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Factors Affecting Perceptions of the Choice between Acquisition and Greenfield Entry: The Case of Western FDI in an Emerging Market

Mehmet Demirbag, Ekrem Tatoglu, Keith W. Glaister

Abstract and Key Results

- This study provides a comprehensive account of foreign establishment mode strategies of firms investing in Turkey. The results of the logistic regression modeling provide support to the hypothesized relationships that take into account the impact of host country specific motives of MNEs on their choice between acquisitions and greenfield investments.
- The host country motives *quality of inputs* and *market potential* have significant negative coefficients, indicating that an MNE will favor the acquisition mode over a greenfield mode as the relative importance of both motives increases.
- The host country motive of *investment risk* has a significant positive coefficient, which increases the likelihood of the venture being a greenfield investment.
- Our results also show that the main investing firm specific and subsidiary level determinants of FDI modal choice identified in prior research also influence the establishment mode choice of Western MNEs when investing in Turkey. Parent diversity, previous commercial association, ownership pattern and resource-intensiveness of the target industry have the expected impact on the foreign investor's choice between a greenfield investment and an acquisition.
- No support is found, however, for the impact of cultural distance and foreign parent size on establishment mode choice. Similarly, the control variables of home region of the investing firm, timing of entry and industrial sector of investment do not affect modal choice.

Key Words

Acquisition · Greenfield Investment · Institutional Theory · Emerging Markets · Turkey

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Mehmet Demirbag (✉)
Senior Lecturer of International Business, Management School, University of Sheffield, Sheffield, United Kingdom.

Ekrem Tatoglu (✉)
Associate Professor of International Business, Faculty of Business Administration, Bahcesehir University, Istanbul, Turkey.

Keith W. Glaister (✉)
Dean and Professor of International Strategic Management, Management School, University of Sheffield, Sheffield, United Kingdom.

Introduction

Spurred by the growth in global commercial activity and the increasing number of firms operating in international markets, the multinational enterprise's (MNE) choice of entry mode into a foreign market has received a good deal of attention from researchers. First, a firm that decides to enter a foreign market has to choose between two related but distinct issues. It has to choose between non-equity modes, such as exporting and licensing, and equity-based entry modes, with either full ownership, i.e., a wholly owned subsidiary (WOS), or shared ownership, i.e., a joint venture (JV). Each of these modes varies significantly in terms of resource commitment and risk, with equity-based entry modes involving the highest level of control.

Following the choice of entering a foreign market by either full or shared equity investments, a second decision is whether to acquire an existing local firm (acquisition) or to create a new venture (greenfield investment). Compared with research on the MNE's choice of ownership of foreign ventures, there has been limited empirical work on the determinants of choice between acquisitions and greenfield investments. The majority of prior research on this strategic choice has been confined to examining firms from a single source country (Hennart/Park 1993, Barkema/Vermeulen 1998, Padmanabhan/Cho 1999, Brouthers/Brouthers 2000). However, there are a few exceptions, which examine the establishment mode decisions of foreign investors from multiple source countries (Caves/ Mehra 1986, Kogut/Singh 1988, Larimo 2003).

The prior literature focuses on firm specific factors that affect entry mode choice of MNEs, with relatively few studies examining host country specific factors. This is understandable because the prior studies mostly consider mature economies. The host country specific factors are of secondary importance for these economies and so they have been neglected. In emerging market economies, however, host country specific factors have a direct impact on the entry mode choice and appear to be as important as firm and industry specific factors. Building on the prior literature this paper seeks to provide new insights into the host country factors motivating foreign multinationals to engage in foreign equity venture formation in the context of an emerging market economy.

As described by Malhotra (2003), modes of entry are alternative routes or means available to a firm for transferring resources from the home country to the host country. The Turkish context in this regard provides a good illustration of the phenomenon of the massive entry of MNEs into emerging markets and their strategic choice of the establishment mode of their investments. Along with its strategic location and ongoing membership negotiations with the EU, it is envisaged that soon Turkey will attract a large volume of European FDI. Foreign firms have already made serious inroads into the Turkish economy since the mid-1980s, following the radical economic and policy changes to liberalize the economy. The high growth of the Turkish economy and the country's large and growing population also played their part. Government economic policies, especially with regard to the reform of foreign exchange policy, capital markets, the privatization of state-owned enterprises, and foreign investment options, have all contributed to Turkey's attractiveness for foreign investors (Tatoglu/Glaister 2000). The number of foreign equity venture formations during the 1980-2003 period reached a total of over 6,500 with the amount of cumulative FDI totaling nearly $17 billion (GDFI 2004).

Drawing on survey data from a sample of 145 Western MNEs, this study makes two contributions to the establishment mode literature. First, it builds upon prior research by providing a comprehensive account of foreign establishment mode strategies of firms from numerous countries investing in Turkey. Second, given the increasing wave of foreign acquisitions recently in Turkey on its way to become an EU member, this study contributes to our understanding of FDI modal choice of European investors. Third, our work extends previous research undertaken in other contexts and shows the extent to which the main determinants of establishment mode strategies reported in prior studies influence the foreign establishment mode strategies of Western MNEs in Turkey.

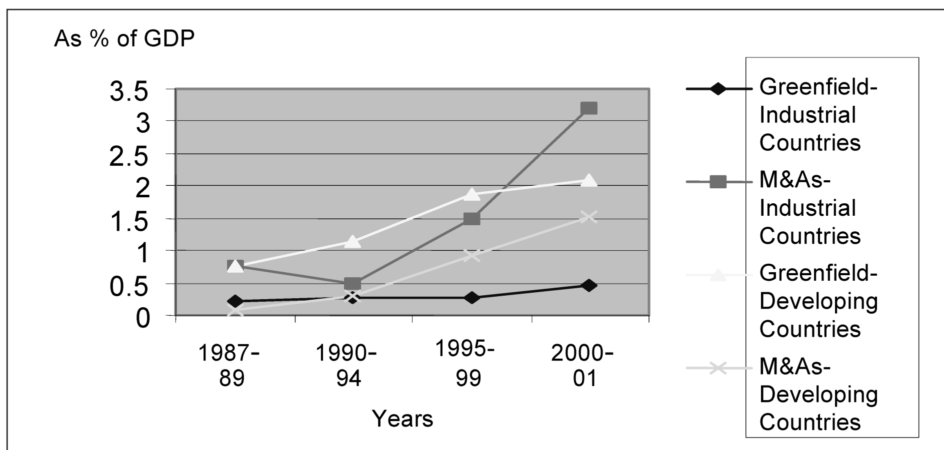
The paper is organized as follows. The next section provides background and develops the hypotheses of the study. The research methods are presented in the third section. Results and discussion are in section four followed by managerial and policy implications. Conclusions are provided in the final section.

The Changing Pattern of FDI in Emerging Markets

Recent evidence on the pattern of FDI entries to emerging market economies indicates a shift towards acquisitions while in the past entries were predominantly greenfield ventures. Turkey, in this context provides a good example where there have been some institutional changes. Findings from this study also have potential for generalization to other emerging market economies which, with dynamic changes and differing factor endowments, differ from mature economies.

The aggregate data presented in Figure 1, indicate that FDI flows to emerging market economies surged during the 1990s, and this surge was accompanied by a dramatic change in the FDI pattern with the proportion of acquisitions within total FDI shifting from almost negligible to a significant level over the decade. This increased proportion of acqui-

Figure 1. Pattern of FDI (Greenfield vs. M&As)



Source: Compiled from Calderon et al. (2004, p. 22)

sitions can be explained by a number of factors, which vary between mature economies and emerging markets (e.g., an improved investment environment coupled with privatization of state enterprises in a number of emerging market economies and the availability of acquirable private sector companies in these countries). The change in the pattern of FDI in emerging markets also coincides with the greater flexibility, in terms of equity ownership of MNEs, introduced by host governments throughout the 1990s.

According to UNCTAD (2000), mergers and acquisitions are the favored option for expansion in Europe (including Eastern Europe) and North America, followed by greenfield investments and strategic alliances. In Central and Eastern Europe, executives of major MNEs surveyed by UNCTAD clearly favor acquisitions (32 percent) more than greenfield investments (23 percent) (UNCTAD 2000).

A similar trend also has been reported by a number of commentators on Turkey. Ernst and Young (2004) reported that in 2003 and 2004 the total number of large scale acquisitions by foreign firms was 38 and the total value of acquisitions was $916 million, while the total FDI in 2003 and 2004 in cumulative terms was $1,483 million (Ernst/Young 2004, Turkan 2005). These figures indicate that a large proportion (61 percent) of FDI inflows in 2003 and 2004 were in the form of acquisition of existing companies, while only 39 percent of FDI inflows were in the form of greenfield investments. Further, in 2005, the total foreign acquisitions in Turkey reached a record level of $18.6 bn. Although some of these entries were large acquisitions (64 large acquisitions in 2005) mainly concentrated in the banking and finance sector, there was also an upsurge of acquisitions of smaller and medium size companies by MNEs. While acquisitions of larger firms may constitute a high proportion of FDI entries in terms of acquisitions, data indicates a similar pattern with regard to cross-border acquisitions of smaller firms in Turkey. In 2004 29 percent of all FDI entries, in 2005, 22 percent of all FDI entries and in 2006 (as of August) 25 percent of all FDI entries in Turkey were in the form of partial or complete foreign acquisitions. The increase in acquisitions over the last decade has dramatically increased foreign MNEs' share of the top 500 manufacturing companies in Turkey, from 21 percent in 1990 to 33 percent in 2003 (Turkan 2005). In contrast, greenfield FDI inflows to Turkey have remained unchanged in recent years.

