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The effect of uncertainty on FDI entry mode decisions: The influence of family ownership and involvement in the board of directors

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ABSTRACT

This study aims to resolve the debate regarding whether family owners facilitate or restrain internationalization, by examining the role of family owners as firms cope with uncertainty. According to the transaction cost economics (TCE) perspective, which differentiates between internal (behavioral) uncertainty and external (environmental) uncertainty, firms tend to choose wholly-owned subsidiaries over joint ventures as internal uncertainty and external uncertainty decrease. We hypothesize that, due to family members' concerns regarding the preservation of socioemotional wealth (SEW), firms with higher family ownership and involvement in the board are even more likely to choose wholly-owned subsidiaries over joint ventures as internal uncertainty and external uncertainty decrease. We use a sample of 1463 observed investments from 681 companies publicly listed on the Taiwan Stock Exchange to test our hypotheses. The empirical results show that family owners' involvement in the board facilitates internationalization when facing low internal uncertainty; as internal uncertainty decreases, firms with higher family involvement in the board have a higher propensity to choose wholly-owned subsidiaries, the high-commitment FDI entry mode.

1. Introduction

The literature on family business internationalization has found contradictory roles of family owners in internationalization. Some studies found that family presence and involvement contributed to a higher degree of internationalization (e.g., Calabrò & Mussolino, 2013; Chen, 2011; Zahra, 2003), while others showed an association of family ownership and involvement with a lower level of internationalization (e.g. Casillas & Acedo, 2005; Fernández & Nieto, 2005; Graves & Thomas, 2006).

To reconcile these conflicting findings, scholars have called for a shift in the focus of family business internationalization from comparative family business/non-family business studies to more comprehensive analyses of the heterogeneous nature of family firms (e.g., Kontinen & Ojala, 2010). Such a shift in emphasis has driven recent studies to focus on a variety of features that lead to family firm heterogeneity and its influence on internationalization. For example, Arregle, Naldi, Nordqvist, and Hitt (2012), Calabrò, Torchia, Pukall, and Mussolino (2013), Kraus, Mensching, Calabrò, Cheng, and Filser (2016), and Pongelli, Caroli, and Cucculelli (2016) found that external involvement (in firm ownership, management, the board of directors, or other aspects of the firm) facilitated internationalization of family firms. Other factors contributing to family firm internationalization included firm age (Baronchelli, Bettinelli, Del Bosco, & Loane, 2016), host country experience (Boellis, Mariotti, Minichilli, & Piscitello, 2016), and international market knowledge (Cesinger et al., 2016).

These recent studies focusing on family firm heterogeneity have produced significant insights and plausible explanations regarding the conflicting role of family owners in internationalization. They commonly focus on the composition of family ownership or board of directors (e.g., foreign investors, external board members, non-family managers), or other firm characteristics (e.g., firm age, experience, knowledge) as the features that contribute to family firm heterogeneity. However, the contexts of internationalization decision-making can be as important, if not more so. We assume that to understand when, or under what conditions, family owners facilitate or restrain internationalization will provide an alternative view that helps reconcile the inconsistent role of family owners in family business internationalization. Specifically, uncertainty plays a crucial role when firms enter a foreign country (e.g., Anderson & Gatignon, 1986; Brouthers, Brouthers, & Werner, 2000; Hill, Hwang, & Kim, 1990). It is imperative to know how family owners influence internationalization decisions when firms cope with uncertainty. Do family owners facilitate or restrain internationalization when firms cope with uncertainty? We therefore undertake this study to examine the role of family owners on foreign direct investment (FDI) entry mode decisions as firms cope with

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uncertainty.

Drawing from the analysis of transaction cost economics (TCE) on FDI entry mode choice (Brouthers, Brouthers, & Werner, 2003; Brouthers & Hennart, 2007), and family businesses' unique concerns regarding preservation of their socioemotional wealth (SEW) (Gómez-Mejía, Haynes, Núñez-Nickel, Jacobson, & Moyano-Fuentes, 2007; Gómez-Mejía, Makri, & Kintana, 2010), we differentiate between internal (behavioral) uncertainty and external (environmental) uncertainty. We argue that, as internal and external uncertainty decrease, firms with higher family ownership and involvement in the board are more likely to make a strong commitment to internationalization and choose wholly-owned subsidiaries over joint ventures. We use a sample of 1463 observed investments from 681 companies publicly listed on the Taiwan Stock Exchange to test our hypotheses. The empirical results show that family owners' involvement in the board facilitates internationalization when firms face low internal uncertainty; as internal uncertainty decreases, firms with higher family involvement in the board have a higher propensity to choose the high-commitment FDI entry mode (i.e., wholly-owned subsidiaries).

This study contributes to the research on family business internationalization strategy in two ways. First, our research finds that the role of family owners in internationalization decisions varies across different contexts. In the case of our study, whether family owners facilitate or restrain internationalization depends on how high is the internal uncertainty they encounter. When facing high internal uncertainty, family owners hesitate to commit resources and thus restrain internationalization. But when they see low internal uncertainty, they are willing to make a strong commitment and thus facilitate internationalization. This perspective provides a possible explanation of family owners' role in family business internationalization and opens a new window of opportunity for future research in family business internationalization strategy.

