

## Parent-Affiliate Agency Conflicts and Foreign Entry Mode Choice

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**ABSTRACT:** We theoretically identify two levels of agency conflicts related to foreign direct investment (FDI): within a parent firm and between parent(s) and an affiliated firm. For a sample of 182 firms that announced U.S.-related FDIs in 1995, we examine the effects of agency conflicts on the choice between a wholly owned subsidiary (WOS) and a joint venture (JV), and the relative share ownership of a parent. Firms with higher management ownership, especially the firms that made related FDIs, and firms with higher foreign affiliate monitoring efficiency are more likely to choose a WOS. Differences between U.S. and non-U.S. parents are also examined.

### INTRODUCTION

When multinational enterprises (MNEs) enter a foreign country, they can use a joint venture (JV), a wholly owned subsidiary (WOS), a strategic alliance, a licensing agreement, a merger or an acquisition of an existing local firm (Eiteman, Stonehill and Moffett 2001). A JV is different from a WOS in that two or more partners in a JV share the profits according to their relative ownership. Shankar and Zeira (1987) give a more specific description of an international JV (IJV).

An IJV is a separate legal organizational entity

representing the partial holdings of two or more parent firms, in which the headquarters of at least one is located outside the country of operation of the joint venture. This entity is subject to the joint control of its parent firms, each of which is economically and legally independent of the other.

Shapiro (1999) lists some benefits and costs of entering a JV. By forming a JV with a local partner, firms can obtain local capital, labor and management, an assured source

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of raw materials, marketing capabilities, an established distribution network, technology, assistance in government approvals, local currency loans, tax incentives and assurances of imports. They can also reduce nationalistic sentiments. Conversely, some sources of disagreement among JV partners are related to marketing programs, dividend policy, reinvestment of earnings, exports to third countries, sources of materials and components, transfer pricing, management selection and remuneration, and expansion. Profits need to be shared with partners, and technology may be given up.

Previous studies on entry mode choice are diverse but fragmented, calling for a need to recognize the conflicts between organizations, and their effects on inter-organizational transactions. Contracts are a key economic institution, and transaction costs are important as they determine why contracts take their specific forms (Williamson 1985). Transaction costs include the costs of negotiating a contract and the costs of monitoring the performance and enforcing a contract (Erramilli and Rao 1993). Although the costs of detecting and preventing opportunistic behaviors of counterparts are a key factor in the transaction cost economics (TCE) approach, such costs have not been fully recognized by the TCE-based studies of foreign entry mode choice.

This paper is the first attempt at analyzing the agency conflicts within a parent firm and between a parent and

its affiliated firm. It empirically examines their association with foreign entry mode choices. The choice of a foreign entry mode is an important corporate decision, and agency theories may help to predict the corporate choice. Managers, as the agents of their shareholders, may not always choose the decisions optimal for their shareholders. A foreign affiliate firm, as the agent of the parent organization, may make sub-optimal decisions from the parent shareholders' point of view (Nohria and Ghoshal 1994; O'Donnell 1997). We integrate agency theories related to the creditor-shareholder and parent-affiliate relationships as well as the shareholder-manager relationship, and develop testable hypotheses on management ownership, financial leverage, monitoring efficiency and degree of international experience.

For a sample of 182 U.S.-related FDIs in 1995, we find that firms with higher inside management ownership are more likely to choose a WOS as a mode of entry. Such a relationship exists only for the related FDIs, and the results suggest that the foreign entry mode choice is affected by the management's incentives to invest in the assets with expertise rather than by the incentives to reduce personal risk through firm-level diversification. Although the combined sample does not show a linkage between financial leverage and foreign entry mode choice, leverage is positively (negatively) related to the propensity to choose a WOS for U.S. (non-U.S.) firms. Firms that can better monitor foreign affiliates are more likely to

choose a WOS and to have higher share ownership in the affiliate. Degree of international involvement affects the U.S. and non-U.S. firms differently.

In the next section, we review the literature on foreign entry modes. Then we examine the agency conflicts at two different levels and their effects on the corporate FDI decisions, and derive some testable hypotheses. Data and research methods, test results, discussions and conclusions will then be presented in that order.

### FOREIGN ENTRY MODES: LITERATURE REVIEW

The sources of the potential benefits from a foreign market entry include diversification, risk sharing with partners, operating flexibility, possession of a proprietary asset, and host country demand. Alternatively, potential costs are identified to arise from political risk, contractual risks, agency costs of managers, and cultural differences among partners (Agarwal and Ramaswamy, 1992; Buckley and Casson, 1996; Hennart and Reddy, 1997; Ojah, Seitz and Rawashdeh, 1997; Swan and Etlie, 1997). Sizes of an affiliate and partners will magnify the benefits and costs of a chosen mode of foreign entry. A stronger home currency would encourage more investment in foreign countries. We present a summary of the literature on foreign entry modes in Table 1. Part A on the next page examines beneficial factors of a foreign entry. Part B summarizes costly factors of a foreign entry, and Part C reviews size and foreign

exchange.

According to the transaction cost economics (TCE) approach, when markets fail to suppress the opportunistic behaviors from the supply side, the firm may want to internalize its transactions by choosing a high control mode in an attempt to minimize the costs of negotiation and supervision (Palenzuela and Bobillo 1999). When a JV's benefits minus the costs of forming and operating the JV are greater than the net benefits of a WOS, a JV improves partnering firms' values (Shan 1991).

#### *Industry-Specific Factors*

Zhao and Zhu (1998) distinguish industry-specific factors (ISF) from venture-specific factors (VSF). One of the motivations to form alliances is to reduce investment risks. Tse, Pan and Au (1997) assert that firms from cultures with higher uncertainty avoidance would choose a lower equity-based entry mode and would be more likely to form alliances with non-PRC (People's Republic of China) firms to reduce risks. They find that those firms are more likely to locate in lower risk areas such as Open Cities and Special Economic Zones (SEZs) and to work with higher-level governments to reduce unnecessary risks.

A firm entering into a highly competitive foreign market may choose to have a JV partner in order to reduce its operating risk. For 428 U.S. entries by Japanese firms during the period 1978-1989, Hennart and Reddy (1997) find that industry

concentration measured by the Herfindahl index for four digit SIC codes in the U.S. industry is insignificantly related to the choice of a green-field JV over an acquisition.

Buckley and Casson (1996) note that a large part of the setup costs of internalization is fixed independent of demand (i.e., economies of scale exist in the area of foreign direct investments), and argue that, as host market size increases, a natural

transition is toward licensing toward an IJV and, finally, to a merger—since licensing arrangements do not incur the setup costs and JVs allow to share the costs with partners.

