



# FDI by firms from newly industrialised economies in emerging markets: corporate governance, entry mode and location

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**Abstract**

Previous studies emphasise that the foreign direct investment (FDI) strategies of firms from newly industrialised economies (NIEs) are different from the FDI strategies of firms from developed economies. It has also been shown that NIE firms are often controlled by founding families who make key strategic decisions, and that they rely heavily on network linkages when developing their FDI strategies. What is less clear, however, is how the corporate governance factors in NIEs, the risk preferences of the main shareholder constituencies, and the network-based business culture affect the decision to undertake FDI in emerging markets. This paper explores the entry mode and location choices of firms from an Asian NIE (Taiwan) in an emerging market (the People's Republic of China). It shows that the choice of equity stake in an affiliate depends upon the extent of family and institutional share ownerships in the parent company. High-commitment entry is found to be positively associated with the affiliate being located in areas with strong economic, cultural and historic links with the parent company. Furthermore, the entry mode and location decisions appear to be interrelated, with the parent's equity stake in the affiliate depending *inter alia* upon the location within China, and the favoured location depending *inter alia* upon the equity stake.

*Journal of International Business Studies* (2007), doi:10.1057/palgrave.jibs.8400279

**Keywords:** governance; networks; FDI; entry mode; location

**Introduction**

The growth in foreign direct investment (FDI) has resulted in a vast literature examining the strategic decisions by firms on the entry mode and location of overseas ventures (see Meyer and Nguyen (2005) for a survey). Earlier studies have investigated FDI flows between developed industrialised economies, or from developed economies in developing countries. More recently there has been a growing recognition of the importance of international investment by firms from newly industrialised economies (NIEs) in emerging markets, in particular in China (Hamilton, 1996; IMF, 2002). Several studies have emphasised that the FDI strategies of NIE firms are different from the FDI strategies of firms from developed economies (Makino *et al.*, 2002). These firms are often controlled by founding families who make key strategic decisions, and they rely heavily on network linkages when developing their strategies (Hsing, 1996; Chen and Chen, 1998). Entry to an emerging

Received: 16 January 2006

Revised: 13 December 2006

Accepted: 2 January 2007

Online publication date: 3 May 2007

economy with inefficient or incomplete markets is a challenge for NIE firms familiar with more sophisticated markets and advanced infrastructure. It may be related to relatively high levels of information asymmetries and risks associated with underdeveloped legal and business environments (Hoskisson *et al.*, 2000; Wright *et al.*, 2005). Previous international business (IB) research leaves unexplored the strategic outcomes of the different risk preferences and monitoring capabilities of the various shareholder constituencies within the parent companies. Yet agency and institutional perspectives suggest that specific patterns of corporate control and the network-based business culture of NIE firms should have an impact upon strategic decisions, including those related to FDI (Bruton *et al.*, 2003; Gao, 2003; Douma *et al.*, 2006).

This paper examines the FDI strategies of firms from NIEs in emerging markets, with a particular focus on the links between the ownership structure of the parent company, the affiliate's location within the host economy, and the choice of the mode of entry. We base our theoretical framework on the IB strategy research and comparative governance perspective, which extends the study of the links between corporate governance and business strategy beyond the traditional UK/US context by viewing corporate governance as a system of interrelated general and institutional elements (Milgrom and Roberts, 1995; Aoki, 2001). Many NIEs, such as Taiwan, South Korea and Singapore, have relatively developed economies and capital market infrastructure, with a substantial number of companies listed on organised stock exchanges. One might therefore expect that general governance factors should have an effect on strategic decisions, as is usually the case in developed economies (Gomes-Casseres, 1990; Hennart and Park, 1994). However, NIE firms typically do not share the same ownership structures as those in developed countries, with many being family-owned and funded. At the same time, they also have other important block-holders, such as domestic and foreign institutional investors (La Porta *et al.*, 1999; Claessens *et al.*, 2000; Yeh *et al.*, 2001; Filatotchev *et al.*, 2005). It is likely that FDI strategies will be affected by these specific features of NIE parent firms' corporate governance. In addition, regional networks are a distinctive characteristic of NIE firms, and may be another important factor affecting internationalisation decisions (Hsing, 1996; Bruton *et al.*, 2003; Gao, 2003). The exact nature of these effects on the FDI

decisions of NIE firms represents a core research issue within the IB framework. From a theoretical perspective, this research provides new dimensions to the discussion of the firm attributes associated with FDI strategies (Shaver, 1998) by integrating IB research with key elements of governance and institutional analysis. It also has practical implications, since NIEs attract substantial amounts of foreign investment themselves, and investors need to have a better understanding of factors that have an impact on the business strategies of NIE firms.

This paper extends the extant FDI research and makes a number of contributions. First, the vast majority of studies on entry mode have focused predominantly on firm characteristics related to the capabilities of the parent company (e.g., size, R&D intensity, the presence of human and proprietary capital). However, we argue that the firm's ownership structure should also have an impact on FDI decisions, since different types of owner have different risk preferences and decision-making horizons (Hoskisson *et al.*, 2002; Filatotchev *et al.*, 2005). More specifically, we analyse the effects on the choice of entry mode of the three main shareholder constituencies in the NIE firms: families, non-family insiders, and institutional investors. Second, the information asymmetries and risks associated with FDI in emerging markets may also be location-specific, and we suggest that they are mitigated by the NIE firms' regional networks. Although the vast majority of previous studies consider entry mode and location choices as two independent aspects of FDI strategy, we suggest that these choices are interlinked. The parent's decision over the extent of the commitment to an overseas venture may also be related to the FDI location. Finally, we test our theoretical arguments using unique, firm-level data on FDI investments from an Asian NIE (Taiwan) in an emerging market (the People's Republic of China).

## Review of the literature and research hypotheses

The two main strands of IB literature on the determinants of FDI have little or nothing to say about how corporate governance factors might affect the FDI decision. Both internalisation theory (McManus, 1972; Buckley and Casson, 1976; Rugman, 1981; Hennart, 1982) and the resource-based view (Teece *et al.*, 1997; Lippman and Rumelt, 1982; Dierickx and Cool, 1989) see FDI primarily as a means by which firms can appropriate rents in overseas markets from the exploitation of their



idiosyncratic resources and capabilities. The essential difference between the two is that whereas the former approach sees FDI as a way to reduce the transaction costs associated with coordinating activities across national boundaries, the latter emphasises that firms may enter foreign markets as a means of creating value (Kogut and Zander, 1993). There is an extensive literature devoted to identifying the firm-specific advantages possessed by firms that engage in foreign production, most of which focuses on firms from developed economies. Dunning (1993) provides a succinct summary of the main findings of these scholars, and suggests a number of firm- and industry-level factors that may be positively associated with a predilection for FDI, including firm size, operating experience, the possession of proprietary resources, and product differentiation.

