

The Influences of Formal and Informal Institutions on Taiwanese Family-owned Firms' Entry Mode Choice

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Abstract This study is designed to shed further light on the foreign direct investment (FDI) decision by the family business, and address the question: Under what situation family-owned firms make the entry mode with high risk commitment. The data source for this study was obtained from Taiwan Economic Journal Database. The database is a comprehensive source for Taiwanese firms' foreign direct investments in 13 countries (Japan, U.S., Indonesia, India, France, Finland, Thailand, Malaysia, Netherlands, Philippines, Vietnam, Germany and Korea). This study included 2451 FDI projects. This study demonstrates that the formal and informal institutions influence a family firm's entry mode decision. In the informal institutions, the family-owned firms choose the joint venture (JV) arrangement. In the formal institutions, the family-owned firms choose the wholly owned entry mode. The results display what situation family-owned firms choose the entry mode.

Keywords Family-owned Firms, Institutional Factors, Entry Mode

1. Introduction

1.1. Research Gap

In emerging markets, the characteristic of business group (BG) have been emphasized [1,2,3,4,5,6]. Granovetter [3] defined business groups as "sets of legally independent firms bound together in persistent formal and/or informal ways." Especially, business group's concentrated ownership is the widespread scenario in emerging markets [7,8]. Business group with concentrated ownership has motivation to appropriate the whole capital that facilitates the BG ownership as endogenous consideration in the process of strategic decision [3,9,10].

Recently, studies have examined that the family business, the specific type of BG, is risk-averse or risk-willing while

the family business makes strategic decisions [11,12]. Among of strategic decisions involve resources risk such as foreign investment, international involvement and diversification. On the one hand, previous research has argued that the family business with risk-averse protect the family wealth, and then the family business avoids high risk decisions [13]. On the other hand, studies have proposed that the family business with risk-willing make high risk decisions for creating family value [14]. Therefore, the paradox is that the family business with both risk-averse and risk-willing makes strategic decisions involving resources commitments of high risk.

Remedying the above the research gap, our study is designed to shed further light on the foreign direct investment (FDI) decision by the family business, and address the question: Under what situation family-owned firms make the entry mode with high risk commitment.

This study aims to extend the research of family business and FDI issue. First, we clarify the family-owned firm takes risk-averse or risk-willing in the FDI decision in emerging markets. Second, we explore how the formal and informal institutions influence the family-owned firm to recognize local investment risk and make the FDI mode choice.

1.2. The Higher Foreign Investment Involves the Higher Risk

The FDI as contracting process includes information searching and evaluation to decide one mode in the host county [15]. Besides, the different entry modes are characterized by the level of control and resource requirements[16]. The wholly owned entry mode involves relatively higher investment. In contrast, the joint venture mode involves the less resource, and the firm needs to share resource and risk with the local partner. Moreover, the external risk can be transferred to the partner who is able to absorb uncertainty including local culture and institutional factors [17,18]. Therefore, the joint venture mode involves the lower risk than the wholly owned entry mode.

1.3. Formal and Informal Institutions Impact the FDI Decision

The factors of formal institutional hazards include voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, rule of law and control of corruption [8, 19]. The formal institutional hazards cause systematic uncertainty. High formal institutional hazards increases the likelihood of exposure to contracting hazards, especially assets may be unlawfully appropriated in countries with weak institutional intervention and with high political and legal risks [20]. Family-owned firms have motivations to minimize contracting hazards to protect assets via family control, by utilizing the wholly owned mode to transfer various family controls [11, 12].

The informal institutional distance generates unsystematic uncertainty; flexibility and rich experience are needed to deal with uncertainty. The foreign partners consider these kinds of situations and then contribute knowledge to solve operational difficulties stemming from informal institutional distance [21, 22]. Foreign partners' local knowledge easily combines with the family assets. The synergy of assets and local knowledge may motivate the family firm to choose the JV arrangement.

2. Materials and Methods

2.1. Data Sources and Sample

The primary data source for this study was obtained from the Taiwan Economic Journal (TEJ) Database, which contains financial and corporate information on family-controlled firms. The database is also a comprehensive source for Taiwanese firms' FDI (foreign direct investments) in 13 countries (Japan, U.S., Indonesia, India, France, Finland, Thailand, Malaysia, Netherlands, Philippines, Vietnam, Germany and Korea) from 1999 to 2007. The FDI data were recorded according to investment date, equity ratio and where the projects are located. This study collected 2451 FDI projects.