Second, our study also contributes to the integration of two theoretical frameworks by injecting the TCE perspective into the SEW model. International business (IB) scholars have widely applied the TCE perspective to elaborate the influence of uncertainty on entry-mode decisions; however, in family business internationalization research, such a theoretical perspective is still scant (Pukall & Calabrò, 2014). Our study endeavors to integrate the TCE perspective and the SEW model to investigate the SEW concerns as family owners cope with external and internal uncertainty.

In the following sections, we will first review extant literature and develop related hypotheses. Then we will describe the sample and our methodology, followed by research findings, discussion, and conclusion.

2. Hypothesis development

2.1. The role of uncertainty in FDI entry mode choice

When entering a foreign country via FDIs, firms must choose an entry mode—either the full-equity approach of wholly-owned subsidiaries or the shared-equity arrangement of joint ventures. Each entry mode brings different benefits, but firms cannot select them both. Therefore, firms have to consider a number of factors when choosing their entry mode. IB scholars have been examining the effect of uncertainty and consider it one of the most important factors (e.g., Brouthers et al., 2000; Gatignon & Anderson, 1988; Hill et al., 1990; Kogut & Singh, 1988; Miller, 1992). They stressed that firms should evaluate different aspects of uncertainty to optimize their returns for the risk assumed (Miller, 1992) and to choose the entry mode that offers the highest risk-adjusted return on investment (Anderson & Gatignon, 1986; Kim & Hwang, 1992). It is well accepted that firms' entry mode choices depend significantly on uncertainty.

Among theories addressing the effects of uncertainty on entry mode choices, transaction cost economics (TCE) is one of the most widely adopted (Brouthers & Hennart, 2007; Brouthers et al., 2003; Zhao, Luo, & Suh, 2004). Based on the behavioral assumptions of bounded rationality and opportunism, the TCE perspective views the "economic institutions of capitalism" or "governance structure" (Williamson, 1985), including firms, markets, and relational contracting, as the solution to opportunism. To economize on bounded rationality and to simultaneously safeguard transactions against opportunism, an appropriate governance structure that can minimize transaction costs is needed (Williamson, 1979, 1985). In brief, the choice of firm, market, or relational contract depends on which governance structure incurs the lowest transaction costs. Important determinants of transaction costs include frequency, asset specificity, and uncertainty (Williamson, 1985).

International business scholars apply the TCE perspective to weigh pros and cons of wholly-owned subsidiary against those of joint ventures (e.g. Anderson & Gatignon, 1986; Brouthers et al., 2003; Kim & Hwang, 1992), asserting that firms adopt the international governance forms that minimize the sum of transaction costs. The TCE perspective distinguishes internal uncertainty from external uncertainty: internal (or behavioral) uncertainty makes it difficult for firms to accurately assess performance afterward, whereas external (or environmental) uncertainty makes firms unable to accurately predict the future and specify in advance all possible contingencies (Brouthers & Hennart, 2007; Williamson, 1985). Below, we illustrate the influences of internal and external uncertainty respectively.

2.2. The effect of internal uncertainty

Internal (or behavioral) uncertainty arises when a firm is unable to verify its employees' performance ex-post facto (Anderson & Gatignon, 1986; Brouthers & Hennart, 2007). This may occur when proper measures of output are unavailable (Ouchi, 1977), when outcomes are not observable (Eisenhardt, 1985), or when standards of desirable performance are ambiguous (Thompson, 1967). Under such circumstances, firms turn to monitor employees' behavior (Thompson, 1967) or shape the antecedent conditions of performance, such as motives of employees, through socialization or clan control—the use of social mechanisms such as common values and beliefs to align employees' personal goals with those of the organization (Eisenhardt, 1985; Ouchi, 1977).

However, behavior monitoring or clan control requires managers' knowledge of how employees think and behave. This is natural in the domestic environment, as managers have acquired the expertise needed over time; however, in the international setting, it can be tough. When a firm begins to enter a foreign market, different norms, values, and beliefs of the foreign country often pose considerable challenges for communication. Employees from the host country may not be capable of comprehending or accepting the values and norms of the parent firm's home country, making it difficult for managers from the parent firm to monitor foreign employees' behavior or to exert clan control. As a result, foreign firms typically find it challenging to have overseas colleagues accept parent firm's goals as their own and thus call for local partners' help to jointly manage local employees (Johanson & Vahlne, 1977, 1990). On the other hand, a local partner can also provide part of the resources needed in the local market and lower the resource commitment of foreign firms (Anderson & Gatignon, 1986).

2.3. The effect of external uncertainty

External (or environmental) uncertainty denotes the inability of an organization to predict future events (Milliken, 1987). It often results from the unpredictability of the target location's environment (Anderson & Gatignon, 1986). For example, unexpected changes of the "rules of the game" stipulated by the local government can baffle foreign firms and disable them from responding effectively, making business operations highly uncertain (Delios & Beamish, 1999;