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The Choice between Shared vs. Full Ownership : The Case of Korean Multinational Corporations

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Multinational Corporations(MNCs) venturing abroad usually encounter a difficult decision of whether to have full ownership of overseas subsidiaries or to jointly manage them with local companies that have a better understanding of the host country's business and market environment. Companies often share the management rights with local partners because it not only decreases the risk regarding international expansion but also save

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time for adjusting to the local environment. However, when companies found no appropriate business partners or do not want their management rights to be interfered with, they prefer full ownership. The choice between shared and full ownership, therefore, becomes an important issue for both MNCs and international business researchers (Kogut, 1988; Gomes-Casseres, 1989; Hennart, 1991).

Foreign direct investments by Korean MNCs actively started in the early 1980s, and these MNCs have been engaged in production and marketing activities in the host countries through their subsidiaries. Compared to the companies from other countries, Korean companies traditionally impose more weights on the management rights and hence, the ownership of the subsidiaries. It is generally known that Korean companies prefer full ownership to shared ones. However, there still are many subsidiaries that adopt the shared ownership due to the host country's market environment as well as the firm-specific factors.

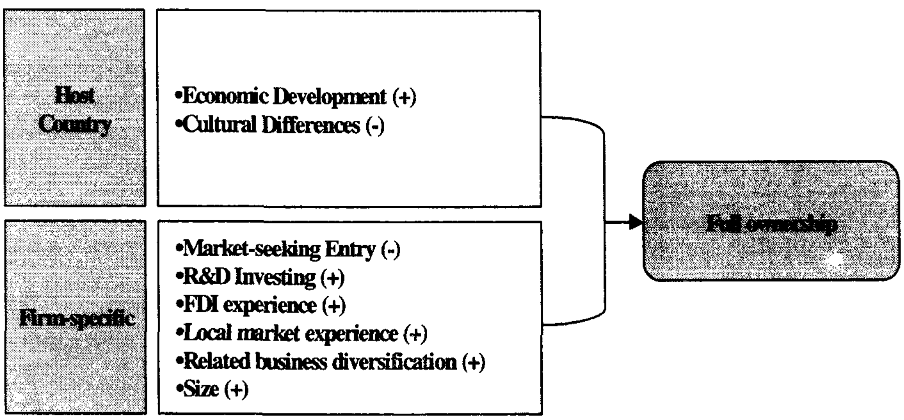
There are many studies on the choice of ownership structure of foreign subsidiaries of MNCs from advanced countries, but a few ones on those from developing countries such as Korea. Using the survey of 74 manufacturing companies, this study examines the factors influencing the choice of entry mode(shared vs. full ownership) of Korean MNCs entering foreign markets. The study classifies the factors affecting the decision between shared and full ownership into firm-specific factors and host country factors.

The remaining part of this paper is composed as follows. The next section explains host country factors as well as firm-specific factors used in this study, and then, introduces the research hypotheses. Section 2 describes the research methodology and elaborates on the variables of interests. Section 3 reports the research results and findings, while section 4 presents our conclusions.

Ⅰ. Determinants of Ownership Decision

The determinants affecting the choice between shared and full ownership can be classified into two categories such as host country factors and firm-specific factors. Host country factors include the level of economic development of the host country, and cultural difference between the host country and the home country. Firm-specific factors consist of the motivation behind the foreign market entry, R&D intensity of the firm, previous foreign and host country experience, business diversification level through the FDI, and firm size. <Figure 1> shows the determinants of ownership structure in this study.

< Figure 1 > Determinants of ownership decision



(+) refers to the preference to the full ownership

1. Host country determinants

Economic development : Companies venturing abroad are likely to encounter market uncertainties such as political instability, economic fluctuation in the host country, change in exchange rates, and regulations of local governments. These kinds of market uncertainties are more prevalent in underdeveloped countries than advanced countries. Therefore, it is expected that the more the host country is developed, the more the company is likely to adopt a full ownership because of the low level of risk. On the contrary, in order to hedge such a risk, a company investing in an underdeveloped country is expected to prefer sharing ownership with local companies.

