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DETERMINANTS OF FORMATION OUTCOME IN DYADIC AND MULTIPARTNER INTERNATIONAL JOINT VENTURES

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ABSTRACT

We consider the determinants of foreign ownership decisions in the context of foreign equity ventures in Turkey. Institutional variables and transaction costs variables are examined as determinants of choice between wholly owned subsidiary, dyadic joint venture and multi-partner joint venture. The findings support the majority of the hypotheses. Particularly important in determining the choice of affiliate structures were found to be political risk, corruption perception, cultural distance, linguistic distance, R&D intensity, FDI concentration, affiliate size and location of affiliate. Institution specific variables were found to be more significant in explaining affiliate formation outcomes than were transaction cost specific variables.

Keywords: Institutional variables, transaction cost variables, FDI, dyadic JVs, multi-partner JVs, wholly owned subsidiaries, Turkey.

INTRODUCTION

Joint ventures (JVs) have increasingly become important market entry mechanisms particularly for MNEs entering emerging market economies. Most studies of JVs appear to assume implicitly that there will be a foreign and a local partner in an JV partnership structure; whereas evidence indicates that there are also multi-partner joint ventures which involve more than two local or foreign partners (Beamish and Kachra, 2004; Griffith et al., 1998). Multi-partner international joint ventures relative to WOS and dyadic partnership structures appear to have some more managerial complexities (Beamish and Kachra, 2004), Geringer and Woodcock, 1995; Dhanaraj and Beamish, 2004) and which may affect operational performance.

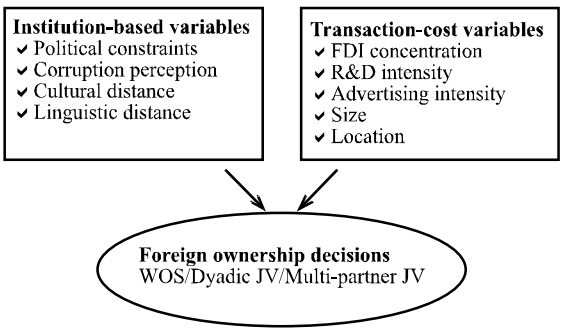
In this study we examine some determinants of JV partnership structure relative to wholly owned subsidiaries in an emerging market. Although there have been studies on determinants of foreign equity ownership in JVs (Gomes-Casseres, 1989; Hu and Chen, 1993; Demirbag and Weir, 2006; Tatoglu, Glaister and Erdal, 2003) there is dearth of evidence on determinants of JV partnership structure relative to WOS. This study aims to fill this gap by using a large dataset from an emerging market economy.

Literature on entry mode decision mainly adapt transaction cost theory, resource based view of the firm and more recently institutional perspective. While we adapt the transaction cost perspective for transaction related dimensions, the host country institutional environment is also known to influence entry mode decisions of MNEs (Brouthers, 2002). Brouthers (2002) further argues that institutional variables extend transaction costs theory by examining the ability of a firm to expand or enhance its competitive advantage. Child et al. (2003:243) refer to natural selection and argue that 'firms operating under more favourable external circumstances have a better chance of prospering'. Peng (2001) and Makino et al. (2004) have both stressed the importance of economic, political, social, cultural and institutional differences across countries and asserted that 'countries do matter' in explaining the variation in behaviour and performance of MNEs.

Transaction costs and institutional environment theories of FDI entry modes differ in terms of the logic underlying each approach. While the transaction cost theory focuses on efficiency, the institutional theory uses legitimacy as its primary criterion. Although some conceptualizations have attempted to integrate both theories (Williamson, 1991), these efforts have remained limited due to the integration of only the regulative environment, while some of the normative and cognitive dimensions of institutional theory have not been used by transaction cost theorists (Yiu and Makino, 2002).