A low level of committed resources would reduce the realized costs in case of expropriation and a greater control would reduce the probability of expropriation. If the political risks are substantial and if host country partners can provide a

**Table 1 PART A:** Literature on the Determinants of a Foreign Entry Mode

THEORETICAL STUDIES	EMPIRICAL	
	FOR	AGAINST
<b>Beneficial Factors of a Foreign Entry</b>		
<ul style="list-style-type: none"> <li>• <b>Diversification:</b> AL, H                             <ul style="list-style-type: none"> <li>---Firms with more international experience need not form JVs to obtain host country knowledge.</li> <li>---Stock markets react more favorably to the announcements of IJV by firms with less international experience.</li> <li>---Div'n effects are greater when host countries are less developed.</li> <li>---Diversification effects are smaller when forming a related JV.</li> </ul> </li> <li>• <b>Operating flexibility:</b> K, KK, HHK                             <ul style="list-style-type: none"> <li>---Firms with a global strategy would favor high-control mode.</li> </ul> </li> <li>• <b>Ownership advantage:</b> HHK                             <ul style="list-style-type: none"> <li>---The more tacit is the know-how, the more favored is a high-control mode.</li> </ul> </li> <li>• <b>Location advantage:</b> TPA                             <ul style="list-style-type: none"> <li>---Firms internalize location-specific advantages.</li> </ul> </li> <li>• <b>Risk reduction:</b> TPA                             <ul style="list-style-type: none"> <li>---Firms may choose a JV to reduce operating risk.</li> </ul> </li> <li>• <b>Host country demand:</b> BC, AR                             <ul style="list-style-type: none"> <li>---Owing to the economies of scale in FDI, firms entering a large host market are more likely to choose a subsidiary.</li> </ul> </li> </ul>	<p>H, AR</p> <p>HCS</p> <p>CGH</p> <p>TPA</p>	<p>OSR: insig</p> <p>OSR</p> <p>KV</p> <p>ZNY</p> <p>HR: insig.</p> <p>OSR: insig. CAR</p>

Index to the studies

- |                                   |                                      |
|-----------------------------------|--------------------------------------|
| AL: Agmon & Lessard 1977          | HR: Hennart & Reddy 1997             |
| AR: Agarwal & Ramaswamy 1992      | K: Kogut 1985                        |
| BC: Buckley & Casson 1996         | KK: Kogut & Kulatilaka 1994          |
| CGH: Crutchley, Guo & Hansen 1991 | KV: Koh & Venkatraman 1991           |
| H: Hennart 1991                   | OSR: Ojah, Seitz & Rawashdeh 1997    |
| HCS: Hu, Chen & Shieh 1992        | TPA: Tse, Pan & Au 1997              |
| HHK: Hill, Hwang & Kim 1990       | ZNY: Zeira, Newburry & Yeheskel 1997 |

shield or hedge from the risks, the presence of a large amount of political risk may lead to the decision of having a JV partner rather than setting up a WOS. Hill, Hwang and Kim (1990) suggest that a low-resource commitment mode is favored in politically risky countries. On the other hand, Anderson and Gatignon (1986) argue that, in a politically and

economically risky country, a mode with greater control is efficient.

The costs of monitoring and enforcing a JV partner are larger when the firm's assets are more firm specific. Erramilli and Rao (1993) argue that when integration costs are low, firms with low asset specificity are as likely as high-specificity firms to choose a WOS but, when the costs

**Table 1 PART B:** Literature on the Determinants of a Foreign Entry Mode

THEORETICAL STUDIES	EMPIRICAL	
	FOR	AGAINST
<p><b>Costly Factors of a Foreign Entry</b></p> <ul style="list-style-type: none"> <li>• <b>Political risk:</b> HHK, AG ---In a politically risk country, a low-resource high-control mode is efficient.</li> <li>• <b>Contractual risk:</b> AR, PR ---A large number of partners would lead to a higher failure rate.</li> <li>• <b>Agency conflicts:</b> C, RM ---CAR would be negatively related to the agency costs and positively related to the monitoring and bonding mechanisms.</li> <li>• <b>Cultural difference:</b> KS, HHK ---In a culturally distant country, firms would be less likely to acquire a firm, a low-resource mode is more likely, and a JV is less likely to succeed.</li> </ul>	<p>KH, OSR</p> <p>C, W, RM</p> <p>KS</p>	<p>PR, HC.</p> <p>HC: success</p>

Index to the studies

AG: Anderson & Gatignon 1986	HHK: Hill, Hwang & Kim 1990	PR: Park & Russo 1996
AR: Agarwal & Ramaswamy 1992	KH: Kim & Hwang 1992	RM: Reurer & Miller 1997
C: Cordeiro 1993	KS: Kogut & Singh 1988	W: Wild 1994
Hc: Hu & Chen 1996.	OSR: Ojah, Seitz & Rawashdeh 1997	

**Table 1 PART C:** Literature on the Determinants of a Foreign Entry Mode

THEORETICAL STUDIES	EMPIRICAL	
	FOR	AGAINST
<p><b>Size and Foreign Exchange</b></p> <ul style="list-style-type: none"> <li>• <b>Size:</b> AR ---Large firms are more likely to choose a sole venture. ---CAR positively related to venture size.</li> <li>• <b>Foreign exchange:</b> CGH, BK ---A stronger home currency would lead to a higher propensity to choose a subsidiary and higher CARs to bidder and target. Host currency volatility leads to a higher propensity to choose a subsidiary (JV) for the U.S. (non-U.S.) parents.</li> </ul>	<p>AR, HR OSR, KV</p> <p>CGH, OSR, HR BK</p>	

Index to the studies:

AR: Agarwal & Ramaswamy 1992	HR: Hennart & Reddy 1997
BK: Baek & Kwok 2002	KV: Koh & Venkatraman 1991
CGH: Crutchley, Guo & Hansen 1991	OSR: Ojah, Seitz & Rawashdeh 1997

of integration increase, low asset specificity firms are more likely to choose a JV because the costs of internal organization outweigh the costs of coordinating with, monitoring and enforcing a JV partner.

Zhao and Zhu (1998) examine the ownership patterns among 818 IJVs in China, and find that skill intensity, market concentration, market potentials, and foreign business agglomeration are positively associated with the foreign equity ownership while local industry R&D intensity and productivity negatively influence the foreign ownership.

