

# Network and Institutional Effects on SMEs' Entry Strategies

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**Abstract** Building on the network and institutional environment perspectives, this study examines the foreign market entry strategies of 851 small and medium-sized enterprises (SMEs) based in Taiwan, a newly industrialized economy. From the network perspective, our findings show that SMEs prefer to enter new markets in two distinct ways: (1) through wholly-owned subsidiaries when they are following their customers into a host country, or when the operations in a host country have more internal network linkages; and (2) through joint ventures when they have stronger supplier relationships. From the institutional environment perspective, SMEs set up wholly-owned subsidiaries when they perceive differences in the macro-economic and industrial-policy environment in a host country; however, they will choose to enter into joint ventures if they perceive a significant degree of socio-cultural difference in a host country. As SMEs decide on entry strategies, they must carefully consider not only the different types of network resource, but also the influence of institutional factors in host countries.

**Keywords** Networks · Institutional environment · Entry strategies · SMEs

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## 1 Introduction

Theories relating to foreign market entry by multinational corporations (MNCs), such as the monopolistic advantage (Kindleberger 1969) and internalization (Buckley and Casson 1976) theories, have postulated that foreign direct investment (FDI) acts as a means by which firms are able to extend their advantages abroad. That is, firms engaging in FDI are superior to their competitors in terms of technological capabilities or the uniqueness of their product offerings. This implies that firms with fewer competitive advantages will be less able to effectively operate in foreign markets. Nowadays, a new breed of MNCs, based in newly industrialized economies (NIEs) and also engaging in FDI, has begun to emerge as significant players in world markets (Alvi 2012; Chiao et al. 2010; Meyer 2001; Wells 1983). Most recently, small and medium-sized enterprises (SMEs) from NIEs have also become active in making foreign direct investments (George et al. 2005; Pinho 2007; Tesfom et al. 2004). Compared to MNCs based in developed countries, NIE-based MNCs, especially SMEs, tend to be smaller in size and possess limited resources and advantages.

How might these SMEs overcome the challenges of lack of resources or international experiences to compete successfully in foreign markets (Chen et al. 2006; Lu and Hwang 2010)? From the perspective of firm-specific advantages, on the one hand, such firms may in fact be advantaged when it comes to capabilities such as small-scale production and flexibility in switching product lines (Chen and Chen 1998). On the other hand, firms tend to regard FDI as a way to access desirable external capabilities and resources, such as logistics support, market information, and technical assistance (Johanson and Mattson 1988). For small firms, network relationships between customers and suppliers or between producers and distributors typically play important roles in their activities in host countries, either in sales or production (Bradley et al. 2006; Fujita 1995). SMEs are often more dependent on network linkages because of the risks and managerial complexity associated with FDI.

Among the theories shedding light on the various facets of FDI, the network approach has offered some insightful interpretations of firms' moves toward internationalization (Madsen and Servais 1997). However, empirical study of the subject has been sparse (Chen and Chen 1998). Because different network relationships result in different flows of information (Gulati 1998) and provide varying network resources or knowledge to firms (Lamin and Dunlap 2011), regardless of their size, it would seem that such relationships would influence firms' foreign-market entry strategies. Therefore, the first purpose of this study is to adopt the network perspective to examine SMEs' entry strategies.

In an effort to aid our understanding of firms' decisions with regard to FDI, we chose to distinguish network relationships in two distinct categories, internal networks and external networks. This study defines these two categories of relationships from the perspective of a parent company. Differing from a domestic firm, an MNC comprises a parent company and subsidiaries (Ghoshal and Bartlett 1990) by means of internal networks, and the relationships between the parent

company and its subsidiaries gradually form an inter-organizational network in which behaviors of subsidiaries are influenced and restricted by the parent company (Granovetter 1985). While MNCs' internal network linkages help the organizations to develop advantages and enhance their competitiveness (Ghoshal and Bartlett 1990), multinationals can also build their own external network linkages (e.g., strategic alliances, joint ventures, and long-term relationships) with external stakeholders such as customers and suppliers. These relationships are conducive to learning new knowledge, gaining information, acquiring resources, penetrating new markets, or accessing technologies to reach their goals (Gulati et al. 2000) and to reduce business speculation behaviors of other parties (Williamson 1991), to name a few advantages. In this paper, we focus on the external networks of a parent company because these linkages do not exist before a subsidiary in a host country has been established. As to the internal networks, we captured the relationships among parent companies and their subsidiaries.

Recently, researchers have begun to make use of the institutional environment perspective to examine firms' entry strategies (Davis et al. 2000; Harzing 2002; Rosenzweig and Singh 1991), as host countries' institutional environments appear to have a significant impact on MNCs' operations (Alvi 2012; Delios and Beamish 1999; Henisz 2004; Pogrebnyakov and Maitland 2011). Institutional environmental factors in host countries, such as industrial policies, government-imposed limitations on incoming foreign investments, restrictions on corporate operations, and government interventions, are always carefully evaluated by MNCs considering entry into foreign markets. Scott (1995) suggested the necessity of categorizing differences in institutional environments in order to effectively analyze the impact of such differences on various strategic behaviors. We can thus infer that differences in various aspects of institutional environments have varying impacts on firms' choice of foreign-market entry strategies. Some differences in institutional environment might lead firms to enter new markets by means of wholly-owned subsidiaries (Davidson and McFetridge 1985), while others may lead to the use of joint ventures (Anderson and Gatignon 1986; Hennart 1988; Hill et al. 1999). Indeed, some such differences may have no effect on firms' choice of entry strategies (Xu and Shenkar 2002). Brouthers et al. (2004) further suggested that future studies may consider examining institutional environments according to various dimensions or constructs. Accordingly, we chose to compare SMEs' home institutional environments with those of their host countries, distinguishing along the lines of macro-economic differences, socio-cultural differences, and industrial-policy differences. It is our hope that such differentiation will help to facilitate our discussion of the effect of institutional environments on firms' choice of entry strategies. The second purpose of this study, then, is to examine firms' entry strategies through the lens of institutional environment.

Taking SMEs as our research subjects, we extend the scope of previous studies, which have primarily been concerned with large corporations (Ghobadian and O'Regan 2006). This paper uses the internal and external perspectives together to empirically test the impact of networks and institutional environments on the international strategies of these MNCs. Following the introduction, we first provide a review of the literature, and then derive our research hypotheses in Sect. 2. In Sect.

3 we describe the research methodology, and in Sect. 4 we discuss our empirical findings. The last section provides our concluding thoughts and remarks.

## 2 Literature Review and Hypotheses

### 2.1 Network Perspective

Firms might be attracted by their foreign customers to operate in foreign markets, or may choose to expand abroad in order to capitalize on their customers' positions in industrial networks. In the process of internationalization, firms may utilize their linkages with host country firms to facilitate their entry into foreign markets, rely on local networks in host countries to ease their entry, or form strategic alliances with local firms (e.g., joint ventures) as a means to enter host countries. Madsen and Servais (1997) proposed three network patterns typical of firms expanding into foreign markets: (1) internationalizing via an existing network in the home country; (2) internationalizing via the pathways established by its (internationalized) partners in the host country network; and (3) seeking an internationalized network, and then joining it. It is evident, then, that different networks lead to different strategies of internationalization (Johanson and Mattsson 1988). Thus, we may conclude that network linkages affect MNC choice of entry strategies.

The network relationships for an MNC can be divided into internal networks and external networks. Though internal networks are formed by the parent company and its subsidiaries, external networks can be viewed from the parent company as well as subsidiaries (i.e., a parent company has its own external networks and each subsidiary has its own external networks). Regarding the value of external networks, for example, the inter-firm networks with local suppliers, local customers, and local regulators in a host country help a subsidiary to access important resources or complementary assets (Gulati 1999; Johanson and Mattsson 1988; Chen and Chen 1998; Luo 2003b) and can be described as a strategic resource contributing to capabilities of a subsidiary (Andersson et al. 2002).

Internal network linkages of MNCs, such as intra-firm networks (Luo 2003a; Ghoshal and Bartlett 1990; Tsai and Ghoshal 1998), include formal and informal relationships. The formal relationship implies that the parent firm of an MNC can take actions within its internal networks, such as job mobility, resources exchange, or employee rotations (Ghoshal and Bartlett 1990; Nohria and Ghoshal 1997). The informal relationship indicates interpersonal relations within the internal networks of an MNC, such as friendship and interactions among its employees (Kilduff and Tsai 2003). Internal network linkages are the ones by which a subsidiary can retrieve resources outside the host country where it is located, and with lower transaction costs.

