JAPANESE FIRMS’ INVESTMENT STRATEGIES IN EMERGING ECONOMIES

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This study jointly examines the effects of organizational capabilities and public and private expropriation hazards on the level of equity ownership chosen for foreign subsidiaries in emerging markets. Specifically, we explore the mechanisms by which 660 Japanese multinational corporations drew upon capabilities developed via industry-specific, country-specific, and total international experience to mitigate these hazards for their 2,827 subsidiaries in 18 emerging markets. Results strongly support a novel specification that forges a link between the capabilities and the public and private expropriation hazards literatures.

Foreign market entry strategy involves choices about which markets to enter and how to enter them. An important decision for the foreign investing firm is the choice of ownership level in a host country subsidiary (Li, 1995; Stopford & Wells, 1972). Studies that have addressed this choice have commonly taken a transaction cost approach (Anderson & Gatignon, 1986; Buckley & Casson, 1976; Hennart, 1982), modeling firms as devising ownership strategies that minimize the cost of exploiting proprietary assets while protecting the rent-generation potential of those assets. As recognized in this research, one set of risks involved in deploying assets in foreign countries stems from the private expropriation hazards firms encounter when conducting transactions with other firms in the foreign, or host, countries (Williamson, 1996). A second set of risks arises from public expropriation hazards that are a function of the ability of a host country’s institutional environment to credibly commit to a given policy or regulatory regime (North, 1990). Empirical research has shown both hazards to have an impact on ownership levels. However, in this research it has implicitly been assumed that a firm’s ability to deal with these hazards is stable over time and invariant to new capabilities developed in its investment activity.

Such an assumption is inconsistent with the substantial body of research on the effects of international experience on market entry strategy (Barkema, Bell, & Pennings, 1996; Davidson, 1980; Davidson & Mc Fetridge, 1985; Erramilli, 1991; Hennart & Park, 1994; Johanson & Vahlne, 1977; Mody, 1993). This research demonstrates that knowledge and capabilities developed by operating in diverse environments influence ownership strategies (Barkema & Vermeulen, 1998; Chang, 1995). Drawing upon this line of research, we contend that the capabilities developed in a firm’s sequence of foreign investment activities (its experience) affect its ability to mitigate public and private expropriation hazards. We demonstrate that one mechanism by which experience affects ownership strategies is augmentation of a firm’s hazard-mitigating capabilities. Following prior research, we consider three types of experience: experience in a given country setting, experience in a given product setting (industry), and other international experience (Hitt, Hoskisson, & Kim, 1997).

We tested our hypotheses using a sample of 2,827 foreign investments made by 660 Japanese firms in 18 emerging economies in Africa, Asia, Europe, and Latin America. Japanese firms provide a suitable empirical context because they have been leading investors in emerging economies, particularly those in Asia (Belderbos & Sleuwaegen, 1996). Also, Japanese firms have been described as taking a capability development approach to foreign investment (Chang, 1995). Furthermore, the emerging
economies context emphasizes public expropriation hazards because of the high variance in the institutional environments in these economies. The issue of private expropriation hazards is also highlighted in emerging economies because Japanese firms are more likely to provide the intangible assets. However, for the case of Organization for Economic Cooperation and Development (OECD) countries, Japanese foreign investment often involves an asset-sourcing motive (Carr, Markusen, & Maskus, 2000; Kogut & Chang, 1991). Finally, the Japanese setting allows for a test of intrafirm capability transfer through the collection of experience data at the parent company level as well as a test of interfirm capability transfer through the collection of data on the presence of a home country partner. This latter analysis accounts for keiretsu (horizontal business alliance) and sogo shosha (general trading company) partners whose presence may also affect entry strategies (Belderbos & Sleuwaegen, 1996; Yoshino, 1976).

**RESEARCH MODEL AND HYPOTHESIS DEVELOPMENT**

In their seminal analysis of the ownership strategies of U.S. multinationals, Stopford and Wells (1972) modeled the ownership decision as contingent on a parent firm’s need to secure and maintain control of a foreign subsidiary and on a need to gain new host country or industry-specific capabilities. Since Stopford and Wells, the literature on the ownership strategy of foreign investors has proceeded along two, seldom converging, paths.

Transaction cost theorists (Anderson & Gatignon, 1986; Hennart, 1982; Oxley, 1997) have advanced knowledge of control, and Beamish and Banks (1987), Hennart (1988, 1991), Mody (1993), and Kogut and Zander (1993, 1996) have developed and furthered research on the need for new capabilities.

These research streams have occasionally overlapped, when studies explicitly identify the need for local expertise and complementary capabilities as a mechanism firms can use to reduce expropriation hazards (Chi, 1994; Hennart, 1988; Teece, 1986). However, research has yet to demonstrate the specific mechanisms by which a firm’s prior investment history affects the trade-off between the potential gains of partnering, in the form of the acquisition of organizationally complex and tacit knowledge and capabilities, and its potential costs, in the form of expropriation of existing knowledge and capabilities. Comprehensive reviews of multinationals call for a pluralistic and integrated approach to the ownership decision (Dunning, 1993: 205–206) that balances these factors. Complicating this challenge is the time-variant profile of knowledge and capabilities, which changes as a firm makes investments and divestments across businesses (Chang, 1992) and thereby alters the calculus of decisions concerning its ownership strategy when investing (Madhok, 1997).

Our model of the relationships underlying this process is laid out in Figure 1. Three bodies of scholarly literature—on private expropriation hazards, public expropriation hazards, and organizational capabilities—underpin the relationships in this figure. We join these literatures by developing...
hypotheses about the mechanisms by which types of experience, and/or the presence of experienced partners, affect the choice of equity ownership levels.

Public Expropriation Hazards

Because the state possesses a legal monopoly on coercion and is present in the background of every economic transaction (North, 1981, 1990), it poses a threat to the revenue streams of all private firms. This threat may take the form of regulatory or tax policy shifts or, at the extreme, outright expropriation of private sector assets. Multinational firms face heightened exposure to these public expropriation hazards owing to two main factors.

First, compared to host country competitors, they possess superior knowledge of foreign factor markets, but inferior knowledge of host country factor markets. This disparity in information leads multinationals to use lower percentages of domestic content in their host country operations than host country competitors. The political costs to host country governments of expropriation (broadly defined to include administrative seizure of a portion of a subsidiary’s revenue stream)—in the form of higher unemployment, lower tax revenue, lower political contributions, or lower votes—are therefore lower than the costs of expropriating host country firms. A complementary argument can be found on the benefit side of the political decision calculus. Domestic constituents may support the expropriation of foreign-owned assets owing to national pride or perceptions regarding national sovereignty. Such motivations may be especially powerful in periods of political or economic uncertainty.

Assistance from a home country government and support from multilateral institutions may offset these disadvantages for some foreign investing firms. However, on the average, host country firms and joint ventures between host country firms and foreign partners tend to be treated more favorably by the host country governments for the reasons described above. Providing an example of this tendency, Bradley (1977) found that expropriation of joint ventures between foreign firms was eight times as likely as expropriation of joint ventures that involved local partners.