#### *Venture-Specific Factors*

Hennart (1991) argues that firms with more experience in a host country need not form JVs to obtain knowledge on host markets. The benefits of having a local partner (e.g., obtaining market knowledge) do not outweigh the costs (e.g., cost of coordinating with, monitoring and enforcing the partner). He finds that the Japanese parent companies with more years of subsidiary existence in the U.S. are more likely to enter through WOSs. Agarwal and Ramaswamy (1992) find in a sample of 97 firms responding to their questionnaires that firms with larger size and higher foreign earnings ratio (i.e., degree of international involvement) prefer (1) a WOS to a JV and (2) a JV over no entry. Zhao and Zhu (1998) find that duration and scale of IJVs as venture-specific factors (VSF) are positively related to the foreign ownership in IJVs in China.

If having a JV partner lessens a parent firm's autonomy over its affiliates, firms with greater potential benefits from the multinational network will prefer a WOS to a JV as a mode of foreign entry. Hill, Hwang and Kim (1990) posit that the firms with a global (multi-domestic) strategy would favor high- (low-) control entry mode. They also argue that the more tacit the know-how, the more favored is a high control mode.

#### **AGENCY CONFLICTS AND FOREIGN ENTRY MODES**

In order to incorporate the costs of monitoring and bonding the agent within the TCE framework, we analyze the agency conflicts within a parent firm as well as between a parent and its affiliated firm. Next we develop hypotheses regarding their association with foreign entry mode choice.

A firm is an economic organization in which some transactions are internalized. Coase (1937) argues that it is more profitable to establish a firm than to use a price mechanism when the costs of discovering the relevant prices, and negotiating contracts, are high; when a short-term contract is unsatisfactory; and when regulations such as a sales tax exist. Shavell (1979) defines the principal-agent relationship as the following: The principal's utility is affected by the outcome determined by the activities of its agent together with a random event, and the principal pays the agent a fee. Information asymmetry is a key factor in principal-agent relationships. Alchian and

Demsetz (1972) suggest efficiency gains from monitoring the agent's actions. Holmstrom (1979) also argues that any additional information about the agent's action, however imperfect, can be used to improve the welfare of both the principal and the agent.

While the corporation is a viable form of an economic organization, the separation of ownership and control of a corporation often leads to the misalignment of principal and agent incentives and to sub-optimal decisions by the agent managers.<sup>1</sup> Alchian and Demsetz (1972) suggest that, in the presence of non-trivial costs of observing behaviors, a party has an incentive to shirk because the cost of shirking is not fully borne by itself.

Agency relationships and their inevitable conflicts may exist at all levels of a firm, as Fama and Jensen (1983: p.322) noted: "Benefits from better decisions can be achieved by delegating decision functions to agents at all levels of the organization who have relevant specific knowledge." When the managers' personal benefits from their modification in corporate decisions outweigh their personal costs, the managers may pursue the personal interests.

Organizations may have the principal-agent relationship just like the stakeholders inside a firm. For example, a parent firm and its affiliate are also a principal and an agent. The

parent firm delegates some task to the affiliate firm in exchange for fund remittance through dividend payments, transfer-pricing, etc. When the goals of the affiliate management are different from that of the parent firm, some decisions made by the affiliate management may not be the first-best choices to increase the parent firm shareholders' wealth.

Next, we will analyze the severity of agency problems and the effectiveness of monitoring and bonding activities on the corporate foreign entry mode decisions at the various levels in a parent-affiliate structure. Table 2 on the next page summarizes agency conflicts within a parent firm and potential ways to reduce them.

#### *Agency Problems between Shareholders and Managers*

Jensen and Meckling (1976) analyze the equity providers and the manager of a firm as a pure principal-agent relationship. When an owner-manager (OM) pursues his/her own wealth maximization, devices like auditing, formal control systems, budget restrictions, and incentive compensation systems may reduce the on-the-job consumption. When a positive amount of monitoring costs reveals agent's actions or information set upon which agent actions are based, monitoring would reduce the on-the-job consumption and increase the firm value (Shavell 1979; Holmstrom 1979).

<sup>1</sup> As Jensen and Meckling (1976) quoted, the 'negligence and profusion' of directors in joint-stock companies are documented as early as in 1776 by Adam Smith.

**Table 2:** The Sources and Reduction of Agency Problems within a Parent Firm

**Agency Problems**

**Potential Reduction**

**Shareholders versus Managers**

- Managers prefer less risk (Amihud & Lev 1981, Marcus 1982).
- Managers prefer more resources under control (Jensen 1986).
- Managers prefer more investment in management-specific assets (Shleifer & Vishny 1989).
- Management equity ownership aligns the incentives with the shareholders' (Jensen & Meckling 1976).
- Management equity ownership may induce more related investments (May 1995).
- Block ownership leads to increased monitoring (Grossman & Hart 1980, Shleifer & Vishny 1986).
- An incentive compensation plan may bond the managers.
- Debt reduces the abuse of the free cash flow (Jensen 1986).

**Shareholders versus Bondholders**

- Shareholders prefer to take more risk (Black & Scholes 1973, Jensen & Meckling 1976).
- Shareholders underinvest if most payoffs accrue to the bondholders (Myers 1977).
- Complex financial claims like convertible bonds & warrants may alleviate the conflicts (Jensen & Meckling 1976).
- Mutual ownership may alleviate the conflicts (Hoshi, Kashyap & Scharfstein 1990).

**Bondholders versus Managers**

- Managers are the agent of shareholders, not of bondholders.
- Manager's motives to diversify & build reputation reduce the agency problems between the shareholders & the bondholders (Amihud & Lev 1981, Hirshleifer & Thakor 1992).



When managers pursue their personal benefits, they may make corporate investment decisions that are less than optimal to the shareholders. Equity ownership by managers may have various effects on their incentives. First, management ownership aligns the interests of the managers with the shareholders. A higher management equity ownership would make a manager's incentives more aligned with that of shareholders. Denis, Denis and Sarin (1997) examine 933 non-regulated firms with 1984 sales greater than 20 million dollars. They find that both management equity ownership and block ownership are negatively related to the number of reported industry segments. Stock market reactions to the announcements of foreign affiliate formations are positively related to the percentage of equity owned by corporate officers and directors (Reurer and Miller, 1997).

