

# **FOREIGN MARKET ENTRY USING EXTERNAL RESOURCES: THE CHOICE BETWEEN JOINT VENTURES AND ACQUISITIONS (\*)**

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## **1. INTRODUCTION**

The foreign market entry through foreign direct investments (FDIs) and, in particular, through wholly-owned subsidiaries has aroused the interest from researchers for decades. The establishment of a wholly-owned subsidiary is the paradigm of the foreign direct investment, although there are FDIs of different nature. On the one hand, FDIs carried on by individual firms or associated with other companies and, on the other hand, FDIs intended to set up a completely new entity or to acquire an existing one. Several works have been devoted to explain the diversity of foreign direct investments.

A first group of works has analyzed those factors which determine the ownership structure of the unit located in the host market: wholly-owned subsidiary or joint venture (investment in coparticipation with other partners). The work by Stopford and Wells (1972) is one of the pioneer studies on this topic. For these authors the choice between wholly-owned subsidiary and joint venture is a conditioned choice: on the one hand, it is conditioned by the possible lack of resources (which would lead the firm to share the equity of the foreign unit) and on the other hand, by the desire of foreign investors to keep total control over their overseas operations (which would lead the firm to invest without partners). The studies by Gatignon and Anderson (1988), Buckley and Casson (1988), Hennart (1988, 1991) and Gomes-Casseres (1989) have developed this idea within the logic of transaction cost analysis. Kogut (1988), Kogut and Singh (1988) and Padmabanan and Cho (1996) have analyzed the effect of cultural differences between the home and host country on the choice of the ownership structure. Erramilli and Rao (1990, 1993) have focused on the peculiar

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\* - The authors thank the financial support from the Spanish Comisión Interministerial de Ciencia y Tecnología (CICYT: Project SEC-96-0748).

characteristics of service firms that influence the selection of the ownership structure. Gomes-Casseres (1990) has studied the ownership structure of a foreign unit by integrating the transaction cost approach with the bargaining power approach, while Agarwal and Ramaswami (1992) have analyzed the effect of the property of firm-specific competencies together with several different factors, like location advantages.

A second group of works has analyzed the decision of penetrating foreign markets either through a greenfield investment or an acquisition [Caves and Mehra (1986), Hennart and Park (1993), Wilson (1980), Zejan (1990)], or, more recently, an acquisition *versus* a joint venture [Hennart and Reddy (1997)]. This group of works shows a broader diversity of approaches than the former one. However, since Hennart and Reddy's (1997) effort, acquisitions are seen as an alternative to joint ventures to get the resources the foreign investor lacks. In this paper we follow this approach and analyze the determinants of the choice between greenfield joint ventures and acquisitions, as both are alternative means to get access to external resources that may be needed to enter a new market. We contrast our predictions with a sample of foreign investments made by Spanish firms. Compared to the existing literature, the main contribution of our work lies on the study of partial acquisitions as an alternative entry mode to total acquisitions and greenfield joint ventures. Thus, we have analyzed the choice of the entry mode considering three options of productive internationalization: establishment of a joint venture, acquisition of 100% of a company and partial acquisition. One second contribution is the use of data relative to Spanish firms, as other studies have made use of data from American or Japanese firms, which have a higher degree of international involvement and competitiveness than Spanish companies<sup>1</sup>.

The structure of this paper is the following: in the next section we discuss within a transaction cost framework the main factors considered as determinants of the choice between joint ventures and acquisitions. In section 3, we contrast empirically the hypotheses posed by estimating several binomial and multinomial logit models. Finally, we summarize the main conclusions reached.

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<sup>1</sup>- The Spanish FDI is featured by its late liberalization, which started in 1979 and consolidated in 1986 when Spain entered the European Economic Community —nowadays European Union.

## 2. THE CHOICE BETWEEN JOINT VENTURES AND ACQUISITIONS

Several reasons have been adduced to justify the internationalization of firms through foreign direct investments. The most common explanation is the possession by the foreign investor of some particular assets, mainly intangible (firm-specific knowledge and experience gained in a country) which can be exploited in other markets at a low cost. The reason why the possession of such knowledge leads to FDI is that its sale represents high transaction costs. Its tacit and firm-specific character makes very difficult its formalization and transference, as it is embedded in the people and organizational routines of the firm. This circumstance compels the company to exploit directly its firm-specific knowledge in foreign countries, in order to realize all its profit potential.

In this way, the natural means of internationalization is the establishment of a wholly-owned subsidiary: the firm sets up a new entity in the host market using its own resources and keeping 100% of its equity. The foreign investor transfers its firm-specific capabilities to this new unit, which are then combined with some different resources available in the host country through market contracting [Hennart and Park (1993, 1055)]. Nevertheless, firms often choose a different entry mode. Sometimes, the foreign investor decides to total or partially acquire the equity of a firm located in the host country, and then transfers its firm-specific advantages to the acquired firm. Other times, the foreign investor decides to set up a foreign unit (joint venture) with other partners. Following Hennart (1988) and Hennart and Park (1993), the use of entry modes different from the establishment of wholly-owned subsidiaries is justified when all the assets owned by the foreign investor are insufficient or inadequate to operate in a foreign market. The sufficient condition would be that the assets the firm lacks are difficult to replicate or to obtain in the market. Such is the case of the knowledge of the host market—in aspects concerning, for example, the structure of distribution networks, the specific needs of the local customers and so on. These are tacit capabilities (as it happens with the firm-specific competencies of the foreign investor) and are, therefore, difficult to be transferred in the market due to the difficulty in making explicit the knowledge, and the incentive problems they would pose. As these are capabilities based on firm's experience, it is neither possible that the foreign investor creates them by itself.