Recent developments including Turkey's application for membership of the EU, a more liberal FDI policy regime (which came into effect in 2003) and privatization policy, have led a number of observers to expect an increase in mergers and acquisition activity in Turkey (Ernst/Young 2004, Erdilek 2003). Some indications of this have already emerged. Examples include HSBC's full acquisition of Demirbank in 2001; BNP Paribas's 50 percent acquisition of TEB (Turk Economy Bank) for $216.8 million in 2004; Unicredito and Koc Group's joint acquisition of Yapi Kredi Bank (57 percent valued at $1.6 billion) in 2004; Vodafone's acquisition of Telsim for $4.550 bn; North Cape Mineral's acquisition of Beykrom and International Power's acquisition of Trakya Elektrik (power generator). Fortis became the latest European group to enter the Turkish banking industry with its acquisition of family-controlled Disbank for about $1.28 billion in cash (*Financial Times* 2005). An agreement has also been reached regarding the acquisition by GE Consumer Finance of a 25.5 percent share in Garanti Bank, Turkey's third largest private bank. Alpha's purchase of 13 percent of the shares of Turkcell (for $1.6 billion), Turkey's largest cellular network is another large scale acquisition in Turkey. The emerging pattern

of FDI entries discussed in this section highlights the importance of change, or perceived change in host country related factors and institutions in determining MNEs' choice between acquisition and greenfield entry. As there have been mixed results in terms of success of some of the acquisitions in emerging market economies, Turkey appears to be a good testing ground to examine the importance of host country factors and institutions in determining MNEs' choice of a particular market entry mode.

Background Literature and Hypotheses Development

While there is no well-developed theory of the determinants of the choice between acquisitions and greenfield investments, previous studies have investigated the influence of a number of variables that discriminate between these two modes, largely drawing on the basic premises of transaction cost theory, the bargaining power model, the cultural model, organizational capability and the learning perspective. The five models identified here are not mutually exclusive. Both the cultural model and the bargaining model could be considered as derivatives of the more basic transaction cost approach (Padmanabhan/Cho 1995).

Transaction cost theory proposes a variety of factors, including both firm-related factors and host country-related factors that potentially could influence the benefits and costs associated with alternative establishment modes. Although there has been a rich literature examining MNE's choice between wholly owned subsidiary (WOS) and joint venture (JV), there has not been a major attempt to extend transaction cost theory to firms' choice between greenfield investments and acquisitions. This paper attempts to fill this gap in the literature. The main argument behind the transaction cost explanation of international market entry modes lies in the transfer or use of the firm specific advantages in cross-border operations. Transaction cost economics suggests that asset specificity is an important factor in MNEs entry mode decision where "the degree to which an asset can be redeployed to alternative uses and by alternative users without sacrifice of productive value" (Williamson 1996, p. 59) is limited. Hennart and Park (1993) dichotomize two types of firm specific advantages. The first type is the organization's ability or technical expertise (i.e., codifiable knowledge), which can be separated from the organization. The second type is rather difficult to separate from the organization and may be deeply embedded. For the first type of firm specific advantages, the international market entrant can combine its resources with embodied resources of the acquired firm. As for the second type of advantage, such a combination may not be possible since it is tightly embedded in the investor organization. In this case a direct entry through a clone of the foreign partner would be a more efficient strategy to enter a new market. (Hennart/Reddy 1997, Hennart/Park 1993). The divisibility problem and unwanted resources of potentially acquirable firms may also increase the transaction costs of acquisitions. In some cases even when the divisibility is possible, unbundling of resources may lead to loss of firm specific "quasi-rents", especially when resources are related (Chatterjee 1990). If we extend this line of argument for the choice between greenfield and acquisition, then the greenfield entry mode seems most efficient, making it possible to install the firm's managerial practices from the outset (Hennart/Reddy 1997, Hennart/Park 1993).

Institutional theory extends the transaction cost theory by adding the institutional dimension. Institutional theory draws its theoretical logic from the argument that different environments are endowed with different levels of resources and institutions of varying effectiveness (Wan/Hoskisson 2003). Meyer and Nguyen (2005), and Henisz (2000) argue that the institutional context in many emerging markets plays a crucial role in the firm's entry mode decision. Institutions in the host countries not only design and implement policies; they also have preferences and are known to favor local business. Institutions also regulate the business environment, which may influence MNEs' location choice and entry mode, and affect foreign investors' perceived risk (Brouthers 2002).

Based on the premises of institutional economics, Wan and Hoskisson (2003) described the home country environment as consisting of factors and institutions. Factors are classified into three categories, endowed factors (derived from the natural environment), advanced factors (e.g., a country's physical infrastructure, capital goods, and financial resources) and human factors (e.g., the quality of labour). While institutions provide a less tangible form of support to organizations, their efficiency would facilitate a better business environment (facilitating transactions) for the business units and organizations alike. Host country institutions can be broadly classified as political, legal and societal institutions. Institutional theory postulates that effectiveness of these institutions will facilitate better performance of MNE affiliates. Dunning (2005) in his recent work extends the eclectic paradigm by integrating the institutional perspective to Ownership (O) and Location (L) advantages. As Meyer and Nguyen (2005), and Henisz (2000) argue, the institutional context in many emerging markets plays a crucial role in the firm's entry mode decision. The host country institutional environment influences the MNE's entry mode by equity composition and mode of entry to the market. Political risk is formulated as a function of institutional environment, which influences MNE's equity ownership level in cross-border operations. The institutional environment in a given host country also affects the MNE's choice between greenfield and acquisition mode, since the local institutional framework shapes transaction costs, business risk, and executives' perceptions on institutional stability of the country. It is possible that the same institutions generate different outcomes suggesting that managers' perceptions of institutions at the time of decision also have impact on the decision (Mudambi/Navara 2002).

Previous research indicates that the institutional environment in which MNEs operate has a significant impact on firm strategies and outcomes including entry mode decisions (Henisz 2000, Meyer/Nguyen 2005). Porter's (1990) main argument on the competitive advantages of nations also revolves around the quality of resource provision, presence of supporting industries and institutional context. In emerging market economies, institutions and institutional factors are particularly important because institutional immaturity raises transaction costs and risk level (Child et al. 2003, Meyer 2001, 2004, Uhlenbruck 2004). The quality of institutions is likely to be an important determinant of the MNE's location and acquisition-greenfield entry decisions, particularly for emerging market economies due to poor legal protection, entrant firm's need for networking and relationship with local authorities. Child et al. (2003, p. 243) refer to natural selection and argue that "firms operating under more favorable external circumstances have a better chance of prospering". Peng (2000) and Makino et al. (2004) have both stressed the importance of economic, political, social, cultural and institutional differences across countries and as-

serted that "countries do matter" in explaining the variation in behavior and performance of MNEs.

Drawing on these theories and associated perspectives, this study considers the influence of a set of host country, investing firm and subsidiary level variables on the establishment mode choice of foreign investors. Of these variables, host country specific factors are taken as the main indicator variables, as they have not been explored fully in the prior literature. The impact of investing firm and subsidiary level variables are treated as control variables.

Some of the firm-related factors include the size of the parent firm (Caves/Mehra 1986, Kogut/Singh 1988), multinational experience of the parent firm (Kogut/Singh 1988, Hennart/Reddy 1997, Mudambi/Mudambi 2002), research and development intensity of the parent firm (Kogut/Singh 1988, Padmanabhan/Cho 1995, 1999, Brouthers/Brouthers 2000), relative size of the investment (Caves/Mehra 1986, Hennart/Park 1993, Padmanabhan/Cho 1995, Brouthers/Brouthers 2000), degree of product diversity (Caves/Mehra 1986, Zejan 1990, Barkema/Vermeulen 1998), and foreign experience (Wilson 1980, Barkema/Vermeulen 1998, Padmanabhan/Cho 1999). Typical examples of the host country-related factors are the level of development and the size of the host country market (Zejan 1990, Padmanabhan/Cho 1995, Brouthers/Brouthers 2000, Mudambi/Mudambi 2002).

Host Country Specific Factors

The elements of host country location motives can be broadly classified into two types. First, there are Ricardian type endowments which mainly comprise of natural resources, most kinds of labour and proximity to markets. Second, there exists a range of environmental variables that act as a function of political, economic, legal and infrastructural factors of a host country. Both types of factors play a crucial role in a firm's decison to enter a host country (Kobrin 1976, Maclayton et al. 1980). The sub themes dealing with host country location factors can be summarised as: market size and economic growth (Aharoni 1966, Kobrin 1979, Davidson 1980, Buckley/Mathew 1980, Root 1987, Young et al. 1989, Sabi 1988), raw materials and labour supply (Moxon 1975, Buckley/Casson 1985, Dunning 1988), political and legal environment (Goodnow/Hansz 1972, Kobrin 1979, Anderson/Gatignon 1986, Agarwal 1994, Root/Ahmed 1978), host government policies (Davidson/McFetridge 1985, Goodnow 1985, Loree/Guisinger 1995), level of industry competition in the host country market (Goodnow 1985, Harrigan 1985a, 1985b), geographical proximity and transportation costs (Goodnow/Hansz 1972, Davidson/McFetridge 1985) host country infrastructure (Dunning/Kundu 1995, Ulgado 1996), and availability of incentives and tax advantages (Loree/Guisinger 1995, Dunning 1993, Sethi et al. 2003). The following subsections provide the rationale for the hypothesised effects of host country specific factors on the MNEs establishment mode decisions.