Second, management ownership increases the manager's employment risk. Since increased equity ownership means less diversified managers' wealth, managers would become more risk averse. Amihud and Lev (1981) hypothesize that the managers, unlike the shareholders, pursue diversification strategies, like conglomerate mergers, to decrease

their undiversifiable employment risk. Since the managers can hardly diversify the risk of unemployment and the damage to their professional reputation, they may decide to diversify at the corporate level. Over a sample of 309 firms on the 1965 Fortune-500 list, Amihud and Lev found that management-controlled firms had more conglomerate mergers during the period 1961-1970.<sup>2</sup> For the 184 firms that made acquisitions between 1979 and 1990, May (1995) also found that the chief executive officers' (CEOs) fraction of personal wealth vested in their own equity is positively related to the covariance of returns between their firms and targets. Also, Marcus (1982) predicts that when managerial effort is a determinant of profit, but it is costly, managers will avoid risk and underinvest in risky projects that would further increase principals' wealth. If human capital is more valuable to the current firm than to outside markets, the manager has an increased interest in survival of the firm. Marcus shows that managers act in a more risk-averse way than is optimal for equity owners.

The choice of setting up an affiliate as a WOS or a JV naturally involves the decision of how much investment and risk the managers are willing to take. When a management

<sup>2</sup> Amihud and Lev assume that the managers' personal benefits may be larger than the shareholders' costs even when the managerial labor markets are efficient, and that the monitoring devices are imperfect. Firms are classified into management-, weak owner-, or strong owner-control sets, where one party or specific group holds less than 10 percent, between 10 percent and 29.9 percent, and at least 30 percent of the stock, respectively.

team has a fixed amount of investments, setting up two 50-50 JVs would be a more diversifying strategy than setting up one WOS for the same investment, as long as the returns from two JVs are not perfectly correlated. So, we propose the following hypothesis.

*H<sub>10</sub>: Firms with high management ownership are more likely to choose a joint venture over a wholly owned subsidiary.*

Third, management ownership seems to encourage investments in related areas. Shleifer and Vishny (1989) argue that managers have an incentive to invest the corporate resources in the assets that are more valuable under their control than under the best alternative manager's control. Since the costs of replacing the entrenching management with more management-specific assets under control are high, the management may demand higher compensation. Shleifer and Vishny (1989) also imply that the incumbent management with an expertise in the current operations is more likely to invest in these areas above the optimal level. Additionally, when the potential management replacement would better manage the current operations, the incumbent management would entrench itself by diversifying into the areas where they have a comparative management advantage.

As Marcus (1982), and Shleifer and Vishny (1989) state, managers would like to increase the investments in management-specific assets. While

managers increase assets in their expertise in order to entrench themselves, shareholders do the same in order to increase corporate focus. By choosing a WOS over a JV in his/her expertise, an entrenching manager would increase assets under his/her control. Hence the following alternative hypothesis is proposed.

*H<sub>11</sub>: Firms with high management ownership are more likely to choose a wholly owned subsidiary over a joint venture.*

### **Agency Problems of Debt**

Holding a common stock share of a corporation is analogous to holding a call option to buy back the firm at the face value of debt (Black and Scholes, 1973). The agency problems of debt are related to the risk taking behavior of common shareholders and the subsequent transfer of wealth from bondholders to shareholders (Jensen and Meckling, 1976). The OM of a firm may promise to take a low-variance high-value project, issue bonds, and then in fact take the high-variance low-value project. If bondholders presume this behavior of wealth transfer, they would pay no more than the price level as if the risky project is taken. Then, the OM is forced to take the high-variance project. If the cash flows from two JVs are less than perfectly correlated, cash flows from a WOS would have higher variance than those from two JVs. Shareholders of a firm with high financial leverage would like to choose a riskier project when other

things are equal, and we propose the following hypothesis.

*H<sub>2a</sub>: Firms with high level of leverage are more likely to choose a wholly owned subsidiary over a joint venture.*

Alternatively, Myers (1977) notes that the shareholders may pass up a positive net present value (NPV) project in the presence of debt, if most payoffs would accrue to the bondholders. This phenomenon is called the under-investment problem of debt. If most FDI projects have positive NPVs, shareholders of the firm with a high leverage may pass up a profitable FDI or invest less by setting up a JV instead of a WOS, and we propose the following competing hypothesis.

*H<sub>2a</sub>: Firms with high level of leverage are more likely to choose a joint venture over a wholly owned subsidiary.*

#### **Agency Problems between Parent and Affiliated Firm**

Headquarters and subsidiaries of an MNE have been viewed as principal and agent (Nohria and Ghoshal 1994; O'Donnell 1997). The headquarters delegate some decision-making authority to the subsidiary management, which possesses unique or superior knowledge. The interests of a WOS are not always aligned with the interests of the whole MNE. O'Donnell (1997) characterizes the conflicts with self-interest seeking and the incongruence of goals.

We extend O'Donnell's (1997)

analysis to the affiliates in general, and argue that an affiliate, whether a WOS or a JV, is the agent of the parent firm(s). Like a WOS, a JV may also have different organizational goals from its parents and, consequently, seek its own interests. One apparent difference between a JV and a WOS is that the former has multiple principals. The goal incongruence problem would be more severe between a JV and its multiple principals than between a WOS and its single principal. The interests of the parent firms may conflict with each other, and it may be more costly to align their combined interests with the interests of the JV.

In order to reduce the agency problems, the principals may directly monitor the agent's behavior, construct devices to align the incentives of the agent to theirs, and bond the agent to act according to the principals' desires (Fama and Jensen, 1983). The effectiveness of monitoring and bonding activities by multiple principals would be different from that by a single principal. Multiple principals of a JV (i.e., an agent) may suffer from a free-riding problem when monitoring the agent's actions and information set. A JV partner has to share the benefits from its own monitoring activities with the other partners, while it bears the total costs of monitoring. The monitoring problems would be more severe when some operations are under the exclusive control of other partners. A foreign affiliate is usually monitored through (1) bureaucratic mechanisms like rules and procedures (Galbraith,

1973) and (2) direct supervision of expatriates. Setting up the bureaucratic mechanisms to satisfy the guidelines of multiple principals would be more costly than that of a single principal, when the direct supervision by one of the principals may provoke additional conflicts of interests with other principals.

To write a contract to bond the agent to act in the best interests of multiple principals would also be more costly when the interests of multiple partners are not unanimous. Common incentives to the foreign WOS management include monetary compensation plans and power and prestige through promotions. Building a compensation plan that suits the mutual needs of multiple partners may be more costly than building a plan for a single principal. In addition, the informal incentives like promotions are likely to bring additional conflicts of interests to the affiliate, especially among the top management team. The incentives based on power and prestige for one partner may not be effective for the managers expatriated by other partner firms, and can sometimes be in conflict with the incentive schemes from the other partners.