2.2. Variables

Dependent variables. The dependent variable was the entry mode. Family-controlled firms with 95% or higher invested in host countries, including acquisition and Greenfield modes were created with a dummy variable of 1. The family-controlled firms with less than 95% investment were created with a variable of 0 to represent minority joint venture and majority joint venture modes. Examining wholly-owned and joint venture modes of entry is consistent with past studies *Independent variables.* Family Ownership was measured by the percentage of shares held by group business. Family control higher than 50% of stocks in firms represents family-controlled firms. We created a dummy variable of 1. A dummy variable of 0 was created to represent non-family-controlled firms.

Moderator variables: Kaufmann, Kraay and Mastuzzi have produced Worldwide Governance Indicators (WGI) from 1996. They define that governance consists of the traditions and institutions by which authorities in a country is exercised. We use these indicators to measure formal institution hazards. Foreign firms lose the appropriation of assets while the score of WGI is low. Formal institutions included six dimensions of governance quality: voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, rule of law and control of corruption. Each item was rated between 0 and 100%. We combined six dimensions into one variable and created 1 for the high quality of formal institutions. A dummy variable of 0 was to represent the low quality of formal institutions. Informal institutional distance referred to four cultural dimensions: power distance, uncertainty avoidance, masculinity/ femininity, and individualism [23, 24]. The formula is as follows:

$$CD_j = \sqrt{\sum_{i=j}^4 \frac{(I_{ij} - I_{it})^2}{V_i}}$$

Control variables. At firm-level, we controlled for R and D expenditure, advertising expenditure and the variables of cooperate governance. Prior studies have suggested a positive effect of R and D expenditure due to avoidance of opportunism by local partners [24]. Similar to advertising expenditure, the free-riding problem should be reduced through higher equity mode [24]. We control for the mechanisms of governance that may also affect the choice of mode (i.e., the ratio of independent directors, the ratio of Managers=directors, and directors equity %) [25]. Industries were also controlled: electronics, transportation, plastics, automobiles, etc (omitted category).

3. Results

Table 1 shows the descriptive statistics and correlation matrix to variables. The regression result for the multinomial logistic model is shown in Table 2.

Model 1 in Table 2 only contains the control variables. Model 2 tests the entry mode choice of family-owned firms with formal institutions. The Model χ^2 value of Model 2 is 2725.968 ($p < 0.001$), indicating high explanatory power of the model. Coefficient of the term of interaction of family firm and formal institutions is positively significant ($\beta = 0.493$, $p < 0.05$). The result confirms that family-owned firms with formal institutions are more likely than non-family firms to choose wholly owned mode. Model 2 also tests the entry mode choice of family-owned firms with informal institutions. The Model χ^2 value of Model 2 is 169.233 ($p < 0.001$), indicating high explanatory power of the model. Coefficient of the term of interaction of family firm and informal institutions is negatively significant ($\beta = -0.684$, $p < 0.05$). The result confirms that family-owned firms with informal institutional distance are more likely than

non-family firms to choose joint venture mode.

4. Discussion and Conclusions

The aim of our study was to introduce the family-owned firms' entry mode choice in different institutional contexts. The most striking finding of the study is that family-owned firms choose JV in regard to informal institutions, but choose wholly owned mode in regard to formal institutions. The results indicate that family-owned firms adopt high risks in the high quality of formal institutions. Regarding informal institutional distance, the family-owned firms choose the JV arrangement. Our results indicate that the family-owned and -controlled businesses utilize the risk-avoiding attitude in the informal institutional context.

In conclusion, our study may provide some evidence that address theoretical implications behind the motivations of governance on family firms' FDI decisions. An in-depth understanding of the environment context needs to be considered in countries with various institutions. According to our findings above, this study extends the existing literature on FDI. Traditionally, based on the transactional cost perspective, the institutional factors as country-level risk influence inconsistent FDI decisions [15,16]. In line with previous findings, the informal and formal institutional factors have different influences through the attitude of family-owned firms to significantly impact their entry mode choice. Therefore, the institutional factors might be cooperative opportunities instead of the country-level risk.