Second, in addition to the lower political costs to a government of expropriation from multinationals, the overseas subsidiaries of multinationals are disadvantaged in their ability to adapt in a manner that reduces the costs of a given expropriation. The same information disparity described above causes multinationals to be at a disadvantage in the disposal of assets compared to their host country competitors. Should a host country government alter regulatory or tax policy in a manner that makes continued operations undesirable, a multinational corporation faces a higher opportunity cost in transforming the assets to their next best use. Furthermore, subsidiaries are more likely to be required to seek permission from headquarters for adaptive moves than are joint ventures. In a static or one-shot game, these additional cost wedges give a host country government flexibility, allowing it to renege on promises and to discriminate against foreign subsidiaries. Of course, in a repeated context, such policies will deter future investment and yield lower long-range political benefits to the host country government. However, as long as politicians have relatively short time horizons, owing to concerns about reelection constraints or the constraint of providing political benefits to nondemocratic support groups such as the military or other politically powerful classes, they will face a time consistency problem in their dealings with multinationals that may result in discriminatory behavior.

Multinationals do not, however, enter into host countries without foresight. Their market entry strategies are specifically tailored to ensure that their expected profits remain higher than they would with the next best alternative use for their capital. Although other strategic options are available to them, including making the host country subsidiary dependent on the home country parent for intermediate products, technology, management skills, or downstream markets (Fagre & Wells, 1982; Lecraw, 1984), we emphasize one strategic option: the percentage of equity ownership chosen for the host country operation.

By increasing the percentage of equity held by host country partners, multinationals can partially alleviate both the knowledge disparity (Hennart, 1988) and organizational rigidity (Gatignon & Anderson, 1988) described above, increasing their share of local content and shifting the political decision calculus of the governments away from expropriation. Furthermore, the reduction in the information disparity also reduces the cost of asset disposal in the event of an expropriation. Assuming that the percentage of equity ownership is positively correlated with host country partner involvement and control over day-to-day operations and, thus, the degree of knowledge transfer, decreasing the equity share of the multinational enhances this information flow and provides an important safeguard against public expropriation hazards. This relationship, which has been the subject of extensive empirical testing with generally
supportive results (Agarwal & Ramaswami, 1992; Brouthers, 1995; Burton & Inoue, 1987; Gatignon & Anderson, 1988; Henisz, 2000a; Kobrin, 1978; Kogut & Singh, 1988; Oxley, 1999; Scholhammer & Nigh, 1984; Shane, 1992), is captured in our first hypothesis.

Hypothesis 1. The greater the level of public expropriation hazards in a country, the lower the ownership position assumed by a foreign investing firm.

Private Expropriation Hazards

Partnering with a host country firm also poses hazards for multinationals. The joint venture partner may, given the necessarily incomplete nature of the joint venture agreement, behave in an opportunistic manner so as to divert the revenue stream of the joint venture away from the multinational. The feasibility of such behavior increases with certain characteristics of the activity pursued by the host country subsidiary (Williamson, 1996).

One category of private expropriation hazards is technological leakage (Pisano, 1990, 1991; Teece, 1986, 1992). Oxley (1997) summarized several problems in contracting for technology, the majority of which vary by transaction rather than by country, including the “fundamental paradox” of information (Arrow, 1971: 152), the tacitness of some information (Kogut, 1988; Mowery & Rosenberg, 1989; Teece, 1986), the absorptive capacity of the contracting partner (Cohen & Levinthal, 1990), and the exclusion of some—especially new—technologies, even in a strong intellectual property regime, from the coverage of patent law. Such transaction-specific variance in the ability of a multinational to contract for technology gives rise to the private expropriation hazard of technological leakage. As this hazard increases, the costs of writing, monitoring, and enforcing contracts increase.

A second category of private expropriation hazards developed in the extant literature is the hazard of free riding on brand name and reputation (Anderson, 1985; Anderson & Coughlan, 1987; Anderson & Schmittekin, 1984; Klein & Leffler, 1981). Gatignon and Anderson argued that multinational firms with strong brand equity will assume higher equity positions in joint ventures to “prevent the local operation from diluting or confusing the international positioning of the brand” (1988: 310). Once again, the presence of an asset with a value that is difficult to protect or describe contractually increases governance costs.

In both cases, a multinational is exposed to the hazard that returns on its sunk costs (either R&D or advertising) will be devalued or expropriated by the joint venture partner. Each of these characteristics of a given transaction increases the potential returns to the host country joint venture partner of an opportunistic expropriation. Because of the condition of “bounded rationality,” joint venture contracts are necessarily incomplete, and these hazards cannot be reliably safeguarded through contract. Therefore, as the private expropriation hazards of technological leakage and free riding on brand name reputation increase, the potential for maladaptation that arises from contractual incompleteness in a joint venture rises.

Once again, multinationals are expected to act with foresight so as to minimize expropriation hazards. Although a wide host of strategic options are available, including the careful design of joint venture contracts, we again emphasize the percentage of equity ownership chosen for the host country operation. Where private expropriation hazards are high, multinationals are expected to increase their equity shares so as to minimize the control over day-to-day operations held by their potentially opportunistic joint venture partners. This prediction, captured in our second hypothesis, has also been the subject of extensive empirical tests (Davidson & McFetridge, 1985; Gatignon & Anderson, 1988; Gomes-Casseres, 1989, 1990; Henisz, 2000a; Hennart, 1991; Kogut & Singh, 1988; Murtha, 1991; Oxley, 1997), the vast majority of which have been supportive (see Delios and Beamish [1999] for a recent exception).

Hypothesis 2. The greater the level of private expropriation hazards in a foreign investing firm’s assets, the higher the ownership position it assumes.

Experience and the Capability to Mitigate Hazards

In addition to studying public and private expropriation hazards, researchers have examined how capabilities developed through prior investment activity influence the strategies used for subsequent investments. In this research stream, a firm’s international expansion strategy is considered to consist of a series of integrated choices through which the firm capitalizes on the best market opportunities and takes advantage of experiential learning (Kogut, 1983). Experiential learning helps to develop new capabilities, and these capabilities affect the way a firm evaluates its ownership position when making its next investments (Chang, 1995). Furthermore, capabilities developed through particular forms of investment, such as operating alliances, enhance the future value of sim-
ilar ownership strategies to the firm (Anand & Khanna, 2000). The relationship between capabilities and a firm’s ownership position stems from the demands placed on the firm when it enters new product or geographic markets. The capabilities required to compete successfully in a new market can differ significantly from the ones required for success in existing markets, and it becomes incumbent on the firm to develop new capabilities suited to the market into which it has expanded. This need stems from the specificity of a firm’s routines (Nelson & Winter, 1982) and the bounded rationality of its managers (Simon, 1997), both of which impede deployment of a firm’s capabilities outside of its current market contexts.

Because of the difficulty of deploying existing capabilities in new product and geographic markets, firms may seek required capabilities via partnerships with other firms that have experience and capabilities in the markets in which the firms are making their investments. That is, foreign firms inexperienced in a given host country often partner with local firms (Inkpen & Beamish, 1997). By a similar line of reasoning, when firms invest in new product-markets, they may seek other firms with experience in that area as partners to augment existing capabilities (Hennart, 1988). This form of partnering tends to be equity-based because of the difficulties encountered in valuing and pricing the discrete tacit assets that underlie the proprietary capabilities sought in such partnerships (Chi, 1994; Hennart, 1988). Researchers have argued that inexperience in markets indicates such capability shortfalls on the part of foreign investing firms and therefore reflects an increased propensity to share ownership with host country firms on entry.