Hypothesis 1 : The more advanced the host country is, the more preference the company shows towards full ownership.

Cultural difference : If there is little difference in culture between the home and the host country, then the company is more capable of resolving labor and management conflicts, resulting in less business uncertainties. On the other hand, when there are huge cultural gaps, understanding the local employees and management practices would be difficult. Hence the need of local partner that has a better understanding of the local environment exist. Therefore, it can be said that the larger the cultural gap between the home and the host country, the more the company prefers shared ownership (Hennart and Larimo, 1998). Gatignon and Anderson (1988) found the positive relationship between the cultural difference and joint venture preference of MNCs.

Hypothesis 2 : The larger the gap in culture between home and host country, the more the company shows preference towards shared ownership.

2. Firm-specific determinants

Entry motivation : When companies undertake foreign investment in order to penetrate into the local markets, they show market-seeking behavior in that market. In this case, mating with a local partner who has an in-depth understanding of the local market is very important. On the other hand, if companies enter local markets in order to exploit cheap labor (efficiency-seeking behavior) or cheap raw materials(resource-seeking), a more controlled form of investment is preferred. Hence, in the case of marketing-oriented investment, it can be stated that companies prefer to share ownership for the sake of gaining market knowledge from their local partners.

Hypothesis 3 : The more the investment is market-seeking, the more preference the company shows towards shared ownership.

Proprietary knowledge : It is easily presumed that companies spending a large amount on R&D are likely to accumulate proprietary knowledge. Therefore, they want to protect proprietary knowledge by internalizing it through full ownership. However, companies without proprietary knowledge try to share ownership through joint ventures in order to acquire this valuable intangible asset from their partners. Therefore, it is reasonable to expect that companies with a large investment in R&D prefer full ownership. Gatignon and Anderson (1988) found that the companies with proprietary knowledge preferred to have full ownership, but Gomes-Casseres (1989) and Hennart (1991) did not find this relationship.

Hypothesis 4 : The larger the R&D intensity, the more the company shows preference towards full ownership.

Experience : Companies without experience in foreign markets are highly likely to encounter unpredictable and unexpected risks. However, companies with international as well as host country experience have accumulated valuable knowledge to manage local subsidiaries and developed strong confidences in dealing with the risks aforementioned. It is common for an inexperienced company to go through a lengthy trial and error process, which would most likely increase investment cost. Therefore, companies without much experience in foreign markets prefer shared ownership instead of paying high investment cost, while more experienced companies prefer full ownership. Hennart (1991) found that Japanese compnies with previous experience in the U.S. martket preferred full ownership.

Hypothesis 5A : The more experience the company has in foreign markets, the more preference it shows towards full ownership.

Hypothesis 5B : The more experienced the company has in the host country market, the more preference it shows towards full ownership.

Diversification : If a company manufactures products, that are different from those produced in its home country, in the foreign subsidiary, then the firm prefer to opt for shared ownership in order to obtain product-specific knowledge from the local partner(Hennart, 1991). On the other hand, when a company enter the local market to manufacture similar products to those in its home country, then the company already has enough knowledge of the products, and does not need to gain product-specific knowledge. As a result, it prefers full ownership(Li, 1995; Delios & Beamish, 1999). In other words, a company that extends its business into the related area in the host country have a stronger tendency to take full ownership of the subsidiary.

Hypothesis 6 : The closer the subsidiary's business is to the MNCs, the more it shows preference towards full ownership.

Size : In general, the larger the size of the company, the more likely it is to receive support from its headquarters. A large-size parent company also tends to exercise more control on subsidiaries abroad. Therefore, the larger the company is, the more it prefers full ownership. In accordance, the smaller the company is, the more it prefers shared ownership because they have insufficient resources to invest in the foreign market. (Stopford & Wells, 1972; Hennart, 1991).