Our findings also suggest that future research should not focus on the direct links between the characteristics of family-owned firms and decision making. The findings show that the family firm's decision depends on various attitudes

and situations beyond the existing literature [26]. The firm-level characteristics and country-level context are reconciled when the family firm adopts the appropriate decision. Family firms must be taking into consideration a wide range of institutional factors to avoid making decisions in a vacuum state. Family firms can leverage the characteristics of stewardship and agent to overcome the institutional challenges, especially in Asia with family characteristics of enterprises to enter the overseas market, and how characterized by the use of family decision-making. If firms do not considerate overseas institutional environment, firms would likely miscalculate overseas risks and benefits. Our research shows that family firms face pressure to the formal institutional situation, and adopt economical thoughts to manage the obvious institutional environment. However, if the family firms face informal cultural factors to adopt social cooperative governance model would help to overcome the cultural factors. Therefore, choosing an appropriate mode of governance would avoid losses caused by wrong decisions.

This study has some limitations. First, our FDI data is collected from secondary data that might be underestimated the rich content of family firms such as social capital and human capital. Second, this study may be not able to capture comprehensive institutional factors. It is possible that future research may examine the circumstances regarding the other institutional factors to address the limitation of our study, using the cultural distance index and formal institutional distance. Future research can propose such a possibility to include the elaborate thought of cultural content such as Luo and Shenkar [27]. Comparing different phenomena (various institutions) facilitates understanding the nature of family firms in foreign environment.

Table 1. Descriptive statistics and Pearson correlations

	Mean	S.D	1	2	3	4	5	6	7	8	9	10	
1 Entry mode	0.71	0.46	1										
2 Family firm	0.86	0.34	-0.01	1									
3 Formal institutional hazards	0.67	0.47	0.19 ***	-0.02	1								
4 Informal institutional distance	2.06	0.82	0.19 ***	-0.03	0.76 ***	1							
5 Foreign investing experience	2.67	2.81	0.03	0.04 **	-0.12 ***	-0.15 ***	1						
6 Local investing experience	1.26	2.23	0.04 *	0.07 ***	0.09 ***	0.14 ***	0.61 ***	1					
7 Firm size	6.54	1.33	0.00	0.25 ***	-0.07 ***	-0.07 ***	0.22 ***	0.19 ***	1				
8 RandD intensity	3.29	9.34	0.01	-0.02	0.09 ***	0.09 ***	-0.06 **	-0.04 *	-0.13 ***	1			
9 Advertisement intensity	0.01	0.01	-0.02	0.06 **	-0.03	-0.03	-0.07 ***	-0.02	-0.01	0.10 ***	1		
10 Export %	61.27	34.64	0.14 ***	-0.04 *	0.20 ***	0.13 ***	0.12 ***	0.13 ***	0.04 *	-0.01	-0.18 ***	1	
11 Independent directors %	0.06	0.12	0.02	-0.22 ***	0.04 **	-0.01	0.26 ***	0.10 ***	-0.13 ***	0.04 **	-0.06 **	0.12 ***	***
12 Managers=directors %	0.17	0.18	0.04 *	0.20 ***	0.08 ***	0.05 **	-0.04 **	-0.01	0.07 ***	0.06 **	0.02	0.10 ***	***
13 Directors equity %	23.43	14.63	0.02	0.01	0.05 **	0.07 ***	-0.34 ***	-0.25 ***	-0.17 ***	-0.01	-0.02	-0.04 **	***
14 CEO equity %	2.15	3.37	0.09 ***	-0.01	0.10 ***	0.06 **	-0.11 ***	-0.09 ***	-0.21 ***	0.06 **	-0.02	0.14 ***	***
15 Board=CEO	34.13	21.31	0.10 ***	0.26 ***	0.10 ***	0.08 ***	-0.07 ***	-0.03	0.05 **	0.02	0.00	0.19 ***	***
16 Electronics industry	0.67	0.47	0.19 ***	0.05 ***	0.24 ***	0.18 ***	-0.01	0.04 *	-0.02	0.12 ***	-0.11 ***	0.39 ***	***
17 Plastics industry	0.03	0.18	-0.06 **	-0.01	-0.08 ***	-0.03 *	0.03	-0.01	0.13 ***	-0.06 **	-0.06 **	-0.09 ***	***
18 Automobile industry	0.01	0.09	-0.01	0.03	-0.08 ***	-0.06 **	0.03	0.00	0.08 ***	0.00	0.02	-0.14 ***	***
19 Transportation industry	0.03	0.18	-0.05 **	-0.05 **	-0.03	-0.03 *	0.03	0.01	0.01	-0.07 ***	-0.06 **	-0.22 ***	***