More recent studies have indicated, however, that internationalisation strategies are associated with information asymmetries and substantial risks, especially when firms invest in emerging markets with relatively less developed legal and business environments. As a result, the specific FDI decisions may also be related to the risk preferences and decision-making horizons of managers and the other main shareholder constituencies, as suggested by agency theory (Carpenter and Fredrickson, 2001; Hoskisson *et al.*, 2002). Given that the firm's degree of internationalisation is an important determinant of the complexity it faces (Sanders and Carpenter, 1998), FDI strategy will depend on the ability of the parent to deal with information asymmetries and potential agency conflicts associated with overseas ventures. The agency framework relates these conflicts to adverse selection, moral hazard and hold-up problems (Stiglitz, 1985; Williamson, 2002). Therefore, FDI decisions should also depend on the firm's governance characteristics, such as the distribution of ownership and control. Although previous research considers the governance parameters of international ventures (see, e.g., Makino and Beamish (1998) for a discussion), the effects of the governance characteristics of the focal firm that undertakes FDI remain relatively unexplored. More specifically, in the context of NIE firms, the core research issue is related to the roles played by family owners and institutional investors (see Douma *et al.* (2006) for a discussion).

As noted above, traditional FDI theory suggests that firms that invest overseas possess competitive advantages such as superior technology, unique

products, or special managerial or marketing know-how. As Chen and Chen (1998: 446) note, 'Weak firms have no place in the field of FDI. FDI is envisaged as an expedition into unfamiliar and treacherous territory, where only the strongest predators survive.' However, many international investors in NIEs are small and seemingly weak, and conventional theory does not provide an adequate explanation for either their motivation or the mechanism of their FDI. Institutional research suggests that, in addition to the family-centred model of governance, informal network linkages are important to many firms in Asian NIEs and other emerging markets. Local networks underpinned by business, ethnic and cultural links enable firms to reduce the risks associated with FDI in emerging markets by accessing vital information and complementary resources. Indeed, Redding (1996) characterises Asian firms as weak organisations linked by strong networks. These arguments suggest that external, network-related factors should play an important role within the context of the NIE firm's FDI decisions, in addition to its internal system of ownership and control.

These arguments imply that it is necessary to augment the traditional IB approaches by introducing relevant elements of the agency and institutional perspectives (see Hoskisson *et al.* (2000) and Wright *et al.* (2005) for a discussion of multidisciplinary research on strategies in emerging markets). We extend internationalisation research by suggesting that the FDI decisions of NIE firms, in particular the decision on the extent of their commitment to an overseas affiliate (i.e., the choice of entry mode), should depend not only on 'traditional' firm and industry characteristics (e.g., firm size, proprietary and human capital, an oligopolistic industry structure) but also on their governance parameters and regional networks. Building on the agency framework, we argue that high-commitment modes in emerging markets may expose the NIE firm to substantial risks and agency costs associated with adverse selection and hold-up problems (Williamson, 2002). The firm's equity stake in an overseas affiliate thus depends, among other factors, on the risk preferences of the major shareholder constituencies and the ownership structure of the parent. In addition, the regional networks of the investing firm may also have an important impact on its choice of entry mode by reducing information asymmetries and providing access to important local knowledge and key contacts. These networks are associated

with previous investments by the NIE firm in the same region, and they are further cemented by cultural and ethnic links between the parent and the specific location of the affiliate. As a result, local networks enable the NIE firm to mitigate agency costs associated with high-commitment entry regardless of its ownership structure. FDI strategy is thus driven by the interplay between the formal governance characteristics of the firm and its informal networks associated with FDI location. In the following sections, we describe important aspects of the Asian model of corporate governance, and develop a number of testable hypotheses with regard to the FDI entry mode and location choices of NIE firms in an emerging market.

### Corporate governance and business networks in Asian NIEs

Comparative corporate governance research (see, e.g., La Porta *et al.*, 1999; Mallin, 2004) has identified a number of specific characteristics of the Asian model of corporate ownership and control that may be particularly important in the context of FDI strategic decisions. First, many listed companies in the region still rely heavily on the support of founding families to finance their operations, in marked contrast to companies in the industrialised countries. Using 20% share ownership as a cut-off level for control, Claessens *et al.* (2000) noted that over half the businesses listed on local stock exchanges in nine South-East Asia countries were controlled by a private family, and this ranged from 9.7% in Japan to 71.5% in Indonesia. More specifically, in a sample of 141 companies listed on the Taiwan Stock Exchange (TSE), Claessens *et al.* (2000) calculated that 48.2% were family controlled, but the proportion of family-controlled enterprises rose to 67.5% if the legal definition on insider shareholding was used. Thus there is evidence that family control plays a crucial role in the management of firms in these economies.

A second distinctive feature of the Asian model of corporate governance is the powerful position of insiders, even in publicly listed companies (Mak and Li, 2001; Chang, 2003). Very often this decision-making power is underpinned by substantial equity stakes that top managers and other board members hold in their firms. For example, in Taiwan, in order to align directors' interests with maintaining the objective of contributing to corporate value, the market regulator sets a minimum shareholding associated with all members of

the executive and supervisory boards (Lien *et al.*, 2005). As a result, even non-family-affiliated insiders hold substantial equity stakes in their companies.

The third characteristic is the growing importance of institutional investors. The increased internationalisation of capital markets in NIEs such as Singapore, South Korea, Taiwan and Malaysia since the early 1990s has included allowing foreign financial institutions to hold equity in locally listed firms (Mallin, 2004). In their analysis of the nine Asian countries, Claessens *et al.* (2000) show that substantial number of shares in listed firms are either widely held, or held by financial institutions, despite the predominance of family control. More specifically, financial institutions control on average 8, 7.5 and 5.3% of the shares in listed firms in Thailand, the Philippines and Taiwan, respectively. In their study of the largest firms in Taiwan, Filatotchev *et al.* (2005) document that institutional ownership amounts, on average, to 6% of the total shareholdings.

Apart from these specific governance characteristics, another important feature of the Asian corporate model is the importance of business networks. Some of these networks have a formal structure (e.g., the South Korean *chaebols* and other forms of business groups: Chang, 2003), while others are more informal and based on interpersonal relationships (e.g., the ethnic Chinese networks: Rauch and Trindade, 2002). Information sharing and the avoidance of contract violation facilitated by these networks may mitigate the information asymmetries and risks associated with internationalisation strategies, and therefore impact on the governance–strategy relationships.

The above discussion suggests that firms in Asian NIEs have a very complex pattern of ownership and control, where substantial family ownership coexists with significant shareholdings by insiders, as well as domestic and foreign institutional investors. It is expected that the interplay between these internal (ownership structure) and external (networks) parameters creates an important framework for the FDI process.

### Ownership structure, regional networks and entry mode choice

Within economics and corporate finance, a substantial body of research has focused on the governance roles of dominant block-holders, especially in the environment of emerging and less developed economies (Claessens *et al.*, 2000).



Hoskisson *et al.* (2002) and Tihanyi *et al.* (2003) provide an extensive survey of the literature, which suggests that shareholders with significant ownership have both the incentives to monitor executives and the influence to promote strategies they feel will be beneficial. In the context of NIEs in South-East Asia and elsewhere, family owners and other block-holders have been identified as an important governance constituency that may shape strategic decisions, including internationalisation (La Porta *et al.*, 1999; Claessens *et al.*, 2000; Douma *et al.*, 2006). Building on this research we want to assess the impact upon the FDI entry mode decision of the extent of (a) family ownership, (b) non-family insider ownership, and (c) the presence of domestic and foreign institutional shareholders. In the remainder of this section, we develop our hypotheses with regard to these questions.