Host Country Investment Risk

In entering a new market, firms aim to minimize the risks associated with operating in the environment. This is particularly the case when the perceived risk is higher than the manageable level. Gatignon and Anderson (1988) define environmental uncertainties as the

extent to which a country's political, legal, cultural and economic environments threaten the stability of a business operation. Thus the level of risk perceived by MNEs plays a crucial role in the entry mode decision (Franko 1971, Ahmed et al. 2002). Brouthers et al. (2002) used the perceived environmental uncertainty concept in explaining MNEs' choice between a wholly owned subsidiary and a joint venture. Brouthers and Brouthers (2003) highlighted that risk propensity variables were significant determinants of both manufacturing and service sector international entry mode decisions.

In this paper, we extend this argument to the firm's entry mode decision of greenfield investment or acquisition. Our argument draws from both institutional theory (North 1991, Coase 1992, Williamson 2000) and capital market failure (Chatterjee 1990). Since institutions moderate transaction costs and influence foreign investors' perceived risk in the host country, the stability/instability of host country institutions may impact MNEs' greenfield or acquisition entry decisions. In emerging market economies change of institutional environment is evidently high therefore one may expect institutions to create particular constraints or facilitation of an entry mode choice. Meyer and Nguyen (2005, p. 76) strengthen this argument by hypothesizing that "efficiency of institutions in supporting markets for critical resources encourages FDI in the form of greenfield".

The counter argument to the institutional perspective is developed by the capital market failure explanation of the choice between acquisition and greenfield market entry modes (Chatterjee 1990). This argument is mainly based on the divisibility of assets and the complementarity of resources of the acquired company. The probability of acquiring unwanted resources may increase utilization costs and increases business risk since the business targeted for acquisition will generally have resources besides the complementary ones. These will tie up financial resources, which will increase the entrant's utilization costs. Due to the indivisibility of these resources and a weaker capital market structure in emerging markets, the acquirer may not be able to recover extra financial outlay by selling these resources. Therefore, in the case of the decision to acquire, in an international context the integration of the acquired company may prove to be a complex process. In order to minimize potential managerial, cultural and organizational fit problems in cross-border acquisitions (and concerns over the organizational compatibility of the acquiree and acquirer – see for example McCloughan/Stone 1998) MNEs tend to go for greenfield investments. Furthermore, in a greenfield investment the managerial link between the parent organization and the affiliate is expected to be stronger (Brouthers et al. 1999, Buckley/Casson 1998, Ahmed et al. 2002, Newbury/Zeira 1997, Kumar/Subramaniam 1997, McCloughan/Stone 1998). This leads to the following hypothesis.

Hypothesis 1. A foreign investor is more likely to choose a greenfield entry mode over an acquisition mode when the perceived host country investment risk is high.

Market Potential

The market potential in the host country is an important determinant of the MNE's entry mode decision. Although it is clear that market growth would often attract entry (Chatterjee 1990) it is not equally clear if the rate of growth will influence the mode of entry. As

Luo (2001, p. 452) puts it "industrial sales growth conditions in a host market affect expected net returns and firm growth during international expansion. This then affects resource commitments, strategic orientations and entry mode decisions".

In a growing market, one may expect MNEs to use a direct entry mode to capture market share and realize growth goals (Porter 1980), but to establish an early presence in the market may require an acquisition rather than a greenfield investment. Buckley and Casson (1998) argue that when a large monopoly of rents exists, the entrant will favor acquisition over greenfield both in manufacturing and distribution. This is because of the entrant's desire to establish long-term control over the domestic rivals' production or distribution facilities. When an investor decides to make a fast move and capitalize on first mover advantages, an acquisition of a local business with an existing network may be preferred to a greenfield investment. Greenfield investments, in the face of rapid market growth, may be too slow to achieve the new entrant's strategic objectives (Buckley/Casson 1998, Meyer 2001, Peng 2000, Laurila/Ropponen 2003). In a high growth market there may be opportunities to purchase established businesses that are financially weak. There have been a number of entries of this nature in emerging market economies when firms have been available for acquisition. This argument can also be strengthened from an institutional perspective. Market oriented firms (for which the market size and growth rate is more important than export oriented firms) are more concerned with linking with local networks and accessing resources through their local partners (Meyer/Nguyen 2005). The institutional perspective appears to support the argument that export oriented FDI is more frequently in the form of greenfield investment since their local network needs are relatively less, whereas market oriented firms may suffer more from liability of foreignness and informal institutions may have motives to inhibit greenfield entries. Institutional analysis further suggests that there may be strong incumbents in market-oriented operations, which would motivate foreign investors to seek acquisitions rather than greenfield investments. An existing firm would be acquired to overcome these incumbents (mainly for complementary effects such as gaining legitimacy, lobbying power of local players and established network of existing firms). This argument may not hold for young industries characterized by rapid growth, as there may be no firms available for acquisition (Chatterjee 1990). Therefore we hypothesize that:

Hypothesis 2. A foreign investor is more likely to choose an acquisition mode over a greenfield mode when a significant market potential is perceived.

Government Regulations and Incentives

Investment agencies in developing countries tend to provide more incentives for greenfield investments than for acquisitions. This is because they are primarily concerned to facilitate an increase in employment, and transmission of knowledge and technology through greenfield investments. MNEs, however, do not have fixed convictions, and in many cases it is reported that they behave in response to the competitive environment (Mudambi 1998). Taxation policy and special economic zones play an important role not only in location choice decision but also in entry mode choice. Several studies have found that taxation policy deters FDI or induces firms to invest in high incentive regions in the

host country (Szanyi 2001, Meyer/Nguyen 2005). Based on a survey of FDI in Hungary, Szanyi (2001, p. 30) concludes that "investment incentives can play an additional role in motivating foreign investors. In Hungary, the conditions for such incentives have most easily been met by large greenfield investors". This is mainly due to the host government's perception of employment creating effects of greenfield investments. Governments in emerging market economies are also keen to strengthen their export oriented industries and these employment and export generating industries are high incentive sectors.

In a recent study of the Czech Republic's national investment incentive scheme, Mallya et al. (2004) found that there may be a selection bias in favor of new and greenfield FDI. A similar conclusion was also drawn by Mudambi (1998). Meyer and Nguyen (2005) argue that the institutional set up in emerging market economies including local authorities and business would have fewer motives to inhibit greenfield investments. Incentives in many emerging market economies are provided for less developed regions where numbers of acquirable established companies are relatively scarce which leaves the new entrant with no option but a greenfield investment. Although in Turkey incentives apply equally to both greenfield investments and acquisitions, many potential acquisitions are not located in high incentive regions and therefore do not qualify for incentives. Therefore we hypothesize that:

Hypothesis 3. A foreign investor is more likely to choose a greenfield investment over an acquisition mode when investment incentives are perceived as important.

Comparative Cost Advantages and Quality of Inputs

Comparative cost advantages coupled with input quality in the host country may influence the foreign investor's entry mode decision. The expected reduction in the cost of operations offered by the two modes of entry depends on a number of factors including the nature of the excess resources, the number of potential entrants, and the extent of competition in the target industry (Chatterjee 1990). When the new entrant expects a large reduction in operating costs from excess resources and requires few complementary resources, then the likelihood of a greenfield investment is higher. There is some evidence to support this argument. Hennart and Park (1993) found that acquisition was favored over greenfield investment when the new entrant seeks access to complementary inputs. Transaction cost economists argue that complementary inputs such as product specific knowledge may be acquired more cheaply in a going concern than in disembodied form through market exchange (Chang/Rosenzweig 2001).

In contrast, Brouthers and Brouthers (2000) argue that greenfield investment may provide a superior method to capture the "economies of independent activities" than do acquisitions. When a firm is motivated by access to quality inputs, acquisition may be favored over greenfield investment. In a study of FDI and entry mode in Hungary, Szanyi (2001) pointed out that foreign investors opted for an acquisition when there was an acquirable company with an established reputation in terms of finished or semi finished goods. Szanyi (2001) also reports that quality of human resources and skills available in local companies motivate MNEs in their acquisition decisions in Hungary. In cost oriented operations, however, Antaloczy and Sass (2001) argue that especially when labor-inten-

sive production processes are transferred to a low-wage location, MNEs prefer a greenfield entry mode. In a study of CEE countries, based on the EBRD database, Wes and Lankes (2001) found that the proportion of skilled labor costs in total production costs was much higher for greenfield investments than for acquisitions, while the share of unskilled labor was more than twice higher for acquisitions than for greenfield investments. They further report that although wage rates for greenfield investments and acquisitions stay approximately the same, in the case of skilled labor the productivity is significantly higher for greenfield investments than acquisitions. However, the relatively low cost of labor is not the only input that the host country can provide. An existing marketing network and knowledge based resources, quality of the labour force, and complementary resources are also important factors in greenfield – acquisition decisions. Due to the ambiguity of the prior literature on comparative cost advantages and quality of inputs, we propose the following two-part hypothesis:

Hypothesis 4a. A foreign investor is more likely to choose a greenfield investment over an acquisition mode when the cost of production is a dominant motive.

Hypothesis 4b. A foreign investor is more likely to choose an acquisition mode over a greenfield mode when the perceived input quality is higher in the country of entry.

Investing Firm Specific Factors

Input Dependency

The relationship between input dependency and entry mode can be explained by both resource dependency and the resource-based views (Yan/Gray 1994, Pfeffer/Salancik 1978, Lecraw 1984, Lee et al. 1998, Das/Teng 2000). Resource dependency theory (Pfeffer/Salancik 1978) portrays the organization as facing a complex set of dependencies between itself and its environment. Thus, MNEs would choose greenfield investments so as to better manage these complexities and uncertainties. A high input dependency between the parent firm and the affiliate may also facilitate a vertical control mechanism. Input dependency of the affiliate on the parent organization tends to reduce the affiliate's autonomy, hence increasing the parent firm's influence on overall strategy of the affiliate (Pfeffer/Salancik 1978, Lecraw 1984, Lee et al. 1998). According to the resource-based view of the firm, where resources are imperfectly imitable and imperfectly substitutable, a greenfield investment rather than the acquisition of an existing company would better protect a firm's resources and knowledge. A greenfield investment would also facilitate efficient knowledge transmission between parent and subsidiary. Finally, cultural and organizational fit problems associated with international acquisitions would be avoided.

