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Equity-based entry modes of the Greater Chinese Economic Area's foreign direct investments in Vietnam

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ABSTRACT

In January 2007, Vietnam became the 150th member of the World Trade Organization (WTO). Vietnam is located in the heart of Asia and has a resource-rich economy, which offers it a significant advantage in attracting foreign direct investments (FDIs). The research focuses on equity-based entry mode choices adopted by multinational corporations (MNCs) in the Greater Chinese Economic Area (GCEA) for entering Vietnam. The statistical results indicate that equity-based entry modes are significant when FDI firms entering Vietnam originate from the GCEA, which includes Mainland China, Hong Kong, Taiwan, and Singapore. However, the interaction results show that industry does not have a moderating effect on the relationship between location and entry mode, whereas it is not found that industrial cluster is specific to any one location. The generalized model has implications for the theoretical and managerial perspectives of both the host and the home countries.

1. Introduction

Ethnic Chinese communities have been increasingly expressing interest in the multinational corporations (MNCs) in the world economy (Ahlstrom, Chen, & Yeh, 2010; Zeng & Williamson, 2007). Most existing researches in international business literatures explain the entry-mode decisions of MNCs in developed countries, from the perspective of both the home countries of parent firms and host countries, with respect to foreign direct investments (FDIs). In this case, both the home and the host countries include developing countries. Our research concerns FDIs from the Greater Chinese Economic Area (GCEA) in Vietnam, which significantly contributes to the overall literature on FDI.

The GCEA comprises both the geographical and social clusters of the Chinese culture, which include Mainland China, Hong Kong, Macau, Taiwan, and Singapore. China first resolved to convert its centrally planned socialist economy into a market-driven one in 1978. The host country, Vietnam, has been initiating a series of economic reforms since 1986; it has been rather successful in attracting FDI. According to a statistics report released by the Vietnamese government, Vietnam's State Banks provided approximately $19 billion in loans to the economy in 2009, which is equivalent to approximately one-fifth of the country's annual gross domestic product (GDP). Vietnam provides a subsidized interest rate to banks for promoting enterprises and export businesses.

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We could not find any publications that developed a formal theory for investigating MNCs from emerging economies (Demirbag, Tatoglu, & Glaister, 2009); further, MNCs in emerging countries have not been studied yet in the context concerning MNCs from developing countries. The objective of this study is to explore the manner in which MNCs from the GCEA enter emerging countries like Vietnam, which probably follows China's footsteps in the developing world, and determining the equity-based entry modes of FDIs. Vietnam provides a good case to test a number of variables on the determinants of equity-based entry mode strategies of emerging country MNCs. Particularly, the objective of this research is to test the relationships between the entry mode and its determinations of the GCEA's FDIs in Vietnam, thereby contributing to the scope of international business study in Asia.

This paper reviews the extant literature on entry modes, develops a theoretical argument for ascertaining the influence of equity-based entry mode strategies using important determinants, and presents the findings obtained from a unique data source, i.e., MNCs from the GCEA in Vietnam. By making the case of FDI in an emerging country, the framework attempts to identify a formal theory of MNCs from emerging countries.

2. Theory and hypothesis

In the existing literature, the primary theoretical approaches that explore the level and pattern of FDI activity mainly extend from Dunning's framework. Dunning's perspective including ownership, location, and internalization (OLI) was extended to test the internationalization of Chinese MNCs (Erdener & Shapiro, 2005), Korean MNCs (Lee & Slater, 2007), and Taiwanese and Singaporean MNCs (Sim & Pandian, 2003). Researchers adopted Dunning's (1980, 1988) eclectic paradigm (the internalization factor) concept and subsequently focused on the variable groups. However, the internalization factor of FDI activity should be divided into three categories: country of origin-, industry-, and firm-specific circumstances (Demirbag et al., 2009; Dunning, 2006). Tse, Pan, and Au (1997) integrated the impacts of country (including the host and home countries), industry, and operations-related factors on the entry-mode choice of FDI firms in China. Tsang's (2005) hypotheses were identified according to three types of variables – country-, industry-, and venture-specific – for determining the modes for entering foreign markets in Vietnam.

We consider this research to two modes of entry, EJV and WOS, from three main perspectives. First, Dunning's paradigm assumes that emerging country MNCs must possess ownership advantages to operate in the host country (Demirbag et al., 2009). Second, the transaction costs theory included in the internalization factor of Dunning's eclectic paradigm explains costs of various entry modes selected (Anderson & Gatignon, 1986; Erramilli & Rao, 1993; Pan, 1996; Wei, Liu, & Liu, 2005). According to the transaction costs theory, in case of significant environmental uncertainty, a firm must select a WOS since an EJV is less efficient in such situations (Tseng & Lee, 2010). Generally speaking, the transaction costs theory includes two views on managing entry modes: non-ownership control mechanisms (i.e., licensing and franchising) and ownership control mechanisms (i.e., EJVs and WOSs) (Brouthers & Hennart, 2007; Demirbag et al., 2009). Compared to developed country MNCs, ownership based on the perspective of organizational control theory becomes essential for emerging market MNCs because the applicability of non-ownership control mechanisms is limited (Demirbag et al., 2009). The level of control offered by WOSs and EJVs (Müller, 2007) depends on market environmental factors, resource capabilities, and the experience of internationalization (Lin, 2000). When entry modes are viewed from an organizational control perspective, the advantages of EJVs include sharing risks, saving production costs, obtaining knowledge of host markets, and securing future growth opportunities from local partners; on the other hand, the predominant advantage of WOSs is complete organizational control. Therefore, WOSs are substantially separated from EJVs (Chen, Hu, & Shieh, 1991; Demirbag et al., 2009; Woodcock, Beamish, & Makino, 1994). Third, a majority of the MNC FDIs in Vietnam are made in the form of either equity joint ventures (EJVs) or wholly owned subsidiaries (WOSs). These so-called equity-based entry modes account for more than 90% of the total projects and total registered capital in Vietnam. Moreover, according to the Statistical Handbook of Vietnam (Troy, 2009), FDIs are merely classified into these two types: WOSs and EJVs.

Most previous research has concentrated on country-, industry-, and firm-specific factors as discriminating variables related to entry mode decisions. Based on the perspective of organizational control theory, the presented relationships between predictor variables of country-, industry-, and venture-specific variables and entry mode decision of emerging country MNCs, we attempt to develop a theoretical model concerning entry mode choices of emerging country MNCs. We retain the main hypotheses of Tsang in Vietnam; in case of emerging country MNCs, we extend the hypothesis by considering arguments of foreign exchange rates. In this study, three variables – country risk, cultural distance, and foreign exchange rates – are considered as country-specific factors; the country risk of Vietnam, the cultural distance between Vietnam and the home country of the MNC, and the foreign exchange rates of Vietnamese VND. Industry-specific factors consider the characteristics of the host country industry, and this study examines the factors of advertising intensity and competitive intensity. Finally, venture-specific factors are concerned with the characteristics of the FDI that the MNC engages in; hence, the characteristics examined here are investment amount, duration, and location. This study controls for countries of origin by considering only GCEA MNEs in Vietnam. We also regard industry categories as control variables. However, the formal hypotheses for these control variables are not suggested.

This theory also develops how the determinants of equity-based entry modes choice of MNCs differ between developed and emerging home country in their emerging host country markets.