Although both joint ventures and acquisitions allow the foreign investor to get access to the resources it lacks, they do it in a very different way:

- Joint ventures allow the foreign investor to combine its firm-specific competencies with those of the other partners [Hennart (1991), Buckley and Casson (1996)]. If those assets were not firm-specific, there would not be incentives for setting up a joint venture since partners could coordinate their exchange through market contracting, getting lower coordination and motivation costs. In a joint venture each partner is encouraged to take care of the effective transference of its own capabilities: if that transference does not take place, the joint venture will not be successful. In addition, the reciprocity mechanism works in this case: a partner will stop its own transfers when it realizes the other partners are not transferring their own capabilities [Teece (1992, 19), Williamson (1985, 191)]. Thus, by developing teamwork with other partners, a joint venture allows the foreign investor to assimilate the assets it lacks, although its own distinctive competencies will become available to the other partners.
- Acquisitions imply buying a firm that possesses the assets the foreign investor lacks. These assets are then integrated in the foreign investor's hierarchy. By so doing, the foreign investor transfers its firm-specific competencies to the acquired firm's infrastructure. However, it is interesting to notice that an acquisition means neither the foreign investor can immediately assimilate the acquired firm's resources and competencies, nor the immediate transfer of its own competencies; although it allows the foreign investor to use the acquired infrastructure in the host market. Acquisitions also imply buying the firm as a whole and by so doing, paying the market value of some assets the foreign investor might not need and that can be difficult to sell to other firms.

In the following pages the transaction cost analysis is used to integrate the different hypotheses posed on this subject.

To set up a joint venture with a partner allows the foreign investor to assimilate the competencies it lacks, specially when they are not easily separable from the owning firm [Hennart and Reddy (1997, 11)]. By setting up a joint venture, the foreign investor gets a direct contact with the partner's personnel and also a direct access to the partner's specific competencies. As it has been said, a joint venture guaranties that the incentives to transfer these competencies do exist.

On the contrary, when investing through an acquisition the assimilation process of the acquired firm's competencies always implies a conflict of interests. Integrating two different firms in one single hierarchy is not always easy. On the one hand, it becomes necessary to integrate the

personnel of the acquired firm in the culture and organizational system of the acquiring firm, which can be very different from those of the former [Jemison and Sitkin (1986), Kogut and Singh (1988, 414)]. There is also a control problem, which is inherent to the relation between the foreign investor and the managers of the acquired firm. As these managers become employees of the acquiring firm, their low powered incentives must be compensated by means of administrative controls [Williamson (1996)], but the problem of getting reliable information about the combination process of the distinctive competencies of the two firms arises. This problem inherent to the assimilation process of the acquired firm's competencies is heightened due to the fact that in every acquisition process there is a small numbers bargaining relationship between the acquiring firm and the manager team of the acquired firm. This team is the more appropriate to supervise the integration process of cultures and competencies, due to the knowledge related to the acquired firm it possesses. It becomes then difficult to find an alternative team or manager that possesses this idiosyncratic knowledge of the acquired firm. In this case, this team is not correctly motivated: once the integration is completed, it becomes less necessary<sup>2</sup>.

In general, the problems and supervision costs the acquiring firm must assume increase with the cultural and geographical distance, due to the difficulty in getting reliable information that allows the foreign investor to evaluate the performance of those managers [Erramilli and Rao (1993, 24), Gatignon and Anderson (1988)]<sup>3</sup>. Cultural differences restrict also the effectiveness of the control mechanisms based on trust and shared values [Woodcock *et al.* (1994, 263)]. On this basis we can formulate the following hypothesis:

*H1. Joint ventures will be preferred to acquisitions when the psychic distance between the home and host country of the FDI increases.*

Nevertheless, investing through a joint venture has always the following disadvantages: firstly, the managing control and the profits have to be shared, at least, with another partner. In addition, there is a risk that the accrued tacit know-how of the foreign investor is spread: although it gets access to the knowledge the partner has about the local market, the latter has also direct access

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<sup>2</sup>- Although joint ventures also imply the combination of different cultures [Barkema *et al.* (1996)], they pose smaller integrative problems than acquisitions, as they do not need the integration of the two firms as a whole. In addition, as it has been already said, the partners are better motivated to transfer their own competencies to the joint venture.