The model of the family-owned business has been the subject of numerous studies (see, e.g., Hamilton, 1996). Agency-based research suggests that family owners may have superior monitoring abilities compared with diffused shareholders, especially when family ownership is combined with family control over management and the boards of the firm and overseas affiliates (Anderson and Reeb, 2004). These monitoring abilities may mitigate the agency costs of moral hazard problems associated with investing in overseas ventures. Because owners in the current generation have the tendency and obligation to preserve wealth for the next generation, family firms often possess longer time horizons than non-family firms (Bruton *et al.*, 2003). Family members therefore represent a special class of large shareholders that may have a unique incentive structure, a strong voice in the firm, and powerful motivation to make a higher, longer-term commitment to an overseas venture (Yeh *et al.*, 2001; Dhnadirek and Tang, 2003).

However, previous research also suggests that family holdings suffer from a relative lack of financial portfolio diversification and limited liquidity of their concentrated equity holdings (Anderson and Reeb, 2004). This means that family shareholders may be affected more adversely by the company's idiosyncratic risks than, for example, financial institutions with diversified portfolios of shares (Maug, 1998), which should increase their relative risk aversion. Although family-controlled business groups may try to compensate for this limited portfolio diversification by introducing product diversification and conglomerate organisa-

tional structures (Chang, 2003), business diversification cannot eliminate the firm-specific financial risk associated with concentrated shareholdings (Yeh *et al.*, 2001; Douma *et al.*, 2006). Agency research clearly indicates that founder-owner firms are less likely to pursue high-risk strategies (such as investing in R&D and innovation) than similar firms whose shareholders are more widely dispersed (Jensen and Meckling, 1976).

From the perspective of the controlling family, therefore, high-commitment entry modes may be associated with risks of committing too many resources to a single venture, which creates potentially significant adverse selection problems. In addition, high-commitment entries may also lead to an increase in the 'hold-up' costs of investment when its value in a project is higher than its value in its next best use or alternative (Williamson, 2002). In the extreme case when the family is a sole owner of both the parent company and its overseas subsidiary, these agency costs reach their maximum. The adverse selection and 'hold-up' agency costs associated with investment in emerging markets should be particularly important issues in Asian NIEs where capital markets are less liquid than in developed economies, and where large shareholders have more limited opportunities for diversification of their equity portfolios. Thus, from the agency perspective, high family ownership in a parent company should be associated with a choice of lower commitment entry mode. Hence:

**Hypothesis 1:** The parent company's share ownership in its overseas affiliate is negatively associated with family share ownership in the parent company.

Non-family managers and board members form another important shareholder constituency that may have a significant impact on FDI strategies. Upper echelon theory suggests that directors have a considerable influence upon such strategic decisions, and upon corporate performance (Finkelstein and Hambrick, 1996). Building on the agency perspective, several studies have confirmed empirical linkages between board characteristics and various strategic choices including internationalisation (e.g., Carpenter and Fredrickson, 2001; Hoskisson *et al.*, 2002). This research indicates that managers have shorter time horizons than institutional shareholders (Priem, 1990). Their equity ownership means that most of their wealth is associated with the company for which they work.

As a result, they will be more risk-averse than investors with diversified portfolios, such as investment institutions and other external shareholders. Therefore insiders' risk preferences may have an impact on the type of entry mode chosen for an overseas venture. On the one hand, a wholly owned subsidiary or a large stake in a joint venture may mitigate potential opportunism by local partners (Rugman, 1981). On the other hand, high-commitment entry modes are associated with significant risks of adverse selection and an increase in the potential 'hold-up' costs of investment, similar to those for family blockholders discussed above. Relatively undiversified 'insider' shareholders may therefore prefer a lower degree of commitment within their firm's international activities. In addition, being engaged in the day-to-day running of the parent company, these insiders may have limited capacity to monitor the overseas venture, which accentuates the potential moral hazard problems associated with high-commitment entry. Filatotchev *et al.* (2001) investigated the strategic decisions regarding the promotion of export intensity of firms in transition economies, and showed that managerial ownership had negative effects on the adoption of export-facilitating strategies, and positive effects on export-blocking strategies. They concluded that managers were exhibiting risk-averse behaviour, and avoiding high levels of international commitment. Bearing in mind a substantial level of managerial (insider) share ownership as a specific institutional feature of corporate governance in many Asian NIEs, we suggest:

**Hypothesis 2:** The parent company's share ownership in its overseas affiliate is negatively associated with non-family insider share ownership in the parent company.

Within the agency perspective, the third group of important shareholders are the institutional investors. There is evidence from studies of both developed and developing countries that the presence of institutional investors promotes good governance and significantly affects the strategic choices of the firm (Filatotchev *et al.*, 2001; Hoskisson *et al.*, 2002; Lien *et al.*, 2005).

More recent corporate finance and strategy studies, however, point out that different types of institutional owner may have different impacts on firm strategies, including internationalisation (Hoskisson *et al.*, 2002; Tihanyi *et al.*, 2003), and, ultimately, on performance (Douma *et al.*, 2006).

Some authors (e.g., Brickley *et al.*, 1988; Kochhar and David, 1996; David *et al.*, 1998) differentiate between 'pressure-resistant' and 'pressure-sensitive' institutional investors and provide empirical evidence in terms of their different effects on strategic decisions. Pressure-resistant investors, such as foreign financial institutions, are unlikely to have strong business links with their portfolio firms, and they may have stronger influence on strategy choices (Hoskisson *et al.*, 2002). On the other hand, pressure-sensitive investors, such as domestic financial institutions, are likely to have business relationships with the firms in which they invest, and often have an obligation to support the agendas proposed by management (Tihanyi *et al.*, 2003). Using evidence from India, Douma *et al.* (2006) show that share ownership by domestic financial institutions has a negative impact on performance compared with foreign institutional investors. In Asian NIEs, domestic financial institutions are also often related to the controlling families through a complex web of informal networks (Filatotchev *et al.*, 2005), and are more likely to cooperate with families with regard to strategic decisions. These arguments suggest that foreign institutional investors with globally diversified portfolios and superior monitoring abilities are more likely to encourage high-risk, high-commitment FDI decisions by firms in NIEs, whereas domestic institutions are more likely to form a coalition with risk-averse family blockholders and insiders in the parent company, supporting a low-commitment entry mode. Our third pair of linked hypotheses is thus:

**Hypothesis 3a:** The parent company's share ownership in its overseas affiliate is negatively associated with the shareholding of domestic financial institutions in the parent company.

**Hypothesis 3b:** The parent company's share ownership in its overseas affiliate is positively associated with the shareholding of foreign financial institutions in the parent company.

Our arguments above suggest that information asymmetries and the risk preferences of the main shareholder constituencies may have an impact, *ceteris paribus*, on the firm's choice of entry mode. The location within a host country for an overseas affiliate represents another important element of FDI strategy, and some potential locations for FDI projects are clearly more attractive and less risky than others. More specifically, the regional

networks of the investing firm may have an important impact on its entry mode decisions by reducing information asymmetries and providing access to important local knowledge and resources, notwithstanding the parent's ownership structure.