Given the emerging nature of the market and the transitional characteristics of the institutional environment, the Turkish context provides a good case to test a number of new dimensions alongside previously tested variables. In particular, this study aims to integrate new institutional dimensions such as linguistic distance and transparency differences between home and host countries. Essentially, the focus of the study is on the choice of foreign investors between WOS and JV partnerships (dyadic or multi-partner). We assign JVs into two categories in terms of number of partners involved: dyadic and multi-partner JVs. As suggested by previous studies (Griffith et al., 1998) that more and more JVs are forming with more than two partners, there is a need to examine factors determining formation outcome of JVs relative to WOS. Hence, three separate comparisons for the partnership strategies of foreign investors are made: (1) comparing a dyadic (two partner) JV with a WOS; (2) comparing a multi-partner JV with a WOS; and (3) comparing a dyadic (two partner) JV with a multi-partner JV. This enhances the robustness of the analysis by providing a better understanding of the variables that impact the partnership structures of foreign investors in Turkey. For the purpose of establishing relationships among transaction costs, institutional level variables and foreign ownership decisions we have developed a conceptual framework as shown in Figure1.

FIGURE 1
A Conceptual Framework of Foreign Ownership Decisions



Based on the conceptual framework provided in Figure 1, the following hypotheses were derived.

H1: In an environment with high political constraints, a foreign investor is more likely to select a dyadic JV over a WOS.
H2: The greater the corruption differences between the home and host countries the more likely that foreign investor will choose a dyadic or a multi-partner JV over a WOS.
H3: As the cultural distance between home and host country increases, the foreign investor will be more in favour of forming a dyadic JV rather than WOS, while it will prefer a WOS over a multi-partner JV.
H4: The greater the linguistic distance between home and host country, the more likely that the foreign investor chooses a dyadic JV over both a WOS and a multi-partner JV.
H5: The greater the FDI concentration in an industry, the more likely that a foreign investor chooses a WOS over both a multi-partner and a dyadic JV.
H6: In an emerging market a foreign investor is more likely to choose a WOS over a dyadic and a multi-partner JV in R&D intensive industries.
H7: A foreign investor is more likely to choose a multi-partner JV over a WOS and a dyadic JV in industries with high advertising intensity.
H8: A foreign investor is more likely to choose a WOS over a multi-partner JV or a dyadic JV when the subsidiary is located in the developed regions of the host country.
H9: A foreign investor is more likely to choose a multi-partner JV over both a WOS and a dyadic JV as the capital size of the subsidiary increases.

RESEARCH METHODS

Data

All foreign equity ventures operating in Turkey are recorded by a government agency, the General Directorate of Foreign Investment (GDFI).

The GDFI acts as a one-stop agency for implementing the regulations concerning foreign investment. It advises and assists foreign investors, receives and processes investment applications, and reviews and approves license, royalty and management contracts. The database of GDFI consists of all FDI firms in Turkey as of 2003 and includes 6,253 FDI firms. This database incorporates data from national authorities and other relevant sources and provides information about the country of origin, mode of entry, the sector of operation, amount of capital and its distribution among foreign and local partners, the number and composition of foreign and local partners, entry date and location of the investment.

A venture is defined as a JV when foreign equity ownership ranges from 5% to 95%, while a venture with foreign equity shareholding of over 95% is considered to be a WOS. This range is consistent with the definition of a JV used by some recent studies (Arregle, 2006; Yiu and Makino, 2002; Lu, 2002). In this study JVs are further classified into two categories: dyadic partnership joint ventures and multi-partner joint ventures. Dyadic partnerships consist of only

one foreign and one local partner while multi-partner JVs involve more than one foreign or local partner.

The characteristics of the sample firms on the basis of the key dimensions of the data source are summarized in Table 1.

TABLE 1
Characteristics of the Sample

	No	%
Foreign Equity Shareholding		
Minority JV	1079	17.3
Co-ownership	852	13.6
Majority JV	1408	22.5
WOS	2914	46.6
Broad Sector of Operations		
Agriculture and mining	244	3.9
Manufacturing	1495	23.9
Service	4514	72.2
Time Period of Formation		
Pre 1980	76	1.2
1980-1989	1448	23.2
1990-1999	3597	57.5
2000 and later	1132	18.1
Country/Region of Origin		
Germany	1102	17.6
UK	453	7.2
Netherlands	467	7.5
France	324	5.2
Italy	259	4.1
Other EU	566	9.0
Switzerland	264	4.2
USA	452	7.2
Arab and other Islamic	1235	19.8
Far Eastern	310	5.0
Eastern Europe and former USSR	496	8.0
Others	325	5.2
Location of Investment		
Marmara region	4153	66.4
Others	2100	33.6
Number of Partners		
WOS	2914	46.6
Dyadic JV	2727	43.6
Multi-partner JV	612	9.8
Total	**6253**	**100.0**