While monitoring and bonding by multiple principals may be more costly because of goal incongruence

among them, an additional principal to a parent-affiliate structure may enable more efficient monitoring. Monitoring by multiple principals would be more desirable when the benefits from the additional partner's monitoring outweigh its incremental costs from free-riding. When a parent firm considers setting up an affiliate for which the monitoring is very costly, the parent firm would like to have a JV partner who has better ability (or lower cost) to monitor the affiliate's operations.<sup>3</sup> Kogut and Singh (1988) hypothesize that the greater cultural distance between the home and the host countries leads to the greater likelihood of a JV or a WOS over acquisition. They confirm their hypotheses for 228 entries into the U.S. market during 1981-1985. Hill, Hwang and Kim (1990) posit that a low resource-commitment mode may be favored when the cultural difference is greater. We propose the following hypothesis related to the affiliate monitoring efficiency.

*H<sub>3</sub>: Firms that are better equipped to monitor affiliate activities are more likely to choose a wholly owned subsidiary over a joint venture.*

A parent firm with a high degree of international involvement would

<sup>3</sup> Instead of having a local JV partner, firms may also set up a WOS and hire an external auditor to monitor their subsidiary in a remote location. The choice would depend on monitoring efficiency and costs. Firms would choose to have a JV partner only when it will be cost-effective to have an equity-shared partner than to purchase inputs from the potential partner at market price and hire a group of monitors.

better monitor its foreign affiliate management, and would be less likely to need a third party (i.e., a JV partner) to supplement its monitoring. We propose the following hypothesis regarding the international involvement.

*H<sub>4</sub>: Firms with a higher degree of international experience are more likely to choose a wholly owned subsidiary over a joint venture.*

#### DATA AND METHODOLOGY

We collected inbound and outbound U.S. FDIs announced in 1995 from the Company News section of the *Lexis-Nexis Academic Universe*. The initial sample includes 182 announcements of WOS or JV formation. Most previous studies limit their analyses to the FDIs between two countries.<sup>4</sup> As different country MNEs may have different motives for FDIs, multi-country analyses of foreign entry mode will provide better understanding of the relationship between motives and modes as well as agency-related variables. Accounting information for the period

1990-1994 is available from the Standard & Poor's *Compustat* and *Datastream* databases. Supplemental sources of information include *Compact Disclosure* and *WorldScope*.<sup>5</sup>

SUBS is an indicator variable that identifies the *i*<sup>th</sup> firm's affiliate as a WOS as opposed to a JV. Following Hennart (1991) and Swan and Ettlie (1997), we assign the value of one if the firm owns 95 per cent or more of an affiliate, and zero otherwise. Non-equity coalitions like strategic alliances are excluded from the sample.<sup>6</sup>

INSIDEO represents officers and directors' stock ownership in the parent firm, and TLRATIO denotes ratio of total liability over total assets. Book value of liabilities and market value of equities are used. To measure the affiliate monitoring efficiency, we collect three variables: DEV, HEMI and CEXP. DEV takes the value of one if both the parent and the affiliate are in the developed countries, and zero otherwise. HEMI takes the value of one if two major partners are from the same western hemisphere, and

<sup>4</sup> For example, Hennart and Reddy (1997) examine 428 U.S. entries by Japanese firms during the period 1978-1989, and Harris and Ravenscraft (1991) use 159 acquisitions of U.S. firms during 1970-1987. Woodcock, Beamish and Makino (1994) use 322 North American entries by Japanese firms in 1992.

<sup>5</sup> *Compustat* contains only the public U.S. firms and *Datastream* contains only the large public foreign firms. Utilization of those data poses a selection bias toward large firms. Agarwal and Ramaswamy (1992) note that large firms are more likely to choose subsidiaries over JVs.

<sup>6</sup> One sample firm formed a foreign affiliate with 90 percent ownership while a new president of the affiliate was given the remaining 10 percent common share as a form of compensation. The affiliate was considered a WOS even if its share ownership was less than 95 percent.

zero otherwise. We define the western hemisphere as the North and South Americas and Western Europe. CEXP takes the value of one if the  $i^{\text{th}}$  firm has any previous direct investment in the current affiliate country. DHC denotes the sum of DEV, HEMI and CEXP variables.

As indicators of the degree of international involvement, we collect

data on foreign sales ratio (FSR) like in Hu, Chen and Shieh (1992). Since foreign sales include exports and the ratio represents degree of international involvement rather than international experience, foreign income ratio (FIR) and foreign asset ratio (FAR) are also collected.

RELSIZE represents the affiliate's size relative to its parent.

Table 3: Descriptive Statistics

Variable	Obs	1	0	Min	Med	Max	Mean	S.D.
SUBS	182	34	148		0		.1868	.3908
RELSHARE	179			0	.50	1.00	.5268	.2847
w/ option	179			0	.50	1.00	.5297	.2798
INSIDERO(%)	127			0	2.81	84.12	12.95	19.58
TLRATIO	140			.025	.4906	.9636	.4973	.2211
DHC	178			0	1	3	1.46	1.03
DEV	182	68	114		0		.3736	.4851
HEMI	182	99	83		1		.5440	.4994
CEXP	176	96	80		1		.5455	.4994
Avg FR	117			-.3117	.2393	1.3370	.2673	.2710
FAR	105			0	.248	.847	.2361	.2150
FSR	115			0	.289	1.00	.2985	.2674
FIR	110			-2.13	.149	2.292	.2310	.4455
RELSIZE	116			0	.0182	5.1836	.1938	.6040
HOSTSIZE	182			162	2,447	40,813	11,843	11,631

Parent Regions	USA (125)	Europe (35)	Asia (28)	Latin Am. (4)
Affiliate Regions	USA (32)	Europe (47)	Asia (77)	Latin Am. (26)