We tested for this direct effect of experience on equity ownership levels but note that the partnerships encouraged by capability shortfalls themselves generate exposure to private expropriation hazards, which in turn complicates these relationships. Extant theory, although identifying both of these effects, has not addressed them jointly. By explicitly considering mechanisms by which experience affects equity ownership levels in foreign subsidiaries and by analyzing the magnitude of this effect under different levels of public and private expropriation hazards, we can make specific predictions about the relative magnitudes of the benefits and costs of such partnerships.

First, we posit that capability shortfalls—which initially hinder growth into new markets—can be overcome as a firm acquires new capabilities by operating in new geographic markets and/or industries (Chang, 1992; Silverman, 1998). At a broad level, the accumulation of international experience reduces the degree of foreignness faced by a firm on entry into a host country (Hymer, 1976, 1960), because it can more quickly absorb the intricacies of the new economic, political, legal and cultural environment (Beamish, 1988). One specific example of this is the ability to detect and safeguard against opportunistic behavior on the part of host country governments. A specific government or a government with a specific institutional configuration may exhibit patterns in its behavior that a firm with prior experience in the same or similar countries can use to mitigate public expropriation hazards. With the development of such knowledge, a multinational can become more integrated in local factor markets as it becomes familiar with local buyers and suppliers, and it can develop capabilities more suited to dealing with local political actors.

_Hypothesis 3a. The negative effect of public expropriation hazards on the level of equity ownership of a subsidiary in a given country is smaller for foreign investing firms with greater host country, industry, or international experience._

Just as the capability to mitigate public expropriation hazards can vary with the extent of multinationals’ experience, these firms might also differ in their ability to mitigate private expropriation hazards. For instance, assume that in each country there are joint venture partners that range from more to less opportunistic in their behavior. Furthermore, assume that channels of expropriation can vary from country to country. A multinational then faces a choice of whom to partner with and on what terms. The multinational will attempt to choose the partner that provides the largest net potential benefit when the gains of complementary capabilities are set against the potential losses from opportunistic behavior.

This partnering choice, and the ability to mitigate concomitant private expropriation hazards, varies positively with a firm’s experience and capabilities in the market and industry in which it invests. These capabilities can be used to draft more complete contracts that safeguard proprietary assets (Mayer, 2000). Country experience, for example, provides important information about the reputations of various potential transaction partners. Industry and total overseas experience yield similar benefits. In each case, experience lets a firm reduce the expected variance in the opportunistic behavior of a potential joint venture partner. Prior studies corroborate this argument that firms can base routines useful for managing transactions with other firms on experience gained through prior entries.
Hypothesis 3b. The positive effect of private expropriation hazards on the level of equity ownership of a subsidiary in a given country is smaller for foreign investing firms with greater host country, industry, or international experience.

Partner Capabilities

The discussion of Hypotheses 3a and 3b points out that a firm can augment existing capabilities—specifically, those that aid in hazard mitigation—through its experience in product and geographic markets. Yet a firm making a foreign investment can also benefit from the experience of other firms not directly involved in the foreign entry as equity partners (Chang, 1995; Levitt & March, 1988; Shaver, Mitchell, & Yeung, 1997). One particular context in which firms can benefit from the experience of other firms is through their membership in business groups. Business groups are a ubiquitous aspect of industrial organization in a variety of countries; for example, there are Korea's chaebols, India's family-centered industrial groups, and Japan's keiretsus.

A growing literature on the economic foundation for business groups emphasizes their ability to substitute for markets that for reasons of low levels of economic development, government regulation, or market size are absent in a host country (Fisman & Khanna, 1998; Khanna & Palepu, 1999). Business groups have also been hypothesized to arise because of foreign trade and investment asymmetries that enhance the returns from the capability of “combining foreign and domestic resources—inputs, processes, and market access—to repeatedly enter new industries” (Guillén, 2000: 364). In our analysis, the absent market is for hazard-mitigating capabilities. The asymmetries of interest to Guillén (2000) were present in our research context, Japanese multinational activity in emerging markets. We expected that, in the absence of (or as a complement to) relevant national or industry experience, Japanese multinationals could utilize existing business group relationships—sogo shosha partnership or keiretsu membership—to obtain hazard-mitigating capabilities.

Sogo shoshas have taken a leading role in the international expansion of Japanese firms (Kojima & Ozawa, 1984; Yoshida, 1986), participating as equity partners in a large percentage of Japanese firms' foreign investments (Yoshino, 1976; Toyo Keizai, 1997). When a sogo shosha is an equity partner in a foreign investment, it provides extensive knowledge of foreign markets, built up by its wide network of foreign subsidiaries and its extensive foreign trading operations. Just as a firm's experience can reduce private and public expropriation hazards, equity participation by a sogo shosha can reduce uncertainty regarding potential proclivities toward, and avenues for, opportunistic behavior.

Membership in a keiretsu can also benefit a multinational (Belderbos & Sleuwaegen, 1996). Horizontal keiretsus are business alliances in which member firms are integrated with one another by such mechanisms as cross-appointments of directors and executives, cross-shareholdings, and joint projects. The close relationships between member firms foster good information flows (Gerlach, 1987). Imai (1987) characterized a keiretsu as a network of knowledge in which firms gain information from one another through ongoing trading relationships, collaborative projects, and personnel exchanges (Gerlach, 1987). Information about foreign markets, along with resources related to finance, technology, and other fields, are pooled (Heloü, 1991). A firm undertaking a foreign investment could readily obtain knowledge about the investment environment from other firms in the same keiretsu. Consequently, we expected the experience of sogo shosha and keiretsu partners to be applied to mitigate public and private expropriation hazards.

Hypothesis 4a. The negative effect of public expropriation hazards on the level of equity ownership of a subsidiary in a given country is smaller for foreign investing firms with sogo shosha partners or keiretsu membership.

Hypothesis 4b. The positive effect of private expropriation hazards on the level of equity ownership of a subsidiary in a given country is smaller for foreign investing firms with sogo shosha partners or keiretsu membership.

METHODS

Sample

The sample of Japanese foreign subsidiaries in 18 emerging economies (see Table 3) was drawn from the 1997 Japanese-language edition of Kaigai Shinshutsu Kigyou Souran-Kuni Betsu—Kuni Betsu (Japanese Overseas Investments—by Country). Toyo Keizai compiled these data as part of an annual survey of the overseas operations of major listed and nonlisted Japanese firms. The survey data were supplemented by Toyo Keizai with information from an-
annual reports, newspaper accounts, and other media. Our initial sample totaled 18,223 subsidiaries. Because parent firm data were required for our analysis, we matched the Japanese parent firms for each subsidiary to the firms listed in the Analysts' Guide (Daiwa Institute of Research, 1996) and in Kaisha Zaimu Karute (Corporate Financial Listing; Toyo Keizai, 1998). Both of these sources are compendiums of accounting and financial data for Japanese public firms.

Once the lists were matched, we removed non-greenfield (acquired) manufacturing operations from the sample. Even though nongreenfield entries, particularly partial acquisitions, can be similar to joint ventures in their information asymmetry and capability transfer motivations for formation (Anand & Delios, 1997; Hennart & Park, 1993; Pisano, 1989), they accounted for just 0.6 percent of all Japanese entries in our emerging economies sample. Therefore, we removed acquisitions to facilitate our analysis and discussion. After restriction to greenfield operations, the sample consisted of 3,076 manufacturing subsidiaries of 660 large public firms. Mean sales were 458 billion yen, and mean employment stood at 4,447. In this group, 16 percent of revenues were derived from exports. On average, each parent had made foreign investments in 8 countries (see Table 1). After “listwise” deletion of cases with missing values, our final sample numbered 2,827 subsidiaries.