Extent of Diversification

Diversified firms are expected to prefer acquisitions rather than greenfield investments. The rationale behind this argument is the assumption that diversified firms have sophisticated management control systems that can minimize transaction costs and achieve effi-

ciency (Brouthers/Brouthers 2000, 2003, Harzing 2002, Larimo 2003, Mudambi/Mudambi 2002, Laurila/Ropponen 2003, Chang/Rosenzweig 2001). This implies that less diversified firms lack the relevant expertise to manage and control expansion through acquisitions and should therefore prefer greenfield ventures. Empirical studies have produced ambiguous findings. Harzing (2002) did not find any significant relationship between entry mode and parent firm's diversification, whereas Laurila and Ropponen (2003) concluded that Finnish based firms in the paper industry used acquisitions for foreign expansion but they did not diversify into totally new product areas or areas of previously minor importance. Barkema and Vermeulen (1998) found a positive relationship between the greenfield mode and the extent of the parent firm's diversification. Other researchers have found some empirical support for the argument that firms favor the acquisition mode when the parent firm is diversified (Wilson 1980, Yip 1982, Zejan 1990, Hennart 1991, Caves/Mehra 1986, Zejan 1990, Barkema/Vermeulen 1998).

Previous Commercial Association

Although some researchers have included multinational experience of the firm in their research design, the impact of previous commercial association has not been fully explored. Previous commercial experience with the host country may interact differentially in terms of entry strategy. Chang and Rosenweig (2001) argued that the choice of entry mode in subsequent investment decisions might be affected by initial experience with a particular entry mode. This notion is known as path dependency. Path dependency means that, all else being equal, if the firm's previous experience with greenfield investment or acquisition is satisfactory, the firm may follow the same entry mode in future market entries.

This notion of path dependency can be extended to the firm's experience of previous commercial association in the host country. Some researchers argue that firms with previous commercial association in the host country will find it easier to make an acquisition rather than a greenfield investment (Wilson 1980, Caves 1982, Madhok 1995, Demirbag et al. 1995, Larimo 2003). This argument is based on the notion that relationships developed in the context of previous commercial association will lead to lower transaction costs (Chatterjee 1990, Madhok 1995) and hence would facilitate expansion through acquisitions in the host country. Larimo (2003), however, argues that parent firms with previous association with the host nation would have presumably accumulated country specific knowledge in-house, and consequently would have less need to acquire local knowledge, which might motivate them to prefer a greenfield investment. The counter theoretical argument is that the previous association of the organization with the host country might provide the firm with an effective management and control of the acquired firm. Clearly, these two theoretical arguments conflict and evidence from empirical studies is also mixed (Kogut/Singh 1988, Andersson/Swensson 1994, Hennart/Reddy 1997, Ellis 2000, Chang/Rosenzweig 2001, Larimo 2003). Although the relationship between local experience and the entry is ambiguous, it can be argued that when internal uncertainty is high (due to lack of host country experience) performance of the operation might be difficult to assess. Transaction cost theory would then suggest that the firm might find it easier to monitor the performance of its operation when it is fully integrated (Erramilli 1991).

Cultural Distance

The concept of cultural distance has been well known since the work of Hofstede (1980) and widely used for predicting the entry mode of MNEs (Harzing 2002). Cultural distance is defined as "the difference between national cultural characteristics of home and host countries" (Hennart/Larimo 1998, Anderson/Gatignon 1986, Brouthers 2002). There are two basic arguments on the impact of cultural distance on MNEs' choice between a greenfield investment and acquisition. The first argument is based on the relationship between cultural dissimilarity and the transaction cost of the entry. As cultural dissimilarity between the home and host country increases, investment in non-redeployable assets in the host country becomes riskier (Tatoglu et al. 2003, Kogut/Singh 1988, Gatignon/Anderson 1988, Erramilli/Rao 1993, Padmanabhan/Cho 1995, Barkema/Vermeulen 1998). This largely stems from the differences in the host country context, which makes a firm's management techniques and procedures less appropriate, and erodes the applicability and value of its organizing principles and routines (Madhok 1998). This argument leads some researchers to conclude that the larger the cultural distance between the home and host countries, the higher the probability of greenfield investment. The second argument is that the larger is the cultural distance between the home and host country, the greater will be the tendency towards a co-operative venture through a partial acquisition of an existing local firm. In line with this view Brouthers and Brouthers (2000) argue that in entering culturally similar countries, MNEs prefer greenfield investment which may facilitate them to maximize firm specific advantages. Chang and Rosenzweig (2001, p. 755) argue that "as firms learn about the host market and become familiar with its culture and institutional environment, one would expect the preference for greenfield investment to diminish". In this case a strategy of initially involving a local partner would help the new venture to acquire local political, legal and societal knowledge.

Some studies report a significant relationship between cultural distance and greenfield entry mode (Kogut/Singh 1988, Barkema/Vermeulen 1998, Chang/Rosenzweig 2001, Harzing 2002, Larimo 2003), while other studies do not find any significant relationship (Padmanabhan/Cho 1995, Anand/Delios 1997, Brouthers/Brouthers 2000). Harzing (2002) argued that these contrasting findings stem from home country effects inherent in single source country surveys (i.e., US and Canadian companies are adept at acquisition while Japanese companies tend to go for greenfield investments). In this study we balance the sample between firms from the US, Japan and European countries in order to minimize the home country effect in the analysis.

Parent Size

Transaction cost arguments predict that there is a relationship between the size of the parent firm and the entry mode. Hennart and Park (1993), for instance, argued that managerial constraints on greenfield expansion might be especially tight when the investor is a relatively small size organization. Kogut and Singh (1988) show that the greater the size of the parent organization, the greater the likelihood of a greenfield entry. Caves and Mehra (1986) also found that larger firms are more likely to enter by a greenfield investment. In contrast other studies (Padmanabhan/Cho 1995, Barkema/Vermeulen 1998,

Shaver 1998, Harzing 2002, Yip 1982, Mudambi/Mudambi 2002) have reported that larger firms tend to prefer acquisitions rather than greenfield investment. The rationale behind this set of findings is that in large firms the managerial resources and capabilities may facilitate the integration and the control of the acquired or partly acquired company. Other studies have produced mixed results. Larimo (2003) examined the entry mode of Nordic firms and found a significant relationship between firm size and entry mode of Finnish firms, but not in the case of Danish, Norwegian or Swedish MNEs. Chang and Rosenzweig (2001) were unable to find any significant relationship between the size of the parent firm and the entry mode. It is perhaps the case that the findings of some of the studies are confounded by the cultural distance between the home and the host countries, the timing of the investment decision and the nature of the selected host countries (developed or developing countries).

Affiliate Specific Factors

Ownership Pattern

The ownership pattern or equity control of the affiliate is expected to have an impact on the MNE's entry mode decisions in emerging markets. However, it can be argued that the degree of ownership is relatively independent of the entry mode, as it is determined by the foreign parent's requirements for complementary inputs. Such requirements may be served equally well by both greenfield or acquisition entry modes. Perhaps not surprisingly, empirical studies report mixed evidence on the relationship between degree of ownership and the entry mode. Gomes-Casseres (1989) noted a relationship between acquisitions and JVs, while Caves and Mehra (1986) reported that acquisitions were less likely in establishing JVs. Hennart and Park (1993), however, found that the ownership level of the affiliate (JV) had no significant impact on the entry mode. Hennart and Larimo (1998) highlighted that Finnish firms tend to choose full ownership of their acquisitions, but use joint ventures for greenfield investments. In a more recent study of Nordic firms, Larimo (2003) found that wholly owned subsidiaries were more likely to be acquisitions. In their survey of FDI in CEE countries, Wes and Lankes (2001) concluded that "greenfield investments were twice more likely to be under full foreign ownership than acquisitions". Given the market structure in Turkey, we expect MNEs to follow a similar strategy to that of entry to other emerging markets in the region.

Resource Intensity

A large proportion of affiliates in emerging markets are in resource-intensive industries. In resource-intensive industries (i.e., mining, food and beverages, tobacco, textile, petroleum, rubber and primary metals), local firms are assumed to have more privileged access to these resources. Gomes-Casseres (1989) argues that the likelihood of MNEs establishing JVs with local companies in these industries is high. The resource-intensive industries, as in many other developing countries, were amongst the priority sectors for Turkish industrialization. MNEs entering these industries would have a resource-seeking motive. We expect that resource intensity of the affiliate's industry will have some impact on

MNEs' preference between greenfield and acquisition (Laurila/Ropponen 2003). Lipsey (2000), for instance, argues that US FDI tends to move to countries with comparative disadvantages in trade relative to the United States. In resource-intensive industries, however, US FDI seems to move towards "countries with comparative advantages in trade relative to the US". In the light of this argument, Lipsey (2000) concludes that while company comparative advantages dominate investment in manufacturing, country comparative advantages dominate in resource intensive industries. In resource intensive industries host governments would prefer to have JVs in the form of greenfield investments. High asset intensity requires larger commitments in terms of capital or other distinctive resources. In an environment of high uncertainty, MNEs may opt for a co-operative form or an acquisition of an existing local company. However, if the new venture is in a resource-intensive industry (which may not require high capital investment or other distinctive resource commitments) then MNEs may prefer greenfield investment over an acquisition.