Because subsidiaries of NIE-based firms, whether large or small, typically rely on both internal and external networks for resources, we will discuss the effect of each type of network resource on firms' choice of entry strategies.

## 2.2 External Network Relationships

External network linkages help MNCs access resources they need, and some may be conveyed only via inter-firm relationships. External network relationships (e.g., relationships with local partners, suppliers, customers, distributors, research institutes, professional organizations, policy makers, etc.) often provide MNCs with vital resources such as marketing know-how and information, thus helping to facilitate subsidiaries' operations (Dyer 1996; Yu et al. 2006). Young and Tavares (2004) showed that various inter-firm networks may also be helpful in the development and acquisition of intangible assets, while external network partners (including suppliers, customers, distributors, research institutes, professional organizations, and regulators and other policy-makers) may play an important role as sources of innovation, new business ideas, and practices.

Some studies have focused on the network relationships of subsidiaries (Ambos et al. 2011) such as dual embeddedness (Andersson et al. 2002; Figueiredo and Klauber 2011) and their effect on subsidiary advantage building. We focused, however, on the external networks of the parent company because the issue involved is the period prior to subsidiary establishment in a host country. Thus the context for our study is this: After deciding to invest in a host country, an MNC choosing its entry strategy will evaluate the roles of external networks and the resources its internal networks can offer to a new subsidiary.

### 2.2.1 Supplier Relationships

When MNCs conduct foreign investment in host countries where they have abundant supplier relationships, they also tend to co-invest with these suppliers, thereby increasing their chances of forming joint ventures. Gulati and Gargiulo (1999) showed that two firms which have previously entered into alliances are more likely to form new alliances together. That is, when a home-country supplier invests in a host country, a home-country manufacturer tends to invest in the same country because establishing a relationship with a new supplier takes more time (Johanson and Mattsson 1988). With the accumulated experience of cooperation with a supplier, an MNC is more likely to form a joint venture in a host country so that the relationship with the supplier can be maintained.

In addition, when SMEs have more relationships with home-country suppliers investing in a host country, these firms are more experienced in terms of dealing with partners and also have more network resources, due to their ties with many suppliers in the host country. Because these SMEs are the customers of these suppliers, they will receive more local information and more diversified resources from the suppliers. Accordingly, information asymmetry will be less of a problem for these SMEs in their operations in a host country. For example, an SME's supplier can introduce potential partners with a lower possibility of opportunistic behaviors to an SME if the SME plans to form a joint venture to serve its local clients. The supplier is able to do so due to its linkages with the SME and local firms. Therefore, perceiving to incur lower searching costs in identifying joint venture partners and less coordination and monitoring costs in running a venture,

lowered transaction cost leads SMEs to prefer joint ventures to wholly-owned subsidiaries when home-country suppliers have already operated in host countries.

*H1: SMEs with stronger home-country supplier relationships in a host country are more likely to choose joint ventures over wholly-owned subsidiaries in the host country.*

According to the network perspective (Chen and Chen 1998; Johanson and Mattson 1988), firms take certain actions so as to maintain their interdependent relationships with others. In the words of Johanson and Mattson (1988, p. 292), “(firms’) activities in industrial markets are a cumulative process in which relationships are continually established, maintained, developed, and broken...to access important resources...” Relationships within a network, apparently, will affect firms’ actions, including their production, scheduling, logistics, and foreign direct investments (Johanson and Mattson 1988). Thus, if they wish to fully utilize network resources, firms must consider their network relationships when entering into foreign direct investments. Empirical examinations also support the practice of following customers into foreign markets. For example, Terpstra and Yu (1988) found that advertising agencies invested in foreign markets by following their customers. Studies of Japanese automobile components suppliers found that they tended to invest in the United States and Canada by following their buyers (Martin et al. 1995; Martin et al. 1998).

Taking an example from the automobile industry, when China Motor Corporation (CMC), a “center” firm in Taiwan, decided to expand into foreign markets, its “satellite” firms—i.e., parts, components, and appliance suppliers—strived to follow the firm in order to win orders and prove that it could offer superior services. Conversely, Taiwanese electronics firms play the role of paramount supplier in the world production chain. Their customers, such as HP, Dell, and IBM (i.e., larger MNCs), sometimes ask the supplier firms to make FDI in certain countries, as doing so would complement the MNCs’ strategies. The suppliers feel that being “requested” by their customers to engage in FDI is a demand they cannot refuse, since the larger MNCs are their key customers. These two cases demonstrate that firms have two primary—and very different—foreign entry strategies linked to their customer network relationships: “following” customers, or being “requested” by customers. In the first case, MNCs actively follow their customers into international markets, and in the second case, MNCs are being “passively” requested by their customers to enter foreign markets. We derived hypotheses about the relationships with customers for the two different perspectives.

### 2.2.2 Following Customers

The network perspective tells us that the closer the relationships within a network, the more resources network members are providing, and the more likely it is that follow-up internationalization will occur. Because firms want to maintain the long-term relationships in their supply chain, they often follow existing trends of internationalization when engaging in FDI (Johanson and Mattsson 1988). Alternatively, if an MNC maintains only weak relationships with its customers, it

will likely not follow its customers in engaging in FDI. Rather, in such a situation, a firm might make use of exports to serve this particular customer. While Johanson and Mattsson (1988) focused on the concept of firms' following their customers' investments, we chose to go one step further, examining the effect that following customers' investments has on MNCs' choice of entry strategies.

When MNCs follow their customers into foreign markets, firms can get some assistance from their networks (such as information about host environments, tips on dealing with host institutions, and business opportunities), thus helping to ease firms' transition into new environments. Suppliers following customers in making investments in host countries may be regarded as the continuance of a network relationship, along the lines of a center-satellite system. Investment in China by the Taiwanese MNC Giant is just such a case: Giant invested in China and its suppliers followed suit (as in a center-satellite system), reflecting the suppliers' (satellites') perception that following their customer was less risky because the center firm was investing there. Accordingly, SMEs that engage in FDI perceive that they will receive stable orders from their customers, and they prefer to concentrate more of their efforts on production activities and developing new products, and less on distribution activities or developing new partnerships with local firms. In such situations, SMEs will be more likely to set up a wholly-owned subsidiary, because they do not want to waste their limited resources on dealing with complex cooperative partnerships in host countries. Therefore, SMEs that follow their customers to invest in a host country, even with fewer resources and less knowledge about the local market, can still rely on their customer relationships to alleviate the uncertainty in the local market (Majkgard and Sharma 1998). This means that MNCs in such a situation will be more likely to set up a wholly-owned subsidiary in a host country. Conversely, a firm having engaged in FDI without following a customer will tend to choose joint venture as its strategy of entry, and will seek to build a new network of local relationships, thereby gaining market information, earning access to technology from its joint venture partners, and developing new customers at the recommendation of its partner. Therefore:

*H2-1: SMEs following their customers to invest in a host country are more likely to choose wholly-owned subsidiaries over joint ventures in the host country.*

### 2.2.3 Requested by Customers

SMEs may also choose to invest abroad in response to a customer or customers' request. Larger MNCs (e.g., HP, Dell, and IBM), having already developed their strategic plans, blueprints for international expansion, or budgets for manufacturing costs, may in fact require their suppliers (e.g., Taiwanese firms adopting the OEM or ODM (original equipment/design manufacturer) business model) to invest internationally. For instance, concerns related to production costs (e.g., New Balance asked OEM suppliers to invest in Myanmar to lower production costs), the diversity of supply locations (e.g., NIKE asked its suppliers to set up plants in Vietnam to reduce its dependence on China as a supplying source), or the existence of import

quotas (or export quota for the textile producers in specific countries) may cause larger MNCs to request their suppliers to set up manufacturing operations in specific countries. These customers often have significant bargaining power and are able to persuade their suppliers (typically SMEs) to engage in FDI. This happens frequently in the case of Taiwanese firms, many of which act as suppliers to foreign OEMs that request investment in Southeast Asia or China in efforts to reduce production costs. Attempting to maintain relationships with these clients, Taiwanese firms typically honor such requests.