Analysis

We tested the hypotheses using Tobit and ordered Probit analyses (Greene, 1997; Maddala, 1983). The former technique is preferred to ordinary least squares (OLS) regression analysis when the dependent variable is “censored” at some value on the left and/or right side because OLS can lead to biased coefficient estimates. In the case of equity ownership, the dependent variable, which we defined as the sum of the equity holdings of Japanese parents that were members of the same horizontal keiretsu, has a lower limit of 0 and an upper limit of 100; hence, the double-censored Tobit procedure (using Eviews 3.1) that we employed was appropriate. Ordered Probit analysis is suited for qualitative dependent variables that have more than two ordinal categories. We used ordered Probit analysis when the dependent variable was defined by ownership category. Following Curhan, Davidson, and Suri (1977), we defined the three types of ownership structures by the equity holdings of the affiliated Japanese parents (in parentheses): minority joint venture (<50%), co-owned or majority joint venture (≥50% but <95%), and wholly owned subsidiary (≥95%). As the results of these analyses were qualitatively similar, we report and discuss only the Tobit results. The study’s measures are discussed below (see Table 2).

Measures

**Public expropriation hazards.** We used two measures. The first, political hazards, taken from Henisz (2000b) is a measure of the extent to which a change in the preferences of any one branch of government (executive, lower and upper legislative chambers, judiciary, and subfederal institutions) may lead to a change in government policy. From existing political science databases, it identifies the number of independent branches of government within a given country with veto power over policy changes. The preferences of each of these branches and the status quo policy are then assumed to be independently and identically drawn from a uniform, unidimensional “policy space.” This assumption allows for the derivation of a quantitative measure of institutional hazards using a simple spatial model of political interaction.

This initial measure is then modified to take into account the extent of alignment across branches of government using annual data on the party composition of the executive and legislative branches for

<table>
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<th>Characteristic</th>
<th>Number of Firms</th>
<th>Mean</th>
<th>s.d.</th>
</tr>
</thead>
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<tr>
<td>Sales in billions of yen</td>
<td>627</td>
<td>457.76</td>
<td>1,592.01</td>
</tr>
<tr>
<td>Number of employees</td>
<td>625</td>
<td>4,447.27</td>
<td>8,025.85</td>
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<tr>
<td>Percentage of total sales abroad</td>
<td>525</td>
<td>16.51</td>
<td>17.76</td>
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<td>Number of foreign subsidiaries as the main parent</td>
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<td>47.11</td>
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<td>Number of countries invested in as the main parent</td>
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<tr>
<td>Number of countries invested in as a parent</td>
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<tr>
<td>Return on assets</td>
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<tr>
<td>Return on equity</td>
<td>611</td>
<td>0.43</td>
<td>15.30</td>
</tr>
</tbody>
</table>

**TABLE 1**

Descriptive Statistics for Japanese Parent Firms
| Variable                      | Mean | Median | s.d. | Maximum | Minimum | 1  | 2  | 3  | 4  | 5  | 6  | 7  | 8  | 9  | 10 | 11 | 12 | 13 | 14 | 15 | 16 |
|-------------------------------|------|--------|------|---------|---------|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|
| 1. Equity ownership           | 61.00| 52.80  | 29.50| 100.00  | 0.13   |   |   |   |   |   |   |   |   |   |   |   |   |   |   |   |
| 2. Political hazards          | 0.66 | 0.73   | 0.30 | 1.00    | 0.16   | -18|   |   |   |   |   |   |   |   |   |   |   |   |   |   |   |
| 3. Equity restrictions        | 1.61 | 1.64   | 0.25 | 1.93    | 0.48   | -.14| -.05|   |   |   |   |   |   |   |   |   |   |   |   |   |
| 4. R&D intensity              | 0.03 | 0.02   | 0.03 | 0.17    | 0.00   | .15| .03| -.06|   |   |   |   |   |   |   |   |   |   |   |   |
| 5. Advertising intensity      | 0.01 | 0.00   | 0.02 | 0.23    | 0.00   | .06| .03| -.06| .16|   |   |   |   |   |   |   |   |   |   |   |
| 6. National experience\(^b\) | 1.33 | 0.00   | 1.69 | 7.11    | 0.00   | -.08| -.08| -.00| -.14| -.08|   |   |   |   |   |   |   |   |   |   |
| 7. Industry experience\(^b\) | 1.73 | 1.59   | 1.74 | 5.87    | 0.00   | .06| .24| -.08| .04| .09| .32|   |   |   |   |   |   |   |   |   |
| 8. Other experience\(^b\)    | 4.25 | 4.44   | 2.29 | 9.31    | 0.00   | -.03| -.31| -.11| .02| -.09| .65| .41|   |   |   |   |   |   |   |   |
| 9. Unrelated entry            | 0.28 | 0.00   | 0.45 | 1.00    | 0.00   | -.10| -.10| -.05| -.08| -.10| -.11| -.62| -.12|   |   |   |   |   |   |
| 10. Keiretsu without sogo shosha| 0.25 | 0.00   | 0.43 | 1.00    | 0.00   | -.10| -.01| -.04| .28| -.11| -.02| .02| .02| .01|   |   |   |   |   |
| 11. Sogo shosha as primary    | 0.11 | 0.00   | 0.31 | 1.00    | 0.00   | -.24| .05| -.02| -.31| -.20| .58| .12| .51| -.01| -.20|   |   |   |   |
| 12. Sogo shosha as secondary  | 0.13 | 0.00   | 0.34 | 1.00    | 0.00   | -.19| .13| .03| .02| -.03| -.08| -.00| -.08| .00| .13| -.11|   |   |   |
| 13. Export intensity          | 0.18 | 0.13   | 0.18 | 0.98    | 0.00   | .24| -.03| -.04| .13| -.02| -.03| .12| .11| -.09| -.07| -.13| -.08|   |   |
| 14. Relative subsidiary size  | 0.11 | 0.03   | 0.34 | 10.00   | 0.00   | .09| -.01| .09| -.06| -.02| -.08| .01| -.12| -.09| -.06| -.03| -.02| .22|   |
| 15. Parent size\(^b,c\)       | 12.90| 12.60  | 1.76 | 16.70   | 9.07   | -.19| .10| -.05| .00| -.12| .62| .23| .69| .07| .71| -.02| -.07| .01| -.16|   |
| 16. Per capita GDP\(^b\)      | 8.26 | 8.44   | 0.76 | 9.39    | 6.85   | -.03| .12| -.05| -.01| -.01| .11| .11| .22| -.02| .06| .06| -.02| .02| .09| .11|   |
| 17. Population\(^b\)         | 8.09 | 8.43   | 1.62 | 11.56   | 4.20   | -.01| .09| .24| .02| -.09| -.06| -.11| .02| -.05| -.02| .01| -.04| -.01| -.10| -.53|   |

\(^a\) N = 2,827. Correlations greater than .03 or less than -.03 are significant at p < .05.
\(^b\) Logarithm.
\(^c\) Annual sales, in billions of yen.
Delios and Henisz

each country. Such alignment increases the feasibility of policy change. The measure is further modified to capture the extent of preference heterogeneity within each legislative branch that increases (decreases) the decision costs of overturning policy for legislatures aligned (opposed) to the executive. Possible scores for this measure range from 0 (minimal risk) to 1 (extremely risky).¹

The second measure, equity restrictions, is a measure of perceived legal barriers to equity ownership by foreign firms. The variable used is the average response of a panel of 2,515 executives surveyed for the World Economic Forum’s World Competitiveness Report to the statement “Foreign investors are free to acquire control in a domestic company.” Table 3 provides average 1985–94 political hazard scores and a logarithmic transformation of the legal restrictions on equity ownership scores for the 18 emerging economies.