Research Methods

Dataset

Empirical studies of MNEs' entry mode decisions have relied on both primary and secondary data. Survey data of managers' perceptions of host country environment and institutions has been widely used in examining entry mode decisions of foreign investors between joint ventures and wholly owned subsidiaries or between greenfield investments and acquisitions (Agarwal/Ramaswami 1992, Brouthers 1995, Barkema/Varmeulen 1998, Luo 2001, Harzing 2002, Brouthers 2002, Brouthers/Brouthers 2002, Brouthers et al. 2002). As Agarwal and Ramaswami (1992, p. 2) argue the "survey technique provides direct measures which are obtained by evaluating managerial perceptions about market potential and investment risk (location advantages)". In a similar vein, Henisz (2000) notes that, in researching political risk "the literature has moved away from attempts to directly quantify hazards and has, instead, adopted the proxy of managerial perception of hazards" (for a detailed discussion, see also Sethi/Luther 1986, Agarwal/Ramaswami 1992). In a research design involving a single recipient country, managerial perceptions are important for the assessment of environmental factors, which are exogenous and constant across firms for the given country. Also, executives' perceptions of the host country and institutions are important because past experience shows that these constructs are difficult to operationalize in entry mode decisions (Agarwal/Ramaswami 1992).

Measuring institutional, industry and firm level variables as a function of managers' perception of institutional environment, industrial and organization related factors on decisions appears to receive significant support from the organization behavior and strategic management literature (Cyert/March 1963, Aharoni 1966, Agarwal/Ramaswami 1992). As Agarwal and Ramaswami (1992, p. 3) argue "these perceptions may be different due to variations in managers' past experiences in that country, level of knowledge of that country, individual biases, etc." The research design of this paper was based on the premise that executives' perceptions of the host country environment would be important determinants of their entry mode decision (greenfield vs. acquisitions).

The analysis in this study is based on the collection of primary data at the firm level. The sample, which includes the foreign partners of Western MNEs headquartered in the USA and Western Europe, results from the pooling of the databases of two surveys. For both surveys, a purposive sample of foreign investors was drawn from the database of the General Directorate of Foreign Investment (GDFI) on the basis of the following selection criteria: (i) partners from Europe and the USA, (ii) having an affiliate with an equity stake of more than 10 percent, (iii) having an affiliate with capital value of more than 1 million USD. It was also decided to investigate only one affiliate for each of the multi-affiliate foreign investors. For these firms the affiliate chosen was the one most recently established.

The data for the first survey were collected in 1995 by means of personal interviews with senior executives in several countries including the UK, Germany, France and Belgium. Data for the second survey were collected in 1999 by means of an international mail survey. The second survey contains items from the earlier survey, and data were collected from recent entries and the ones that were not covered in the first survey. The first survey mainly included entries prior to 1980s, while the second survey largely focused on entries post 1990. The aim was to capture implications of policy and institutional changes throughout 1980s and 1990s by an integrated dataset. Efforts were thus made in both surveys to reach key informants. For the information needed for the postal survey, key informants were typically either president or CEO of the investing firms. In those cases where a known area manager was involved in the entry decision from the very outset, then questionnaires were sent to these area managers. Both surveys followed the guidelines developed by Huber and Power (1985) for using single informants, and the structured nature of both surveys enabled us to merge both data sets.

All interviews and the questionnaires designed for data collection were in English. The composite database consists of 145 foreign affiliates formed by Western MNEs from 15 different countries. Potential for any bias that may stem from the pooling of datasets was checked in order to examine the generalizability of the study's findings. First, the responses provided to the questions were investigated for each sample and showed no significant differences ($p > 0.1$). Second, the responding companies from each sample were also compared across the main characteristics of the sample such as parent size, time period of formation and ownership pattern and again showed no clear differences ($p > 0.1$).

There is not a well established method for merging datasets in international business research; however, there are two main approaches which have been applied by researchers: the means-based approach and regression-based imputation (Schofield/Polette 1999, Brown 2002). The means-based approach has been mainly applied to smaller datasets while the regression-based imputation technique has been used for merging larger datasets and estimating missing values (Brown 2002). With the means-based approach (also called the cell-based approach), if there are no significant differences between means of variables from the two datasets, then the variables from the datasets are pooled into a merged dataset. This approach has commonly been used by health economists (Cameron/Wolfson 1994, Schofield/Polette 1999) for simulation purposes. Lane et al. (2001) used the means-based approach to compare and identify absorptive capacity and learning in international joint ventures in Hungary. The regression approach relies on mathematical models, which goes beyond the scope of this paper. Although the means-based approach has some limitations for larger datasets (Cameron/Wolfson 1994), it is relatively simple

to apply as it relies on tables of average values associated with a particular variable, rather than complicated mathematical models (Schofield/Polette 1999). Secondly, the technique is flexible and depends on only a small number of readily available variables. This study uses the means-based data merging technique. We pooled data from the two surveys to establish a larger dataset which facilitates more rigorous testing of hypotheses. The merged dataset also enabled us to cover a larger time scale to identify impacts of policy changes throughout the second half of the 1990s.

For the full set of sample firms, 99 (68.3 percent) have greenfield investments and 46 (31.7 percent) have acquisitions. In terms of the time period of formation of affiliates, about 66 percent of the affiliates were established in the period 1987-94, 14 percent formed in the period 1980-1986, and the remaining 20 percent formed prior to 1980. Table 1 summarizes the characteristics of the sample.

Table 1. Sample Characteristics

Industry of Affiliate	N	%	**Time Period of Formation**	N	%
Auto, transport and related equipment	24	16.6	Pre-1986	49	33.8
Electricals and electrical machinery	23	15.9	Post-1986	96	66.2
Food/drink manufacturing	8	5.5	**Market Entry Mode of Affiliate**		
Chemicals	28	19.3	Greenfield	99	68.3
Textile, apparel and leather	5	3.4	Acquisition	46	31.7
Computer and software	5	3.4	**Foreign Parent's Diversity**		
Metal, iron and steel	7	4.8	Single business	13	9.0
Other manufacturing	14	9.7	Dominant business	65	44.8
Export-import trading	11	7.6	Related business	51	35.2
Tourism	2	1.4	Unrelated business	16	11.0
Financial and consultancy services	10	6.9	**Previous Association**		
Construction and transport services	5	3.5	Yes	95	65.5
Other services	3	2.1	No	50	34.5
Country of Origin			**Mode of Ownership**		
Germany	32	22.1	WOS	59	41.0
Switzerland	5	3.4	JV	86	59.0
United Kingdom	25	17.2	**Number of FP Employees**		
Netherlands	7	4.8	0-49	2	1.4
France	8	5.5	50-99	2	1.4
Belgium	3	2.1	100-499	15	10.3
Italy	7	4.8	500-999	7	4.8
Finland	3	2.1	1000-4999	22	15.2
Japan	4	2.8	5000-9999	9	6.2
Canada	1	0.7	10000-19999	16	11.0
US	42	29.0	Greater or equal 20,000	72	49.7
Sweden	4	2.8	**Input Dependency of Affiliate**		
Denmark	2	1.4	No dependency	27	18.6
Austria	1	0.7	1-20% dependency	56	38.6
Norway	1	0.7	21-50% dependency	23	15.9
			Over 50% dependency	39	26.9

Measurement of Variables

The dependent variable, the mode by which the operation was established, was captured by a dummy variable, which takes the value of 0 if the entry is made by acquisition and 1 if the entry is made by greenfield investment.

The independent variables were measured as follows:

Based on institutional theory, Dunning's (1993) concept of locational choice of MNEs and transaction cost explanation of international production, we identified a set of 15 host country specific motives drawn from an extensive review of the extant literature. The questions relating to host country motives were *ex post* measures of foreign parent managers' perceptions of the relative importance of the locational factors at the time of the investment decision. Respondents were asked: "How important were the following factors in your decision to choose Turkey as a location for the equity venture?" Responses were assessed using five-point scales (i.e., 1 = "of no importance" to 5 = "of major importance"). These items are reproduced in Appendix A. The correlation matrix of the 15 host country location factors revealed a number of low to moderate intercorrelations between motives. Due to potential conceptual and statistical overlap, exploratory factor analysis using varimax rotation was undertaken to extract a parsimonious set of variables. Host country selection criteria with factor loadings greater than 0.4 were grouped for each factor derived. There were no double loading factors above the sort criteria of 0.4.The factor analysis produced six underlying factors that make good conceptual sense and explained a total of 68.7 percent of the observed variance, as shown in Table 2. The six factors may be summarized as: *investment risk*, *government regulations*, *financial incentives*, *quality of inputs*, *comparative cost advantages*, and *market potential*. An internal reliability test exhibited strong Cronbach alpha values for the underlying factors ranging from 0.53 through 0.94. Thus, scales exhibited well over 0.50 reliability levels suggested by Nunnally (1978) as a minimum level for acceptable reliability. For a validity check, the sample was split randomly and Cronbach alphas were recalculated for the factors on each subsample. Alphas continued to be satisfactory with a range of 0.52 to 0.91.

The control variables were measured as follows:

Input dependency of affiliate (INPUT) was categorized as no dependency, 1-20 percent dependency, 21-50 percent dependency and higher than 50 percent dependency (Appendix B). An ordinal variable was created that takes the value from 1 to 4 to represent each category respectively.

Parent diversity (DIVER) was measured using Rumelt's (1974) categories, i.e., single business, dominant business, related business, and unrelated business (Appendix C). An ordinal variable was created that takes the value from 1 to 4 to represent each category respectively.

Previous commercial association (EXPERIENCE) is a dummy variable that takes a value of 1 if the foreign parent firm has previous commercial association with the Turkish market in the forms ranging from foreign trade and arms length contracts (e.g., licensing, patent, marketing agreement) to FDI (e.g., JV or WOS) and 0 otherwise.