SUBS<sub>*i*</sub> = 1 if the  $i^{\text{th}}$  firm chooses a wholly owned subsidiary, and 0 if a JV, RELSHARE<sub>*i*</sub> = the  $i^{\text{th}}$  parent's relative share ownership in the affiliate firm, INSIDERO<sub>*i*</sub> = the  $i^{\text{th}}$  firm's common equity held by insiders, TLRATIO<sub>*i*</sub> = ratio of the  $i^{\text{th}}$  firm's total liability over the sum of the total liability and market value of equity, DHC<sub>*i*</sub> = DEV<sub>*i*</sub> + HEMI<sub>*i*</sub> + CEXP<sub>*i*</sub>, DEV<sub>*i*</sub> = 1 if both the parent and affiliate are in developed countries, HEMI<sub>*i*</sub> = 1 if two major partners of the  $i^{\text{th}}$  firm's JV are from the same western or eastern hemisphere, CEXP<sub>*i*</sub> = 1 if the  $i^{\text{th}}$  parent has any direct investment in the affiliate country, Avg FR = average of FSR<sub>*i*</sub>, FAR<sub>*i*</sub> and FIR<sub>*i*</sub>, FSR<sub>*i*</sub> = ratio of the  $i^{\text{th}}$  parent's foreign sales over total sales during the previous fiscal year, FAR<sub>*i*</sub> = ratio of the  $i^{\text{th}}$  parent's foreign assets over total assets at the end of the previous fiscal year, FIR<sub>*i*</sub> = ratio of the  $i^{\text{th}}$  parent's foreign income over net income during the previous fiscal year, RELSIZE<sub>*i*</sub> = ratio of total investment in the  $i^{\text{th}}$  firm's affiliate over total assets of the  $i^{\text{th}}$  parent at the fiscal year-end prior to announcement, and HOSTSIZE<sub>*i*</sub> = the  $i^{\text{th}}$  firm's host country GDP in 1994.

Following Hennart (1991), we use the total investment in the affiliate over the parent's total assets in 1994. We predict RELSIZE has a negative impact on SUBS since firms may choose to have a partner in a project with a large investment owing to capital rationing and risk diversification purpose. Host country's gross domestic product per capita is denoted as the HOSTSIZE variable.

### TEST RESULTS

Table 3 (to the left) reports the descriptive statistics of the variables. Samples include 125 FDIs by U.S. organizations, plus 35, 28 and four FDIs in the U.S. by European, Asian and Latin American firms respectively. A majority of parent firms (148) chose a JV as a new affiliate form. For 179 firms with available information, the average share ownership is slightly higher than 52 percent, while the average ownership is about 53 percent if the option to acquire additional shares had been exercised. The ownership by a median parent firm is 50 percent. Average inside ownership is about 13 percent, but its median value is only 2.8 percent. Leverage ratio of a parent firm ranges from 2.5 percent to 96.4 percent, and its mean and median values are close to 50 percent.

For 68 cases, both affiliates and parents are from the developed countries. Ninety-nine affiliates are

located in the same hemisphere as their parent, and the parents of 96 affiliates had prior experience in the host country. On average, about a quarter of the assets of a parent firm are foreign, and about 30 percent of sales are from foreign countries. Although the average affiliate size is about 19 percent of its parent, more than half the affiliates are smaller than two percent of its parent in asset size.<sup>7</sup>

To examine whether the means of dependent variables are different between two groups of each independent variable, we performed t-tests. We divided the sample firms into two groups based on the zero-one value of indicator variables, or the median value of continuous variables. T-tests assume that observations are either randomly drawn from two independent and normally distributed populations or in very large number. Nonparametric Mann-Whitney tests supplemented the t-tests since they do not make any assumption on the population distribution.

In Panel A of Table 4 (on the next page), we report the results from the tests of differences. Of the firms with a higher percentage of insider ownership, 25.2 percent chose a WOS as a foreign entry mode, while only 11.4 percent of the firms with lower insider ownership did so. The difference of 13.8 percent is statistically significant. Management's incentives to reduce risks at the firm level do not seem to

<sup>7</sup> The median (mean) values of the parent firm's total asset, total investment in the affiliate, and the investment by a parent are 12,493 (43,797.5), 200 (627.87), and 80 (332.12) million U.S. dollars, respectively.

Table 4: Tests of Mean Difference: Subsidiary/JV

Panel A: Mean Differences						
Variable	Group	N	Sub %	Diff.	P (t)	MWZ
INSIDERO	Insider ownership higher	65	25.2%	13.8%	.042**	1.645*
	Insider ownership lower	64	11.4%			
TLRATIO	TL/(TL+MVE) higher	71	22.1%	4.2%	.536	.622
	TL/(TL+MVE) lower	71	17.9%			
DHC	DEV+HEMI+CEXP higher	86	27.1%	15.1%	.013**	2.282**
	DEV+HEMI+CEXP lower	92	12.1%			
DEV	P and A developed countries	68	29.3%	17.2%	.008***	2.861***
	Not both from developed	114	12.1%			
HEMI	Invest in parent's hemisphere	99	25.3%	14.5%	.010***	2.477**
	In different hemisphere	83	10.8%			
CEXP	Previous direct investment	96	19.8%	1.1%	.862	.180
	No previous country experience	80	18.8%			
AVG FR	Average Foreign Ratios higher	59	24.4%	.4%	.959	.052
	Average Foreign Ratios lower	58	24.0%			
FSR	Foreign sales ratio higher	58	28.3%	6.5%	.419	.813
	Foreign sales ratio lower	57	21.7%			
FAR	Foreign asset ratio higher	53	23.4%	-2.0%	.779	-.282
	Foreign asset ratio lower	52	25.4%			
FIR	Foreign income ratio higher	55	22.9%	.99%	.902	.226
	Foreign income ratio lower	55	21.9%			
RELSIZE	Affiliate/Parent ratio higher	58	34.5%	16.2%	.049**	1.880*
	Affiliate/Parent ratio lower	58	18.3%			
HOSTSIZE	Host country GDP higher	91	28.0%	19.1%	.001***	3.035***
	Host per capita GDP lower	91	9.6%			

  

Panel B: Related and Unrelated FDIs				
	Insider ownership higher	Insider ownership lower	Diff.	T stat
RELATED	5% (n=60)	10% (n=60)	15%	2.187**
UNRELATED	13% (n=8)	27% (n=11)	-14%	-.750