<sup>3</sup>- Datta (1991) and Chatterjee *et al.* (1992) found a negative relationship between the economic performance of a unit after its acquisition and the cultural differences between the acquiring and acquired firms.

to the capabilities of the investor. The risks assumed when setting up a joint venture increase with the importance of these capabilities, as they get close to the partner and it can assimilate them. The more specific knowledge capable of yielding economic rents the foreign investor possess, the higher the costs of using an entry mode that implies sharing the ownership. The acquisition of 100% of the equity becomes then an attractive option for the firms that are more interested in protecting their own competencies when investing abroad [Woodcock *et al.* (1994, 259)]. As it does not imply sharing the equity of the unit located in the host market, it allows the foreign investor to minimize the risk of spread of its own distinctive competencies. This allows us to formulate the following hypothesis:

*H2. Acquisitions will be preferred to joint ventures in the case of investments made by firms with a high degree of development of distinctive competencies.*

On the other hand, acquisitions will be preferred when it is easy to transfer the specific knowledge from the acquiring to the acquired firm. In these circumstances not only is easier to get access to the external resources the foreign investor lacks, but also its own distinctive competencies keep protected, direct access to clients is reached and benefits of the foreign unit are not shared. Following Hennart and Park (1993), the more separable from the organization the knowledge is, the easier will become its transference. This is the case of firms with a stronger multinational nature: Hennart and Reddy (1997) found that the higher the international experience of the firm, the more standardized becomes the transfer of its distinctive competencies. In this way, Caves and Mehra (1986) found that these firms showed a higher tendency towards acquisitions versus the establishment of wholly-owned subsidiaries. Basing on this idea, we formulate the following hypothesis:

*H3. Acquisitions will be preferred to joint ventures when the investing firm has a high degree of international experience.*

As it has been already pointed out, foreign investors usually lack the knowledge of the host market. As far as the foreign investor is already present in the host market, the need for a local partner with such a local experience and the tendency to invest through a joint venture decrease. At the same time, as the experience of the investing firm in the host market increases, the postacquisition integration costs decrease [Hennart and Park (1993)]. Furthermore, once the investing firm does not need the local experience, investing through an acquisition has additional

advantages: as it has been said above, it guarantees the foreign investor direct access to the acquired firm's infrastructure and market share, while protecting its own distinctive competencies. Hence:

*H4. Acquisitions will be preferred to joint ventures when the experience of the foreign investor in the host market increases.*

Finally, we introduce in our study an analysis of what has been called the *digestibility* of the targeted assets [Hennart and Reddy (1997)]. Although both joint ventures and acquisitions allow the foreign investor to get access to the assets it lacks, the latter imply buying the firm as a whole and by so doing, paying the market value of all its assets. Then, it could be expected that *ceteris paribus* the financial resources necessary to invest through an acquisition are higher than that necessary to invest through a joint venture. To this point, it is expected that a threshold of financial resources exists under which the firm can not invest abroad through an acquisition. Additionally, if the acquired firm is large and it is not divisionalized it could be difficult to separate desired from undesired assets, which, in turn, would imply paying the market value of some assets the foreign investor does not need and can be difficult to sell to other firms. In contrast, the desired assets can be obtained through a joint venture without having to change the ownership of these assets, and hence without having to disentangle them from undesired assets [Hennart and Reddy (1997)]. On this base we formulate the following hypothesis:

*H5. The more digestible the targeted assets are, the higher the tendency to invest through an acquisition.*

### 3. TESTS OF THE THEORY

#### *3.1 Characteristics of the data*

In order to contrast the hypotheses previously formulated we have used a database with FDIs made by Spanish firms. This database was compiled by one of the authors of this paper, as a part of a broader research, from news items about FDIs made by Spanish firms published in *Expansion* —the leading economic newspaper in Spain. This database (DB) collects 339 FDIs made by Spanish firms through joint ventures and total or partial acquisitions from 1988 to 1994 inclusive. For every FDI, we collected information relative to the ownership structure of the unit

located in the target market, the way it was set up in that market and information about the foreign investor.

In order to identify the productive investments made by Spanish firms—including those established to provide services in the host country— all those FDIs whose main object lied exclusively on distribution and marketing activities of products manufactured by the foreign investor in its home market, those intended to establish a first contact in the host country, and finally those aimed at creating financial holdings or similar have been eliminated in the DB. This gives us a total of 157 productive foreign direct investments made by Spanish firms through joint ventures and acquisitions in the period. 110 of these investments took the form of joint ventures, whereas the remaining 47 gave rise to acquisitions —24 total acquisitions and 23 partial acquisitions. Table 1 shows the geographical and time distribution of these investments.

**TABLE 1**  
*Geographical and time distribution of the FDIs used in the analysis*

	Time distribution			
	<i>JOINT VENTURE</i>	<i>TOTAL ACQUISITION</i>	<i>PARTIAL ACQUISITION</i>	<i>TOTAL</i>
<b>Year</b>				
88	10	2	3	15
89	9	5	2	16
90	17	4	5	26
91	15	4	5	24
92	23	2	6	31
93	16	4	1	21
94	20	3	1	24
<b>TOTAL</b>	<b>110</b>	<b>24</b>	<b>23</b>	<b>157</b>
	Geographical distribution			
	<i>JOINT VENTURE</i>	<i>TOTAL ACQUISITION</i>	<i>PARTIAL ACQUISITION</i>	<i>TOTAL</i>
<b>Area</b>				
EU	20	18	12	50
OECD (no EU)	11	2	5	18
LATIN AME.	26	3	4	33
ELSEWHERE	53	1	2	56
<b>TOTAL</b>	<b>110</b>	<b>24</b>	<b>23</b>	<b>157</b>



### *3.2 Dependent variable and method of analysis*

Our interest in adopting different options of internationalization led us to use qualitative dependent variables. In turn, it led us to estimate several logit models to contrast the previously formulated hypotheses. As a first step we took a dichotomous dependent variable that is valued 1 when the foreign unit is the result of an acquisition (total or partial) and 0 when it is the result of a joint venture. Using this variable we have estimated binomial logit models where the probability that the investment was made through an acquisition is explained by the independent variables defined below. In these estimations, the coefficients obtained for every independent variable evaluate the effect of the increments of such variables on the probability that the dependent variable is valued 1.