**** $p < 0.001$, *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Table 1. Descriptive statistics and Pearson correlations (continued)

	10	11	12	13	14	15	16	17	18	19
1 Entry mode										
2 Family firm										
3 Formal institutional hazards										
4 Informal institutional distance										
5 Foreign investing experience										
6 Local investing experience										
7 Firm size										
8 RandD intensity										
9 Advertisement intensity										
10 Export %	1									
11 Independent directors %	0.12 ***	1								
12 Managers=directors %	0.10 **	-0.10 ***	1							
13 Directors equity %	-0.04 **	0.04 *	-0.05 **	1						
14 CEO equity %	0.14 **	0.04 **	0.46 ***	0.08 ***	1					
15 Board=CEO	0.19 ***	-0.13 ***	0.38 ***	0.01	0.26 ***	1				
16 Electronics industry	0.39 ***	0.14 ***	0.19 ***	0.00	0.21 ***	0.21 ***	1			
17 Plastics industry	-0.09 ***	-0.06 **	0.07 ***	-0.07 ***	-0.11 ***	-0.03	-0.26 ***	1		
18 Automobile industry	-0.14 ***	-0.04 **	-0.04 **	0.04 **	-0.05 **	-0.06 **	-0.12 ***	-0.02	1	
19 Transportation industry	-0.22 ***	-0.08 ***	-0.09 ***	0.08 ***	-0.11 ***	-0.16 ***	-0.26 ***	-0.03 *	-0.02	1

**** $p < 0.001$, *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Table 2. The influence of formal international hazards and informal institutional distance on entry mode choice

	Model1			Model2		
	coefficient	S.D.	<i>p</i>	coefficient	S.D.	<i>p</i>
Intercept	0.342	0.894		-1.561	1.043	
Family firm * Formal institutional hazards				0.493	0.251	*
Family firm * Informal institutional distance				-0.684	0.278	**
Family firm				1.036	0.523	*
Formal institutional hazards				-0.271	0.238	
Informal institutional distance				0.909	0.264	***
Foreign investing experience	0.003	0.037		0.050	0.038	
Local investing experience	0.022	0.027		-0.034	0.029	
Firm size	0.018	0.039		0.041	0.041	
RandD intensity	-0.003	0.005		-0.006	0.006	
Advertisement intensity	2.031	3.290		2.782	3.411	
Export %	0.004	0.002	**	0.003	0.002	
Independent directors %	-0.386	0.478		-0.590	0.492	
Managers=directors %	-0.723	0.336	*	-0.710	0.343	*
Directors equity %	0.004	0.003		0.003	0.004	
CEO equity %	0.044	0.019		0.044	0.019	*
Board=CEO	0.007	0.003	**	0.007	0.003	**
Electronics industry	0.341	0.057		0.289	0.059	
Plastics industry	0.000	0.127		-0.071	0.129	
Automobile industry	0.238	0.263		0.295	0.264	
Transportation industry	0.059	0.127		-0.022	0.130	
1999	-0.154	0.161		-0.167	0.164	
2000	-0.057	0.156		-0.084	0.159	
2001	-0.212	0.155		-0.265	0.159	
2002	0.202	0.156		0.174	0.159	
2003	0.035	0.139		0.040	0.143	
2004	0.129	0.143		0.098	0.146	
2005	-0.343	0.115	***	-0.353	0.117	**
2006	-0.022	0.129		-0.034	0.131	
2007	0.208	0.127		0.182	0.129	
2Log Likelihood		2734.597			2725.968	
Rpseudo-R ²		0.068			0.094	
LR χ^2		169.233***			237.862***	
Observations		2451			2451	

*** $p < 0.001$, ** $p < 0.01$, * $p < 0.05$

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