Operationalization of Variables

Dependent Variables

We use the number of partners as dependent variables for statistical analyses (WOS, dyadic JV or multi-partner JV). This approach enabled us to examine differences between dyadic JVs and multi-partner JVs.

Independent Variables

The political constraints index (POLCON) was developed by Henisz (2002), which measures the feasibility of a change in policy given the structure of a nation's political institutions (the number of veto points) and the preference of actors that inhabit them (the partisan alignments of various veto points and the heterogeneity or homogeneity of the preferences within each branch). The POLCON database covers almost all major nations and is calculated for virtually all countries for the post-war period (1960-2004) which fits well with the database used for this study. The PolconV index for Turkey was directly adapted from Henisz's database.

The corruption perception (CORRUPT) index was computed as follows. Transparency International's corruption index was used to identify transparency distance between home and host countries (as suggested by Habib and Zurawicki, 2001, 2002). Then the distances between home and host countries were multiplied by the sectoral bribery index.

Cultural distance (CULT-DIST) is measured by using the methodology developed by Kogut and Singh (1988) based on Hofstede's (1980) measures of four dimensions of national culture: power distance, uncertainty avoidance, masculinity/femininity, and individualism.

There seems to be no developed measure of linguistic distance (LINGDIST) between world languages in the international business or management literature. Recently there has been an attempt to operationalize the concept to explore the relationship between cultural distance dimensions and distance between languages (West and Graham, 2004). Chen et al. (1995) developed a measure of linguistic distances between 130 localities around the world.

Industry R&D intensity (R&DINTENS) was calculated by following the methodology used by Chen and Hennart (2005). As suggested by Chen and Hennart (2005), the ratio of R&D expenditures to sales at the four digit Standard Industrial Classification (SIC) were created by using data in Turkey's Statistical Yearbook 2005, in which data goes back as far as 2001 (p. 380). In a comparative study, Martins and Price (2004) use the same method in creating R&D intensity for industrial sectors.

Industrial advertising intensity (ADINTENS) was calculated by using data from Marketing Turkiye (2000) and Turkey's Statistical Yearbook (2001).

Location (LOCATION) is a dummy variable that is coded 1 if the affiliate is located in the Marmara region,

the most developed region of Turkey, and 0 otherwise. The subsidiaries located outside the Marmara region are mainly concentrated in Central Anatolia, Aegean and Mediterranean regions.

Capital size of affiliate (LN_SIZE) is measured using the logarithm of the amount of total investment in US dollars. Data on capital size of affiliates have been converted into US dollars using the average rate of exchange for each year as reported by the Central Bank of Turkey. The logarithmic transformation is generally used to normalize the size variable, which might otherwise be badly skewed.

Control Variables

In addition to the variables discussed above, two variables are included in the model to control for possible extraneous variation:

Triad vs. non-triad countries: TRIAD is a dichotomous variable where the value of 1 denotes triad nations and 0 otherwise. A similar taxonomy was also used by Glaister et al. (1998), Marangozov (2005) and Demirbag et al. (2007b). Triad nations include EU countries (i.e. pre-2007 membership), USA, Japan and also other countries of Western Europe including Norway, Lichtenstein and Switzerland and partnerships between companies from these countries. Non-Triad countries consist of other OECD countries (South Korea, Australia, New Zealand), non-EU Central and Eastern European countries (Bulgaria, Romania, Macedonia, Albania, Slovenia) Russia, Ukraine, Central Asian Republics, China, India, Taiwan, Malaysia, Islamic countries of Asia, Middle East and North Africa, and others including mixed partnerships within these groups.