Cultural distance (CULT-DIS) was measured by Kogut and Singh's (1988) composite index, which measures the overall difference between two countries on each of Hofstede's

Table 2. Factors of Host Country Specific Motivation

Factors	*Factor-loads*	*Eigen-value*	*% Variance Explained*	*Cum. Percent*	*Cronbach Alpha*
Factor 1:		3.11	20.73	20.73	0.94
Investment risk					
Economic stability	0.95				
Political stability	0.94				
Factor 2:		1.96	13.04	33.77	0.61
Government regulations					
Level of industry competition	0.71				
Repatriability of profits	0.67				
Government policy towards FDI	0.54				
Factor 3:		1.60	10.65	44.42	0.66
Financial incentives					
Availability of incentives	0.85				
Availability of tax advantages	0.74				
Factor 4:		1.32	8.82	53.24	0.75
Quality of inputs					
Availability of qualified local personnel	0.88				
Availability of good quality inputs	0.85				
Factor 5:		1.18	7.87	61.11	0.53
Comparative cost advantages					
Geographical proximity	0.75				
Access to neighboring markets	0.72				
Availability of low cost inputs	0.52				
International transport and communication costs	0.45				
Factor 6:		1.13	7.56	68.67	0.59
Market potential					
Growth rate of Turkish economy	0.87				
Market size	0.64				

K-M-O Measure of Sampling Adequacy = 0.78; Bartlett Test of Sphericity = 613.757; $p < 0.0000$.

(1980) cultural dimensions, i.e., power distance, uncertainty avoidance, masculinity/femininity, and individualism.

Foreign parent size (PAR-SIZE) was measured by eight size categories determined by the number of employees, as shown in Table 1. An ordinal variable was created that takes the value from 1 to 8 to represent each category.

Natural resource intensity of target industry (RESOURCE) is a dummy variable given the value of 1 if the affiliate is in a resource-intensive industry and 0 otherwise. Following Gomes-Casseres (1989), resource-intensive industries were identified as food, beverages, textiles, rubber, tobacco, paper, petroleum, and mining.

Ownership mode of affiliate (OWN) is measured by a dummy variable that takes the value of 1 if the affiliate is a WOS or 0 if it is a JV. A venture is defined as a JV when foreign equity ownership ranges from 10 percent to 90 percent, while a venture with foreign equity shareholding of over 90 per cent is considered to be a WOS. This range is consistent with the definition of a JV used by the U.S. Department of Commerce. Park and Ungson (1997), and Hladik (1985) also followed the same definitions. Although there

are some other studies defining joint ventures as "ventures where two or more partners establish a separate organization in which each partner holds a minimum equity stake of 5 percent (Beamish/Kachra 2004), we excluded those ventures with less than 10 percent foreign ownership, which makes our study reasonably consistent with previous studies of this nature (Beamish 1988, Gomes-Casseres 1989, 1990, Chowdhury 1992).

In addition to the control variables discussed above, three further variables are included in the model to control for possible extraneous variation:

Date of entry. The entry mode literature (Laurila/Ropponen 2003, Mudambi/Mudambi 2002, Harzing 2002, Larimo 2003) predicts that the timing of entry is an important variable in the MNE's entry strategy decision. A dummy variable for the timing of entry (DATE) was assigned to control for variation that might result from the enactment of new ownership related legislation in Turkey in 1986. A value of 0 was given for pre-1986 entries and 1 for post-1986 entries.

Region of origin. Although cultural distance can measure certain dimensions of variance between individual countries, a broad region of origin variable is introduced to control for variations between Anglo-American and continental European MNEs' choice of a particular mode of entry. A dummy variable (COUNTRY) was assigned with 1 = Anglo-American, and 0 = Continental Europe.

Industry of affiliate. To control for industry variations, four broad industrial groupings (automobile, electrical, chemical, and finance and trade) are introduced as dummy variables.

Analysis

Binomial logit analysis estimates the probability of an event occurring and has been utilized frequently in studies on foreign establishment mode strategies (Hennart/Park 1993, Andersson/Swensson 1994, Padmanabhan/Cho 1995, 1999, Brouthers/Brouthers 2000). The binomial logit model can be expressed as:

$$P(Y_i = 1) = 1/[1 + \exp(-a - X_i B)]$$

where Y_i is the dependent variable, defined by a dummy variable either 1 or 0. The value of 1 denotes the probability of an event occurring rather than another as shown by the value of 0. X_i is the vector of independent variables for *i*th observation, a is the intercept parameter, B is the vector of the regression parameters (Amemiya 1981). The regression coefficients estimate the impact of the independent variables on the probability of an event that occurs. A positive sign for the coefficient means that the variable increases the probability of the event occurring, a negative sign signifies the opposite. The maximum likelihood estimates of the parameters were obtained employing logistic regression.

The explanatory power of the model is assessed using the *model chi-square* statistics, which test the null hypotheses that all parameter coefficients are zero, except the intercept term. Large chi-square values and small p values indicate good fit. The predictive ability of the model can be determined by the *correct classification rate*, which shows the percentage reduction in classification errors with respect to random selection. However, to identify an acceptable level of predictive accuracy, the obtained classification rate has to

be compared to the rate that would have been obtained by chance. In the case of unequal group sizes the standard to calculate this rate should be *proportional chance criterion*. The formula for this criterion is: $\alpha^2 + (1 - \alpha)^2$ where α is the proportion of cases in group 1 and $1 - \alpha$ is the proportion of cases in group 2. For a rough estimate of the acceptable level of predictive accuracy, Hair et al. (1995) suggest that the classification rate should be at least one-fourth greater than the proportional chance criterion.

Results and Discussion

The hypotheses were tested by conducting binomial logistic regressions on the functional relationships between the hypothesized effect variables and foreign investors' acquisition/greenfield choice. Prior to running the binomial logistic regression, a correlation matrix of the variables was prepared. The pairwise correlations were not large enough to warrant concern about possible multicollinearity problems. The results of the binomial logistic model for Western MNEs' acquisition/greenfield choice are shown in Table 3. The models have high overall explanatory power with significant chi-square values ($p < 0.01$). Table 3 shows that all four models have good correct classification rates (79.3 percent to 83.4 percent) that are well above the base line rate. While the specificity (their ability to correctly predict acquisitions) of all models leaves room for improvement (58.7 percent to 65.2 percent), their sensitivity (their ability to correctly predict greenfield investments) is excellent (88.9 percent to 91.9 percent). Pseudo R-square measures confirm that the models have relatively good explanatory power.

A summary of the hypotheses with the independent and control variables and their predicted and actual signs is shown in Table 4. Three of the hypothesized variables receive consistent and significant support in all four models: investment risk, quality of inputs and market potential. Five of the control variables also have expected signs: input dependency, parent diversity, resource intensity, previous commercial association and mode of ownership. Of the remaining variables, government regulations, financial incentives, comparative cost advantages, cultural distance and parent size are insignificant in all four models.

Host Country Specific Factors

Three of the six host country-specific factors have significant coefficients, i.e., *investment risk* (FACT1) ($p < 0.05$), *quality of inputs* (FACT4) ($p < 0.01$), and *market potential* (FACT6) ($p < 0.05$). The coefficient of *investment risk* (FACT1) is positive at $p < 0.05$, suggesting a moderate level of support for *Hypothesis* 1. The finding that the factor of *investment risk* positively affects the MNE's choice of greenfield mode can be partially explained by the higher level of financial resource commitments required for an acquisition compared to a new venture. Moreover, similar to many other emerging markets, the Turkish market poses particular challenges to foreign investors because the legal and institutional environment is relatively poorly developed, capital markets are thin and there are numerous market failures. Such market inefficiencies and weak resource bases may increase the riskiness of the investment and thus affect an MNE's choice of alternative

Table 3. Logistic Regression Results

Variables	Definition	Model 1		Model 2		Model 3		Model 4	
		Coefficient	Wald-stat.	Coefficient	Wald-stat.	Coefficient	Wald-stat.	Coefficient	Wald-stat.
	Intercept	1.53	1.58	1.16	0.82	1.27	0.94	3.98	2.27
FACT1	Investment risk	0.51**	4.59	0.51**	4.63	0.49**	3.71	0.42**	2.83
FACT2	Government regulations	0.16	0.41	0.15	0.37	0.16	0.42	0.09	0.15
FACT3	Financial incentives	0.28	1.31	0.30	1.46	0.30	1.49	0.25	0.96
FACT4	Quality of inputs	-0.57***	5.46	-0.58***	5.65	-0.57***	5.44	-0.59***	5.23
FACT5	Comparative cost advantages	-0.15	0.39	-0.16	0.47	-0.15	0.41	-0.16	0.45
FACT6	Market potential	-0.47**	3.42	-0.46**	3.22	-0.45**	3.09	-0.49**	3.21
INPUT	Input dependency	0.70***	7.68	0.71***	7.71	0.70***	7.66	0.67***	6.68
DIVER	Parent diversity	-0.59**	3.60	-0.63**	4.00	-0.63**	4.020	-0.55**	3.37
RESOURCE	Resource intensiveness of affiliate	0.94**	2.72	0.97**	2.89	0.99**	2.96	1.51**	5.03
EXPERIENCE	Previous commercial association	-1.13**	4.54	-1.18**	4.86	-1.14**	4.52	-1.12**	4.62
CULT-DIS	Cultural distance	-0.29	0.76	-0.27	0.66	-0.36	0.77	-0.44	1.02
PAR-SIZE	Parent size	-0.11	0.69	-0.09	0.53	-0.10	0.48	-0.23	1.98
OWN	Mode of ownership	1.48***	8.25	1.49***	8.39	1.48***	8.16	2.12***	10.4
DATE	Period of formation			0.41	0.72	0.42	0.74	0.23	0.54
COUNTRY	Broad home country origin					0.23	0.14	0.33	0.28
AUTO	Automobile							0.33	0.32
ELECT	Electrical							-0.62	0.96
CHEMICAL	Chemical							0.38	0.52
FIN_TRADE	Finance and Trade							-0.32	0.22
Model chi-square		51.17***		51.89***		52.03***		60.62***	
N		145		145		145		145	
Sensitivity		88.9		88.9		89.9		91.9	
Specificity		58.7		60.9		60.9		65.2	
Correct ratio		79.3		80.7		80.0		83.4	
Baseline rate		56.6		56.6		56.6		56.6	
Cox and Snell R sq.		0.297		0.301		0.301		0.342	
Nagelkerke R sq.		0.417		0.422		0.423		0.479	

*p < 0.1; **p < 0.05; ***p < 0.01 (all one-tailed)
Positive signs indicate a higher likelihood of greenfields, negative signs a higher likelihood of acquisitions.