Even when firms engage in FDI at the request of their customers, the customers may provide limited support for the international ventures. Most customers also do not invest in the host country themselves. This means that regardless of firms' readiness to engage in foreign direct investment, they must respond to such requests or risk losing their customers, even, for example, when their supply chain partners lack international experience. When a supplier decides to invest in a host country because of the request of a customer, on the other hand, the customer may still perceive the supplier's cooperation as a passive behavior. Customers such as these larger MNCs often have stronger bargaining power relative to their suppliers, and usually have many suppliers to choose from. Therefore, SMEs tend to perceive that these customers prefer to choose or work with suppliers showing the intention to cooperate actively (i.e., investing voluntarily) instead of passively (i.e., investing by request). In addition, SMEs may feel that their customers will perceive that the purpose of their suppliers' choice to invest abroad passively is only to maintain stable orders from the customers, rather than to keep long-term *guanxi* relationships. In this case, SMEs will not depend too heavily on their customers' support, since they think that the customers have no *renqing* pressure. Nonetheless, FDI is always a major decision for SMEs, especially for those with limited, or no, international experience. Usually SMEs are not ready to set up foreign plants based on a customer's requests; however, if they are ready, they probably will act more quickly to win the confidence of their customers. Facing unstable business orders, high risk, and highly uncertain operational environments, SMEs responding to the customers' requests to engage in FDI prefer to work with local partners by forming joint ventures, so as to reduce their risks in host countries. Depicted by Johanson and Mattsson (1988) as early starter(s) or lonely international(s), some firms' internationalization is simply dictated by their exchange partners, distributors, or customers. These firms lack expertise in managing foreign operations and, accordingly, rely heavily on the assistance of local partners in host countries. Thus, joint ventures are their preferred entry strategies.

*H2-2: SMEs investing in a host country at the request of their customers are more likely to choose joint ventures over wholly-owned subsidiaries in the host country.*

### 2.3 Internal Network Relationships

If complementary assets are required, MNCs tend to form joint ventures with local firms (Delios and Beamish 1999). Moreover, when complementary assets are hard



to obtain from local markets, MNCs' motivation to form joint ventures is greater still (Buckley and Casson 1998; Hennart 1988). On the other hand, if MNCs' internal networks are efficient and are able to provide the resources required for operations in host countries, the necessity of working with local firms is drastically reduced.

MNCs can be regarded as networks of subsidiaries and resources which are distributed by parent firms among network members (Ghoshal and Bartlett 1990). For example, the sharing of international experience between a parent firm and its subsidiary not only generates spillover effects (Shaver et al. 1997) but also helps to reduce the risks associated with operating overseas (Guillen 2002). Subsidiaries can overcome foreign market imperfections and operate effectively by acquiring resources from internal networks. This is the case because internal network resources from parent firms can help to reduce dependency on local resources, as well as mitigate economic risks and transaction costs (Kobrin 1982). Thus, subsidiaries with more internal network relationships are able to access more support and resources from their parent firms, leading to higher possibility for entering host markets by means of wholly-owned subsidiaries.

*H3: SMEs with stronger internal network relationships are more likely to choose wholly-owned subsidiaries over joint ventures in a host country.*

## 2.4 Institutional Environment Perspective

Multinational corporations tend to enter host markets without a local partner when they perceive that there are small institutional differences between their home and host countries (Isobe et al. 2004). Institutional distance, on the other hand, will tend to increase the risk and difficulty associated with FDI (Brouthers 2002). Such a situation, in turn, will lead MNCs to choose entry via joint venture in an effort to reduce perceived barriers to entry and risk (Cui and Jiang 2010).

As various researchers have pointed out, institutional environments may be characterized along a number of dimensions. Scott (1995) categorized institutional environments into three dimensions: regulative, normative, and cognitive. Luo (2003a) devised a schema of categorization based on market opportunity, regulatory interference, and structural uncertainty; Oetzel et al. (2001) came up with two classifications of dimension, political risk and economic risk. Other studies have developed alternate systems of categorization for the various dimensions of institutional environment. Overall, the previous categories can be regarded as having to do with three primary factors: country, industry, and firm-related factors (Miller 1992). The firm-related factors in a host country's environment are mainly determined by the suppliers and customers, which were included in the network factors we proposed before. Xu and Shenkar (2002) also pointed out that a country's social, religious, and ethical characteristics, and its resultant cultural distance, must be taken into account when FDI is being considered (Isobe et al. 2004). Oliver (1997) proposed that each level of institutional environment has a different impact. Peng (2003) also suggested that pressures from different systems, such as restraints, norms, and stress on cognition (Scott 1995), will lead firms to choose different

strategies. Thus, in this study, we added the culture factor into our institutional environment constructs and broke down institutional environments into three essential elements: macroeconomic, socio-cultural, and industrial-policy differences. We then examined their effect on firms' entry strategies.

#### 2.4.1 *Macroeconomic Differences*

Macroeconomic differences refer to a host country's overall environmental climate and how that climate influences the operations of foreign firms (Miller 1992). This "climate" may also include political and social factors. Economic conditions such as market potential, population, national income, and literacy rates, will influence the preferred entry strategy of an MNC (Davidson and McFetridge 1985). Buckley and Casson (1998) asserted that legal and economic factors matter greatly to MNC operations; indeed, such factors may make it impossible for MNCs to integrate their operations, forcing them to form joint ventures with local firms. Beyond purely economic factors, political factors also affect the activities of MNCs (Boddewyn and Brewer 1994), which typically operate in a variety of countries, making them highly vulnerable to political risk factors. In other words, political systems in host countries influence not only policy reliability, target specificity, and industrial strategies, but also MNCs' broader strategic and organizational structures. When investing in an unfamiliar and politically unstable host country, firms will lower their percentage of ownership (Gatignon and Anderson 1988) as a method of dealing with the perceived risk.

By using objective measures of institutional environments, previous studies assumed that all firms from the same country perceive institutional environments in the same way. In fact, each firm is characterized by different capabilities and operational scope, which influence its perception of institutional environments both at home and abroad. We therefore focused on firms' perceptions of institutional environments, because these perceptions are linked directly to their choice of entry strategies.

When an MNC based in a developed country invests in an emerging market, which is typically associated with an unfavorable environment, the perceived institutional differences will increase the risk of investment and thus increase the possibility of setting up a joint venture to deal with the risk in the host country. It is interesting that when an MNC based in an emerging market invests in a developed country, which is generally considered a favorable environment, the perceived institutional differences by the firm due to unfamiliarity with the local environment still increase the risk of investment. To ease the uncertainty faced in the host country, an MNC based in an emerging market prefers to form a joint venture with a local partner. Therefore, the perceived institutional difference, not whether the host country is a developed or a developing country, generates the risk of investment in a host country, as viewed by a foreign firm. Greater institutional difference leads to higher odds of forming joint ventures in host countries. This argument holds stronger for FDI by SMEs, due to their lack of resources and international experience.

The differences in economic or political factors between host and home countries influence both the chances for financial success or failure as well as the investment commitment by MNCs, and, therefore, the choice of entry strategy. If MNCs operate in a country characterized by significant macroeconomic differences from their home country, they will need joint venture partners to help them adapt to the local political system and economic environment. Also, if MNCs are unfamiliar with a host country's general macro-environment, they will perceive a higher level of associated risk, leading them to enter the host country by means of joint ventures; thus, hypothesis 4:

*H4: SMEs perceiving greater macroeconomic differences are more likely to choose joint ventures over wholly-owned subsidiaries in a host country.*

#### 2.4.2 Socio-Cultural Differences

Xu and Shenkar (2002) suggested that a host country's societal characteristics and its cultural distance from the home country must be taken into account when firms make FDI decisions. Researchers have proposed several measures of distance between countries, including psychic distance (Yu and Ito 1988), cultural distance (Kogut and Singh 1988), psychological distance (Johanson and Vahlne 1977), and institutional distance. We analyzed socio-cultural differences in such a way as to simultaneously consider cultural distance and other social differences between two countries.