Hypothesis 7 : The larger the size of company, the more it shows preference towards full ownership.

Ⅱ. Methodology

1. methodology and dependent variable

The study is based on the survey data of 74 Korean MNCs undertaken FDI from 1980 to 1996. There were about 400 cases of Korean MNCs FDI in this period[1] and researchers asked them to comply with the survey by mailing or visiting the company. As a result, we could collect the data for 192 FDI cases(reply rate of approximately 50%). However, we excluded the FDI cases in the field of service industries (eg. banking, trading, and sales), and only used 74 cases from manufacturing industry in this study.

The dependent variable (ENTMODE) represents either shared (equity ownership between 5% and 94%) or full (equity ownership between 95%

1) Data of Korean FDIs are from the List of Subsidiaries of Foreign Investment published by Bank of America (1997).

and 100%) ownership. It is captured by a dummy variable which takes a value of one if the Korean MNC entered a foreign market through full ownership and zero if it took shared ownership. Because of the nature of the dependent variable, a binomial logistic regression model is used in which the probability of full ownership is explained by the independent variables. The regression coefficients estimate the impact of the independent variables on the probability that the MNC entry will be full ownership. The model can be expressed as follows.

$$P(Y_{i=1}) = 1/(1+\exp(-a-X_iB))$$

Y_i = dependent parameter(full ownership=1)

X_i = vector for independent parameter

a = intercept parameter

B = vector for regression analysis parameter

2. independent variables

The level of economic development of the host country (OECD) is measured by whether the host country is an OECD member or not. If the host country is a member of OECD, the dummy variable takes a value of one. Otherwise its value is zero.

The cultural distance (CULDIS) is measured by the composite index of Hofstede's cultural dimensions, which was revised by Kogut & Singh (1988). A higher value of CULDIS represents a larger cultural distance between Korea and the host country. CULDIS is calculated with the following formula:

$$\text{Cultural Distance(CULDIS)} = [\sum(I_{ij} - I_{ik})2 / V_i]/4$$

I_{ij} : ith dimension for jth country

V_i : Variance for dimension i

j : Cultural Index of Country j

k : Korean Culture Index

The motivation behind foreign market entry (MARKET) is measured by a dummy variable. If the Korean MNC entered the foreign market in order for market-seeking opportunities according to the survey from the firm, MARKET takes a value of one; otherwise, it is zero. A company's R&D intensity (RNDINT) is measured by its R&D expenditures as a percentage of its domestic sales[2].

A company's experience is measured in following two categories; international and host country experience. International experience (INTLEXP) is measured by the number of overseas subsidiaries (Larimo, 1997; Padmanabhan & Cho, 1999). Host country experience (COUNEXP) is measured by a dummy variable. If a Korean MNC has previous experience in the host country, it takes a value of one. Otherwise, it takes the value of zero (Agarwal & Ramaswami, 1992).

The degree of diversification (COMMO) is measured by a dummy variable equal to one if a Korean MNC enters the foreign market with its core or related business, and to zero otherwise (Beamish & Banks, 1987; Gomes-Casseres, 1989). A Korean MNCs size is measured by its domestic sales revenue. <Table 1> summarizes variables and expected signs.

2) Since it is difficult to get the global sales of Korean companies, we used domestic sales instead.

< Table 9 > Summary of Variables and Expected Signs

Variable		Name	Explanation	Measurement	Expected Sign
Dependent Variable		ENTMODE	Type of Ownership	Full ownership=1, Shared ownership=0	·
Independent Variable	Host Country Factors	OECD	Economic Development	OECD = 1, Non-OECD = 0	+
		CULDIS	Cultural Distanc	Hofstede' s cultural index	-
	Firm-Specific Factors	MARKET	Motivation for FDI	Market-seeking = 1 Otherwise = 0	-
		RNDINT	R&D intensity	R&D expenditure/sales	+
		INTLEXP	International Experience	Number of overseas subsidiaries	+
		COUNEXP	Experience in host country	Experience in host country (Yes =1, No=0)	+
		COMMO	Business Diversification	Diversification to core Business = 1, Diversification to non-coreBusiness = 0	+
		SIZE	Size of Parent Company	Sales revenue	+