Industry of affiliate: To control for industry variations, three broad industrial groupings are introduced as dummy variables. Group 1 manufacturing (MANUFAC1) industries included food, beverages, textile, apparel, leather, metal, iron, steel, mining, petroleum and gas, Group 2 manufacturing (MANUFAC2) industries comprised of auto, transport and related equipment, electrical, electronics, durables and chemicals. Service industries (SERVICES) included export-import trading, tourism, banking and financial services, construction, logistics and other services.

The correlation matrix of the independent variables in the study is shown Table 2. The pairwise correlations do not seem to present serious multicollinearity problems for the multivariate analysis, as none of the variables have correlation coefficients above 0.60.

Model Specification

The entry mode choice of WOS and alternatives within JV partnership structures is modelled as a qualitative choice problem. Three partnership structures were considered: WOS, dyadic JV (one foreign partner and one local partner) and multi-partner JV (more than two partner firms). The nature of the dependent variables allowed us to use the multinomial logit approach to estimate the effect of explanatory variables on the probability that each of the three partnership

TABLE 2: Correlation Matrix

Variable name	Mean	SD	1	2	3	4	5	6	7	8	9	10	11	12	13
1. POLCON	0.62	0.20	1.00												
2. CORRUPT	14.80	12.13	0.11*	1.00											
3. CULTDIST	1.36	0.92	-0.04	0.43*	1.00										
4. LINGDIST	2.06	0.54	-0.03	-0.54*	-0.43*	1.00									
5. FDICON	0.18	0.17	-0.02	-0.10*	-0.05	-0.07	1.00								
6. R&DINTS	51.46	81.8	-0.01	0.05	0.02	0.02	0.41*	1.00							
7. ADVINTS	242.3	133.1	-0.07	0.05	-0.02	-0.04	0.23*	0.14*	1.00						
8. LOCATION	0.66	0.47	0.01	-0.02	0.00	0.00	0.13*	0.07	0.08	1.00					
9. LN_SIZE	12.70	2.35	-0.32*	0.20*	0.12*	0.12*	0.04	0.06	0.08*	0.01	1.00				
10. MANUFAC1	0.13	0.33	-0.04	-0.20*	0.06	0.09*	-0.20*	-0.14*	-0.38*	-0.08	0.09*	1.00			
11. MANUFAC2	0.15	0.35	-0.08	-0.14*	0.05	0.11*	0.16*	0.53*	0.11*	0.04	0.25*	-0.16*	1.00		
12. SERVICES	0.72	0.44	0.10	-0.27*	-0.08	-0.16*	0.01	-0.32*	0.19*	0.02	-0.27*	-0.50*	0.57*	1.00	
13. TRIAD	0.65	0.47	-0.05	0.57*	0.58*	0.58*	-0.07	0.04	-0.05	-0.02	0.19*	0.11*	0.11*	-0.21*	1.00

Notes:
SD = Standard deviation
*p < 0.01 (two-tailed test)
N=6,253

alternatives would be chosen. The multinomial logit analysis allows the explanatory variables to affect different odds of choosing one alternative partnership structure relative to the other. The probability that the ith firm will choose the jth formation strategy (P_{ij}) is given in the following model.

$P_{ij} = Pr (R_{ij} > R_{ik})$, for k≠j, j= 0,1,2,3 where R_{ij} is the maximum utility for firm *i* if the firm chooses the entry mode *j*

$P_{ij} = \exp (x_{ij}\beta j) / \Sigma \exp (x_{ij}\beta_j)$,

where P_{ij} is the probability of choosing alternative *j* and βj is the vector of coefficients to the independent variables. The parameters (βs) are estimated by maximizing a log likelihood function.

RESULTS AND DISCUSSION

Empirical results are presented in Table 3. The estimated coefficients as shown in Table 3 should be interpreted as representing the marginal utility of choosing a dyadic or multi-partner JV over a WOS. Therefore, a negative coefficient signifies less likelihood of an JV partnership structure over a WOS.