Earlier studies have tended to use cultural distance to explain MNCs' entry strategies or performance (Root 1987). Cultural distance has been cited as causing some managerial problems (e.g., underestimating the amount of the FDI contribution, difficulties in transferring management practices, high costs of information, etc.), in turn causing MNCs to consider the option of sharing ownership with local firms (Root 1987). An increase in cultural distance means an increase in the possibility that MNCs will enter host countries by means of joint ventures (Gatignon and Anderson 1988). From an institutional environment perspective, when the cultural distance between the home and host countries is larger, MNCs will face significant difficulties in understanding local customs, norms, and language, and will need local partners to help them to overcome such challenges. This means that MNCs will be more likely to choose joint ventures, as they will feel an acute need for the support and endorsement of local partners. Conversely, if the socio-cultural distance is not significant, MNCs will require no such support. Therefore:

*H5: SMEs perceiving more pronounced socio-cultural differences are more likely to choose joint ventures over wholly-owned subsidiaries in a host country.*

#### 2.4.3 Industrial-Policy Differences

Host countries' industrial regulations also influence MNCs' ownership structures. Specifically, if a government sets limitations on foreign ownership, MNCs may be forced to form joint ventures if they wish to gain entry to a foreign market

(Gatignon and Anderson 1988). Industrial-policy uncertainty represents the degree of structural variation in MNCs' various international markets (Luo 2003a). If local market needs are constantly changing and market demand is unstable, foreign firms will likely suffer, and will require the expertise of local partners to provide them with the information necessary to successfully operate in the local market. In such situations, MNCs will prefer to form joint ventures to serve local markets (Brouthers 2002). On the other hand, industrial-policy differences increase the costs of collecting business information and making transactions due to unfamiliarity with the government's industrial regulations. High industrial-policy differences will, therefore, negatively influence the effect of resources on performance, and will increase the risks associated with resource commitments (Luo 2003a). Thus, MNCs operating in markets characterized by high industrial-policy differences tend to choose joint ventures in host countries.

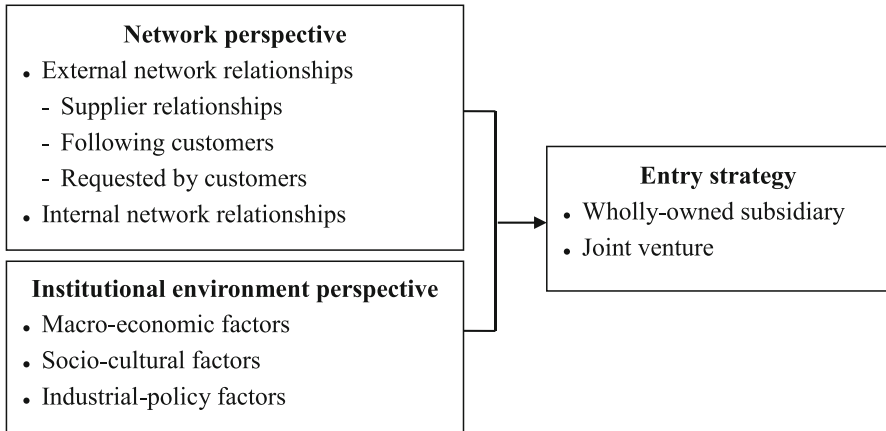
Industrial policy differs among countries, and MNCs can selectively take advantage of these differences. When investing in developing countries, MNCs usually enjoy preferential policies. Therefore, if significant industrial-policy differences between the host and home countries are perceived by a firm, the firm tends to perceive higher risk and difficulties in running the investment, and thus it is more likely to enter the market through joint ventures.

Additionally, if further limitations on industrial policy exist in a host country—such as requiring the transfer of technology to local firms, limiting the number of product lines, making certain export requirements, or demanding the use of local components—MNCs have no choice but to abide by the limitations. In such situations, MNCs will have great difficulty operating by themselves, and will need local partners' assistance to deal with local governments, to influence government policies, and to respond to policy changes (Delios and Henisz 2003). Therefore, when facing a high degree of variation in an external industrial environment, MNCs should avoid investing too much, so as to maintain flexibility (Miller 1992), and should attempt to transfer operating risks, in part, to local partners (Anderson and Gatignon 1986).

*H6: SMEs perceiving greater industrial-policy differences are more likely to choose joint ventures over wholly-owned subsidiaries in a host country.*

## 2.5 Interaction of Network and Institutional Perspectives

Environmental differences between the home and host countries increase the transfer cost of resources and decrease the value of resources (Brouthers et al. 2004). Similarly, for a firm engaging in FDI in a host country, the value and applicability of its network resources nurtured at the home country will be affected by the differences in institutional environments between the two countries (Xu and Shenkar 2002; Kostova 1999; Madhok 1997). Therefore, the country factor or location differences may reduce an MNC's key capabilities, network structure, or firm-specific advantages (Tallman 1991). Some existing literature has implied the interaction effects of the network and institutional perspectives. The institutional differences between home country and host countries will erode the allocation and



**Fig. 1** Research framework

adoption of a firm's network resources, thus influencing MNCs' choice of entry strategies (Xu and Shenkar 2002; Kostova 1999; Madhok 1997). This research stresses that institutional differences or environmental difficulties moderate the relationships between network resources and SMEs' entry mode choices.

*H7: The institutional environment differences between home country and a host country moderate the relationships between network resources and SMEs' entry mode choice.*

Figure 1 illustrates the relationships between entry strategies and the variables associated with the perspectives of network and institutional environment.

### 3 Methodology

#### 3.1 Samples and Data

The data in this study were drawn from a database maintained by the Taiwanese government. The research context was chosen for the following reasons: First, foreign direct investment from Taiwan, an NIE, has been increasing steadily over the years (Chiao et al. 2010) and has made Taiwan a country noted for FDI activities (Lall 1991). Second, in terms of size, investing firms from Taiwan are smaller than those of MNCs from developed countries. There is limited empirical evidence on MNCs' network relationships for Taiwanese firms, which are usually smaller in size and have limited international experience (Chiao and Yin 2013), and in order to enter new markets, these firms need to utilize network relationships to overcome the liability of smallness. Third, Asians are renowned for their emphasis on network relationships; the network phenomenon is very important throughout Asia and the Chinese world (Wong 2011). Empirical findings show that Taiwanese firms leverage network resources in FDI activities (Chen and Chen 2004). Thus, using

**Table 1** The distribution of sample firms by industry and size

Industry Parent company size	Metal and machinery	Information and electronics	Chemicals and plastics	FTO	Total	Percentage
Number of employees						
1–99	117	138	83	68	406	47.7
100–199	79	74	30	30	213	25.0
200–299	29	42	23	25	119	14.0
300–399	11	30	14	13	68	8.0
400–499 <sup>a</sup>	10	18	4	13	45	5.3
Total	246	302	154	149	851	100
Percentage	28.9	35.5	18.1	17.5	100	

*FTO* food, textile and other industries

<sup>a</sup> The statistics published by the Ministry of Economic Affairs, Taiwan, classify manufacturing industries into four major industries, namely, food, textile and other industries (abbreviated as FTO industry), chemicals and plastics industries, metal and machinery industries, and information and electronics industries

In accordance with the definition of SMEs by the US, firms with less than 500 employees are classified as SMEs

Taiwanese firms as the empirical sample is helpful in understanding SMEs' network relationship in FDI activities.

Our data and sample were extracted from a database maintained by the Statistics Bureau, Ministry of Economic Affairs, Taiwan. The data were collected through a national survey that aimed to investigate the FDI status of Taiwanese manufacturing firms in 2003. MNCs here were defined by the firms with investments in more than two countries (Hill 2012). There were 1852 Taiwanese firms in the database. On the basis of the Standard Industrial Classification, published by the Statistics Bureau, Ministry of Economic Affairs, 311 non-manufacturing firms were removed. According to the US Small Business Act of 1953, the general definition by the Small Business Administration (SBA) of small and medium enterprises is firms having fewer than 500 employees. Thus, 206 firms with employees of more than 500 were removed, and 484 firms were removed because they had closed their operations. Ultimately, we ended up with a final sample of 851 SMEs with FDI. All variables used in the study were derived from this database. The sample distribution is shown in Table 1. Most firms were in the information and electronics or metal and machinery industries.

## 3.2 Variables and Measurements

### 3.2.1 Dependent Variable

We examined the factors affecting the entry strategies employed by Taiwanese SMEs making FDI; accordingly, we used entry strategies as the dependent variable.

Following previous studies (Anderson and Gatignon 1986; Blomstermo et al. 2006; Bouquet et al. 2004; Franko 1971; Gomes-Casseres 1989; Hennart and Reddy 1997; Hill 1990), the cut-off point for a wholly-owned subsidiary is 95 % of ownership, so a subsidiary is considered wholly-owned when the parent company owns more than 95 % of the equity. A fully controlled subsidiary was treated as a wholly-owned subsidiary, and a partially controlled subsidiary was treated as a joint venture. Logistic regression was used in the analysis, with 1 representing a wholly-owned subsidiary.