Private expropriation hazards. Lacking microanalytic data on the private expropriation hazard of technological leakage like the data found in Oxley (1997), we used the conventional measure—R&D expenditures as a percentage of sales (R&D intensity)—as an imperfect proxy. For similar reasons, we adopted the advertising-to-sales ratio (advertising intensity) as an imperfect proxy of the extent of private expropriation hazards of free riding on brand name and reputation (see Gatignon & Anderson, 1988; Gomes-Casseres, 1989; Hennart, 1991; Hennart & Park, 1993; Kim & Hwang, 1992; Kogut & Singh, 1988). Both measures were five-year (1992–96) averages of data from Kaisha Zaimu Kigou. Both measures are also proxies for firm-level capabilities (research and marketing). Although we acknowledge the limits of these proxies, we stress that, at least in the emerging market context, these capabilities are more in need of protection from opportunistic behavior than in need of complementary capabilities.

Capabilities. We measured experience at the firm level by examining a firm’s foreign investment activity in a given host country, in a given industry, and in countries other than the focal host country. The variables, national (host country) experience, industry experience, and other (international) experience, were based on the extent of a firm’s investment activity at the date of a subsidiary’s founding. Each variable was the logarithm of the number of subsidiary years of relevant (host country, industry, and other) experience. A subsidiary year was one year of operations by one subsidiary.

¹ The political constraint index data set is available from http://www-management.wharton.upenn.edu/henisz/.

### Table 3

<table>
<thead>
<tr>
<th>Country</th>
<th>Political Hazard</th>
<th>Legal Restrictions on Equity Ownership</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>0.57</td>
<td>0.48</td>
</tr>
<tr>
<td>Brazil</td>
<td>0.16</td>
<td>1.44</td>
</tr>
<tr>
<td>People’s Republic of China</td>
<td>1.00</td>
<td>1.39</td>
</tr>
<tr>
<td>India</td>
<td>0.55</td>
<td>1.34</td>
</tr>
<tr>
<td>Indonesia</td>
<td>1.00</td>
<td>1.79</td>
</tr>
<tr>
<td>South Korea</td>
<td>0.68</td>
<td>1.93</td>
</tr>
<tr>
<td>Malaysia</td>
<td>0.30</td>
<td>1.79</td>
</tr>
<tr>
<td>Mexico</td>
<td>0.76</td>
<td>1.30</td>
</tr>
<tr>
<td>Philippines</td>
<td>0.75</td>
<td>1.83</td>
</tr>
<tr>
<td>Poland</td>
<td>0.31</td>
<td>1.45</td>
</tr>
<tr>
<td>Singapore</td>
<td>0.32</td>
<td>1.11</td>
</tr>
<tr>
<td>South Africa</td>
<td>0.68</td>
<td>0.96</td>
</tr>
<tr>
<td>Taiwan</td>
<td>0.29</td>
<td>1.64</td>
</tr>
<tr>
<td>Thailand</td>
<td>0.73</td>
<td>1.82</td>
</tr>
<tr>
<td>Turkey</td>
<td>0.60</td>
<td>0.75</td>
</tr>
<tr>
<td>Vietnam</td>
<td>1.00</td>
<td>n.a.</td>
</tr>
</tbody>
</table>

¹ These are 1985–94 averages.

In calculating these measures, we included the experience of current subsidiaries and of subsidiaries that a Japanese parent had owned and exited prior to 1997. We identified exits by searching several earlier versions (1986, 1989, 1992, and 1994) of Kaigai Shinshutsu Kigyou Souran.

Three dummy variables captured the effect of sogo shosha or keiretsu participation. The first, sogo shosha as primary partner, was coded 1 when a sogo shosha was the largest Japanese equity holder. The second, sogo shosha as secondary partner, was coded 1 when a sogo shosha had an ownership position lower than that of another Japanese firm. We identified nine sogo shoshas (Itochu, Kanematsu, Sumimoto Corporation, Tomen, Nichimen, Nissho Iwai, Marubeni, Mitsui & Co. and Mitsubishi Corporation), as listed in the Analysts’ Guide under industry code 40101 (general trading companies). To separate the effects of keiretsu membership from sogo shosha ties, we created a dummy variable for overseas operations in which a partner from one of the big six horizontal keiretsus (Mitsubishi, Mitsui, Sumitomo, DKB, Fuyo, and Sanwa; see Dodwell [1996/1997]) took an equity stake, but no sogo shosha was active (keiretsu without sogo shosha).

### Control Variables

We determined whether a subsidiary was in a core business of the focal Japanese parent by first developing a profile of the parent firm’s businesses
by searching through Toyo Keizai's Japan Company Handbook and Principal International Businesses: The World Marketing Directory, 1996 (Dun & Bradstreet, 1995). If the subsidiary's industry did not match one of the parent firm's businesses, it was coded as an unrelated entry (1).

Following established practice, we controlled for export intensity (parent firm exports/parent firm sales) (Chang, 1995; Terpstra & Yu, 1988), relative subsidiary size (subsidiary's number of employees/parent firm's number of employees), and parent size (the size of the Japanese parent measured as annual sales in billions of yen) (Agarwal & Ramaswami, 1992; Delios & Beamish, 1999; Gatignon & Anderson, 1988; Kogut & Singh, 1988; Oxley, 1997), purchasing-power-adjusted per capita level of GDP (gross domestic product) of the host country (Delios & Beamish, 1999; Gomes-Casseres, 1989, 1990; Green & Cunningham, 1975; Kobrin, 1976) and the population of the host country (Green & Cunningham, 1975; Kobrin, 1976). Logarithmic transformations of data were used for all the control variables but unrelated entry, relative subsidiary size, and export intensity.

RESULTS

Models 1–4 of Table 4 display the results of the Tobit analyses for our emerging country sample with (1) no experience interactions, (2) public sector expropriation hazard and parent firm experience interactions, (3) public and private sector expropriation hazard and parent firm experience interactions, and (4) public and private sector expropriation hazard and parent firm experience and partner firm presence interactions. The coefficient estimates on the nonexperience variables were correctly signed and significant, with p-values of .01 or lower, with the exception of firm size and relative size (insignificant), advertising intensity (correctly signed, p values of .24, .22, .14, and .07), and R&D intensity (correctly signed, p values of .02, .02, .34, and .19). The experience variables and the sogo shosha and keiretsu variables were highly significant in the base specification (column 1). However, consistent with our hypotheses, much of the impact of these variables on the predicted level of ownership occurs through indirect channels—by mitigating the impact of public and private expropriation hazards. Finally, the industry and regional dummies were jointly significant (F = 11.23, log likelihood ratio = 238.94). The adjusted multiple squared correlation coefficient ($R^2$) ranges from .24 to .25. Using an F-test, one can reject the hypothesis that the coefficients on the newly included variables in columns 2, 3, and 4 are equal to zero; p-values are .03, .24, and .004. As well, a test for the inclusion into model 4 of the interactions introduced in model 3 allows rejection of the null hypothesis that the omitted variables are redundant (p = .09).