Table 4. Summary of Hypotheses and Control Variables

	Hypothesis	Variable Name	Expected Sign	Actual Sign
H1.	A foreign investor is more likely to choose a greenfield entry mode over an acquisition mode when the perceived host country investment risk is high.	FACT1	(+)	(+)**
H2.	A foreign investor is more likely to choose an acquisition mode over a greenfield mode when a significant market potential is perceived.	FACT6	(–)	(–)**
H3.	A foreign investor is more likely to choose a greenfield investment over an acquisition mode when investment incentives are perceived as important.	FACT2 FACT3	(+)	n.s.
H4a.	A foreign investor is more likely to choose a greenfield investment over an acquisition mode when the cost of production is a dominant motive.	FACT5	(+)	n.s.
H4b.	A foreign investor is more likely to choose an acquisition mode over a greenfield mode when the perceived input quality is higher in the country of entry.	FACT4	(–)	(–)**
	Control Variables			
Investing Firm Specific Factors				
Input dependency		INPUT	(+)	(+)***
Extent of diversification		DIVER	(–)	(–)**
Previous commercial association		EXPERIENCE	(–)	(–)**
Cultural distance		CULT-DIS	(+/-)	n.s.
Parent size		PAR-SIZE	(+)	n.s.
Broad home country origin		COUNTRY	(?)	n.s.
Affiliate Specific Factors				
Mode of ownership		OWN	(+)	(+)***
Resource intensiveness of affiliate		RESOURCE	(+)	(+)**
Period of formation		DATE	(+/–)	n.s.
Automobile		AUTO	(?)	n.s.
Electrical		ELECT	(?)	n.s.
Chemical		CHEMICAL	(?)	n.s.
Finance and trade		FIN_TRADE	(?)	n.s.

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

entry modes. While an acquisition allows quick entry and immediate access to local resources, the acquired company may require deep restructuring to overcome organizational and cultural misfits between the two organizations. Especially in emerging markets, this restructuring may be so extensive that the new operation resembles a greenfield investment and hence makes acquisition a much costlier option than a greenfield investment (Meyer/Estrin 2001). So where the host country market offers a higher level of investment risk, MNEs may prefer to enter by establishing new ventures rather than via acquisitions.

The coefficients of *market potential* (FACT6) and *quality of inputs* (FACT4) are negative and significant ($p < 0.05$ and $p < 0.01$), which increase the likelihood of the venture being an acquisition. These findings provide some support for *Hypothesis* 2 and *Hypothesis*

4b. Two factors in particular play a critical role for Western MNEs' preference for acquisitions. First, Turkey has a rich source of good quality inputs, including an abundant and well-qualified labor force, which can be obtained at a relatively low cost by acquiring partial or full ownership of an existing local business. Second, Turkey is one of the key emerging markets characterized by high economic growth and a rapidly increasing population, which will induce market-seeking FDI. This potential has been shown in a recent survey (Loewendahl/Ertugal-Loewendahl 2000) that compares Turkey with Central and East European countries in terms of attractiveness to MNEs. Based on the perceptions of senior MNE executives, Turkey was ranked first as the most favorable location for market-seeking MNEs.

There was no support for *Hypothesis* 3. The coefficients of both *government regulations* and *financial incentives* were positive but insignificant ($p > 0.1$). This indicates that *government regulations* and *financial incentives* did not influence the Western MNEs' choice of establishing a new venture or making an acquisition.

Investing Firm Specific Factors

The coefficient of input dependency (INPUT) is positive and significant ($p < 0.01$), substantiating the arguments associated with both resource dependency and the resource-based views. This finding supports the view that Western MNEs are more likely to choose a greenfield mode over an acquisition when their affiliates are highly dependent on parents' resources. Western MNEs prefer greenfield investments in order to manage the complexities and uncertainties of the environment and to enable efficient knowledge transmission between parent and subsidiary. Greenfield investments also avoid problems of potential cultural and organizational misfit often encountered in international acquisitions.

The coefficient of DIVER is negative and significant ($p < 0.05$), suggesting that highly diversified MNEs will prefer to enter the host country via acquisitions. This finding is consistent with earlier studies (Yip 1982, Caves/Mehra 1986, Brouthers/Brouthers 2000), arguing that firms pursuing a diversification strategy, whether in their national markets or abroad, tend to use acquisitions in order to obtain the industry-specific assets that they lack. More diversified firms also have relatively sophisticated management control systems, which can be exploited through acquisitions, thus increasing organizational efficiency (Hennart/Park 1993).

The negative and significant coefficient for EXPERIENCE ($p < 0.05$) corroborates prior research that draws on the organizational learning perspective. MNEs with extensive host country experience or previous commercial association may understand how to handle acquisitions from this acquired knowledge and thus be more likely to choose an acquisition over a greenfield investment (Caves/Mehra 1986, Barkema/Vermeulen 1998). Where a foreign firm has an established affiliate, local staff may be able to assist in identifying local targets, and in analyzing, negotiating and managing an acquisition. In contrast when a firm is contemplating entry for the first time into a new market, there are likely to be problems associated with a lack of familiarity with the host country, such as information gaps and lack of expertise in local negotiations. Organizational and cultural fit may also be more problematic when the venture is a first entry into a host country. This

is in accordance with the findings of Barkema et al. (1996), and Very and Schweiger (2001), who noted that host country experience facilitates further investments by way of acquisitions and increases the chances of success for new acquisitions.

Cultural distance (CULT-DIS) and foreign parent size (PAR-SIZE) were found to be not significantly related to establishment mode choice. Other studies that investigated the effect of cultural distance on entry mode choice also failed to report significant results (Barkema et al. 1996, Brouthers/Brouthers 2000). Similarly, prior research examining the influence of foreign parent size on entry mode choice reported no significant results (Yip 1982, Kogut/Singh 1988, Barkema/Vermeulen 1998, Padmanabhan/Cho 1999). Prior studies that have reported significant results for these variables also produced conflicting findings (see Kogut/Singh 1988). It appears that the predictive ability of both variables is rather limited, consequently receiving little support as major determinants of modal choice.

Affiliate Specific Factors

The positive and significant coefficient on mode of ownership (OWN) ($p < 0.01$) is in line with those of Wes and Lankes (2001) regarding FDI in CEE countries and confirms the view that Western MNEs will favor a greenfield investment over an acquisition when the affiliate is a WOS.

The positive and significant coefficient on RESOURCE ($p < 0.05$) tends to confirm our view that the foreign investor is more likely to choose a greenfield investment over an acquisition when the affiliate is in a resource-intensive industry. Market-seeking FDI in emerging markets is often best served through acquisition of local firms. A greenfield entry could be too risky or too slow for a market-seeking foreign investor who wishes to make a rapid market entry and serve country-specific customer preferences in the quickest way. In such cases the best way to obtain control over marketing assets may be through the purchasing of a local firm rather than building a subsidiary from scratch. In contrast, resource-seeking FDI, aimed at utilizing host country raw materials and human capital, may be facilitated better by a greenfield entry. Where host country markets readily provide access to qualified local labor, good quality raw materials and supplies of intermediate goods, such inputs may be obtained through a greenfield venture.

None of the additional control variables, which include date of entry (DATE), region of origin (COUNTRY) and industry of affiliate, are significant. When these variables are included in the model there is little change in the size of the coefficients of the independent variables. The findings show that there was no significant impact of these control variables on Western MNEs' choice of either greenfield investment or acquisition.

Managerial and Policy Implications

The paper has investigated factors influencing the choice between an acquisition and a greenfield entry mode in an emerging market context. A relatively large dataset enabled the testing of a number of hypotheses in order to investigate the relationship between host country, investing firm and subsidiary level factors and entry mode choice in Turkey. Each entry mode has its own implications for managerial practice and public policy.

Our first *Hypothesis* 1 received significant support, implying that potential for political hazards was taken into account by MNEs in entry mode decisions. Although policy makers in emerging market economies place high emphasis on investment incentives, potential political or economic hazards (i.e., economic stability, political stability) seem to play a more important role in the firm's decision of establishing greenfield investment.

Findings presented in this paper are of some importance to policy makers in emerging countries in general and inward investment agencies in particular. We did not find support for *Hypothesis* 3, where we expected executives' perception of investment incentives to be an important determinant of greenfield investments. As investment incentives in Turkey apply equally to both acquisitions and greenfield investment this may explain why we did not find support for *Hypothesis* 3. However, it seems that incentives do not significantly influence MNEs' choice of greenfield or acquisitions, a finding that policy makers should be aware of.