### 3.2.2 Variables Related to the Network Perspective

*Supplier relationships.* Many Taiwanese firms invested in a particular country because their suppliers or customers had invested in that country. Suppliers or customers represent two important external network relationships in FDI activities. The supplier relationships were measured by a dummy variable (with 1 representing an answer of yes to the statement, “Many of our suppliers in the host country are from Taiwan”).

*Following customers and requests by customers.* Customer relationships were measured in two ways, each with 1 representing an answer of yes to the statement, “We invested in the host country because our customers invested in the host country” or “We invested in the host country at the request of our customers.”

*Internal network.* Taiwanese MNCs are in the early stages of internationalization, and centralized control by the parent company is the norm. Further, for a new subsidiary, the resources it can retrieve from the internal networks of an MNC highly depend on the support of the parent company. Therefore, we focused on the linkages between the parent firm and the new subsidiary as the measurements of internal network relationships, and three items were used: (1) our components and semi-manufactured goods are mostly provided by the parent firm (1 representing yes); (2) we market products for the parent firm (1 representing yes); and (3) our manufacturing technologies are provided by the parent firm (1 representing yes). We then summed the three items together to get a score ranging from 0 to 3.

### 3.2.3 Variables Related to Institutional Environment Differences

We measured institutional environments according to firms' reported perceptions, as our sample group of firms offers a wide array of products and services and covers a wide range of operations and capabilities (Miller 1992). Even when investing in the same country, different MNCs will face different institutional environments and competitive conditions. For these reasons, we decided it would be most appropriate to measure firms' perceptions of institutional environments. We believed that doing so would allow us to ascertain the most accurate assessment of the impact of institutional environments on FDI decisions (Murtha and Lenway 1995). Additionally, we felt that the notion of institutional environment, influenced as it is by perception, is not an absolute but a relative concept, and is also affected by the (perceived) institutional environment of the home country (Brouthers et al. 2004). Thus, we assessed perception of the institutional environments of foreign countries by measuring the differences between the home and host country. This measurement

is similar to the concept of institutional distance (Kostova 1999). The perceived differences in institutional environments were measured according to the following items, which allow for comparison of a host country with a home country:

1. for macroeconomic differences: turbulent political and economic conditions; inefficiency in government administration;
2. for socio-cultural differences: social customs and business practices; gaps in communication;
3. for industrial-policy differences: strict regulations on selling locally; requirements that exports and imports be balanced; limitations on employing expatriates; requirements for local sourcing; restrictions on manufacturing specific products or components; foreign capital requirements; requirements of technology transfer.

Participants' responses with regard to the differences in each item were summed and ranged from 0 to 2, 0 to 2, and 0 to 7, respectively. The higher the numeric value, then, the higher the perceived difference in the institutional environment.

### 3.2.4 Control Variables

To avoid the confounding effect of related variables, we controlled two variables: resources of parent company, and industrial effect. If a parent company owned fewer resources, it would be more likely to share ownership with a local firm. Earlier studies have shown that large firms with more resources are more likely to transfer more resources to subsidiaries and to set up wholly-owned subsidiaries in a host country (Gatignon and Anderson 1988; Gomes-Casseres 1997; Kogut and Singh 1988; Meyer 2001). We transformed the revenues of a parent company into a logarithm as a proxy for resources from a parent company.

Industry characteristics represent different degrees of sensitivity toward institutional environments (Brothers et al. 2002; Henisz 2004), as well as toward the choice of entry strategies (Isobe et al. 2004; Kogut and Singh 1988; Meyer 2001). We classified parent firms into four industries: metal and machinery, information and electronics, chemicals and plastics, and food, textile and other industries. We used the food, textile and other industries as the reference group, and set three dummy variables to distinguish the effect of different industries on entry strategies.

## 4 Results and Discussion

Table 2 shows the descriptive statistics and correlations between variables. "Following customer to invest in People's Republic of China" (mean = 0.35) is much more than "following customer to invest in other countries" (mean = 0.11). This is perhaps due to the geographic closeness of Taiwan and the People's Republic of China, which makes it easier for Taiwanese MNCs to actively follow their customers. However, "requested by customers" does not show significant differences between subsamples (mean = 0.36 and 0.30), perhaps indicating that



**Table 2** Means, standard deviations and correlation coefficients

Variables	Whole sample (N = 851)		Taiwan/PRC (N = 672)		Taiwan/other countries (N = 179)		1	2	3	4	5	6	7	8	9
	Mean	SD	Mean	SD	Mean	SD									
1. Entry strategies (D)	0.64	0.48	0.67	0.47	0.52	0.50	1								
2. Parent company resource	5.23	0.79	5.20	0.80	5.34	0.78	-0.002	1							
3. Network_supplier relationships (D)	0.84	0.37	0.82	0.39	0.91	0.29	-0.051	-0.009	1						
4. Network_following customers (D)	0.30	0.46	0.35	0.48	0.11	0.31	0.084*	0.008	-0.050	1					
5. Network_requested by customers (D)	0.35	0.48	0.36	0.48	0.30	0.46	0.035	-0.010	0.005	-0.044	1				
6. Network_internal network	2.20	0.58	2.20	0.55	2.19	0.69	0.166**	-0.015	-0.059	-0.021	0.034	1			
7. Institutional_macro-economic	0.45	0.61	0.49	0.63	0.31	0.52	0.103**	0.009	-0.013	0.125***	0.055	0.036	1		
8. Institutional_socio-cultural	0.23	0.48	0.19	0.40	0.40	0.66	-0.043	-0.042	-0.018	-0.065	0.006	0.071*	0.072*	1	
9. Institutional_industrial-policy	0.48	0.74	0.54	0.78	0.27	0.55	0.080*	-0.037	-0.070*	0.135***	0.072*	0.105***	0.174**	0.035	1

Number of samples = 851

64.0 % with entry strategies = 1 and 36.0 % with entry strategies = 0

83.8 % with Network\_supplier relationships = 1 and 16.2 % with Network\_supplier relationships = 0

29.6 % with Network\_follow customers = 1 and 70.4 % with Network\_follow customers = 0

34.5 % with Network\_request by customers = 1 and 65.5 % with Network\_request by customers = 0

Taiwan/PRC (N = 672): sub-sample of Taiwanese MNCs invested in People's Republic of China

Taiwan/other countries (N = 179): sub-sample of Taiwanese MNCs invested in all other countries besides PRC

D dummy variables

\* p < 0.05; \*\* p < 0.01

**Table 3** Logistic regression model: choice of entry strategies

Variables Beta (Wald value)	Model 1	Model 2	Model 3	Model 4
<b>Control variables</b>				
1. Parent company resource	-0.025 (0.077)	-0.015 (0.027)	-0.026 (0.082)	-0.019 (0.042)
2. Metal and machinery	-0.102 (0.231)	-0.240 (1.193)	-0.104 (0.236)	-0.225 (1.035)
3. Information and electronics	0.460 (4.722)**	0.335 (2.373)*	0.426 (3.970)**	0.328 (2.246)*
4. Chemicals and plastics	0.030 (0.016)	-0.058 (0.057)	0.004 (0.000)	-0.051 (0.044)
<b>Independent variables</b>				
1. Network_supplier relationships		-0.291 (1.980)*		-0.283 (1.853)*
2. Network_following customers		0.449 (7.180)***		0.363 (4.497)**
3. Network_requested by customers		0.113 (0.527)		0.080 (0.255)
4. Network_internal network relationships		0.576 (19.805)***		0.575 (19.333)***
5. Institutional_macro-economic			0.347 (7.594)***	0.312 (5.872)***
6. Institutional_socio-cultural			-0.230 (2.318)*	-0.267 (2.928)**
7. Institutional_industrial-policy			0.164 (2.428)*	0.089 (0.675)
Constant	0.579 (1.371)	-0.544 (0.792)	0.430 (0.724)	-0.608 (0.968)
<b>Model indices</b>				
Cox and Snell R <sup>2</sup>	0.013	0.048	0.029	0.059
Model Chi square	11.118	42.249	24.927	52.043
% of model prediction	64.0	65.3	64.7	66.6
Log-likelihood	1100.585	1069.454	1086.776	1059.660
Significance of model ( <i>p</i> )	0.025	<0.001	0.001	<0.001

Wholly-owned (1) vs. joint venture (0)

Number of samples = 851

Wald statistics in parentheses for logistic regression

\*  $p < 0.1$ ; \*\*  $p < 0.05$ ; \*\*\*  $p < 0.01$  (one-tailed tests)

customers will request suppliers to go international, regardless of where the international location in question might be. The socio-cultural factor of institutional environment differences in the People's Republic of China (mean = 0.19) is smaller than in other countries (mean = 0.40). This reveals the lesser cultural distance between Taiwan and the People's Republic of China, as evidenced by the use of the same language and the historical closeness of the two.