A number of recent studies on the role of social and business networks in facilitating internationalisation strategies emphasise information sharing and the deterrence of opportunistic behaviour as common characteristics of network-based relationships. For instance, Rauch and Trindade (2002) demonstrated that the presence of ethnic Chinese networks increased bilateral trade, while Rauch (1999) showed that colonial ties and a common language did likewise. Information sharing and the avoidance of contract violation would also seem to be important factors in foreign investment decisions (Gao, 2003), particularly in the case of emerging markets, such as China, where there are few market institutions facilitating internationalisation, as opposed to more mature, developed economies.

These arguments suggest that location-specific networks within the host country may reduce the perceived riskiness of the FDI project and the associated agency costs for the parent company. Firms entering more distant markets, geographically and culturally, are taking on greater risk, and these risks may be mitigated by network-related factors, such as access to key local contacts, knowledge and information in a particular FDI destination. These networks may be based on the historical development of business links between the investing firm and local businesses through, for example, investment projects undertaken in a specific location in the past (He, 2003). The network effects are particularly strong when network members share the same cultural values and common heritage, and Chinese and Asian ethnic networks are often used as examples (Rauch and Trindade, 2002; Gao, 2003). Hence, it is possible to integrate agency arguments with regard to the NIE firm's entry mode and research on location-specific networks, and argue that investments involving a large equity stake are likely to be located in more familiar and culturally closer areas that reduce the parent's risk exposure. Although these arguments do not establish explicit causality between the entry mode and location choices, they suggest the following hypothesis:

**Hypothesis 4:** The parent company's share ownership in its overseas affiliate is positively

associated with the extent of the economic and cultural network links of the parent company in the location of the affiliate within the host economy.

## Data and methodology

The empirical context for this study is provided by Taiwanese FDI in China. The choice of China as the host economy was made on the grounds that it is the largest emerging market in the world, and has been the host to vast amounts of FDI from many different countries over the past three decades. China also has a large spatial economy with a diverse pattern of FDI in different regions (Cheng and Kwan, 2000).

Taiwan was selected as the home country for three main reasons. First, Taiwan is a relatively well-developed Asian NIE, with substantial numbers of companies listed on the domestic stock exchange. Many of these firms are engaged in FDI, and they provide reliable and accurate data about shareholdings and other firm-specific information. Second, Taiwan has many of the characteristics of the Asian archetype of corporate governance system outlined above: extensive family control, powerful insiders, growing importance of institutional investors. The findings of this study may thus be generalised to other NIE countries. Third, people from China and Taiwan share a common culture and heritage, and family and social network ties are particularly important in their business transactions. In this regard, Taiwan is similar to many other countries in South East Asia in that it has a large population of 'overseas Chinese'. As Gao (2003: 624–625) reports, over 50 million ethnic Chinese live outside China, including 20 million in Taiwan, 7 million in Indonesia, 6 million in Hong Kong and Macau, 5 million in Malaysia, 5 million in Thailand, and 2 million in Singapore. Weidenbaum and Hughes (1996) estimate that companies owned by overseas Chinese account for about 70% of the private business sector in Singapore, Malaysia, Thailand, Indonesia and the Philippines. Taiwanese FDI thus provides an excellent opportunity to study the impact of ethnic Chinese networks on FDI. Furthermore, the political aspects are also important in that China continues to insist that Taiwan is a province of China. This political reality provides an additional risk dimension to our arguments related to FDI in emerging markets (Zhang *et al.*, 2003).

### FDI by Taiwanese firms in China

From 1949 to the mid-1980s, there were virtually no commercial links between Taiwan and the People's Republic of China. However, despite enduring official restrictions on the three direct links of trade, transport and communication, trade and investment flows between Taiwan and the mainland have since grown rapidly, based on the complementarities of the two economies. Many Taiwanese firms have chosen to invest overseas to access cheaper resources (including labour), and have often favoured locations on the mainland.

Taiwanese FDI on the mainland increased substantially from US\$155 million in 1989 to over US\$3 billion in 1993, but slowed in subsequent years, especially after the Taiwanese government implemented a 'go slow, be patient' policy in 1996. FDI on the mainland picked up again in 2000, when the 'go slow' policy was replaced by one of 'active openness and effective management', which raised the ceiling on the size of individual investments, eased the restrictions on the permitted sectors, and allowed Taiwanese firms to invest directly on the mainland. This initiative was accompanied by WTO accession for both countries in January 2002, further increasing cross-strait trade and investment. The growth in Taiwanese FDI in China throughout the 1990s has been accompanied by marked changes in industrial composition, with the major bulk of investment moving from labour-intensive, low-technology

manufacturing sectors (textiles and garments, food and beverage processing, etc.) towards more capital-intensive, high-technology products in the electronic and electrical appliance sector.

As regards the geographic distribution, much of the early Taiwanese FDI was in the South Coast provinces of Guangdong, Fujian and Hainan, followed by the Middle Coast locations of Shanghai, Jiangsu and Zhejiang, as shown in Table 1. The Middle and South Coast provinces of China are the ancestral home for many thousands of people who fled China for Taiwan after the establishment of the People's Republic in 1949 (Zhang, 1994). Many of them subsequently rebuilt their businesses in Taiwan, but the family links with China remain (Zhang, 2002). There is considerable anecdotal evidence that such links do play a part in terms of the FDI location. For example, the Tomson Group is a typical family-controlled firm in the textile sector, whose founder (Tang Jun-Nian) was born in Shanghai and then emigrated to Taiwan. In 1992 he decided to go back to Shanghai and invested US\$50 million in a local subsidiary, the largest Taiwanese company in Shanghai at that time. The company has subsequently refocused into the real estate and construction business and participated in the development of the Pudong commercial centre. A second example involves the Formosa Plastic Group, a well-known family business in Taiwan, whose chairman (Wang Yung-Qing) is originally from Fujian province. He invested

**Table 1** The geographical distribution of Taiwanese FDI projects in China, 1991–2003

<i>Year</i>	<i>Total FDI value: US\$m</i>	<i>Number of projects</i>	<i>South Coast</i>	<i>Middle Coast</i>	<i>North Coast</i>	<i>Inland</i>
1991	174	237	168	31	19	19
1992	247	264	174	53	21	16
1993	3168	9329	4571	2519	933	1306
1994	962	934	346	327	112	149
1995	1093	490	167	191	54	78
1996	1229	383	161	149	35	38
1997	1615	728	357	240	58	73
1998	2035	1284	578	372	64	270
1999	1253	488	185	171	39	93
2000	2607	840	294	395	59	92
2001	2784	1186	320	617	83	166
2002	6723	3116	1089	1209	124	694
2003	7698	3875	1750	1457	149	519
Cumulative 1991–2003	31588	23154	10160	7731	1750	3513

*Notes:* The 'South Coast' refers to Guangdong, Fujian, Guangxi and Hainan provinces; the 'Middle Coast' to Shanghai municipality, and to Jiangsu and Zhejiang provinces; the 'North Coast' to Beijing and Tianjin municipalities, and Hebei and Shandong provinces; and the 'Inland' area refers to all other provinces, municipalities and autonomous regions.

*Source:* Ministry of Economic Affairs, Taiwan, *Statistics on Outward Investment*, 2005.