This table presents the results of the univariate tests to see if the average share ownership in an affiliate firm after option features exercised is different between two groups. N denotes the number of observation in a group, Sub % the percentage of firms in a group that chose a WOS, Diff. the difference in Sub % between two groups, P (t) the p-value from t-tests, and MWZ the Z value from the Mann-Whitney tests.  $INSIDERO_i$  = the  $i^{th}$  firm's common equity held by insiders,  $TLRATIO_i$  = ratio of the  $i^{th}$  firm's total liability over the sum of the total liability and market value of equity,  $DHC_i = DEV_i + HEMI_i + CEXP_i$ ,  $DEV_i = 1$  if both the parent and affiliate are in developed countries,  $HEMI_i = 1$  if two major partners of the  $i^{th}$  firm's JV are from the same western or eastern hemisphere,  $CEXP_i = 1$  if the  $i^{th}$  parent has any direct investment in the affiliate country,  $AVG FR$  = average of  $FSR_i$ ,  $FAR_i$  and  $FIR_i$ ,  $FSR_i$  = ratio of the  $i^{th}$  parent's foreign sales over total sales during the previous fiscal year,  $FAR_i$  = ratio of the  $i^{th}$  parent's foreign assets over total assets at the end of the previous fiscal year,  $FIR_i$  = ratio of the  $i^{th}$  parent's foreign income over net income during the previous fiscal year,  $RELSIZE_i$  = ratio of total investment in the  $i^{th}$  firm's affiliate over total assets of the  $i^{th}$  parent at the fiscal year-end prior to announcement, and  $HOSTSIZE_i$  = the  $i^{th}$  firm's host country GDP in 1994. \*, \*\* and \*\*\* denote the statistical significance at 10%, 5% and 1% level, respectively.



affect the foreign entry mode decisions.

Firms with higher total leverage ratio do not seem to be more likely to choose a WOS than those with lower leverage (22.2 percent vs. 17.9 percent). Neither  $H_{20}$  nor  $H_{2a}$  is supported by the data. On average, firms with a higher DHC score are more likely to choose a WOS as an entry mode. Twenty-seven percent of those parent firms chose a WOS while only 12 percent of the parents with lower score did so. The difference of 15.1 percent is also statistically significant and the component variables like DEV and HEMI show similar patterns. Firms like to have a WOS when the parent and its affiliate are in developed countries or in the same hemisphere and the parent has prior host country experience; thus, the parent can better monitor its foreign affiliates. The results support Hypothesis Three.

Firms with a higher average foreign ratio do not show a pattern of preference between subsidiaries and JVs relative to the firms with a lower ratio.<sup>8</sup> The authors interpret the result as suggesting that firms with more international experience do not necessarily better monitor their foreign affiliates. Contrary to the prediction, a higher percentage of the firms investing in a relatively larger foreign affiliate chose a WOS than those investing in a relatively smaller affiliate. Note, however, that a

relatively large affiliate is still a very small fraction of its parent, since the median value of an affiliate's size relative to its parent is 1.8 percent. Firms investing in a foreign country that has a relatively higher GDP per capita are more likely to choose a WOS (28 percent vs. 9.6 percent) and the 19.1 percent difference is statistically significant. Firms investing in less developed countries seem to seek a local partner to overcome some informal barriers against foreign firms in that country.

## DISCUSSIONS

### *Related and Unrelated FDIs*

To further analyze managers' incentive to invest in the areas where they have expertise, we divide the sample into two groups: FDIs in related and unrelated areas. Results from the t-tests of mean difference are presented in Panel B of Table 4. In the related-FDI sub-sample, firms with higher insider ownership are more likely to choose a WOS than those with lower ownership (25 percent vs. 10 percent), and the difference is statistically significant. The results, however, are different within the unrelated-FDI sub-sample. Only 13 percent of the firms that had higher insider ownership and made an unrelated FDI chose subsidiaries, while 27 percent of unrelated-FDI sample firms with lower insider ownership chose subsidiaries. Although the difference is statistically

<sup>8</sup> Agarwal and Ramaswamy (1992) and Hennart (1991) report that firms with more international experience are more likely to choose a subsidiary because they need not obtain country knowledge from a local partner.

Table 5: Tests of Mean Difference: U.S. and Non-U.S. Parents Comparison

Variable	Sample	Group	N	Sub%	t	MWZ	Own%	t	MWZ
INSIDERO	U.S.	Higher	51	22%	1.410	1.147	55.6%	.644	.403
		Lower	51	12%			52.0%		
	Non-U.S.	Higher	13	31%	.910	.913	55.1%	.100	.209
		Lower	13	15%			53.9%		
TLRATIO	U.S.	Higher	52	19%	.558	.560	57.0%	1.048	.600
		Lower	53	15%			51.4%		
	Non-U.S.	Higher	18	28%	.246	.249	52.6%	.871	.496
		Lower	19	32%			61.8%		
DHC	U.S.	Higher	39	12%	.396	1.385	50.6%	.105	.229
		Lower	38	8.8%			51.2%		
	Non-U.S.	Higher	27	30%	.612	.615	57.8%	.966	1.048
		Lower	27	22%			49.5%		
DEV	U.S.	Yes	39	23%	1.352	1.476	57.5%	1.235	1.085
		No	87	13%			51.0%		
	Non-U.S.	Yes	29	38%	2.427	2.295	63.5%	2.812	2.581
		No	27	11%	**	**	41.2%	***	***
HEMI	U.S.	Yes	58	24%	2.305	2.335	57.3%	1.692*	.958
		No	68	8.8%			**		
	Non-U.S.	Yes	41	27%	.514	.518	54.0%	.474	.302
		No	15	20%			49.5%		
CEXP	U.S.	Yes	59	14%	.737	.738	50.2%	1.217	1.125
		No	65	18%			56.0%		
	Non-U.S.	Yes	38	29%	.771	.774	56.3%	.964	.868
		No	16	19%			47.3%		
AVG FR	U.S.	Higher	44	18%	.050	.051	58.2%	.876	1.237
		Lower	43	19%			53.0%		
	Non-U.S.	Higher	15	33%	.727	.733	62.0%	.738	.924
		Lower	15	47%			70.1%		
FSR	U.S.	Higher	42	19%	.052	.052	58.9%	.981	1.749*
		Lower	43	19%			52.9%		
	Non-U.S.	Higher	13	31%	.884	.887	65.3%	.117	.238
		Lower	17	47%			66.6%		
FAR	U.S.	Higher	42	19%	.000	.000	60.0%	1.356	1.866*
		Lower	42	19%			51.7%		
	Non-U.S.	Higher	10	40%	.240	.246	66.0%	.145	.110
		Lower	11	45%			68.2%		
FIR	U.S.	Higher	43	21%	.700	.500	61.2%	1.806*	2.215
		Lower	44	16%			50.6%		
	Non-U.S.	Higher	12	33%	.573	.582	56.7%	1.194	1.296
		Lower	11	45%			71.9%		
RELSIZE	U.S.	Higher	38	24%	.331	.213	53.6%	.347	.783
		Lower	39	21%			56.0%		
	Non-U.S.	Higher	19	53%	2.187	2.096	68.9%	1.643	1.711*
		Lower	20	20%	**	**	51.5%		
HOSTSIZE	U.S.	Higher	63	20%	1.390	1.380	54.5%	.622	.147
		Lower	63	11%			51.5%		
	Non-U.S.	Higher	30	43%	3.959	3.373	69.1%	5.005	4.360
		Lower	26	3.9%	***	***	33.9%	***	***

Own% refers to the equity ownership percentage in an affiliate. See Table 4 for description of other variables.

insignificant, this result along with the results found with the related-FDI sub-sample strongly suggest that managers' incentives to invest in the assets in which they have expertise seem to affect the foreign entry mode decisions more strongly than their incentives to reduce firm-level risk.