(+) refers to the full ownership

Ⅲ. Results

1. sample description

The samples used for this study are from 74 cases, which consist of 44 (59.5%) shared and 30 (40.5%) full ownership cases. According to the region of host countries, the investment are; 20 in the Americas, 47 in Asia, and 7 in Europe. For the industry category, there are a total of 19 industries that include electronics, communications, textile, and chemistry as shown in <Table 2>.

<Table 10> Investment by Location/Industry

Industry	Location			Total
	Americas	**Europe**	**Asia**	
Food & Beverage		3	5	8
Textile	2		10	12
Cosmetics		1		1
Chemicals	1		4	5
Cement	1		1	2
Medicine			1	1
Non-metalic mineral			1	1
1st Metals	4		7	11
Machinery & Equipment	1		2	3
*Electronic Goods & parts*Total	5	2	8	15
Communication Equipment & Parts	3		4	7
Others	3	1	4	8
Total	20	7	47	74

As shown in <Table 3>, the correlation matrix of the independent variables suggests little colinearity except for cultural distance (CULDIS) and level of economic development (OECD). CULDIS and OECD showed a strong correlation of 0.812. Since both the correlation between CULDIS and ENTMODE (0.330) and correlation between OECD and ENTMODE (0.341) were lower than 0.812, it is highly likely that there is multicollinearity between CULDIS and OECD. To check this, the study performed a regression analysis with three different models. In Model 1, the highly correlated parameters OECD and CULDIS are both included in the regression formula. Model 2 excluded the OECD parameter, while Model 3 excluded the CULDIS parameter. Through these three different models, we reviewed how the presence of each parameter influences the independent variable.

<Table 11> Correlation matrix

ENTMODE	1								
OECD	0.34**	1							
CULDIS	0.33**	0.81**	1						
MARKET	-0.18	0.11	0.06	1					
RNDINT	-0.10	0.17	0.18	0.07	1				
INTLEXP	-0.08	0.11	0.14	-0.07	0.05	1			
COUNEXP	-0.11	0.01	0.10	0.12	0.14	0.18	1		
COMMO	0.20	-0.03	0.03	0.08	0.04	-0.10	0.03	1	
SIZE	-0.16	-0.21	-0.21	-0.17	-0.07	0.15	0.17	0.06	1
	ENTMODE	OECD	CULDIS	MARKET	RNDINT	INTLEXP	COUNEXP	COMMO	SIZE

2. Analysis of Results

The results of the binomial logistic regression are presented in Table 4. A positive coefficient means that the independent variable help to increase the probability that full ownership will be chosen: a negative coefficient signifies the opposite.

<Table 12> Summary of the results

Hypothesis	Name	Expected Sign	Statistics		
			Model 1	Model 2	Model 3
Hypothesis 1	OECD	+	1.818(**)	0.652(**)	·
Hypothesis 2	CULDIS	-	0.31	·	0.818
Hypothesis 3	MARKET	-	-1.397(*)	-1.284(*)	-0.998(*)
Hypothesis 4	RNDINT	+	1.826	1.858	1.875
Hypothesis 5A	INTLEXP	+	1.095	1.171	1.256
Hypothesis 5B	COUNEXP	+	0.915	1.348	1.245
Hypothesis 6	COMMO	+	2.543(*)	2.890(*)	2.053(*)
Hypothesis 7	SIZE	+	1.685	1.514	1.475

[a] * = $p<0.05$, ** = $p<0.01$

As seen in the table, the more the host country is economically developed, the larger the company shows preference to full ownership. The coefficient of OECD is positive and significant at 0.01 level. Therefore Hypothesis 1 is supported. Since developed economies are less uncertain and relatively stable, Korean MNCs seem to prefer to enter these markets through full ownership.