**Table 4** Results of interaction effects

Variables	Model 5
Control variables	
1. Parent company resource	-0.016 (0.028)
2. Metal and machinery	-0.209 (0.874)
3. Information and electronics	0.328 (2.210)*
4. Chemicals and plastics	-0.070 (0.079)
Independent variables	
1. Network_supplier relationships	-0.257 (1.449)
2. Network_following customers	0.264 (1.144)
3. Network_requested by customers	0.048 (0.045)
4. Network_internal network relationships	0.575 (18.289)***
5. Institutional_macro-economic	0.339 (3.152)**
6. Institutional_socio-cultural	-0.226 (1.037)
7. Institutional_industrial-policy	-0.058 (0.125)
Interaction variables	
1. Macro-economic × supplier relationships	0.085 (1.066)
2. Macro-economic × following customers	0.154 (0.299)
3. Macro-economic × requested by customers	-0.227 (0.713)
4. Macro-economic × internal network	-0.030 (0.118)
5. Socio-cultural × supplier relationships	-0.193 (4.872)**
6. Socio-cultural × following customers	-0.432 (1.170)
7. Socio-cultural × requested by customers	0.221 (0.426)
8. Socio-cultural × internal network	-0.003 (0.001)
9. Industrial-policy × supplier relationships	0.035 (0.221)
10. Industrial-policy × following customers	0.237 (0.975)
11. Industrial-policy × requested by customers	0.151 (0.454)
12. Industrial-policy × internal network	-0.021 (0.074)
Constant	-0.026 (0.002)
Model indices	
Cox and Snell R <sup>2</sup>	0.070
Model Chi square	61.958
% of model prediction	67.0
Log-likelihood	1049.745
Significance of model ( <i>p</i> )	<0.001

Wholly-owned (1) vs. joint venture (0)

Number of samples = 851

Wald statistics in parentheses for logistic regression

\*  $p < 0.1$ ; \*\*  $p < 0.05$ ; \*\*\*  $p < 0.01$  (one-tailed tests)

Apparently, there is no serious multicollinearity among independent variables. Table 3 presents the results of the logistic regressions. Model 1 only includes control variables and serves as the base model. Model 2 shows the impact of

network relationships, Model 3 shows the impact of institutional environments, and Model 4 shows the results of a full model. The differences in Chi square values suggest that both of the network-based and institutional-based variables significantly increase the percentages of explained variances.

Our findings (Model 4 in Table 3) reveal that SMEs with more external networks (i.e., relationships with suppliers) tend to form joint ventures ( $\beta = -0.283$ ,  $p < 0.1$ ); thus, Hypothesis 1 is supported. This finding is similar to Tang and Liu's (2011) study, which showed that joint ventures establish linkages and connect to existing host networks more easily than do wholly-owned subsidiaries. On the other hand, network relationships enable Taiwanese firms to pursue more risky investments abroad rather than serving foreign customers through exporting or licensing agreements (Chen and Chen 1998).

SMEs investing in host countries by following their customers tend to enter through wholly-owned subsidiaries ( $\beta = 0.363$ ,  $p < 0.05$ ). Therefore, Hypothesis 2-1 is supported. This suggests that following customers to invest in foreign markets appears to make firms more likely to choose wholly-owned subsidiaries as relevant, essential market information is provided by these customers. This pattern of internationalization is similar to two concepts proposed by Johanson and Mattsson (1988), specifically "The Late Starter," representing firms pulled to foreign markets because of internationalized market networks, and "The International among Others," representing firms entering foreign markets with the assistance of their customers or partners.

However, responding to customers' requests appears to have no significant impact ( $\beta = 0.080$ ,  $p > 0.1$ ); thus, Hypothesis 2-2 is not supported. Though firms lacking local experience may choose to enter into joint ventures, Johanson and Mattsson (1988) also designate an "Early Starter," who has sufficient resources to enter foreign markets through acquisition or by setting up greenfield plants in host countries. Furthermore, firms with operating experience in other countries ("The Lonely Internationals") may have little difficulty establishing operations by themselves, and little need to enter into joint ventures in a new market.

SMEs with more internal network relationships are more likely to set up wholly-owned subsidiaries ( $\beta = 0.575$ ,  $p < 0.01$ ), which supports Hypothesis 3. If SMEs have enough resources to support operations in host countries, they tend to enter through wholly-owned subsidiaries. This finding is consistent with Tang and Liu's (2011) study, which declared that for MNCs with higher internal networks wholly-owned subsidiaries are usually considerably more compatible with the parent firm in terms of matching the structural requirements, culture, systems, and procedures. Luo's (2003a) empirical study also found that MNCs' internal markets can help to overcome external market failures or market imperfections when the relationships between parent firms and subsidiaries are good. When it comes to FDI in countries where differences in institutional environments are significant, linkages to parent firms can decrease the negative impact of the liability of foreignness for subsidiaries. From the resource dependence perspective (Pfeffer and Salancik 1978), if parent firms can provide resources and information to their subsidiaries, those subsidiaries will be less dependent on local organizations for resources. Our findings indeed support this argument.

With regard to institutional environments, as the level of perceived differences in the macroeconomic environment increases, the likelihood that wholly-owned subsidiaries will be established also increases ( $\beta = 0.312, p < 0.01$ ), suggesting a rejection of Hypothesis 4. As the level of perceived socio-cultural differences increases, the likelihood that joint ventures will be established also increases ( $\beta = -0.267, p < 0.05$ ), suggesting the acceptance of Hypothesis 5. These results indicate that there is no significant relationship between industrial-policy differences and entry strategies ( $\beta = 0.089, p > 0.1$ ), suggesting a rejection of Hypothesis 6. Since previous studies (Davis et al. 2000) did find that host country institutional environment is a strong determination of MNC entry strategy, our findings offered something different. A bit surprisingly, our findings are not completely consistent with previous studies. We postulate that when large differences exist in the macroeconomic environment, implying unstable political and economic conditions in developing countries, Taiwanese firms may feel that the possibility of their partners' opportunistic behaviors outweighs any conceivable assistance these partners might offer.

As to socio-cultural differences, the findings suggest that Taiwanese SMEs tend to choose joint ventures to reduce risks and misunderstandings when such differences are great. On the other hand, when investing in countries with similar cultures, firms are more likely to choose wholly-owned subsidiaries (Gatignon and Anderson 1988).

Differences in industrial policy do not appear to affect the entry strategies of Taiwanese firms. Some governments, out of nationalism or protectionism, limit the ownership of MNCs in certain industries (e.g., China limiting foreign ownership in the retail and transportation industries to stakes of less than 50 %), which increases foreign firms' propensity to form joint ventures. On the other hand, some industries need to have wholly-owned subsidiaries to protect their intellectual property if the government policies in place are insufficient. This may be the reason for the insignificance of industrial policy with respect to entry strategy. Other studies have also found that host government policies do not play an important role in the selection of entry strategies (Kobrin 1979; Brewer 1983). For this reason, some researchers have concluded that the relationship between FDI and government policies is mixed, at best (Kobrin 1979; Agarwal 1980).

In summary, our empirical findings are consistent with Xu and Shenkar's (2002) argument that differences in institutional environment have an impact on entry strategies, and that the impact of different institutional environments varies. Specifically, firms that perceive significant differences in macro-economic factors are more likely to choose to make use of wholly-owned subsidiaries, and firms that perceive significant differences in socio-cultural factors are more likely to choose to make use of joint ventures.