Afterwards, in order to study in an exploratory way the differences between total and partial acquisitions, we have used a dependent variable with three categories, valued 0 when the FDI is made through a joint venture, 1 in those cases where the investment is made through the acquisition of 100% of the equity of a firm established in the host market, and 2 when the FDI gives rise to a partial acquisition. Given that the dependent variable presents more than two categories, in order to test the previously formulated hypotheses, multinomial logit models were estimated. In the binomial logit models, the estimates of coefficients for independent variables measure the effect of the variations of such variables on the probability that the dependent variable will be valued 1. However, in multinomial logit models, the estimated coefficients measure the effect of the variation of the independent variable on the relative probability that the dependent variable will take a particular value. In other words, it is not so much the effect on the probability itself that the dependent variable will take a particular value that is estimated, but rather that the effect on this probability in relation to the probability that the variable will take another value, which is used as reference—in this particular case we have taken the value 0 as reference. Another difference with binomial logit is that in multinomial models  $n-1$  coefficients are estimated for each independent variable, where  $n$  is the number of categories of the dependent variable. It is advisable to point out that it is irrelevant to sort such categories [Aldrich and Nelson (1984)]. Therefore, the multinomial model will estimate two coefficients for the independent variables which are defined later. Such coefficients indicate the effect (positive or negative) of an increase of the independent variable with respect to the relative probability of investing through a total or a partial acquisition versus the creation of a joint venture. For instance, a positive sign for a coefficient associated to an

independent variable and to the option of 100% acquisition, indicates that the probability to adopt such form of internationalization with respect to the creation of a joint venture increases when increments of the independent variable occur. Thus, the hypotheses are considered to be accepted when the sign of the coefficients associated to every independent variable coincides with the relation expected, and such coefficients are statistically significant. The estimates were obtained by using the LOGIT procedure of the LIMDEP statistical package.

### *3.3 Independent variables*

Table 2 shows the independent variables used in this study and their predicted incidence (positive or negative) over the probability that the FDI is carried on through a particular entry mode. To contrast Hypothesis 1, we have created variables GEOG 1, GEOG 2 and GEOG 3 in order to measure the psychic distance –cultural and economic– between the home and host country. By using these variables we have built up groups of countries that show a similar psychic distance relative to Spain. Thus, GEOG 1 variable is valued 1 when the host country is an OECD country, but not belonging to the European Union, and 0 in the remaining cases. GEOG 2 variable is valued 1 when the country is not an OECD country except for Latin American nations (former centralized economy European countries and the Asian and African continents) and 0 in the remaining cases. Finally, GEOG 3 is valued one when the host country is a Latin American nation and 0 in the remaining cases<sup>4</sup>. Thus, the European Union is the geographic area that acts as reference for these variables: each group of countries described by those variables shows a greater economic and/or cultural distance from Spain than the European Union. The greater the psychic distance, the greater the dissimilarities between the host and the home country and the greater the integration problems, as we established in Hypothesis 1. It should be pointed out that, although some authors have shown that the difficulty inherent to the assimilation process of the acquired firm's competencies increases when the FDI implies a diversification process, we have been unable to introduce such a measure in our analysis, as hardly any of the Spanish firms included in the DB diversified its foreign investment in different sectors.

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<sup>4</sup> - Mexico entered the OECD in 1994, so it is not considered an OECD member in this study.

**TABLE 2**

*Predicted incidence of the independent variables on the probability that the FDI is made through an acquisition*

<i>INDEPENDIENT VARIABLES</i>	<i>DESCRIPTION</i>	<i>ACQUISITION</i>
GEOG 1	FDIs located in OECD non EU countries	-
GEOG 2	FDIs located in non OECD and non Latin America countries	-
GEOG 3	FDIs located in Latin America	-
ADV	Expenses incurred in advertising activities (dummy)	+
I&D	Expenses incurred in R&D activities (dummy)	+
PRPRES 1	Previous presence in the host market derived form exports and contractual agreements	+
PRPRES 2	Previous presence in the host market derived form FDIs	+
NUMFDI	Number of FDIs made by the firm in the period	+
NUMDUM	The firm invested more than once in the period	+
SIZE	Turnover of the foreign investor	+
SIZE <sup>2</sup>	Turnover of the foreign investor <sup>2</sup>	-
SERVICE	FDIs carried on in Service sector	?
REGSEC	FDIs carried on in regulated sectors	?
CONSTRUCTION	FDIs carried on in Construction sector	?
FINANCE	FDIs carried on in Finantial service sector	?
MANUFACTURING	FDIs carried on in Manufacturing sector	?

