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Local complementary inputs as drivers of entry mode choices: The case of US investments in Brazil

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ABSTRACT

The theory of entry mode choice has modeled that choice as solely determined by the foreign investor. Hennart's bundling model, on the other hand, argues that foreign entry into a host market involves the bundling of intangibles contributed by the foreign investor with local complementary inputs contributed by local actors, and that the chosen mode of entry will be the one that maximizes the joint gains of both parties. That chosen mode will depend on the relative efficiency of the various markets on which intangibles and complementary assets can be bundled. We test the model on a sample of US entries into Brazil. We find that the number of available suppliers of local complementary assets and the degree of concentration of the Brazilian industry are significant determinants of the choice US investors make between joint ventures and wholly-owned subsidiaries, and between greenfields and acquisitions, thus providing support for the model.

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1. Introduction

The modes chosen by foreign investors to enter a foreign market, i.e. whether they take full ownership of their foreign affiliate or whether they share ownership with local firms, and whether they enter with a de novo investment (a greenfield subsidiary) or through an acquisition, have been a major topic in the international business (IB) literature. Some have even argued that we have now a good knowledge of the drivers of these modes, and that recent work has been making only marginal contributions (Shaver, 2013). Yet in an article published in the 40th anniversary issue of the Journal of International Business Studies, Hennart (2009) argues that the entry mode literature needs to be re-evaluated. According to him, the literature has modeled entry mode as solely dependent on the preferences of the foreign investor. Yet successful manufacture and sale in a foreign market requires that the foreign investor bundle its imported assets with complementary local inputs, such as land, raw materials, labor, utilities, permits, and distribution. These inputs have owners, whose interests and motives may be relevant to the entry mode choice. While the literature has modeled the entry mode as resulting from a unilateral decision by the foreign investor, Hennart argues that it should be seen as the outcome of a joint decision between the foreign investor and the owners of these local inputs. His model suggests that a crucial variable in that decision is the efficiency of alternative local markets available to the foreign investor for accessing these complementary inputs.

The neglect of the potential role played by owners of local complementary inputs may account for the lack of consistent empirical support for some of the predictions of the extant literature. Anderson and Gatignon's (1986) hypothesis that foreign investors with highly proprietary assets would choose a wholly-owned subsidiary (a WOS) over a joint venture (a JV) was not supported by Gomes-Casseres (1989) in his study of US firms

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Table 1
New US affiliates in Brazil, 2005–2010.

Ownership of subsidiary	> 95%	>5% <95%	Total
Greenfield	Wholly-owned greenfield (150)	Greenfield joint venture (31)	All greenfields (181)
Acquisition	Full acquisitions (100)	Partial acquisitions (16)	All acquisitions (116)
Total	All WOS (250)	All JVs (47)	All entries (297)

investing abroad and by Hennart (1991) in the case of Japanese firms entering the United States, while Kogut and Singh (1988) found that R&D intensive foreign investors chose JVs. Similarly, Brouthers and Brouthers (2000) and Padadmadhan and Cho (1999) found support for Vermeulen and Barkema's (2001) hypothesis that foreign investors with extensive international experience will choose greenfields over acquisitions, while Andersson and Svensson (1994), Caves and Mehra (1986), Fosgren (1989) and Harzing (2002) found that internationally experienced foreign investors were more likely to choose greenfields. These contradictory results may have been due to the neglect of the role played in the entry mode by local owners of complementary inputs.

This paper provides, as far as we know, the first test of Hennart's model. To the best of our knowledge, ours is also the first large-sample econometric study of the entry mode chosen by foreign firms investing in Brazil. We look at US entries into Brazil between 2005 and 2010. Focusing on one investor and one host country allows us to control for cultural differences between investors and differences in host country conditions. The United States is a major investor into Brazil. Brazil is an emerging market in which we would expect some markets for complementary inputs to be inefficient. We proxy the difficulties faced by foreign investors in obtaining such inputs by estimating the number of key suppliers for each new US affiliate established in Brazil. We find support for our hypothesis that when the number of potential suppliers is low, the chance that entry will be with a JV rather than with a WOS is high. Likewise, the more concentrated the industry entered, the more likely the entry will be through a JV rather than through a WOS, and through an acquisition rather than through a greenfield. Some variables that have taken contradictory signs in previous studies, for example the investor's R&D intensity and its international experience, become insignificant when we enter the difficulty of accessing complementary local inputs.