Three models presented in Table 3 estimates the relationship between independent variables and the number of partners in joint ventures by using WOS (by definition which are single organizations) as the base outcome. The first model includes only institution specific variables, while the second model includes transaction cost specific variables. The full model (Model 3) incorporates institutional, transaction cost and industry level variables. The ?2 values are significant for all three models ($p<0.001$), exhibiting high-level of overall explanatory power.

Table 3 shows that the POLCON variable has positive and significant coefficients ($p<0.001$), which should be interpreted as higher likelihood of the partnership structure being chosen a dyadic or a multi-partner JV. This finding indicates a high level of support for H1.

In Model 1, there are two positive significant coefficients on CORRUPT ($p<0.01$), providing a good deal of support for H2. The finding implies that in high transparency distance cases MNEs tend to choose dyadic JV rather than WOS or multi-partner JV structures. In Model 3, however, the variable measuring corruption perception differences between home and host countries (CORRUPT) lends support only to multi-partner JV structure. This finding can be largely explained by the premises of institutional theory. In an environment where MNEs perceive high level of arbitrariness, inclusion of more partners may facilitate risk minimization.

Strong support has been found for H3, concerning cultural distance (CULTDIST) on partnership structure. Signs of coefficients for cultural distance differ for dyadic and multi-partner JVs. This finding implies that as the cultural distance between partners increases, the likelihood of a dyadic JV formation increases and while the likelihood of multi-partner JV formation decreases. This finding lends support to TCP argument for JV formations.

The coefficients of linguistic distance are both significant and positive in both Model 1 ($p<0.01$) and Model 3 ($p<0.01$). This finding suggest that as the linguistic distance between home and host countries of partners increases foreign investors will be more in favor of establishing a dyadic and/or multi-partner JVs. In Model 3 as the coefficient for a dyadic JV is higher and more significant than multi-partner JVs, in the high linguistic distance cases, a dyadic JV appears to be more likely than both WOS and a multi-partner JV. Our findings imply that as linguistic distance increases between partner firms the higher will be the likelihood of dyadic JVs, providing strong support for H4.

The coefficient on FDICON is negative and significant in both Model 2 and Model 3 ($p<0.001$), indicating strong support for H5. This finding also suggest that when there is a high proportion of foreign investors from the same country in the same industry, the likelihood of establishing a WOS will be higher than both multi-partner and dyadic JV formations. Our findings in both models tend to confirm TCP arguments rather than resource based arguments developed by Beamish and Kachra (2004). Our findings may also be interpreted in the light of institutional theory; in that presence of more firms from the same country in the same industry is an indication of both industry attractiveness and less uncertainty. Increased number of MNEs in an industry may create a learning environment for new entries, which may influence their entry mode choice.

Our analyses provide some support for H6 that examines the relationship between R&D intensity of industry and formation outcome ($p<0.05$). Coefficients associated with R&DINTENS in Model 2 and Model 3 are negative and significant for dyadic and multi-partner JVs, indicating that high research intensity of the industry causes MNEs to choose WOS rather than any form of partnership.

No support has been found for H7 as the coefficients of ADVINTENS are insignificant ($p>0.05$) in both