In order to contrast Hypotheses 2 relative to the foreign investor's accumulation degree of distinctive competencies, some independent variables have been built. We have estimated the relative importance of the technological capabilities of the firms included in the DB from the expenses incurred in Research and Development activities. For that purpose, we have built the fictitious variable R&D which is valued 1 when the foreign investor ranks among the top 125 Spanish firms investing in R&D during the period of the study —not necessarily the same year of the FDI—, and 0 in the remaining cases. The information to build this variable has been obtained from the reports published by *Futuro* and *Mercado* magazines between 1990 and 1992 relative to the ranking of the 125 Spanish firms that incurred in highest R&D expenses. We have estimated the relative importance of the marketing skills of the foreign investor from its advertising expenses. As in the previous case, we have built a dummy variable (ADV) which is valued 1 when the foreign

investor ranks among the top 200 Spanish firms investing in advertising during the period of study—not necessarily the same year of the FDI—, and 0 in the remaining cases. We have built this fictitious variable from the information published by the *IPMark* magazine in the years between 1988 and 1993 relative to the ranking of the 200 Spanish firms that incurred in highest expenses in advertising.

The fictitious nature of these two variables is due to the fact that no information is available about the expenses on R&D and advertising for the firms not included in these listings. Anyway, it seems reasonable to assume that these variables have a non-linear effect, and that a threshold of accumulation of competencies exists from which the firm is induced to protect them.

In order to contrast Hypothesis 3 relative to the international experience of the investing firm, we have built NUMFDI and NUMDUM variables. The former collects the number of FDIs made by each firm and identified in the DB in the period of study. NUMDUM is a dummy variable which is valued 1 when the foreign investor has made more than one FDI in the period of study and 0 in the remaining cases.

To contrast Hypothesis 4 relative to the experience of the foreign investor in the host market we have built PREVPRES 1 and PREVPRES 2 variables which reflect the degree of presence of foreign investors in the host market prior to the FDIs identified in the data base. The variable has been split into two indicators that differentiate the kind of presence in the host market prior to the FDI: thus, PREVPRES 1 is valued 1 when such a presence derives from exports made to the host market or from the development of contractual agreements with local firms—licensing contracts, management contracts, etc.— and is valued 0 in the remaining cases; whereas PREVPRES 2 is valued 1 when such a presence derives from the realization of FDIs in the host market, and 0 in the remaining cases. The long standing presence of the firm in the host market may reduce the postacquisition integration costs.

Finally, in order to contrast Hypothesis 5 relative to the digestibility of the targeted assets, we have used the variable SIZE which collects the turnover of the foreign investor in 1994<sup>5</sup>—this information has been obtained from the annual report published by DUNS 50,000. As it seems

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<sup>5</sup> - We have used the 1994 turnover as the annual report published by DUNS 50,000 for this year contains information about a higher number of companies than in previous years.

reasonable to assume that this variable has a non-linear effect, we have also built the variable  $SIZE^2$  which collects the square of the first one.

Finally, we have used some sectorial variables in order to analyze the influence of the sector of activity on the form of investment. Categorization of the FDIs collected in the DB has been carried out using the following classification of the activities:

- CONSTRUCTION: It is valued one for FDIs (6) carried on in *Construction* sector.
- MANUFACTURING: It is valued one for FDIs (91) carried on in *Manufacturing* sectors.
- REGSEC: It is valued one for FDIs (26) carried on in activity sectors that have been traditionally regulated and are being now increasingly deregulated, as air transport, communications and energy sectors<sup>6</sup>.
- SERVICE: It is valued one for FDIs (18) carried on in *Service* (non-finance) sectors —except for those collected in REGSEC variable.
- FINANCE: It is valued one for FDIs (16) carried on in *Financial service* sector.

Table 3 shows the correlation matrix of the variables used in both models as well as the mean value and standard deviation corresponding to each of them. There is not high correlation, except for those relative to the firm's size, the number of FDIs, and financial service. This is an expected result: on the one hand, firm's size is associated in some way with the accumulation degree of resources and, on the other hand, banks and insurance firms are among the largest in the Spanish economy.

### 3.4 Results

The empirical test of the hypotheses posed above has been developed in two stages. First, several binomial logit models have been estimated in order to contrast the decision to acquire or invest through a joint venture. Table 4 shows the results of the binomial logit models estimated. Columns (1) and (2) show the estimates corresponding to the two alternative binomial logit models

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<sup>6</sup> - OECD (1993)

which have been built with NUMFDI and NUMDUM variables. In a second stage several multinomial logit models have been estimated. These models consider the joint venture and the two entry modes a firm can choose when investing abroad through an acquisition: total and partial acquisition (Table 5). For every model tables show the value of the coefficients of the independent variables, their standard error and an indication of their level of significance. Generally speaking, it is observed that the different models offer estimates that are statistically significant. In addition they make it possible to classify satisfactorily the different observations in percentages higher than 82%.

Taken as a whole, our results confirm most predictions advanced. As to Hypothesis 1, our results show that a higher cultural and economic distance positively affects the probability that the investment is made through a joint venture. GEOG1, GEOG2 and GEOG3 variables measuring the psychic distance between the home and host countries show the adequate sign and are statistically significant (both in the binomial and multinomial models). As to the empirical verification of the second hypothesis related to the foreign investor desire to protect its own distinctive competencies, results are not as expected. ADV and R&D variables (showing the degree of marketing and technological capabilities respectively) do not perform as expected<sup>7</sup>. This is a usual result in this literature when the data are not from US firms [Hennart (1991), Kogut and Singh (1988)].