US\$90 billion into the power-generating sector in Fujian either directly or through a US subsidiary. Similarly, the biggest tea producer in China, the Ten-Ren Group, is the result of FDI from Taiwan to Fujian. The Taiwanese parent is a typical family-owned company, and one of the reasons why the chairman (Li Rui-Ho) chose Fujian as a location in 1990 was the personal linkages with his home town. All of these projects involved a high-commitment entry mode, in line with our expectations.

### Data sources and sample

Firm-level data were obtained from the Securities and Futures Commission in Taiwan. All companies listed on the TSE are required to submit annual reports to the Commission, making this a reliable and comprehensive source of data. The available series include performance measures and financial accounting data, as well as data on ownership and FDI. The FDI data are detailed, and record both the amounts invested in individual projects and where the projects are located. The data for all the firm-specific characteristics refer to the end of 1999, except for the shareholding in the affiliate and the firm's cumulative investment in the province, which both relate to the year of establishment. The data for all the location-specific attributes relate to the year before the relevant affiliate was established: thus, for example, we use data for 1999 for projects established in 2000.

### The model and variables

The dependent variable in the entry mode model is the percentage equity stake (STAKE) taken by the Taiwanese parent company in its Chinese affiliate. The values of this variable are all non-zero, as only firms with FDI projects are included in the sample, but the variable is censored in that the maximum value cannot exceed 100%. Indeed, several of the 285 affiliates were wholly owned subsidiaries. OLS estimation would thus give rise to biased and inconsistent estimates, so Tobit analysis was used (Greene, 2001: 908).

In order to construct the ownership variables, we adopted a methodology similar to La Porta *et al.* (1999) and Claessens *et al.* (2000), although some changes were made to accommodate the specific context of Taiwanese firms. The family shareholding variable (FAM) is the combined equity holding of the largest individual shareholder, and his/her close family. Following Claessens *et al.* (2000), the membership of the family was determined by

linking the shareholders who shared a common family name with the largest individual owner. However, this alone was not sufficient, as five major Chinese family names (i.e., Lin, Li, Chen, Chang and Wang) are very common in Taiwan. Thus a further criterion was added to identify family members in these named families, that is, a shared first name. In traditional Taiwanese families, a common first name implies kinship and also has the role of indicating the generation of each individual within the family. After identifying all the family members related to the largest shareholder, the shareholdings of all the individuals within the family were added together to calculate the ownership of the family in total. Three other ownership variables were also included. The first related to the extent of insider ownership. Taiwanese firms operate under a two-tier structure, and there are mandatory equity ownership requirements for both directors and supervisors. Some of these directors/supervisors will be members of the largest family, but others will not, and this group constitutes an influential group of shareholders. We therefore include the combined shareholding of insiders who are not members of the largest family (IS-NF) as an explanatory variable. The final two variables relate to the respective shareholdings in the parent companies of foreign (FFIN) and domestic (DFIN) financial institutions.

Our Hypothesis 4 is related to the potential role of location-specific networks, and we used two proxies for regional networks of the parent. The first variable is the logarithm of the cumulative (US\$) value of the previous investment (PIN) by the parent company in the province wherein the affiliate is located. Such previous investment approximates the extent of existing firm-specific business and economic links with the province, and it helps to address the connection between mode choice and location choice. We expect PIN to have a positive impact on the percentage equity stake. In addition, we also include three dummy variables (DIN, DS and DM) for the Inland, South Coast and Middle Coast areas respectively (the North Coast area was used as a control), in order to capture more general location-specific effects. We expect that the stake should be higher *ceteris paribus* in the South and Middle Coast provinces, which are the ancestral homes for many people who fled China at the end of the 1940s and where the cultural and ethnic network links with Taiwan are strongest.

Finally, we included a number of control variables, drawing upon the effects established in

the literature (Dunning, 1993; Hennart and Park, 1994). The size of the parent company (SIZE) is expected to be positively associated with the equity stake taken in the overseas affiliate, because large firms typically possess greater financial and managerial capabilities, and hence have less need for cooperation with other partners. It is also expected that parent companies that are technology-intensive (R&D) and/or marketing-intensive (ADV) will also favour high-commitment entry modes as they will want to internalise their proprietary technology and managerial know-how, and minimise the potential for opportunistic behaviour by their partners. We also included two industry dummy variables: one (ELEC) for affiliates in the electrical industry, and the other (TEXT) for affiliates in the textile sector. The various explanatory variables, their definitions, and their expected impacts upon the percentage equity stake (STAKE) are summarised in Table 2.

Data have been collected for all publicly listed Taiwanese companies that made one or more direct

investments in China between 1999 and 2003. After excluding firms in the financial sector, the final sample consisted of 122 parent companies. In total, the sample firms have undertaken 285 FDI projects in China: 107 of these projects are located in the South Coast provinces, 126 in the Middle Coast, 36 in the North Coast, and the remaining 21 projects have been established in the Inland area, as shown in Table 3. On average, the value of these initial investments amounted to 4.15% of the fixed assets of the parent companies. This figure does not take account of capital raised locally for the Chinese affiliates, or any subsequent investments, but it is clear that the investments are not insubstantial for the parent companies, and that significant risks are involved. One hundred and twenty affiliates were in the electrical industry, and 13 in the textile industry. Table 3 also provides some descriptive statistics on ownership structure. The average family ownership in the parent companies was 17.7%, with the non-family insiders accounting for 5.3% on average, and the domestic and foreign institutional investors for

**Table 2** The explanatory variables

Variable	Definition
<i>Firm-specific variables</i>	
SIZE	Number of employees in the parent company ('000)
R&D	R&D expenditure as a percentage of sales of the parent company (%)
ADV	Promotion expenditure as a percentage of sales of the parent company (%)
ELEC	Dummy variable=1 for an affiliate in the electrical industry; =0 otherwise
TEXT	Dummy variable=1 for an affiliate in the textile industry; =0 otherwise
PIN	The natural logarithm of the cumulative previous investment (US\$) by the parent company in the province where the affiliate is located
STAKE	The percentage shareholding taken by the parent company in the Chinese affiliate (%)
<i>Corporate governance variables</i>	
FAM	The percentage shareholding in the parent company held by members of the family with the largest combined shareholding (%)
IS-NF	The percentage 'insider shareholding' in the parent company (i.e., the combined shareholding of the CEO, the directors and the supervisors) who are not members of the largest family (%)
DFIN	The percentage shareholding held by domestic financial institutions in the parent company (%)
FFIN	The percentage shareholding held by foreign financial institutions in the parent company (%)
<i>Location dummy variables</i>	
DIN	Dummy variable=1 for the Inland area; =0 otherwise.
DS	Dummy variable=1 for the South Coast area; =0 otherwise.
DM	Dummy variable=1 for the Middle Coast area; =0 otherwise.
<i>Location-specific attributes</i>	
GDP	Gross domestic product ( $\times 10^{12}$ yuan) at constant 2000 prices
WAGE	Average wage rate ( $\times 10^3$ yuan) at constant 2000 prices
INF	'Transport infrastructure'=length (km) of roads and railways divided by land area (km <sup>2</sup> )
TFDI	Cumulative Taiwanese FDI per capita (US\$)
TFDI <sup>2</sup>	TFDI squared

4.1 and 3.6%, respectively. Clearly, families represent dominant shareholders who hold concentrated equity portfolios in parent companies. On average, the parent companies own 75.6% of the equity in their affiliates. However, there are marked differences in the average stakes held by the Taiwanese parent companies in their Chinese affiliates between the four geographical areas: the lowest percentage (58.0%) is on the North Coast while the highest (81.6%) is on the South Coast.