#### ***FDIs by U.S. and Non-U.S. Firms***

Motivations of FDI by the U.S. and non-U.S., and especially developing country firms seem to be different. As Kwok and Reeb (2000) show, the cross-sectional relationship between internationalization and debt ratio is negative and the relationship between internationalization and risk is positive for the U.S. firms. The relationships, however, for the non-U.S. firms are the opposite.

If U.S. firms seek return maximization and non-U.S. firms seek risk minimization from FDIs in general, some entry mode factors may affect those firms differently. First, the risk-taking and wealth transfer aspect of financial leverage may better explain U.S. firms' choice of entry mode, while the underinvestment problem may better explain non-U.S. firms' decisions. Table 5 on the prior page shows the t-test and Mann-Whitney test results for each variable between U.S. and non-U.S. FDIs. As predicted, 19 percent of the U.S. firms with higher TLRATIO chose subsidiaries while only 15 percent with lower TLRATIO did so. Average share ownership within the higher TLRATIO group is higher (57 percent vs. 51 percent) albeit statistically insignificant. We, however, see an

opposite pattern among non-U.S. firms. Among the non-U.S. firms with a higher financial leverage, a smaller percentage of the firms chose subsidiaries and the average share ownership is also lower than among the non-U.S. firms with a lower leverage ratio.

Second, degree of international involvement may increase the propensity to make FDIs for both U.S. and non-U.S. firms. While U.S. firms would like to choose a WOS in order to take advantage of higher returns from foreign projects, non-U.S. firms (especially the ones with a small number of foreign affiliates) would like to choose a JV in order to minimize the risks inherent in FDIs. Results in Table 5 (shown on the page of the left) are also consistent with the arguments. For example, 19 percent, 19 percent and 21 percent of the U.S. firms with higher foreign sales, asset and income ratios chose subsidiaries, while 19 percent, 19 percent and 16 percent of the U.S. firms with lower foreign ratios chose subsidiaries, respectively. The average share ownership is higher for the U.S. firms with higher foreign ratios (59 percent vs. 53 percent; 60 percent vs. 52 percent; 61 percent vs. 51 percent). The opposite pattern is observed among the non-U.S. firms: a low propensity to choose subsidiaries, and lower average share ownership percentages among non-U.S. firms with higher foreign ratios.

#### **CONCLUSIONS**

This paper examines the agency conflicts related to FDI in two layers:

within a parent firm, and between a parent and an affiliate. Authors integrate agency theories related to the shareholder-manager, creditor-shareholder and parent-affiliate relationships, and find that management ownership, monitoring efficiency and degree of international involvement affect the foreign entry mode choices and the equity ownership in a foreign affiliate. For the 179 FDIs announced in 1995 involving at least one U.S. firm, we find that firms with higher inside management ownership are more likely to choose a WOS as a mode of entry. The relationship exists only for the related FDIs, and we interpret the result as the management's incentives to invest more in the assets with expertise affect the entry mode decisions rather than the incentives to reduce personal risks by diversifying at the firm level. Although financial leverage does not seem to affect the foreign entry mode choice, it affects positively (negatively) the propensity to choose a WOS for U.S. (non-U.S.) firms. Consistent with the view that parent-affiliate is a principal-agent relationship, firms that are better capable of monitoring foreign affiliates are more likely to choose a WOS and to have higher share ownership in the affiliate. Leverage and foreign ratios seem to affect non-U.S. firms differently than U.S. firms.

The idea of the agency conflicts' effects on corporate decision-making is not unprecedented. For example, Lee and Kwok (1988) identify the international environmental factors that may affect the agency costs and

bankruptcy costs of the multinational corporations (MNCs) differently from the domestic corporations (DCs), and find that MNCs have higher agency costs and lower debt ratios than DCs.

This study contributes to the literature by analyzing the various agency conflicts that are not previously formalized by the transaction cost economics (TCE) approach, and by relating them to the choice between a wholly owned subsidiary (WOS) and a joint venture (JV). In addition to the traditional subject of agency conflicts within a firm, this study adopts the idea of a foreign WOS as an agent of its headquarters and extends it to the foreign affiliate with multiple parents, i.e., a JV. The agency conflicts and mechanisms to reduce/eliminate them are empirically measured, and their effects on the foreign entry mode choices are tested.

Unlike the most previous studies that limit their analyses to the FDIs between two countries over a period, this study examines the multilateral sample of FDIs. As different country MNEs show different motives for FDIs, multi-country analyses of foreign entry mode provide better understanding of the relationship between motives and modes as well as agency-related variables.

This study provides additional industry-specific and venture-specific factors of foreign entry mode choices from the agency theory framework, which includes insider ownership, financial leverage, affiliate monitoring efficiency, and degree of international involvement. Stakeholders of a parent

company, (i.e., shareholders, creditors and management among others) can learn from the theories and findings of this study the nature of intra-firm dynamics in FDI mode decision. MNC headquarters, local JV partners, and foreign affiliate's management can learn the nature of inter-organizational dynamics in relation to the cost/benefits of a particular entry mode.

As Andersen (1997) points out, there is no widely accepted way to measure the transaction costs and agency costs in particular. We indirectly measure the agency conflicts within a parent firm through insider ownership and the financial leverage ratio, as well as the parent firm's capabilities to monitor its foreign affiliated firms through country experience, hemisphere, development of countries, and foreign involvement ratios. Also, this study is based on a sample of single year observations, and one needs to consider a time factor when generalizing the results of this study.

Agency costs introduced in this paper are not exhaustive. Although the nontrivial conflicts between the potential JV partners would be a factor in deciding whether to enter a foreign country and in choosing an entry mode between a WOS and a JV, the difficulty of collecting such data prevents the current study from testing the idea empirically. A possible examination, however, is to see whether the conflicts between JV partners are associated with stock market reactions to the JV formation announcements

or whether such conflicts lead to a higher failure rate of the JVs.

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