Focusing on the results in model 4, we review the tests of our hypotheses in turn. First, the negative and significant coefficient estimates for both measures of public expropriation hazards (p < .001) support the hypothesis that as these hazards increase, firms increasingly rely upon host country partners to increase domestic content, maintain compliance with existing legal statutes, ease the disposal of assets, and provide information and access to the domestic political system. Second, although the coefficient estimates on R&D and advertising intensity were consistently positive, providing partial support for the traditional transaction cost hypothesis that as private expropriation hazards increase, Japanese multinationals favor higher levels of equity control, neither estimate was statistically significant in model 4.

Next, in contrast to the model 1 results, industry and national experience have no direct impact on equity ownership levels in the results for model 4, which included the full set of experience interactions. The positive and significant coefficient estimates on the interaction of the parent firm's industry experience (p = .03) with the host country's level of political hazards, as well as the interaction between other international experience and the level of equity restrictions (p < .001), support the prediction (Hypothesis 3a) that parent firm experience can reduce the sensitivity of a multinational corporation to public expropriation hazards. Only parent firm industry experience appears to help mitigate private expropriation hazards (p = .02). This result partially supports Hypothesis 3b, which predicts that the total years of experience in an industry may improve partner-screening abilities and provide more knowledge regarding the most likely avenues of expropriation.

Mirroring the results for parent firm experience, the coefficient estimates on keiretsu or direct sogo shosha participation that were significant in model 1 are insignificant in model 4, once we take into account the indirect effect of hazard mitigation. However, secondary sogo shosha participation (empirically always observed in connection with the presence of a keiretsu partner) still has a significant impact on the choice of equity ownership. The positive and significant coefficient estimates on the interactions of the dummy variables for keiretsu presence (p = .02) and sogo shosha as primary partner (p < .001) with political hazards provides partial support for Hypothesis 4a, stating that part-
### TABLE 4
Results of Tobit Analysis on Equity Ownership

<table>
<thead>
<tr>
<th>Variable</th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
<th>Model 4</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><strong>Adjusted R²</strong></td>
<td><strong>Log likelihood</strong></td>
<td><strong>Number of observations</strong></td>
<td></td>
</tr>
<tr>
<td>Public expropriation hazards</td>
<td>-20.72** (2.33)</td>
<td>-31.39** (7.16)</td>
<td>-31.52** (7.16)</td>
<td>-26.23** (7.62)</td>
</tr>
<tr>
<td>Political hazards</td>
<td>-17.06** (2.74)</td>
<td>-32.61** (9.01)</td>
<td>-31.73** (9.02)</td>
<td>-42.45** (9.67)</td>
</tr>
<tr>
<td>Equity restrictions</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private expropriation hazards</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R&amp;D intensity</td>
<td>66.07* (28.73)</td>
<td>69.76* (28.73)</td>
<td>103.31 (107.33)</td>
<td>138.47 (107.78)</td>
</tr>
<tr>
<td>Advertising intensity</td>
<td>57.53 (49.23)</td>
<td>59.07 (49.17)</td>
<td>201.23 (136.16)</td>
<td>253.36 (138.11)</td>
</tr>
<tr>
<td>Parent firm experience</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other experience</td>
<td>2.24** (0.55)</td>
<td>-7.27** (2.65)</td>
<td>-7.30** (2.66)</td>
<td>-9.42** (2.91)</td>
</tr>
<tr>
<td>Industry experience</td>
<td>-1.11* (0.56)</td>
<td>-4.76 (3.56)</td>
<td>-3.30 (3.60)</td>
<td>-2.43 (3.66)</td>
</tr>
<tr>
<td>National experience</td>
<td>-2.23** (0.63)</td>
<td>7.16 (4.29)</td>
<td>6.18 (4.32)</td>
<td>5.46 (4.52)</td>
</tr>
<tr>
<td>Presence of partner capabilities</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Keiretsu without sogo shosha</td>
<td>-5.60** (1.53)</td>
<td>-5.86** (1.54)</td>
<td>-5.85** (1.54)</td>
<td>-12.63 (10.09)</td>
</tr>
<tr>
<td>Sogo shosha as primary</td>
<td>-18.15** (2.92)</td>
<td>-18.28** (2.91)</td>
<td>-17.07** (3.03)</td>
<td>-4.58 (17.72)</td>
</tr>
<tr>
<td>Sogo shosha as secondary</td>
<td>-12.36** (1.78)</td>
<td>-12.35** (1.78)</td>
<td>-12.62** (1.78)</td>
<td>-34.60** (14.34)</td>
</tr>
<tr>
<td>Experience/capabilities and public expropriation hazards</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other experience × political hazards</td>
<td>0.75 (1.22)</td>
<td>2.39 (1.75)</td>
<td>-0.91 (1.33)</td>
<td></td>
</tr>
<tr>
<td>Industry experience × political hazards</td>
<td>2.44 (1.67)</td>
<td>-0.32 (1.75)</td>
<td>3.71 (1.71)</td>
<td></td>
</tr>
<tr>
<td>National experience × political hazards</td>
<td>0.13 (2.13)</td>
<td>-1.30 (2.22)</td>
<td>-2.01 (2.22)</td>
<td></td>
</tr>
<tr>
<td>Keiretsu without sogo shosha × political hazards</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sogo shosha as primary × political hazards</td>
<td>26.48** (7.83)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sogo shosha as secondary × political hazards</td>
<td>4.30 (6.48)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other experience × equity restrictions</td>
<td>5.59** (1.52)</td>
<td>6.01** (2.16)</td>
<td>7.59** (1.68)</td>
<td></td>
</tr>
<tr>
<td>Industry experience × equity restrictions</td>
<td>1.14 (1.94)</td>
<td>1.05 (2.07)</td>
<td>-0.20 (1.97)</td>
<td></td>
</tr>
<tr>
<td>National experience × equity restrictions</td>
<td>-5.90** (2.35)</td>
<td>-1.65 (2.72)</td>
<td>-4.40 (2.46)</td>
<td></td>
</tr>
<tr>
<td>Keiretsu without sogo shosha × equity restrictions</td>
<td></td>
<td></td>
<td>-0.60 (5.85)</td>
<td></td>
</tr>
<tr>
<td>Sogo shosha as primary × equity restrictions</td>
<td>-20.82* (9.90)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sogo shosha as secondary × equity restrictions</td>
<td>13.55 (7.76)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Experience/capabilities and private expropriation hazards</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other experience × R&amp;D intensity</td>
<td>-2.24 (15.61)</td>
<td>-0.32 (16.16)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industry experience × R&amp;D intensity</td>
<td>-44.57** (22.87)</td>
<td>-51.46* (22.86)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>National experience × R&amp;D intensity</td>
<td>45.10 (24.09)</td>
<td>48.23* (24.35)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Keiretsu without sogo shosha × R&amp;D intensity</td>
<td>-50.41 (57.37)</td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Sogo shosha as primary × R&amp;D intensity</td>
<td></td>
<td>n.a.</td>
<td>n.a.</td>
<td></td>
</tr>
<tr>
<td>Sogo shosha as secondary × R&amp;D intensity</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other experience × advertising intensity</td>
<td>7.03 (27.72)</td>
<td>8.74 (20.09)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industry experience × advertising intensity</td>
<td>-68.73 (38.23)</td>
<td>-72.76 (38.17)</td>
<td></td>
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</tr>
<tr>
<td>National experience × advertising intensity</td>
<td>-22.80 (38.51)</td>
<td>-1.81 (40.49)</td>
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</tr>
<tr>
<td>Keiretsu without sogo shosha × advertising intensity</td>
<td>159.36 (131.60)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sogo shosha as primary × advertising intensity</td>
<td>n.a.</td>
<td>n.a.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sogo shosha as secondary × advertising intensity</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Control variables</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Relative subsidiary size</td>
<td>1.30 (1.81)</td>
<td>1.24 (1.82)</td>
<td>1.38 (1.82)</td>
<td>1.51 (1.81)</td>
</tr>
<tr>
<td>Parent size</td>
<td>-0.85 (0.82)</td>
<td>-0.82 (0.82)</td>
<td>-0.71 (0.82)</td>
<td>-0.62 (0.82)</td>
</tr>
<tr>
<td>Export intensity</td>
<td>17.19** (3.87)</td>
<td>17.38** (3.87)</td>
<td>17.23** (3.87)</td>
<td>16.64** (3.85)</td>
</tr>
<tr>
<td>Unrelated entry</td>
<td>-8.01** (1.54)</td>
<td>-7.85** (1.55)</td>
<td>-7.98** (1.55)</td>
<td>-7.92** (1.54)</td>
</tr>
<tr>
<td>Per capita GDP</td>
<td>5.27** (1.14)</td>
<td>5.10** (1.17)</td>
<td>5.13** (1.17)</td>
<td>5.15** (1.17)</td>
</tr>
<tr>
<td>Population</td>
<td>3.70** (0.57)</td>
<td>3.48** (0.58)</td>
<td>3.49** (0.58)</td>
<td>3.49** (0.58)</td>
</tr>
<tr>
<td>Constant</td>
<td>36.79 (21.10)</td>
<td>79.53** (26.60)</td>
<td>74.50** (26.66)</td>
<td>88.45** (27.25)</td>
</tr>
</tbody>
</table>