As to the empirical verification of the third hypothesis related to the transferability of the specific competencies of the foreign firm, variables NUMFDI and NUMDUM have the suitable sign and are statistically significant for total acquisitions almost in all models. This result shows a higher tendency towards acquisitions in those firms with a stronger multinational nature. As it has been said above, firms with a high degree of international experience have standardized the process of transferring their distinctive competencies. Due to this fact, acquisitions become a more attractive option not only as a way of penetrating a new market, but also as a way to develop it using the market share of the acquired firm, even when the acquiring firm is already established in the host market. In this way, Hennart and Park (1993) and Hennart and Reddy (1997) found that the experience of Japanese firms in the USA did not negatively affect the probability of future acquisitions in that market. When making estimations with the NUMDUM variable, we tried to establish whether the relevant factor referring to the number of FDIs made by the foreign investor was simply greater than one —indicating the non occasional nature of the FDI collected in the DB—,

and not the increments of this variable. The results obtained show that this is the case, as NUMDUM variable shows a higher statistical significance in all models estimated. This means that NUMDUM collects better than NUMFDI the accumulation degree of international experience, as it allows distinguishing between the systematic and sporadic foreign investors. It is important to notice that the database has covered the period following the Spanish FDI liberalization (in previous years Spanish firms investing abroad needed a governmental authorization, which meant an important barrier to their international expansion). For this reason, we can assume that the Spanish firms that have invested abroad only once between 1988 and 1994 have a lower international vocation than those that invested more than once. Results of NUMFDI and NUMDUM variables also show some evidence related to Hypothesis 2. Following the Internalization Theory [Buckley y Casson (1976), Teece (1976, 1977), Hennart (1982)], firms that show a higher tendency to expand abroad through FDI are those that have accumulated more firm-specific capabilities and, then, have more competencies to protect.

The statistically significant coefficient opposed to the acquisition option showed by SERVICE also supports hypothesis 3. The functioning of service firms is based on a series of internal organizational routines in such a way that the product being sold is the productive process itself. As such organizational routines tend to be specific of a peculiar way of organization, the transference of competencies towards the host market is usually made by reproducing the functioning of the firm in its home country. In this sense, to combine the organizational routines of the acquiring and acquired firms would be very difficult and confusing for the clients. This would aggravate when the foreign investor tried to develop a worldwide known brand name that guaranteed an homogeneous quality for international clients, as it happens in most service firms that compete in international markets<sup>8</sup> [Fladmoe and Jacque (1995, 1239)]. In addition, as service firms have a larger component of intangible assets, it is not advisable for them to invest through acquisitions: the acquired firm's assets can not be used by the acquiring firm, neither sold to other firms. However, the tendency of service firms not to invest through total acquisitions is stronger than that relative to partial acquisitions (Table 5). It could be due to the fact that in partial acquisitions there is a local partner who is more

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<sup>7</sup> - To this respect, results obtained for the category of total acquisitions in the multinomial models estimated are specially interesting, as in total acquisitions the partners that concur in a joint venture or a partial acquisition are not present.

<sup>8</sup> - Following Hallwood (1994), the reputation and marketing advantages associated with a worldwide known brand name would lead firms to internationalization through FDI, irrespective of the transaction costs in the exchange of firm's specific competencies.

motivated to control the foreign unit (as it happens in the joint ventures) than the manager/s of a wholly owned subsidiary.

As to Hypothesis 4, related to the experience of the foreign investor in the host market, results of PREVPRES 1 and PREVPRES 2 variables are not as expected, showing that the experience of Spanish foreign investors in the host market does not affect their choice between joint ventures and acquisitions. This result could be due to the fact that these FDIs located in host countries where the foreign investor was already present could be related to a “new type of genuine strategic alliances” [Schmidt and Fallerman (1993, 750)] which pursue more ambitious objectives than just entering a new market. These alliances do not fit well within the internalization theory.

On the other side, the size of the investing firm does positively affect the probability of investing through an acquisition, as the positive and statistically significant coefficient of the variable SIZE (Table 4) shows—in model 1 this coefficient shows a  $p=0.1010$ . Variable SIZE<sup>2</sup> also shows the expected sign (although it is not statistically significant in all models estimated, it is always closed to the threshold of significance). This result evidences that there is a minimum amount of financial resources necessary to invest abroad through an acquisition, but once surpassed that minimum, the size becomes less important in the decision to invest through an acquisition.

Finally, partial acquisitions have been included in this study in an exploratory way. This option combines some characteristics of joint ventures and total acquisitions. Results show that partial acquisitions perform more similarly to total acquisitions than to joint ventures. This result probably indicates that firms invest through partial acquisitions when they cannot buy 100% of the equity of the local firm, rather than when they need a partner. To this point, coefficients of variable SIZE in tables 4 and 5 are specially interesting: variable SIZE shows a statistically significant coefficient favorable to acquisitions in almost all models estimated, but this significance increases for partial acquisitions, showing that the largest firms use more often this form of FDI. This result points out that partial acquisitions are not due to the lack of financial resources, but to the lack of a chance for acquiring 100% of the equity.



