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The influence of plant characteristics on the entry mode choice of overseas firms

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Abstract

One of the most important strategic decisions a manufacturing firm makes while expanding overseas is making the choice between setting up greenfield operations or acquiring a local firm. Using a knowledge-based framework, I propose that the ability to transfer knowledge and competencies across national boundaries is much easier in plants characterized by physical capital investment. Hence, during overseas entry, manufacturing firms are likely to use greenfield operations. On the other hand, in plants characterized by human capital investment, the difficulty in transferring knowledge and the need to learn and adapt to host nation requirements will make a local acquisition the preferred mode of entry by manufacturing firms. Using 682 entry decisions made by manufacturing firms during entry into the U.S., I investigate this notion while controlling for size of the industry, research intensity of the industry, degree of unionization, cultural distance, and the value of investment. Study findings indicate that in plants characterized by human capital intensity, the preferred entry mode is acquisitions over greenfield operations. However, foreign entrants with physical capital-intensive plants prefer greenfield operations over acquisitions.

Keywords: Decision; Manufacturing strategy; Empirical research

1. Introduction

Investment by foreign firms in the U.S. manufacturing sector has been an important phenomenon for several decades. For instance, foreign investment in this sector is estimated at $149 billion for 1998 and at $74 billion for 1999 (U.S. Department of Commerce, 2002). During entry into foreign markets, the choice of the mode of entry is one of the critical decisions in a firm's implementation of manufacturing strategy. This choice influences an entrant's ability to replicate its manufacturing competencies effectively and efficiently in the host country environment, thereby impacting the manufacturing unit's future survival and success. Therefore, this topic is of considerable importance to manufacturing managers planning to operate in overseas markets.

Given the importance of this topic to all firms, a significant number of studies have been conducted on

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a firm's entry mode strategy. These studies have tested the rationale of entry mode under the framework of the monopolistic advantage theory (Hymer, 1976), transaction cost theory (Hennart, 1991), internalization theory (Rugman, 1981), and eclectic paradigm (Dunning, 1988). Extant research has focused on various dimensions of firm, industry, and country level explanatory variables, and theoretical and empirical support exists for the assertion that they play a role in the entry mode choice of a firm (see Datta et al., 2002 for a review of 52 studies on this topic). Firms making entry mode choice based on these factors are reported to have higher entry mode success than firms selecting modes of entry that do not take these factors into consideration (Brouthers, 2002).

A firm has several options for entry into international markets. These include exporting, licensing, franchising, joint ventures, and wholly owned subsidiaries. Previous studies have generally served us well in increasing the level of conceptual understanding of the factors influencing entry mode choice between the above choices. However, to the best of my knowledge, one question has received no attention. *Once a firm has made the decision to enter an international market through a wholly owned subsidiary, how do plant characteristics influence the choice between acquisition and greenfield operations*? This study seeks to add one more consideration to the entry decision of manufacturing firms, namely plant characteristics. It is important that this factor is incorporated in the entry mode choice, as the viability of a firm's strategy in a host nation will be contingent on its ability to replicate and adapt its manufacturing competencies to the local host country context. While the importance of integrating manufacturing with firm strategy has been strongly argued in the operations literature (Skinner, 1969), this important link has been ignored in the entry mode literature. For instance, my review of empirical studies on entry mode choices of overseas entrants reveals that none of them focuses on manufacturing plant characteristics.

This study seeks to address this important question by incorporating the influence of plant characteristics on the entry mode choice of an overseas firm setting up manufacturing operations in the U.S. In particular, it focuses on the decision made between two choices, acquisition or setting up a greenfield operation, while controlling for the influence of other critical variables identified in previous literature. In a greenfield investment, a foreign firm starts operations on its own in a host country. An acquisition, in contrast, involves the foreign firm acquiring an established entity in the host country. Both greenfield investment and acquisition by the foreign firm result in 100% ownership by a single firm, though the means of achieving it is different. This choice between greenfield operations and acquisitions is a very important strategic choice, as investments made in manufacturing plants are not easily reversible and involve significant resource commitments by the investing firm (Andersen, 1997). As a result, the popular press is awash with reports wherein numerous foreign firms have stumbled in overseas markets due to a poor choice in their mode of entry (e.g., Druckerman and Wingfield, 2000).

This paper consists of five sections, inclusive of this introduction. In Section 2, a conceptual framework is presented and hypotheses are developed, and Section 3 explains the data collection process and research methodology used. The final section presents the results of the study and concludes with implications for theory and practice.

2. Conceptual framework and hypothesis development

2.1. Conceptual framework

Among the several theoretical notions commonly applied to entry mode choice are monopolistic advantage theory (Hymer, 1976), transaction cost theory (Hennart, 1991), eclectic paradigm (Dunning, 1988), and internalization theory (Rugman, 1981). These theories will serve as a conceptual basis for the framework linking the logic of plant characteristics in the entry mode choice of manufacturing firms. According to Hymer's monopolistic advantage theory, multinational firms exist because they possess unique resources which are imperfectly replicable. These unique resources offer firms monopolistic advantages while operating in overseas markets, as they cannot be easily imitated. Therefore, a firm operating abroad will seek to keep unique advantages internally, because they do not carry the danger of losing their specific competencies (internal knowledge) through