power for mode of establishment and ownership choice of MNEs, by controlling for parent experience and capabilities in a sample of 751 manufacturing subsidiaries of 405 Japanese MNEs. In the European context of few ownership restrictions we find that host competitiveness, host culture type, and industrial growth are the most appropriate location predictors for entry mode. We create a profile of joint venture, full acquisition and wholly owned greenfield modes and reveal how different strategic contexts interact with location factors to determine the MNE expansion approach. Our results imply that location variables are important determinants of expansion strategy, indispensable in analysing subsidiaries of MNEs even in hosts with stable political environment. © 2005 Elsevier Ltd. All rights reserved.

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1. Introduction

Entry mode expresses the means of internationalisation of the firm and is one of the most essential features of the multinational enterprise (MNE) activity. The entry mode determines the MNE level of exposure to, and use of, local assets and management. Many scholars point

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out that this level of exposure influences profitability and stability of operations (Beamish, Delios, & Lecraw, 1997; Chen & Hu, 2002; Nitsch, Beamish, & Makino, 1996; Woodcock, Beamish, & Makino, 1994). For this reason entry mode is extensively analysed in different contexts, by assessing the effect of the factors that determine the investment process: firm-specific capabilities, internalisation and location. The first two factors are manifestation of the MNE competence and strategy and make the subsidiaries with a common parent similar in design. However, the necessity of the parent to adapt to different host realities makes its subsidiaries less similar in practice. Therefore, location factors presumably shape the entry mode choice as much as MNE capabilities do. Some scholars insist that location is a neglected factor in the analysis of MNE activity and has to be reintegrated into it (Dunning, 1998). However, while there are many studies about the effect on entry mode of the first two groups of factors, the methodology for reflecting the location effect is barely developed.

Some authors control loosely, rather than analyse, the location factors through the (single-host) designs of their entry mode studies or through implicit assumptions, despite the fact that some location factors are indispensable in any research of entry mode. The best example of such a factor is government restriction on foreign ownership (Chen & Hu, 2002). More focused studies incorporate explicitly the relevant political hazards and government restriction by reflecting highly variant institutional environments, often of developing countries (Delios & Henisz, 2000; Padmanabhan & Cho, 1996). However, this sole focus on political factors contributes little to the understanding of how other types of location factors affect entry mode. Given the theoretical importance of all types of location factors we attempt to isolate their effect on 751 entries of 405 Japanese MNEs in Europe.

There is a two-fold reason to choose Europe as the focal point of the analysis. First, our aim is to choose a location where political restriction plays a minimal role and location variation comes primarily from non-political factors. European countries are ideal in this respect because their policy to investors is integrated and common, while important differences in local factors remain. Second, we exclude investments in other continents, in order to reduce as much as possible the variance of strategic and other motivational variables. The paper studies only subsidiaries in manufacturing industries because these entries of higher commitment depend most on local conditions, and have been frequently used in previous studies (Belderbos, Capannelli, & Fukao, 2001; Caves, 1996; Heitger & Stehn, 1990; Padmanabhan & Cho, 1996).

2. Explanatory factors for entry mode choice

Forms of international expansion like exporting and licensing are modes of low commitment that do not constitute foreign direct investment (FDI), and are beyond the scope of this study. The studies of modes of higher commitment have followed different approaches. Hennart and Reddy (1997) divide entry mode to local asset seeking and wholly owned modes and focus on the former one, which corresponds to acquisitions and joint ventures. Other scholars incorporate all relevant modes by using two separate variables for ownership structure and mode of establishment (Padmanabhan & Cho, 1996). We integrate both ownership structure and mode of establishment in one multinomial dependent variable, which includes greenfield investment, acquisition, and joint venture, in approximate order of

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