#### 4. CONCLUSIONS

In this paper we have analyzed the problems involved in the choice of entry mode when investing abroad using external firm-specific resources. By using empirical data from Spanish FDIs, we have obtained several conclusions:

- Firstly, taken as a whole, our results confirm that transaction cost considerations significantly influence the choice between joint ventures and acquisitions. Our results confirm the role of joint ventures and acquisitions as alternative options to overcome the lack of resources. Nevertheless, joint ventures are the most proper entry mode when the foreign investor needs to accede to local market know how and there is a great psychic distance between the home and host countries, as the partners are correctly motivated to transfer their own competencies to the joint venture. Acquisitions show a disadvantage related to the difficulty in integrating the acquiring and acquired firms, so they are more advisable when the foreign investor has some experience in the integration process of two firms or when it seeks for some additional advantages as the access to the market share of the acquired firm or the protection of its own specific competencies.
- These additional advantages referred to in the last lines become stronger when 100% of the equity of the foreign unit is acquired, as this total acquisition means that control and profits are not shared with other partners. In this way, partial acquisitions emerge as an hybrid option between joint ventures and total acquisitions and so they show the disadvantages of both options. Our results reveal that partial acquisitions perform more similar to the latter than to the former which could mean that in most cases the acquiring firm buys a capital share of the acquired firm because it can not purchase 100% capital, but not because it needs a partner.

**TABLE 3**

*Correlacion matrix*

<i>EU</i>	<i>LAT. AM</i>	<i>OECD</i>	<i>R.WORL</i>	<i>PREVPR1</i>	<i>PREVPR2</i>	<i>SIZE</i>	<i>SIZE2</i>	<i>NUMFDI</i>	<i>ADV</i>	<i>R&amp;D</i>	<i>REG. SE.</i>	<i>SERVICE</i>	<i>CONSTR.</i>	<i>FIN.</i>	<i>MANUF</i>	<i>NUMDU</i>	
<i>D</i>																	
1.000	-0.352	-0.238	-0.509	-0.004	0.245	0.032	0.019	-0.052	-0.047	-0.018	-0.120	0.140	0.006	0.221	-0.138	-0.032	<i>EU</i>
	1.000	-0.179	-0.3841	0.084	-0.058	0.073	0.065	0.152	0.091	0.053	0.190	-0.038	0.141	-0.018	-0.162	0.037	<i>LAT. AM</i>
		1.000	-0.259	-0.117	0.053	-0.012	-0.026	0.046	-0.013	0.067	0.010	0.003	0.037	-0.049	0.006	0.032	<i>OECD</i>
			1.000	0.012	-0.248	-0.128	-0.092	-0.175	-0.042	-0.060	-0.045	-0.101	-0.148	-0.206	0.284	-0.030	<i>REST W.</i>
				1.000	-0.183	-0.102	-0.082	-0.081	-0.045	0.088	-0.036	-0.121	-0.067	-0.113	0.201	-0.071	<i>PREVPR1</i>
					1.000	0.311	0.282	0.306	0.155	0.043	0.001	0.041	-0.029	0.267	-0.180	0.293	<i>PREVPR2</i>
						1.000	0.973	0.677	0.420	-0.182	-0.034	-0.103	-0.046	0.768	-0.360	0.157	<i>SIZE</i>
							1.000	0.577	0.358	-0.205	-0.098	-0.087	-0.048	0.711	-0.286	0.155	<i>SIZE2</i>
								1.000	0.529	0.006	0.065	-0.074	-0.048	0.536	-0.311	0.394	<i>NUMFDI</i>
									1.000	0.215	0.180	-0.199	-0.134	0.272	-0.122	0.248	<i>ADV</i>
										1.000	0.302	-0.032	0.094	-0.294	-0.062	0.270	<i>R&amp;D</i>
											1.000	-0.160	-0.088	-0.150	-0.523	0.173	<i>REG. SE</i>
												1.000	-0.071	-0.121	-0.422	-0.081	<i>SERVICE</i>
													1.000	-0.067	-0.234	0.001	<i>CONSTR.</i>
														1.000	-0.395	0.017	<i>FIN SERV</i>
															1.000	-0.089	<i>MANUF</i>
																1.000	<i>NUMDU</i>
0.32	0.21	0.11	0.36	0.10	0.23	660798.3	4.74 10 <sup>12</sup>	4.55	0.31	0.43	0.17	0.11	0.04	0.10	0.58	0.66	<i>MEAN</i>
0.47	0.41	0.31	0.48	0.30	0.42	2081534.1	1.94 10 <sup>13</sup>	6.46	0.46	0.50	0.37	0.32	0.19	0.30	0.50	0.47	<i>ST. DV.</i>

**TABLE 4**  
Binomial logit models estimates [*beta coefficient values (standard deviation in parenthesis)*] Cases: 157  
(0= Joint venture, 1= Acquisition)

Variable name	Description	Model (1)	Model (2)
CONSTANT		1.9696	1.3758
GEOG 1	FDIs located in OECD non EU countries	-2.6695*** (0.8328)	-2.5969*** (0.8300)
GEOG 2	FDIs located in non OECD and non Latin American countries	-4.9601*** (0.8790)	-5.0347*** (0.8923)
GEOG 3	FDIs located in Latin America	-3.2157*** (0.7841)	-3.0829*** (0.7627)
ADV	Expenses incurred in advertising activities (dummy)	-2.0898** (0.8222)	-1.9533** (0.7880)
R&D	Expenses incurred in R&D activities (dummy)	0.5638 (0.6135)	0.4479 (0.6215)
PREVPRES 1	Previous presence in the host market derived from exports and contractual agreements	-1.3555 (1.039)	-0.9811 (0.9815)
PREVPRES 2	Previous presence in the host market derived from FDIs	0.5587 (0.6279)	0.2981 (0.6486)
NUMFDI	Number of FDIs made by the firm in the period	0.0795 (0.0669)	
NUMDUM	The firm invested more than once in the period		1.2598** (0.6359)
SIZE	Turnover of the foreign investor	0.2077 10-5 (0.1267 10-5)	0.2632 10-5** (0.1141 10-5)
SIZE <sup>2</sup>	Turnover of the foreign investor <sup>2</sup>	-0.1060 10-12 (0.9219 10-13)	-0.1565 10-12* (0.7999 10-13)
SERVICE	FDIs carried on in Service sector	-4.0667*** (1.079)	-3.8655*** (1.098)
REGSEC	FDIs carried on in regulated sectors	-0.4416 (0.8989)	-0.7126 (0.8847)
CONSTR	FDIs carried on in Construction sector	-3.4093** (1.454)	-3.3412** (1.418)
FINANCE	FDIs carried on in Financial service sector	-9.7622** (4.742)	-9.2671** (4.305)
Chi-cuadrado		87.147 p<0.000001	89.732p< 0.00001
* p<0,1	** p<0,05	*** p<0,01	