With regard to the interaction effects (Model 5 in Table 4), only one out of twelve is significant (socio-cultural  $\times$  supplier relationships;  $\beta = -0.193, p < 0.05$ ). In the context of socio-cultural environment differences in a host country, supplier relationships influence SMEs' entry mode choices. SMEs with more home-country supplier relationships more easily gain support from these suppliers; thus, when investing in countries characterized by high levels of socio-

cultural environment differences, SMEs tend to cooperate with their suppliers and choose to employ a joint venture strategy.

Because we broke down institutional environments into three elements to deeply explore the interaction effect of the network and institutional perspectives, we conducted additional logistic regression analysis by using three constructs from the institutional environments we proposed (i.e., macro-economic, socio-cultural, and industrial-policy). We used the means of the three constructs to separate our samples into eight groups and examine the differences in the network variables among those groups (Bruning and Kintz 1987; Taggart and Hood 1999; Kim 2003). Table 5 shows that the statistical results only for Group 7 are similar to those in Model 4 in Table 3, and in some groups (such as Groups 3 and 8), the results are very different from those in the model. Thus, Hypothesis 7 is supported. This suggests that elements of institutional environments exert different impacts on the relationships between network resources and entry modes, and should be examined separately.

With regard to our control variables, we found that resources endowment of the parent company have no effect on entry strategies. Firms in the information and electronics industry were more likely to set up wholly-owned subsidiaries than were firms in the food, textile, and other industries; firms in the metal and machinery industry were more likely to choose joint ventures. We can therefore conclude that the industry to which a firm belongs likely influences the firm's choice of entry strategies.

The limitations of this relatively strict definition of SMEs are evident when compared with other studies. To test the robustness of our results, we also ran the sample defined as less than 250 employees and 200 employees (the official definition of SMEs in Taiwan) and the results were highly consistent with those reported for Models 6 and 7 in Table 6. Except for social-cultural differences, other results were highly consistent with those reported for Model 4 in Table 3. That is, the conclusions with different definitions of SMEs were very similar to what we reported in this paper.

Since the criteria for defining SMEs vary among countries, we decided to take the same definition as the US SBA's after having run the robustness test for general definition in this study. For instance, Korea defines SMEs as firms with fewer than 300 employees, and Hong Kong's definition for SMEs is even stricter—fewer than 100 employees. Other countries define SMEs still more strictly, such as Belgium, where an SME comprises fewer than 50 employees. Hence, we believe that the SBA's definition for SMEs is most relevant for easy comparison with earlier studies.

## 5 Conclusion and Suggestions

The purpose of this study is to examine the entry strategies of Taiwanese SMEs by taking both the network and institutional environment perspectives. Our empirical results show that following customers into foreign markets, more internal network linkages, and the perception of significant differences in a host country's macroeconomic environment are all associated with entry into foreign markets by

**Table 5** Results of interaction effects with 8 groups

Variables	Groups							
	1	2	3	4	5	6	7	8
Institutional_macro economic	H	H	H	H	L	L	L	L
Institutional_cultural	H	H	L	L	H	H	L	L
Institutional_policy	H	L	H	L	H	L	H	L
Number of samples in each group	41	40	103	148	30	68	139	282
<b>Control variables</b>								
Parent company resource	0.548 (1.073)	-0.496 (0.502)	0.198 (0.440)	-0.073 (0.078)	0.057 (0.008)	0.199 (0.420)	-0.064 (0.065)	-0.126 (0.685)
Metal and machinery	0.444 (0.082)	2.234 (1.626)	0.446 (0.307)	-1.341 (5.652)***	1.340 (0.846)	-0.263 (0.107)	0.124 (0.043)	-0.199 (0.300)
Information and electronics	0.408 (0.165)	3.048 (3.699)**	0.636 (0.727)	-0.320 (0.292)	1.757 (1.378)	0.062 (0.005)	0.352 (0.381)	0.240 (0.443)
Chemicals and plastics	-0.584 (0.223)	1.371 (0.921)	-0.848 (1.094)	-0.116 (0.033)	2.361 (1.818)*	-0.732 (0.740)	-0.044 (0.004)	0.264 (0.333)
<b>Independent variables</b>								
1. Network_supplier relationships	0.238 (0.074)	-7.782 (0.033)	0.949 (1.801)*	-0.207 (0.157)	-0.269 (0.042)	-2.108 (3.377)**	-1.109 (2.739)**	0.041 (0.015)
2. Network_following customers	0.654 (0.437)	-0.799 (0.564)	0.884 (2.505)*	0.642 (2.431)*	0.509 (0.189)	-0.257 (0.106)	0.854 (4.199)**	0.146 (0.224)
3. Network_request by customers	0.073 (0.007)	-0.933 (1.190)	0.757 (1.947)*	-0.502 (1.617)	0.849 (0.696)	0.099 (0.024)	0.268 (0.436)	0.056 (0.040)
4. Network_internal network	0.612 (0.652)	-1.227 (2.017)*	1.034 (4.429)**	0.545 (2.534)*	0.334 (0.164)	0.402 (0.706)	0.523 (2.835)**	0.655 (8.481)**
Constant	-2.807 (0.978)	10.617 (0.061)	-2.767 (1.795)*	1.176 (0.601)	-5.705 (0.024)	0.595 (0.082)	0.781 (0.264)	0.232 (0.064)

Table 5 continued

Variables	Groups							
	1	2	3	4	5	6	7	8
Model indices								
Cox and Snell R <sup>2</sup>	0.102	0.233	0.138	0.102	0.185	0.124	0.086	0.043
Model Chi square	4.414	10.624	15.298	15.893	6.133	9.034	12.429	12.327
% of model prediction	75.6	72.5	76.7	69.6	73.3	60.3	66.2	63.1
Log-likelihood	41.140	43.924	101.089	172.050	32.058	85.175	166.743	365.7449
Significance of model ( <i>p</i> )	0.002	0.224	0.054	0.044	0.632	0.339	0.133	0.137

Wholly owned (1) vs. joint venture (0)

Number of samples = 851

Wald statistics in parentheses for logistic regression

\*  $p < 0.1$ ; \*\*  $p < 0.05$ ; \*\*\*  $p < 0.01$  (one-tailed tests)



**Table 6** Results of SMEs in terms of different number of employees

Variables	Model 6 (n = 709)	Model 7 (n = 642)
Sample selection	Number of	Number of
Beta (Wald value)	employees $\leq 250$	employees $\leq 200$
Control variables		
1. Parent company resource	-0.102 (0.917)	-0.113 (1.005)
2. Metal and machinery	-0.194 (0.628)	-0.318 (1.492)
3. Information and electronics	0.447 (3.329)**	0.289 (1.233)
4. Chemicals and plastics	-0.014 (0.003)	-0.141 (0.235)
Independent variables		
1. Network_supplier relationships	-0.341 (2.181)*	-0.411 (2.845)***
2. Network_following customers	0.587 (9.528)***	0.596 (9.110)***
3. Network_requested by customers	0.124 (0.517)	0.105 (0.335)
4. Network_internal network relationships	0.642 (20.184)***	0.626 (18.149)***
5. Institutional_macro-economic	0.238 (2.903)**	0.245 (2.849)**
6. Institutional_socio-cultural	-0.337 (3.914)**	-0.227 (1.634)
7. Institutional_industrial-policy	0.065 (0.313)	0.059 (0.229)
Constant	-0.412 (0.373)	-0.197 (0.077)
Model indices		
Cox and Snell R <sup>2</sup>	0.074	0.071
Model Chi square	54.660	47.114
% of model prediction	67.3	66.2
Log-likelihood	883.565	805.583
Significance of model (p)	<0.001	<0.001

Wholly-owned (1) vs. Joint venture (0)

Wald statistics in parentheses for logistic regression

\* p < 0.1; \*\* p < 0.05; \*\*\* p < 0.01 (one-tailed tests)

means of wholly-owned subsidiaries. We also found that firms tend to make use of joint ventures when supplier relationships are strong and when the perception of socio-cultural differences is great.

## 5.1 Further Discussion

The network perspective may be seen as acting in complement with the oligopolistic reaction argument in explaining FDI entry strategy choices. In this study, we took network relationships into consideration to show their impact on foreign investments (i.e., by inducing firms to follow their suppliers or customers). In addition, factors in host countries (i.e., external institutional environments) are important in the discussion of FDI, especially when significant institutional differences exist (Yu and Ito 1988). Future studies may wish to extend our findings to assess the impact on subsidiary performance of institutional environments, network relationships, and ownership strategies.