### Empirical results

Table 4 provides the descriptive statistics and correlation matrix of the variables used in our empirical tests. As this table shows, the parent company's ownership stake in its Chinese affiliate is positively and significantly associated with share ownership of foreign institutional investors,

whereas the correlation coefficients for family and domestic institutional owners are negative and significant ( $P < 0.05$ ), in line with our expectations. The previous investment PIN variable is strongly positively correlated with entry mode, and the parent is more likely to hold high equity stake in an affiliate located in the South Coast province.

The Tobit regression results for the entry mode model are displayed in Table 5. The first column relates to Model 1, which contains only the five variables suggested by the previous literature. Only two of the explanatory variables are statistically significant. The first is firm size, the coefficient of which is positive confirming the expectation that larger firms, with more resources, are more likely to take a larger stake in their overseas affiliates. The other is the dummy variable (ELEC) for affiliates in the electrical industry. Perhaps more interesting,

**Table 3** Firm sample characteristics

Variable	Inland	South Coast	Middle Coast	North Coast	China
Number of affiliates	21	107	121	36	285
Average shareholding in parent company held by the largest family (%)	21.16	19.61	15.48	17.66	17.80
Average shareholding in parent company held by domestic financial institutions (%)	2.69	3.94	4.53	4.18	4.13
Average shareholding in parent company held by foreign financial institutions (%)	2.25	4.63	3.32	1.82	3.54
Average insider shareholding in parent company held by non-family members (%)	3.59	5.74	5.14	5.20	5.02
Average stake by parent company in affiliate (standard deviation)	68.0 (30.3)	81.6 (31.2)	76.9 (30.2)	58.0 (29.7)	75.6 (31.3)

Notes: The 'South Coast' refers to Guangdong, Fujian, Guangxi and Hainan provinces; the 'Middle Coast' to Shanghai municipality, and Jiangsu and Zhejiang provinces; the 'North Coast' to Beijing and Tianjin municipalities, and Hebei and Shandong provinces; and the 'Inland' area refers to all other provinces, municipalities and autonomous regions.

**Table 4** The correlation matrix of the explanatory variables in the entry mode models

Variable	Mean	s.d.	STAKE	SIZE	R&D	ADV	ELEC	TEXT	DIN	DS	DM	FAM	DFIN	FFIN	IS-NF	PIN
STAKE	75.63	31.32	1.000													
SIZE	2.68	4.13	0.170	1.000												
R&D	1.35	1.74	0.053	-0.128	1.000											
ADV	6.06	5.71	0.054	0.073	0.054	1.000										
ELEC	0.42	0.49	0.067	-0.130	0.375	-0.229	1.000									
TEXT	0.05	0.21	-0.041	0.021	-0.169	-0.008	-0.186	1.000								
DIN	0.074	0.26	-0.069	-0.018	-0.068	0.129	-0.105	0.003	1.000							
DS	0.375	0.49	0.148	-0.077	0.041	0.043	0.087	-0.135	-0.219	1.000						
DM	0.425	0.50	0.036	0.143	0.079	-0.165	0.044	0.152	-0.242	-0.666	1.000					
FAM	17.80	13.25	-0.113	-0.091	-0.064	-0.069	-0.047	-0.157	0.169	0.041	-0.133	1.000				
DFIN	4.13	4.32	-0.123	0.037	-0.046	-0.163	-0.030	0.095	-0.094	-0.033	0.080	-0.009	1.000			
FFIN	3.54	5.42	0.266	0.099	0.174	-0.245	0.422	-0.105	-0.067	0.156	-0.036	0.148	-0.026	1.000		
IS-NF	5.02	5.31	-0.016	-0.123	0.250	0.164	-0.212	-0.044	-0.068	0.031	-0.087	-0.327	0.014	-0.250	1.000	
PIN	4.89	6.58	0.220	0.358	0.023	-0.156	0.150	0.075	-0.067	0.122	0.060	0.146	0.135	0.509	-0.189	1.000

Notes: All correlation coefficients with an absolute value greater than 0.12 are statistically significant at the 5% level or higher.

**Table 5** The Tobit regression results for the entry mode models

Variable	Model 1	Model 2	Model 3	Model 4
Constant	82.39*** (8.15)	90.86*** (11.73)	91.42*** (11.63)	70.24*** (13.52)
SIZE	3.92*** (1.21)	2.28** (1.12)	1.41 (1.19)	1.44 (1.19)
R&D	1.256 (2.448)	-0.387 (2.344)	-0.626 (2.323)	-1.007 (2.277)
ADV	0.458 (0.746)	0.986 (0.740)	1.052 (0.734)	1.128 (0.729)
ELEC	14.939* (9.048)	-2.427 (8.822)	-2.396 (8.764)	-3.756 (8.601)
TEXT	-9.418 (18.397)	-10.621 (17.522)	-16.584 (17.660)	-16.166 (17.507)
FAM		-0.668** (0.290)	-0.754*** (0.290)	-0.734** (0.290)
DFIN		-1.421* (0.818)	-1.737** (0.828)	-1.673* (0.812)
FFIN		5.248*** (1.059)	4.409*** (1.117)	4.213*** (1.091)
IS-NF		0.532 (0.765)	0.551 (0.760)	-0.097 (0.754)
PIN			1.592** (0.750)	1.150* (0.641)
DIN				13.51 (15.86)
DS				35.60*** (11.62)
DM				27.31** (11.40)
Log-likelihood	-804.32	-785.26	-782.98	-777.92
$\chi^2$		38.12***	4.56**	10.12**

**Notes:**

(1) The dependent variable was the equity stake (STAKE) of the parent in the Chinese affiliate. Tobit estimation was used, with upper censoring at STAKE=100%.

(2) The 'South Coast' refers to Guangdong, Fujian, Guangxi and Hainan provinces; the 'Middle Coast' to Shanghai municipality, and Jiangsu and Zhejiang provinces; the 'North Coast' to Beijing and Tianjin municipalities, and Hebei and Shandong provinces; and the 'Inland' area refers to all other provinces, municipalities and autonomous regions.

(3) The 'North Coast' area is taken as the base alternative: the coefficients for the three location dummies (DIN, DS, DM) thus refer to the differential effects relative to the North Coast.

(4) The standard errors are in parentheses: \*denotes the variable is significant at the 10% level using the Wald test; \*\* at the 5% level; and \*\*\* at the 1% level.

(5) The  $\chi^2$  statistic compares the log-likelihood of the model with that of the previous model.

however, is the fact that both R&D/sales and advertising expenditure/sales are statistically insignificant, although both have the expected signs. These findings support the view that the firms in the sample are not strong predators with substantial ownership advantages (Chen and Chen, 1998). In particular, many of the Taiwanese firms have

little or no R&D expenditure, yet have not been deterred from venturing into China.