**TABLE 5**

*Logit multinomial models estimates [beta coefficient values (standard deviation in parenthesis)] Cases: 157*

Variable name		Model (1)		Model (1)	
		TOTAL ACQUISITION	PARTIAL ACQUISITION	TOTAL ACQUISITION	PARTIAL ACQUISITION
CONSTANT		0.6207	1.6484	-0.1772	1.3822
GEOG 1	FDIs located in OECD non EU countries	-3.2488*** (1.070)	-2.2478** (0.9203)	-3.2412*** (1.065)	-2.3177** (0.9314)
GEOG 2	FDIs located in non OECD and non Latin American countries	-5.1980*** (1.223)	-4.7886*** (1.029)	-5.3935*** (1.231)	-4.9181*** (1.048)
GEOG 3	FDIs located in Latin America	-3.4370*** (0.9284)	-3.1305*** (0.9563)	-3.3001*** (0.9146)	-3.1577*** (0.9577)
ADV	Expenses incurred in advertising activities (dummy)	-2.2386** (1.088)	-2.1494** (0.9503)	-1.6587* (0.8982)	-2.3037** (0.9541)
R&D	Expenses incurred in R&D activities (dummy)	0.6480 (0.7207)	0.4406 (0.7383)	0.4369 (0.7303)	0.3097 (0.7511)
PREVPRES 1	Previous presence in the host market derived form exports	-0.1648 (1.097)	-13.010 (213.9)	0.4051 (1.082)	-12.938 (213.4)
PREVPRES 2	Previous presence in the host market derived form FDIs	1.0801 (0.7165)	0.1364 (0.7579)	0.7729 (0.7333)	-0.1022 (0.7960)
NUMFDI	Number of FDIs made by the firm in the period	0.1794* (1.1010)	0.0175 (0.0720)		
NUMDUM	The firm invested more than once in the period			1.8972** (0.9072)	0.7688 (0.7972)
SIZE	Turnover of the foreign investor	0.1294 10-5 (0.1741 10-5)	0.2854 10-5* (0.1566 10-5)	0.2465 10-5* (0.1472 10-5)	0.3115 10-5** (0.1485 10-5)
SIZE <sup>2</sup>	Turnover of the foreign investor <sup>2</sup>	-0.2695 10-13 (0.1179 10-12)	-0.1615 10-12 (0.1125 10-12)	-0.1643 10-12 (0.1186 10-12)	-0.1744 10-12* (0.9725 10-13)
SERVICE	FDIs carried on in Service sector	-3.2098*** (1.143)	-14.782 (208.1)	-2.9597** (1.184)	-14.698 (211.5)
REGSEC	FDIs carried on in regulated sectors	-0.2275 (1.139)	-0.5499 (1.035)	-0.7073 (1.076)	-0.6584 (1.022)
CONSTR	FDIs carried on in Constructor sector	-2.3769 (1.550)	-14.730 (382.3)	-2.2171 (1.509)	-14.759 (381.1)
FINANCE	FDIs carried on in Financial service sector	-11.107 (9.021)	-10.828** (5.455)	-7.8870 (5.027)	-11.392* (5.947)
Chi-cuadrado		104.7 p<0.000001		105.7 p<0.000001	
* p<0,1    ** p<0,05    *** p<0.01					

**TABLE 6**  
*Classification tables for estimated models*

<i>Binomial Logit Model 1. Predicted</i>				
True	Joint venture	Acquisition	Total	
Joint venture	104	6	110	
Acquisition	13	34	47	
Total	117	40	157	
% correct	87.9%			
<i>Binomial Logit Model 2. Prediction</i>				
True	Joint venture	Acquisition	Total	
Joint venture	102	8	110	
Acquisition	11	36	47	
Total	113	44	157	
% correct	87.9%			
<i>Multinomial Logit Model 1. Prediction</i>				
True	Joint venture	Total acq.	Partial acq.	Total
Joint venture	105	2	3	110
Total acquisition	8	13	3	24
Partial acquisition	8	3	12	23
Total	120	18	18	157
% correct	82.8%			
<i>Multinomial Logit Model 2. Prediction</i>				
True	Joint venture	Total acq.	Partial acq.	Total
Joint venture	105	2	3	110
Total acquisition	7	13	4	24
Partial acquisition	7	4	12	23
Total	119	19	19	157
% correct	82.8%			

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