* Values in parentheses are standard errors. Coefficient estimates for industry and regional dummies are not reported.

** Logarithm.

* *p < .05

** **p < .01

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fimer firm experience can reduce the sensitivity of a firm to public expropriation hazards. The multiple relationships between sogo shoshas and host country governments seem to restrain opportunistic behavior by the latter. Such constellations of transactions were found to mitigate private expropriation hazards by de Figueiredo and Teece (1996). No support was found for Hypothesis 4b.

Figures 2 and 3 illustrate the variable effects of public expropriation hazards by plotting the predicted level of equity ownership for varying levels of pairs of independent variables of interest (with all other variables held constant at their means). These two figures provide evidence of the quantitative significance of the results. In Figures 2 and 3, we observe that under all categories of experience, and with or without keiretsu or sogo shosha participation, increasing public expropriation hazards reduces the predicted level of equity ownership. Furthermore, the difference obtained in the predicted level of the dependent variable from a one-standard-deviation increase above its mean level ranges from 15.1 to 38.7 percent of one standard deviation of the dependent variable (29.2 percentage points), depending on the level of experience or the presence of keiretsu and/or sogo shosha partners. These results lend further support to Hypothesis 1.

Figure 2 also depicts the strong support found for Hypothesis 3a; more experienced firms are less sensitive to increases in public expropriation hazards. Firms with levels of national, industry, and other experience one standard deviation below the mean are twice as sensitive as firms with experience levels one standard deviation above the mean to a one-standard-deviation increase in public expropriation hazards. Similarly, as indicated by the coefficient estimates for the experience and private expropriation hazards terms found in Table 4, inexperienced firms are much more sensitive than experienced firms to changes in private expropriation hazards (the nonsignificance of the main effect of private expropriation hazards prohibits a plot of these interactions). These results are consistent with the hypotheses that firms with more experience possess advantages in affecting the political decision calculus of host country governments (Hypothesis 3a), in screening potential counterparties (entities they might have dealings with in a host country), and in writing, monitoring, and enforcing contracts with private sector counterparties (Hypothesis 3b). Experienced firms are thus less likely to rely upon the relatively crude safeguard of adjusting their level of equity control in their foreign

FIGURE 2

Own Experience, Public Expropriation Hazards, and Ownership*a

* All independent variables were held constant at their mean levels, with the exception of the dummies for diversification (0) and for no keiretsu or sogo shosha participation. Values on the vertical axis are percentages.
subsidies to safeguard against public and private expropriation hazards.

Finally, Figure 3 provides qualified support for Hypothesis 4a, in that firms without keiretsu or sogo shosha partners are marginally more susceptible to increases in public expropriation hazards. Reliance on partners with the requisite industry, host country, and international experience appears to be a substitute for own-firm experience in the mitigation of these hazards.

Turning to the control variables, we see that the negative and significant coefficient estimate (p < .001) on the unrelated entry dummy indicates that firms with no experience in a specific line of business are more likely to yield equity control to their host country partners so as to gain the knowledge and capabilities necessary to compete in the new industry. We interpret the negative sign and significance (p < .001) of the other international experience term in conjunction with a positive and significant coefficient estimate on export intensity (p < .001) as evidence of an important but, unfortunately, unavailable variable that was omitted from our analysis. Multinationals that produce abroad for export to their home country markets (thus exhibiting low export intensity and high total experience) tend to be less willing to share equity ownership, or see fewer benefits to sharing it. In contrast, firms that produce abroad for overseas consumption may be more willing to share equity ownership and may see larger benefits from doing so, because the local partners' knowledge of the host country distribution system and local tastes and preferences are of higher value to the parent firm.

Finally, national per capita GDP (p < .001) and population (p < .001) were positively associated with equity ownership levels. These results suggest that Japanese multinationals entering wealthier markets—which tend to be more similar to Japan than poorer markets—rely less heavily upon the information provided by host country partners at the times of entry. Larger markets may be too important to the firms for them to risk entry failure due to disputes with a local partner. Hence, Japanese firms invest the resources necessary to acquire information internally rather than rely upon potentially opportunistic host country partners.

To insure that our results were not spurious, owing to sample selection bias, we undertook several tests for the effect of unobserved firm-level heterogeneity on the entry mode choice (Shaver,
These hypotheses demonstrate that Japanese firms' capabilities and hazards literatures. Our tests of the extent of experience in international markets.

**DISCUSSION**

This study offers an integrated approach for examining the ownership decisions of foreign investors. We demonstrate that a firm's capabilities, in terms of its experience in an industry and a country of expansion as well as elsewhere, influence the level of equity ownership the firm chooses in a foreign subsidiary by increasing its stock of hazard-mitigating capabilities and thus reducing its sensitivity to public and private expropriation hazards. These hazard-mitigating capabilities were shown to both develop with a parent firm's own experience and be transferred to the firm through the participation of keiretsu or sogo shosha partners.