Hypothesis 2, stating that the larger the cultural distance is, the more the company prefers the shared ownership is not supported. The coefficient of CULDIS is positive and insignificant statistically. On the contrary to previous studies (Hennart & Larimo, 1998; Kogut & Singh, 1988), the cultural distance between the home and host country does not affect the MNCs choice of ownership structure.

It is expected that if the Korean MNC intends to enter the host country market for market-seeking behavior, shared ownership is preferred over full ownership. This hypothesis(Hypothesis 3) is supported with a significance level of 5%. Hence, Korean MNCs entering foreign markets for the sake of market-seeking have a greater tendency to enter through shared ownership, in order to penetrate into those markets with the help from local partners.

However, contrary to previous studies, Korean MNCs R&D intensity is not found to be a statistically significant determinant. Hence Hypothesis 4 is not supported. This implies that Korean MNCs proprietary knowledge does not affect its choice of entry mode in foreign markets. Korean MNCs do not have apparent technological superiority, and hence their R&D intensity does not affect the global ownership decision.

In addition, Korean MNCs international as well as host country experiences do not affect its choice of foreign ownership strategy after considering other factors, contrary to previous studies (Hennart, 1991). Hence Hypothesis 5 is not supported. In particular, for Korean MNCs, this result is probably attributable to the relative lack of experience in overseas businesses.

All three models to test the Hypothesis 6 are found to be significant at 5 percent level and this result is consistent with previous studies, Thus, Korean MNCs tend to enter foreign markets through full ownership when diversifying their business into core ones (Beamish & Banks, 1987; Gomes-Casseres, 1989). By undertaking full ownership, Korean MNCs can exploit their product knowledge in foreign markets.

It is generally known that large companies tend to take full ownership in foreign markets because they are better prepared to provide resources to their subsidiaries (Lambkin, 1988; Agarwal & Ramaswami, 1992). This study, however, finds no significant correlation between the company size and ownership decision to reject the Hypothesis 7.

In sum, this study accepted 3 independent variables, OECD, MARKET, and COMMO as meaningful determinants among 8 variables tested. According to the regression analysis employing these three variables, the preciseness of ENTMODE classification was found to be 78.9%, meaning that the model with these three parameters is relatively highly representative.

Ⅳ. Conclusions

This study examined host country and firm-specific factors affecting the choice of Korean MNCs ownership strategy in the foreign markets. We analyzed the data of 74 Korean MNCs by employing a binomial logistic regression model.

According to the results of this study, as for the firm-specific factors, Korean firms entering foreign markets in order to penetrate local markets prefer shared ownership while those pursuing core business diversification prefer full ownership. As for the host country factors, the more advanced the host country(such as OECD countries) is, the more preference is given to full ownership. However, contrary to the cases of MNCs from advanced countries, Korean MNCs cultural distance, R&D intensity, experience, and size turned out to be insignificant factors in affecting their choice of foreign ownership decision.

Even this study, which tried to examine the factors affecting Korean MNCs foreign ownership strategy, has some limitations. Our sample is limited to just 74 cases and many of them are concentrated in two regions (America and Asia). Hence, in future studies, increasing the number of cases with more extended study period will provide more understanding and insights to this topic.

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ABSTRACT

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This study is based on the survey data of 74 Korean multinational corporations, which undertook foreign direct investments from 1980 to 1996. The study examined the firm-specific as well as the host country-specific factors affecting the decision between shared and full ownership. According to the results of this study, as for the firm-specific factors, Korean firms entering foreign markets in order to penetrate local markets prefer shared ownership while those pursuing core business diversification prefer full ownership. As for the host country factors, the more advanced the host country(such as OECD countries) is, the more preference is given to full ownership.

Key words : Korean Multinational Corporation, Shared Ownership, Full Ownership