With regard to institutional environments, previous studies have suggested that countries are characterized by different institutional environment factors, and that, accordingly, the measurements of such environments should be more detailed. We divided institutional environments into three constructs—macro-economic factors, socio-cultural factors, and industrial-policy factors—and discussed the impact of each separately. To our knowledge, most previous studies have used objective measurements for assessing institutional environments, implying that all firms perceive the environments in the same way. In fact, each firm is characterized by different capabilities and operational scope, which influences its perception of institutional environments both at home and abroad. We therefore measured firms' perceptions of institutional environments, in our analysis.

To compare the results of using subjective and objective indicators in our analysis, we collected objective institutional environment data from the Heritage Foundation (<http://www.heritage.org>) about the three constructs separately to examine their effects on firms' entry mode. The constructs were macro-economic factors (including overall administrative burden, quality of the legal system, laws relating to ICT, competition in the ISP sector, efficiency of the tax system, and freedom of the press), socio-cultural factors (including overall infrastructure quality, waiting time for telephone lines, telephone mainlines, public pay telephones, internet servers), and industrial-policy factors (including state of cluster development, venture capital availability, subsidies for firm-level R&D, quality of scientific research institutions, availability of scientists and engineers utility patents, ICT manufactured exports, and foreign ownership restrictions). Comparing the results in Table 7 and Model 4 in Table 3, we can see the differences between using objective and subjective data. While the results in Table 7 show that, as the level of industrial-policy differences increases, the likelihood of setting up joint ventures also increases, the results in Table 4 show that the tendency of adopting joint ventures is associated with the increase of socio-cultural differences. Though both subjective and objective indicators have their own merits and limitations, we believe that, due to the influence of resources on hand and background of a firm, the perception of the same phenomenon (such as the differences in culture or industrial policies of a host country compared with those of the home country) may not be the same for different firms. Further, if we use the objective data in our research, we may get biased results because the correlation between the two sets of data is low. To our knowledge, this is the first study to discuss the institutional context by collecting both subjective and objective data to explore the impact on firms' entry strategy. We suggest that future studies could access more detailed data of the two types of indicators on firms' behavior.

## 5.2 Limitations and Suggestions for Future Research Directions

From the institutional environment perspective, institutional behavior variables may be seen as existing at three levels: individual, organizational, and cross-group relationships. The institutional environments in which firms operate include firms' internal cultures, the culture of their home country, and the relationship between society and firms. Subsidiaries face two different levels of institutional environments: relationships between internal environments and parent firms or other

**Table 7** Results of objective institutional measures

Variables	Model 8
Control variables	
1. Parent company resource	-0.008 (0.094)
2. Metal and machinery	-0.232 (0.220)
3. Information and electronics	0.356 (0.222)*
4. Chemicals and plastics	-0.018 (0.245)
Independent variables	
1. Network_supplier relationships	-0.267 (0.208)
2. Network_following customers	0.430 (0.170)**
3. Network_requested by customers	0.128 (0.157)
4. Network_internal network relationships	0.579 (0.131)***
5. Institutional_macro-economic	0.016 (0.027)
6. Institutional_socio-cultural	0.029 (0.032)
7. Institutional_industrial-policy	-0.058 (0.034)**
Constant	-0.535 (0.789)
Model indices	
Cox and Snell R <sup>2</sup>	0.054
Model Chi square	47.032
% of model prediction	67.5
Log-likelihood	1064.671
Significance of model ( <i>p</i> )	<0.001

Wholly-owned (1) vs. Joint venture (0)

Number of samples = 851

Wald statistics in parentheses for logistic regression

\*  $p < 0.1$ ; \*\*  $p < 0.05$ ; \*\*\*  $p < 0.01$  (one-tailed tests)

subsidiaries; and relationships between external environments and host country environments. Future works might address issues about the interactions among different levels of institutional environments (Soh and Yu 2010).

The empirical analysis, based on a sample of 851 SMEs operating in a newly industrialized economy, showed that only certain types of external relationships significantly affect FDI. This means that with respect to decisions made by SMEs on entry strategy, supplier relationships (H1) and customer-following (H2-1) play a more important role than requests by customers to invest abroad (H2-2). Can these empirical results be applied to large MNCs or to SMEs based in developed countries? Though the data constraints of the present study limit the capability to examine the external validity of these results, this definitely deserves further exploration. In addition, due to the limitations of the government database, a dichotomy (i.e., a wholly-owned subsidiary vs. a joint venture) was used as the dependent variable and a logistic regression analysis was conducted. Measuring the ownership of a foreign subsidiary of SMEs on a ratio scale would offer more insight into entry strategy decisions. Future research should use a more refined measure of ownership when assessing network and institutional effects on entry strategies.

Pan and Tse (2000) proposed that the model of choice of entry modes can be divided into a multi-level hierarchy. Managers would structure various entry modes into a multi-level hierarchy and consider only a few factors at each level of hierarchy. We focus on the first level of the model and examine the equity issues of MNCs on the choice of equity joint venture and wholly-owned subsidiaries. Future researchers can explore other choices of entry modes such as non-equity modes or further decompose the different kinds of wholly-owned subsidiaries such as greenfield, mergers, and acquisitions (Demirbag et al. 2007).

Finally, to confirm the robustness of our results, we conducted the following tests. To assess the impact of firm size, we did separate analyses for firms with fewer than 250 and 200 employees, and the results were similar. As to the characteristics of the sample, about 79 % of the Taiwanese SMEs were invested in China. We used the bootstrapping method, selected those firms invested outside of China (179 samples), and randomly selected 179 firms invested in China for regression analysis. Again, the results of the two groups were similar. Thus, our findings are robust and suggest that future research might adopt similar approaches to increase the findings' generalizability. Furthermore, we also separated the responses into two sub-samples, one with firms investing in China (672 observations) and one with firms investing in other countries (179 observations). Though the results of the two sub-samples are similar, some differences can be found. These differences may be attributed to location advantages, which determine the importance of different external network relationships and in turn affect firms' choice of entry strategy (Dunning 1988). Overall, we found that firms with internal network relationships tend to choose wholly-owned subsidiaries whether they invest in China or not. External network relationships also play an important role in firms' entry strategy, but depend on where firms invest. Firms following their customers in investing in China tend to choose wholly-owned subsidiaries, while firms with supplier relationships investing in other countries tend to engage in joint ventures. Furthermore, institutional environments also affect firms' entry strategy, but the countries in which investment takes place have a significant impact. Macroeconomic difference is a significant institutional factor (consistent with the original results of all samples), but the significance does not occur in the direction we expected. In our hypothesis 4, we expected that macroeconomic differences would lead SMEs to choose joint ventures, but the results of our samples and of our two sub-samples all revealed that macroeconomic differences lead SMEs to choose wholly-owned subsidiaries. Surprisingly, socio-cultural institutional differences do not affect firms' choice of entry strategy; this may be the case because the similar language and historical background of the home and host countries make it easier for Taiwanese firms to invest in China. However, when Taiwanese SMEs invest in other countries, firms are influenced by industrial policy differences and tend to adopt joint ventures as their entry strategies. Although our findings in this regard are quite robust, we did find that the results were also sensitive to the different locations of our sample. Thus, we suggest that future research should be cautious when generalizing our research findings, since location advantages may play a moderating role in firms' entry strategies.

### 5.3 Contributions and Implications

We believe that our study makes the following contributions: (1) integrating the network and institutional environment perspectives to examine factors affecting SMEs' entry strategies into foreign markets; (2) empirically testing our hypotheses using a large, government-maintained database so as to complement existing but incomplete inferences based on small samples; (3) increasing the external validity of related theories by using samples from an NIE (i.e., Taiwan) to supplement the existing research on European, American, and Japanese MNCs (e.g. Taylor et al. 2000; Ma and Delios 2007); (4) going further with the exploration of the different impact on entry strategies by suppliers and customers, implying that it is necessary for MNCs to take into account network relationships with suppliers and customers in making foreign market entry strategies; and (5) by dissecting the impact of customers on SMEs' FDI decisions, we show how "following the customers" and "requested by customers" affect firms' entry decisions. Because we found that both internal and external network relationships affect firms' choice of entry strategies, we recommend that practitioners, when making investments abroad, carefully take into account such relationships. In addition, differences in macroeconomic and socio-cultural factors should be considered when firms enter foreign markets.

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