The effects of corporate governance are explored in Model 2 through the introduction of the four ownership structure variables. These variables provide a further significant improvement in the explanatory power of the model ( $\chi^2=38.12$ ,  $P<0.01$ ), with three of the four variables being statistically significant. The coefficient for the FAM is negative, confirming Hypothesis 1 and suggesting that family shareholders are more concerned to minimise their exposure in the emerging market setting than they are to maintain control over their affiliates. The effect of insider shareholding (IS-NF) is insignificant, and our Hypothesis 2 is not supported. However, both parts of Hypothesis 3 receive strong support. The share ownership of the parent companies in their Chinese affiliates is negative and significant with respect to the shareholding of domestic financial institutions (DFIN), but positive and significant with respect to the shareholding of foreign financial institutions (FFIN). These results support the notion that the former are pressure-sensitive investors, whereas the latter are pressure-resistant investors.

In Model 3, we test for the impact of location-specific networks by including the previous investment (PIN) variable. The regression coefficient for this variable is positive and strongly significant ( $P<0.05$ ), suggesting that the parent's share ownership in its overseas affiliate is positively associated with previously developed economic links (Hypothesis 4). In Model 4, we also include the three dummy variables for the Inland area, the South Coast, and the North Coast. The inclusion of these three dummy variables leads to a significant improvement in the overall explanatory power of the model ( $\chi^2=10.12$ ,  $P<0.05$ ), suggesting that the location of the affiliate does have an impact upon the stake taken by the parent company. The significant positive values for the dummies related to the South and Middle Coasts (DS, DM) suggest that parent companies take higher equity stakes in affiliates located in these regions than in those located on the North Coast or in the Inland area, again in line with Hypothesis 4.

### The choice of location

The above analysis clearly confirms that the equity stakes taken by the Taiwanese parent companies in their Chinese affiliates depend *inter alia* upon the locations of those affiliates. Hypothesis 4 suggests an association between the entry mode and loca-

tion choices without identifying a causality link. But the choice of location is also likely to depend upon the chosen equity stakes. To investigate this possibility, we estimate a model of location choice using multinomial logit analysis (Greene, 2001; Hensher *et al.*, 2005). The dependent variable is a discrete choice between  $J$  possible location alternatives: that is,  $j=1$  (Inland area),  $j=2$  (South Coast),  $j=3$  (Middle Coast), or  $j=4$  (North Coast). To verify possible links between the entry mode and location choices, the parent company's equity stake (STAKE) in its Chinese affiliate is included as a regressor. In addition, we also include a number of control variables. A considerable number of empirical studies have estimated econometric models of FDI location within host countries, including many that have considered FDI location within China (Broadman and Sun, 1997; Wei *et al.*, 1999; Cheng and Kwan, 2000; Coughlin and Segev, 2000; Zhao and Zhu, 2000; Belderbos and Carree, 2002; Zhou *et al.*, 2002; Chadee *et al.*, 2003; He, 2003). The main findings of these studies are that the location decision is influenced by five groups of variables: regional market size, labour costs, quality of infrastructure, and agglomeration economies. In line with previous research, the multinomial logit model in Table 6 thus includes five location-specific attributes and two industry dummies as controls. First, the effect of regional market size is captured by regional GDP (GDP), which is expected to have a positive effect upon FDI location. Second, labour costs are represented by the average wage rate (WAGE) in manufacturing, and are expected to have a negative effect upon FDI location. Third, the total combined length of railways and roads, divided by the land area (INF), is used as a proxy for the quality of infrastructure, since regions with better transport systems are likely to attract more inward FDI. Fourth, there are established theoretical reasons why new investment should be attracted to areas where there are already agglomerations of previous FDI. Various authors, starting with Marshall (1920), have suggested that firms tend to cluster together. Therefore the per capita cumulative stock of Taiwanese FDI (TFDI) is included to capture these effects, and also the square of this variable (TFDI<sup>2</sup>) in order to test for possible diminishing returns. The stock of Taiwanese FDI is preferred to the total FDI stock, as the two have quite different geographical distributions and it is the former that is the most relevant to the decisions of Taiwanese investors. No measure of investment incentives is included because the

**Table 6** The multinomial logit regression results for the location choice models

<i>Variable</i>	<i>Model 5</i>	<i>Model 6</i>
GDP	2.81** (1.39)	2.75** (1.39)
WAGE	0.340 (0.423)	0.351 (0.427)
INF	-3.94 (4.45)	-3.58 (4.46)
TFDI	0.318*** (0.117)	0.291*** (0.118)
TFDI <sup>2</sup>	-0.0027*** (0.0009)	-0.0024*** (0.0009)
INLAND	-5.42* (3.04)	-5.75* (3.06)
SOUTH	-5.39** (2.56)	-6.25** (2.59)
MIDDLE	-6.36** (2.51)	-6.83*** (2.52)
ELEC × INLAND	-0.135 (0.641)	-0.176 (0.641)
ELEC × SOUTH	0.816 (0.424)	0.732* (0.434)
ELEC × MIDDLE	0.872** (0.427)	0.817* (0.432)
TEXT × INLAND	0.646 (1.469)	0.630 (1.470)
TEXT × SOUTH	-0.732 (1.444)	-0.741 (1.457)
TEXT × MIDDLE	2.122* (1.107)	2.082* (1.115)
STAKE × INLAND		0.0088 (0.0084)
STAKE × SOUTH		0.0218*** (0.0062)
STAKE × MIDDLE		0.0162** (0.0060)
Log-likelihood	-321.51	-314.65
Pseudo-R <sup>2</sup>	0.186	0.204
χ <sup>2</sup>	32.44***	46.17***

Notes: (1) The dependent variable in each model is the discrete choice of location between the Inland area, the South Coast, the Middle Coast, and the North Coast. Each model was estimated by multinomial logit.

(2) The 'South Coast' refers to Guangdong, Fujian, Guangxi and Hainan provinces; the 'Middle Coast' to Shanghai municipality, and Jiangsu and Zhejiang provinces; the 'North Coast' to Beijing and Tianjin municipalities, and Hebei and Shandong provinces; and the 'Inland' area refers to all other provinces, municipalities and autonomous regions.

(3) The 'North Coast' area is taken as the base alternative.

(4) The standard errors are in parentheses: \*denotes the variable is significant at the 10% level using the Wald test; \*\* at the 5% level; and \*\*\* at the 1% level.

(5) The χ<sup>2</sup> statistic compares the log-likelihood of the model with that of a 'base' model containing only three alternative-specific constants.

Taiwanese FDI projects in this study were undertaken between 1999 and 2003, during which time the special zones no longer offered special treat-

ment to foreign investors. Finally, we include two industry dummy variables: one (ELEC) for affiliates in the electrical industry, and the other (TEXT) for affiliates in the textile sector. The industry dummies and the equity stake are firm-specific characteristics, and thus enter the model as interaction terms with the alternative-specific constants. The North Coast is selected as the base alternative. The parameter estimates in discrete choice models have no obvious behavioural interpretation, apart from their sign and level of significance, but are useful in determining whether the variable has a positive or negative effect upon the choice probabilities.