The next sections makes the case that owners of complementary local inputs have been omitted from models that predict the choice of entry modes, and explains why one would expect them to play a role in that choice. We then present our hypotheses, our data, our methodology, and our results. We follow with our conclusions, in which we derive some implications for further research on entry modes.

2. Theory and hypotheses

2.1. Complementary local inputs

When entering a foreign market, foreign investors must make a series of decisions. They must decide whether to contract with a local firm (for example to license their knowledge to it) or to set up a foreign subsidiary. If they decide to set up a foreign subsidiary in the target market, they must decide whether to keep full equity of the subsidiary (i.e. enter through a WOS) or to share it with another firm, for example through a JV. A separate decision facing foreign investors is whether to bundle by themselves the necessary inputs to set up a subsidiary (i.e. set up a greenfield), or to buy an existing firm (to make an acquisition). In the rest of the paper we follow Brouthers and Hennart (2007) and define WOSs as both fully-owned greenfields and full acquisitions, and JVs as greenfield JVs and partial acquisitions (see Table 1). By acquisitions we will mean both full and partial acquisitions, and by greenfields both greenfield JVs and greenfield WOSs.

The IB literature has generally modeled the choice between entry with a WOS and entry with a JV, and that between entry with a greenfield affiliate and entry with an acquisition, as unilaterally determined by the foreign investor. Anderson and Gatignon (1986), one of the most cited article on entry modes, states that foreign investors will choose a WOS when they have considerable knowledge of the target market, but will opt for a JV when they want to reduce their resource commitment because they see the target market as risky. They add that foreign investors will set up a WOS if they want to exploit proprietary assets because this will allow them to limit their unauthorized diffusion. Brouthers (1995: 11) succinctly summarizes Anderson and Gatignon's model in these words: "In selecting the appropriate entry mode firms have to answer two questions: (1) what level of resource commitment are they willing to make? (2) What level of control over operations do they desire?"

Other IB models of the evolution of entry modes in a host country also see the process as essentially determined by the foreign investor. The Uppsala internationalization process model (Johanson & Vahlne, 1977, 1990; Johansen & Valhne, 2009) predicts that the mode of entry chosen by foreign investors will progress from a JV to a WOS as they gain additional experience from their current activities in the host market. The organizational learning perspective (Barkema and Vermeulen, 1998; Vermeulen & Barkema, 2001; Padadmadhan & Cho, 1999) argues that a firm's own past experience determines its choice between greenfields and acquisitions. In none of these frameworks do owners of complementary assets seem to play any active role in the foreign investor's decision. Which entry mode to choose is the foreign investor's sole prerogative.

The preceding frameworks do not explicitly recognize that foreign investors typically choose to locate production in a target country (as opposed to export to that country from their home country) when the local complementary inputs they need are more efficiently obtained in the target country than at home. These inputs include land, raw materials, labor, utilities, government permits, and access to customers. Since these inputs have owners, it seems strange to keep them out of the picture. The neglect of the potential role these owners might play in the determination of entry mode probably stems from the particular treatment of complementary local inputs in one of IB's dominant model, the OLI paradigm (Dunning, 1988).

The OLI paradigm does take local complementary inputs into account. It states that firms will serve foreign markets through foreign production when the foreign investor's ownership advantage (O advantage), for example its technological innovation, cannot be easily sold or rented to local firms and is best exploited in conjunction with local factors of production. Dunning calls these complementary local inputs 'location advantages' (L advantages). He argues that for foreign production to take place, O advantages must be poorly tradable (i.e. internalization of these advantages is required) and they are more profitably bundled with local rather than home country complementary inputs. But while the transactional characteristics of O advantages are at the center of

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