**Experience and the Capability to Mitigate Hazards**

A primary contribution of this study is its application of the organizational capabilities approach to multinational entry strategy in combination with more traditional perspectives from the private and public expropriation hazards literatures. Received theory on multinationals emphasizes the important impetus to, and support of, foreign direct investment that is provided by advantages rooted in proprietary assets. According to the dominant transaction cost and internalization paradigms, a firm moves into an international market by direct investment when it can displace the transaction costs of operating via arm's length in that market by the establishment of a foreign subsidiary. Yet, in placing proprietary assets in the host country, the firm exposes those assets to public and private expropriation hazards. The observed effects of these hazards on ownership strategies were broadly consistent with extant theory, yet our findings point to an important dynamic in the foreign investment behavior of firms.

This dynamic emerged from our tracing of firms' investment histories, as mirrored in the time sequence of the establishment of foreign subsidiaries. We tracked how entry mode strategies varied with the extent of experience in international markets. By studying a cross section of firms with variation in the level of host country, industry, and other experience, we examined hypotheses that bridge the capabilities and hazards literatures. Our tests of these hypotheses demonstrate that Japanese firms' strategic responses to private and public expropriation hazards were contingent on their levels of experience in foreign markets and particular industry segments. The results also show that public and private expropriation hazards had the strongest effect for firms that were relatively inexperienced.

Our combination of these literatures helps point to ways in which inconclusive empirical results concerning the relationship between experience and ownership can be resolved. The so-called experience-effects literature is rich in the number of empirical studies that have been conducted and in the industrial and geographic contexts that have been studied. These studies show a variety of contradictory effects, including a negative relationship between a firm's experience and local equity ownership levels (Davidson, 1980; Gatignon & Anderson, 1988; Johanson & Vahlne, 1977), a positive relationship between the two (Davidson & McFetridge, 1985; Stopford & Wells, 1972), and curvilinear effects of experience on ownership (Erramilli, 1991).

Our results suggest that the inconsistent results may have stemmed from a misspecification of the relationship. As suggested in our arguments and as demonstrated in our empirical results (see, in particular, Figure 2), the net effect of experience depends crucially on the profile of an overseas investment. For investments in countries with high public expropriation hazards, experience generates information on local factor and political markets that may aid in the implementation of safeguards other than the formation of alliances with local partners. Hence, we see higher levels of equity ownership for experienced firms than for less experienced firms. Similarly, for investments with high private expropriation hazards, industry experience provides firms with better information on partner type and the likely avenues of expropriation by opportunistic partners. This experience aids in the implementation of safeguards other than taking higher levels of ownership.

Although our theory and evidence suggest that experience and hazards interact to influence the choice of ownership levels, it also provides corroborating evidence concerning the importance of differentiating among different forms of experience and capabilities (Miller & Shamsie, 1996). By specifically identifying firms' levels of experience in international markets, host countries, and the industries in which the firms were investing, the analyses captured both geographic and product scope aspects of firm growth (Barkema & Vermeulen, 1998). Like earlier researchers, we found that the extent of geographic and product line expansion (Chang, 1995; Barkema et al., 1996; Joha-
son & Vahlne, 1977; Pennings, Barkema, & Douma, 1994) influenced an investing firm's ownership strategy. In sum, these effects point to the importance of understanding the extent of product and multinational diversity in a firm's operations when examining foreign ownership choices (Hitt et al., 1997).

**Partner Capabilities**

In addition to a foreign investing firm's operations, conditions in its home country likewise influenced ownership strategies. In our theoretical and empirical analyses, we considered the domestic context by evaluating the role of keiretsu affiliation and sogo shosha partnership. Our study identified sogo shosha affiliation as a means by which public expropriation hazards could be mitigated. A sogo shosha's equity participation in a foreign venture provided the subsidiary with a parent that had relatively extensive knowledge of, and political connections in, the host country. Sogo shoshas fulfilled various roles, such as finding appropriate local partners where needed and negotiating with host country governments (Ozawa, 1979; Yoshino, 1976). Membership in a horizontal keiretsu presented firms with an alternative hazard mitigation mechanism. Member firms could draw upon the massed investment experience of other members and exploit alliances forged in the domestic context in the international setting (Reddy, Osborn, & Pratap, 1998).

**Limitations and Future Directions**

Our analysis pointed to an important temporal component in the foreign entry strategy of Japanese firms. A limitation of the analysis, however, is that we used cross-sectional rather than panel data. Given the encouraging results obtained herein, a useful extension would be for researchers to examine the evolution of foreign investment using a cross-sectional time series framework. This would allow for explicit modeling of the impact of experience on market entry strategy by looking at one firm over time rather than at similar firms with varying experience levels.

Ideally, we would like to extend the depth as well as the coverage of our data. Murtha (1991) and Oxley (1997) demonstrated that microanalytic measures of private expropriation hazards outperformed commonly used accounting-based proxies, such as advertising and R&D intensity. Our accounting-based proxies for various capabilities did not let us identify specific internal routines or processes that can affect entry strategy. Additionally, our analysis suffers from at least two errors of omission. Our sample was biased toward profitable overseas opportunities because we did not have data on the countries that were not chosen for entry. Furthermore, we explicitly limited our analysis to the choice of the level of equity control made by Japanese parent firms. We set aside consideration of alternative hazard mitigation strategies, including licensing, exporting (which serves the dual purpose of generating hard currency and creating dependence on tacit knowledge of the parent company regarding international distribution channels), hiring additional domestic workers, sourcing additional intermediate products, hiring political risk management services, writing more detailed contracts, utilizing international arbitration in the event of disputes, and employing more generic, rapidly depreciating, or mobile assets.

A further line of analysis is suggested by the consistent role that sogo shoshas and keiretsus occupied in these foreign investment decisions. The robust effect of these variables highlights the importance of considering the domestic context of firms when conducting international business research (Barkema, Shenkar, Vermeulen, & Bell, 1997). One of the more interesting, and limiting, aspects of international business research has been its isolation from a firm's domestic activities. Likewise, discussions of growth in the domestic context have been isolated from discussions of growth, often concurrent, in foreign markets. Although researchers have treated domestic and foreign strategy and growth as separate phenomena, in the minds of managers and in the actions of firms, there is certainly considerable relatedness between the two.

**Conclusions**

Despite these limitations, we believe our results demonstrate that a multinational's hazard-mitigating capabilities—developed over time with experience in a given industry, host country, or other international market or, alternatively, transferred from keiretsu and/or sogo shosha partners—affect its chosen levels of equity control over its subsidiaries in emerging markets. Our research extends previous studies by explicitly examining two mechanisms by which experience affects entry strategy. In countries with high public expropriation hazards, experience substitutes for local knowledge of host country factor and political markets provided by local partners, thereby increasing equity ownership levels. In contrast, for investments with high private expropriation hazards, ex-
experience facilitates the writing, monitoring, and enforcement of contracts and aids in partner selection, thereby reducing the tendency to take a higher equity stake in subsidiaries to guard against opportunistic behavior.

By demonstrating the differential impact of experience on investment in countries with various levels of public expropriation hazards and on investments with various levels of private expropriation hazards, we have modeled one dimension of a firm’s capabilities as an analytically tractable component of its foreign entry strategy. Given the level of public and private expropriation hazards inherent in emerging market investment opportunities, these findings should be salient to multinationals considering entry into these countries as well as to host country policy makers seeking to encourage and influence the level of equity ownership in such entries.

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