TABLE 3
Results of Multinomial Logistic Regression: JVs Compared with WOS

		Model 1		Model 2		Model 3	
Variable name	Variable description	Dyadic	Multi-partner	Dyadic	Multi-partner	Dyadic	Multi-partner
Constant		0.130 (0.141)	-0.762*** (0.231)	-1.378*** (0.169)	-4.607*** (0.241)	-0.072 (0.260)	-2.901*** 0.399
POLCON	Political constraints index	1.292*** (0.137)	2.088*** (0.212)			1.102*** (0.146)	1.186*** (0.233)
CORRUPT	Corruption perception	0.013** (0.003)	0.012** (0.005)			0.007 (0.014)	0.013** (0.007)
CULTDIST	Cultural distance	0.207*** (0.039)	-0.295** (0.067)			0.178*** (0.040)	-0.241** (0.070)
LINGDIST	Linguistic distance	0.338*** (0.060)	0.337** (0.105)			0.280*** (0.064)	0.278** (0.112)
FDICON	FDI concentration			1.390*** (0.214)	-1.857*** (0.360)	-0.837*** (0.226)	-1.554*** (0.387)
R&DINTS	R&D intensity of the target industry			-0.002** (0.001)	-0.002** (0.001)	-0.007* (0.005)	-0.001* (0.000)
ADVINTS	Advertising intensity of the target industry			0.000 (0.000)	0.001 (0.000)	0.002 (0.003)	0.002 (0.002)
LOCATION	Location of affiliate			-0.237*** (0.058)	-0.590*** (0.094)	-0.239*** (0.059)	-0.579*** (0.095)
LN_SIZE	Logarithm of the capital size			0.139*** (0.012)	0.287*** (0.017)	0.077*** (0.014)	0.234*** (0.019)
MANUFAC2	Group 2 manufacturing industries					0.126 (0.133)	-0.277 (0.198)
SERVICES	Service industries					-0.478** (0.100)	-0.814*** (0.151)
TRIAD	Triad countries					0.137 (0.098)	0.193 0.169
LR		243.26***		417.83***		620.49***	
Log likelihood		-5781.70		-5699.72		-5591.42	
Pseudo		0.120		0.135		0.152	

Notes:
Standard errors in parentheses
*p< 0.05; **p<0.01; ***p<0.001; N=6,253

models 2 and 3. This finding, although somewhat surprising, implies that in advertising intensive industries MNEs tend to go for WOS. This empirical finding appears to contradict the argument put forward by Beamish and Kachra (2004) that scarcity of heterogeneous resources and experiences in emerging market economies might only be offset by incorporating more partners to JVs.

The coefficient on LOCATION is negative and significant in both Model 2 and Model 3 (p<0.001), providing strong support for H8, In fact the MNEs are more likely to choose a WOS rather than JVs when the subsidiary is located in the developed regions of

the host country. This result provides further support to our earlier argument on the impact of agglomeration in FDI concentrated regions. In more developed regions need for a partner may be limited than in less developed regions of an emerging market economy.

Finally strong support has also been found for H9 in that the coefficient on LN_SIZE is positive and significant in both Model 2 and Model 3 ($p<0.001$). That is, the foreign investor is more likely to choose a multi-partner JV over both a WOS and a dyadic JV options as the capital size of the subsidiary increases. This is in line with earlier studies on equity ownership share in foreign equity ventures (Mutinelli and Piscitello, 1998; Pan and Li, 1998; Pan and Tse, 2000; Makino and Neupert, 2000; Demirbag et al., 2007b).

As far as industrial variations are concerned, no significant differences were detected for both Group 1 Manufacturing and Group 2 Manufacturing industries, while for service industries foreign investors would be more in favor of a WOS rather than both dyadic and multi-partner JV formations. The impact of the broad home country origin, (TRIAD) was also found to have no significant impact on MNEs' choice of a particular subsidiary formation strategy.

CONCLUSIONS

Drawing on both institutional and transaction cost perspectives, this study attempts to identify the main determinants of MNEs' choice among various subsidiary formation outcomes in an emerging host country context. Based on a large dataset of FDI entries in Turkey, this study has examined subsidiary formation strategies by using a multinomial logit model. In terms of the determinants of subsidiary formation outcomes most of the study's hypotheses were supported. Particularly important in determining JV partnership structures were found to be political risk, corruption perception, cultural distance, linguistic distance, R&D intensity, FDI concentration, size and location of subsidiary. It should also be borne in mind that when compared to transaction cost specific variables, institution specific variables were found to be more significant in explaining subsidiary formation outcomes. No support, however, has been found for the impact of advertising intensity. As for the control variables, no significant variation has been detected.

Further research could extend the investigation in several directions. First, future research investigating changes in affiliate formation over a time period would enhance our understanding of the impact of institutional changes on equity compositions as well as affiliate formation outcomes. Second, it would be useful to replicate the linguistic distance measure used in this study in other contexts. This would serve to validate the findings of this study. Third, comparison studies of countries with a similar development level to that of Turkey and diverse culture dimensions would provide greater insight into the role of the institutional environment and organizational factors on affiliate formation outcomes in emerging market economies.

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