The acquisition of existing local brands by MNEs may create some anxiety amongst policy makers, consumers and other players in the market (i.e., suppliers, distributors). These anxieties can be observed through reactions of actors related to FDI. At a recent news conference, the head of Foreign Investors' Association (YASED) stated that "*acquisitions should not be perceived as a bad type of foreign investment, this is a new trend in the world. Since we have so many privatizable and acquirable companies, we expect foreign investors to play their role*" (Hurriyet 2005). To overcome such anxieties acquirer companies' investments in culture transmission and rehabilitation, and the internationalization of local brands need to be highlighted as major contributions to the host economy.

Our study finds a significant relationship between the perceived market potential and entry mode decision, implying that the current trend of increasing acquisition may stabilize at some point. The market potential in certain sectors (e.g., banking, telecoms, and power generation) is still large enough to attract acquisitions rather than greenfield investment. First mover advantages seem to be an underlying motive here; however, the parent company may not be able to avoid lengthy negotiations, which may increase transaction costs. Failure to integrate a new acquisition within the existing MNE network of affiliates may also diminish potential benefits.

Cultural distance was not found to be statistically significant with respect to establishment mode choice. Nevertheless, managers of foreign firms may still prefer acquisitions as they can provide investors with the opportunity to establish local links in an effort to overcome a liability of foreignness. A major disadvantage of entering the host country through an acquisition, however, is the management costs involved in integrating the acquired firm with the parent firm. This disadvantage tends to be greater as the cultural distance between the acquirer and the acquired firm's country increases (Hennart/Reddy 1997). Another way of seeking to overcome a liability to foreignness is to establish a collaborative venture with a local partner. Firms without previous experience in the host market are unlikely to have the knowledge of the local market and marketing channels. Linking with a local partner might be an effective way of providing them with such knowledge as well as additional managerial, technical and financial resources. The initiation of such a collaborative venture is likely to come from the foreign firm rather than the local partner.

Our findings suggest that MNEs with previous commercial association with the host country market tend to choose an acquisition over a greenfield investment. A recent World

Bank study indicated that greenfield investments in emerging markets follow acquisitions (Calderon et al. 2004). This is particularly important as inward investment agencies in emerging economies are primarily concerned with attracting greenfield investments from MNEs. Further to our findings, Mudambi (1998) also argued that firms with previous experience of the local market are the ones with the highest probabilities of making new investments in the area. Official regulations, or political pressure requiring greenfield investment may therefore discourage MNEs causing them to locate their investments in what they perceive to be more favorable areas. This is also important in the sense that MNEs tend to rationalize their operations between regions and countries.

The level of bureaucracy and red tape may be an important factor determining MNEs' actions and entry mode selection. As Meyer and Estrin (2001) argued, "the markets for complementary resources are fairly efficient in mature economies, but not necessarily in emerging economies". Inefficiencies, for example, arising from overly bureaucratic procedures, may affect MNEs' entry mode decisions causing them to prefer acquisition where the bureaucratic impact might be considerably less compared to a greenfield investment.

Conclusions

This study builds on prior research by providing a comprehensive account of foreign establishment mode strategies of firms from numerous countries investing in Turkey. The results of the logistic regression modeling provided support to the hypothesized relationships that take into account the impact of host country specific motives of MNEs on their choice between acquisitions and greenfield investments. The host country motives *quality of inputs* and *market potential* have significant negative coefficients, which indicate that an MNE will favor the acquisition mode over a greenfield mode as the relative importance of both motives increases. The host country motive of *investment risk* has a significant positive coefficient, which increases the likelihood of the venture being a greenfield investment.

Our results also show that the main investing firm specific and subsidiary level determinants of FDI modal choice identified in prior research also influence the establishment mode choice of Western MNEs when investing in Turkey. Parent diversity, previous commercial association, ownership pattern and resource-intensiveness of the target industry have the expected impact on the foreign investor's choice between a greenfield investment and an acquisition. The high level of support found between input dependency and MNEs' choice of establishment mode tends to confirm the arguments of the resource dependency and resource-based views. No support is found, however, for the impact of cultural distance and foreign parent size on establishment mode choice. Similarly, the control variables of home region of the investing firm, timing of entry and industrial sector of investment do not affect modal choice.

Although each emerging market has its own development path and institutions, our results may be applicable to other emerging markets with a large stock of acquirable companies. The investment risk (capturing aspects of political risk) hypothesis could be extended to other emerging markets where institutional development has not yet reached the desired level resulting in high transaction costs because of the prevalent bureaucracy,

red tape and potential for intervention. The role of financial incentives provided differentially to greenfield investments and acquisitions may be valid in other emerging markets. Our results indicate that different country, industry and subsidiary level factors affect foreign investors' entry mode decisions of greenfield or acquisitions. Once the pool of acquirable companies decreases, MNEs may place more emphasis on factors providing comparative advantages, and incentives. This may escalate competition for FDI in the region, given the fact that some of the new EU countries offer attractive packages for MNEs (e.g., flat tax rate and some other new incentives).

This study extends prior research in several ways. Apart from some notable exceptions undertaken largely in the CEE context (e.g., Meyer 2001, Meyer/Estrin 2001, Wes/Lankes 2001, Szanyi 2001), previous studies have paid insufficient attention to the establishment mode decision of foreign investors in emerging economies. These economies have become increasingly important to MNE operations. This study, therefore, adds to the scant literature on FDI modal choice of Western MNEs in emerging economies. A second contribution lies in the methodology adopted. The study examines the importance of a comprehensive set of host country motives drawing on the perceptions of senior MNE executives. This approach provides a realistic picture of the impact of locational factors on FDI modal choice. A third area of contribution stems from the composition of the sample. Our sample consists of foreign investors from numerous countries; in contrast prior studies on the establishment mode choice of foreign investors tend to be confined to a single source country. Finally, the study contributes further evidence to the international business literature by replicating the findings of previous research in the different context of an emerging market economy.

We recognize that the present study has limitations. (i) Our indicators may be viewed as somewhat parsimonious with a more elaborated set of data inputs required to fully support the set of constructs analyzed. This should be taken into account in future research. (ii) The data set does not encompass relatively recent FDI to Turkey. It should be noted that there may be differences in findings had more recent FDIs been included in the data. It would be useful in future research to expand the time period under consideration. (iii) R&D expenditures of MNEs and their research intensity are not covered in our surveys, therefore we could not test the relationship between R&D expenditure and entry mode. (iv) Our research design allowed us to collect data on surviving entries, therefore, firms divested before the surveys are excluded from our study. (v) Measuring cultural-distance through an aggregate measure has been criticized for not capturing the richness of cultural diversity (Barkema/Vermeulen 1998), and such criticism also applies to our research. Further, Hofstede's fifth dimension has not been derived for Turkey, which limits our interpretation of the impact of cultural distance. Despite this limitation, it is still the case that many studies continue to use Hofstede's four original dimensions. (vi) Although there are different patterns of institutional changes in different emerging market economies, by implication we assume that Turkey is representative of this group of countries. Nevertheless, the usual caveat applies, as this study is of an *exploratory nature* using only one country and the results are not necessarily generalisable to other countries. Future studies should therefore incorporate more countries into the research design.

Several areas may be identified for future research. First, this study examined the determinants of choice between greenfield investment and acquisition in a host country at

the time the venture is established. Future research should endeavor to provide a longitudinal examination of factors underlying FDI modal choice. As the relationships tested are host country-specific, the hypotheses would benefit from further testing in different country contexts in order to examine whether our findings for Turkey hold in other emerging markets. It would also be useful for future research to examine the consequences of establishment mode choice in terms of subsequent subsidiary performance in an attempt to test the validity of the chosen mode. Our research highlights that new research designs in this area may be strengthened by perspectives borrowed from knowledge management (i.e., comparative study of knowledge management in greenfield joint ventures and in joint ventures formed through acquisitions). Finally, as the choice between greenfield investment and acquisition is a highly complex and dynamic process involving a large number of contingencies, there is a need to develop an integrative theoretical perspective that draws on relevant aspects of the disparate existing theories in order to better explain the nature of this process.

Appendix A. Host Country-specific Motives

How important were the following factors in your decision to choose Turkey as a location for your operations? (Please circle according to the importance of each motive on the scales below where 1 = 'of no importance', 5 = 'of major importance')

Q#	Host Country Specific Motives	
Q1	Market size	1-2-3-4-5
Q2	Growth rate of Turkish economy	1-2-3-4-5
Q3	Political stability in Turkey	1-2-3-4-5
Q4	Economic stability in Turkey	1-2-3-4-5
Q5	Availability of qualified local personnel	1-2-3-4-5
Q6	Turkish government policy towards foreign direct investment	1-2-3-4-5
Q7	International transport and communication costs	1-2-3-4-5
Q8	Repatriability of profits	1-2-3-4-5
Q9	Availability of incentives	1-2-3-4-5
Q10	Availability of good quality inputs (raw material, labour, etc.)	1-2-3-4-5
Q11	Availability of low cost inputs	1-2-3-4-5
Q12	Availability of tax advantages	1-2-3-4-5
Q13	Geographical proximity	1-2-3-4-5
Q14	Level of industry competition	1-2-3-4-5
Q15	Suitability of Turkish market to access neighbouring markets	1-2-3-4-5

Appendix B. Input Dependency of Affiliate

Please indicate what proportion of inputs of your Turkish affiliate is purchased from your company? Please tick.

(i) 0 %
(ii) 1–20%
(iii) 21–50 %
(iv) Over 50 %

Appendix C. Parent Diversity

Which of the following best describes your company?

(i) Dependent on single product
(ii) Dependent on one major area of related products
(iii) Diversified into related product areas
(iv) Diversified into unrelated product areas

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