The empirical results are shown in Table 6. Model 5 includes the five location-specific attributes, as suggested by the literature, the two industry dummy variables, and the alternative-specific constants. The coefficient on GDP is positive as expected, and statistically significant. Both terms representing cumulative Taiwanese FDI (TFDI and TFDI<sup>2</sup>) are significant, with the negative sign for the squared term indicating that the benefits from agglomeration economies may be subject to diminishing returns. Labour costs (WAGE) and the quality of infrastructure (INF) are both statistically insignificant. This may be related to the fact that wages costs reflect productivity differences and/or differences in human capital, and the infrastructure variable is a rough proxy. Further, an average measure of wages may not capture the marginal costs of hiring additional unskilled labour. None of the interaction terms involving the industry dummies is significant, but all three alternative-specific constants are significant.

In Model 6, we include STAKE as an additional explanatory variable. The inclusion of these three interaction terms leads to a very significant improvement in the explanatory power of the model ( $\chi^2=13.72$ ,  $P<0.01$ ). It appears that affiliates in which the parent companies have large equity stakes are significantly more likely to be located in the provinces in the South and Middle Coast areas. It should be stressed that these provinces have been the recipients of the lion's share of foreign investment from Taiwan, but the benefits of this FDI stock should be captured by the agglomeration economies variable in our empirical analysis. Combined with results in Model 4 (Table 5) this finding suggests that the two FDI decisions (on entry mode and on location) are interdependent, and further research is needed to address the issue of the timing of these strategic decisions.

## Discussion

This paper has examined the impact of various governance- and network-related factors upon the FDI decisions of NIE firms in emerging markets using a sample of Taiwanese publicly listed companies investing in China. We advance existing research on FDI by arguing that investment in emerging markets exposes the investing firm to information asymmetries and risks. Building on the agency framework, we suggest that the governance characteristics of the investing firm and its local networks may operate in concert when determining the extent of commitment to an overseas venture after controlling for the conventional antecedent factors of the FDI decisions identified in previous research. To our knowledge, this is the first attempt to consider the effects of these firm-level factors on FDI.

Two general contributions to the previous research on FDI decisions are made here. First, we show that the ownership structure of the parent company matters with regard to its FDI decisions, and various investor constituencies may have different impacts on the firm's choice of entry mode. More specifically, share ownership by foreign financial institutions in NIE firms is associated with a high-commitment FDI strategy, and these findings are consistent with the theory of strategic diversification, including international diversification (Sanders and Carpenter, 1998; Tihanyi *et al.*, 2003). In contrast, high levels of share ownership by the family and domestic institutional investors are associated with low levels of equity commitment, and these results too are consistent with this framework. These findings also extend more recent research in the agency and strategy literatures that recognises the different governance effects of domestic and foreign constituencies of shareholders on organisational outcomes in emerging markets (e.g., Douma *et al.*, 2006) by focusing on FDI strategic decisions.

Second, our research suggests that the firm-level, location-specific attributes such as its local business, ethnic and cultural networks may have an impact on the entry mode choice. Unlike corporate governance, business networks represent informal mechanisms that may deal with the information asymmetries and risks associated with the overseas venture, and our findings extend previous, agency-grounded research on interrelationships between corporate governance and business strategy (Hoskisson *et al.*, 2002).



Our study also makes a contribution to IB research by analysing the interrelationships between the FDI entry and location choices of firms from NIEs into emerging markets. In this paper, we provide evidence that the two FDI decisions are interrelated, and that the factors that affect the FDI location choice should have a significant effect upon the entry mode decision, and vice versa. However, we were unable to establish the timing of the two FDI decisions and the causal links between them, because of data limitations. Nevertheless, our results contribute to current knowledge by suggesting that complex interrelationships between governance and FDI decisions may be intermediated by institutional factors. In other words, firms from NIEs are likely to invest in wholly owned subsidiaries in regions where they have developed extensive networks, as is the case for Taiwanese firms in the Middle and South Coast provinces of China. So far, only a few studies incorporate the institutional context of the host economy (see Gomes-Casseres, 1990, for a discussion), and our study provides an extension of this research.

Our findings are important for research in other Asian NIEs and emerging economies, such as Malaysia, Thailand and Indonesia. Countries in the early stages of industrialisation are defined by the immaturity of their securities markets, with family block holders and business networks playing a prominent role in the corporate landscape (Mody, 2004). Although previous research acknowledges the importance of ownership structure effects on performance in these countries (e.g., Claessens *et al.*, 2000; Dhnadirek and Tang, 2003), little is known about the interrelationships between corporate governance and strategic decisions, including FDI. The importance of inward and outward FDI in their economic growth is clear, and our analysis of the determinants of internationalisation strategies of local firms may have important practical implications for the government, managers and investors.

Our analysis indicates that, when developing internationalisation strategies, the managers of NIE firms have to balance the potentially conflicting objectives and risk preferences of different groups of shareholders, in particular families and institutional investors. The risk of a particular FDI project in an emerging market may be mitigated not only by managers' decisions over the extent of the commitment to an overseas venture but also by a careful selection of the FDI location. In this respect, the existing economic, cultural and historic

links with a particular location represent an important organisational resource that managers of the NIE firm may use strategically to reduce the potential agency costs associated with an overseas venture. From the perspective of potential investors, domestic and foreign institutions investing in NIE firms should take into account a range of factors beyond the narrow confines of the financial performance and profitability of their portfolio firms. More specifically, our analysis shows that the business strategies of NIE firms are heavily influenced by controlling families and their business networks, and that these factors have a profound impact on the firm's growth through internationalisation. Foreign investors taking equity stakes in local firms need to have a clear understanding of the longer-term strategic implications of family ownership and network links when making investment decisions.

This study has several limitations that may suggest a number of avenues for future research. The analysis has provided evidence of strong links between governance and FDI decisions, but the set of hypotheses tested in this study was far from comprehensive. For example, we did not consider the possible effects of corporate board characteristics in NIE firms, and future research should verify the impacts of this governance factor on strategic decisions (Daily *et al.*, 1999). It is also important to look at the effects of different ownership structures on other aspects of the FDI decision (e.g., partner selection in joint ventures). Because of data limitations, we were unable to verify the possible effects of the purposes of investment on the choice of entry mode and location. However, we provide further evidence supporting arguments that firms choose FDI strategies based on industry conditions and their attributes (Shaver, 1998: 571) by including firm-specific governance characteristics. Although we identified links between corporate governance, networks and the two FDI decisions, we cannot verify the causal relationship between them.

## Conclusions

By focusing on the internationalisation of NIE firms, our study further develops FDI research. The contrasting effects of ownership structure on the extent of FDI commitment may have important implications for the IB literature. Although we focus specifically on NIEs, variations in governance regimes around the world (La Porta *et al.*, 1999) suggest there is scope for international analysis of the links between governance and FDI strategy. Our

evidence indicates that the FDI strategies of NIE firms entering emerging markets are an outcome of a complex interplay of organisational and institutional factors that is best understood on the basis of a multi-lens, interdisciplinary research framework.

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## Acknowledgements

We are grateful to the participants at the 2006 Annual Conference of the Academy of International Business, the editors and two anonymous reviewers for their helpful comments.





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