

Faculdade de Economia, Universidade do Porto
Master in International Economics and Management

**Corruption and MNCs' entry mode. An empirical
econometric study of Portuguese firms internationalizing
to PALOPs**

Marlene Vidal Grande

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Supervisor: Aurora A.C. Teixeira

Short Bio

Marlene Vidal Grande was born in Hamburg, Germany, on December 20, 1986. She finished her high-school education in Hamburg and started undergraduate studies at the *Faculdade de Letras da Universidade do Porto* in 2006. In 2009 she received the *Licenciatura em Línguas e Relações Internacionais* degree. She initiated post graduate studies in 2009 and is presently enrolled in the *Mestrado em Economia e Gestão Internacional* at *Faculdade de Economia da Universidade do Porto*, with the dissertation entitled “Corruption and MNCs’ entry mode. An empirical econometric study of Portuguese firms internationalizing to PALOPs”.

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Abstract

Extant literature on MNC entry modes and corruption tend to convey the idea that corruption leads to the choice of low equity, i.e. joint-ventures with local partners, or non-equity modes, namely export and contracting, in order to avoid the contact with corrupt state officials. Some recent studies argument, however, that despite corruption, linguistic and historical ties between home and host countries might guide MNCs to prefer high equity modes, namely, wholly-owned subsidiaries. Despite the pertinence of such argument these studies have been empirically tested in a limited set of countries, namely Asian countries.

Given the relevance of FDI for low developed countries, namely those paved by high levels of corruption, as it is the case of a significant number of African countries, the testing of the above argumentation in these latter set of countries constitutes a challenging and useful endeavour on a development perspective. Thus, focusing on a rather unexplored setting, the African countries, most specifically the PALOP (*Países Africanos de Língua Oficial Portuguesa*), which includes countries with noticeable levels of perceived corruption - very high (e.g., Guinea-Bissau, and Angola), high (e.g., Mozambique, Sao Tome and Principe) and middle (e.g., Cape Verde) -, and that maintain quite close linguistic and historical ties with Portugal, we seek to assess the extent to which PALOP's perceived corruption levels influence the entry modes of Portuguese MNCs.

A direct questionnaire to the population (562) of Portuguese firms that internationalize to the five PALOPs markets/countries was implemented and we managed to gather the response of 147 firms, which represented 334 firm-market observations. Regarding the 'traditional' determinants of entry mode choices, the estimation of logistic regressions indicate that, for the sample in analysis, larger and more innovative firms tend, on average, to choose FDI as their preferable entry mode and, unexpectedly firms' international experience is not associated to high equity entry modes. Moreover, the openness of the host market favors the entry via FDI, whereas the host market size is negatively related to the equity mode propensity, i.e., in the case of countries with higher GDP per capita levels, Portuguese firms tend to enter most likely via exports. Finally, we found that FDI entry mode is associated to the less corrupt markets contrarily to recent studies that argument that when cultural and historical ties exist equity entry modes are the most prominent choice by MNCs. Thus, our results do not support the content that cultural and historical links are likely to perform a key development role in helping, through fostering foreign direct investment, African countries to overpass the dismissal growth that some have been facing in the last decades. On the contrary, our findings highlight the pressing need for these countries to combat corruption if higher economic growth via FDI attraction is envisioned.

Keywords: Corruption; Emerging Economies; Africa; Entry modes; FDI

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Abbreviations

CPI	Corruption Perception Index
FDI	Foreign Direct Investment
IA	Institutional Approach
JV	Joint-venture
MNC	Multinational Company
OLI	Ownership, location and internalization dimension (Dunning's Eclectic Paradigm)
PALOP	African Countries with Portuguese official Language (<i>Países Africanos de Língua Oficial Portuguesa</i>)
R&D	Research and Development
RBT	Resource-based Theory
TCA	Transaction Cost Approach
WOS	Wholly-owned subsidiary

Introduction

Multinational companies (MNCs) are increasingly influenced by institutional instability, perceived risk and uncertainty in their process of investing in emerging economies (Uhlenbruck *et al.*, 2006). Extant literature suggests the existence of a negative correlation between inflows of FDI and corruption (Uhlenbruck *et al.*, 2006; Javorcik and Wei, 2009). Specifically, the analysis is centered on quantifying FDI flows and to assess how firms adapt their entry mode to existing corruption (Straub, 2007).

In such contexts, evidence is found that firms prefer joint-ventures to wholly-owned subsidiaries (Rodriguez *et al.*, 2005; Uhlenbruck *et al.*, 2006; Straub, 2007; Javorcik and Wei, 2009; Demirbag *et al.*, 2010). Regardless whether firms face petty bureaucratic or high-level political corruption (Straub, 2007), and the level of pervasiveness and arbitrariness of corruption (Rodriguez *et al.*, 2005; Uhlenbruck *et al.*, 2006; Demirbag *et al.*, 2010), existing empirical studies suggest that corruption influences the entry mode, particularly towards the choice of non-equity modes or partnering.

More recently, however, some evidence was found that in case of strong cultural ties between home and host country MNCs revealed preference for wholly owned subsidiaries (Demirbag *et al.*, 2010). Such studies which analyze the impact of corruption on MNCs entry mode choice, however, have focused mainly on Eastern Europe (Javorcik and Wei, 2009) and Asia (Demirbag *et al.*, 2010) or took a general overview based on a cross-country composition (Uhlenbruck *et al.*, 2006; Straub, 2007). Similar analyses encompassing African countries have been rather neglected in this regard.

African based analyses are pertinent for two set of reasons. On the one side, these countries' institutional settings are in general paved by considerable degree of political instability, businesses uncertainties and corruption (Transparency International, 2009). On the other side, in the case of African countries which have experienced in the last decades dismissal growth performances (Asiedu, 2002) the FDI might potentially perform a key role towards development by exploring historical linkages with MNCs from their former metropolitan states.

Among African countries, a sub-set of countries, the PALOP (*Países Africanos de Língua Oficial Portuguesa*), includes countries with both very low (e.g., Equatorial Guinea, Guinea-Bissau, and Angola), low (e.g., Mozambique, São Tome and Principe) and middle (e.g., Cape Verde) levels of transparency as perceived by the Corruption Perception Index

(Transparency International, 2009). Given the close ties between Portugal and the PALOP based on linguistic and historical factors, it would be scientifically pertinent to analyze the extent to which PALOP's corruption levels influence the entry modes of Portuguese MNCs in these countries. Given the above mentioned linguistic and historical proximity between Portugal and the PALOP, it would be expectable, according to Demirbag *et al.* (2010), that Portuguese MNCs which invest in PALOP see wholly-owned subsidiaries as the preferred mode of entry, despite the high degree of corruption/institutional weaknesses of these countries.

The empirical analysis undertaken in the present study aims therefore to assess the extent to which Portuguese MNCs' entry modes in PALOPs corroborates Demirbag *et al.*'s (2010) thesis. Moreover, it contributes to the scarce literature on corruption and MNCs' entry models by analyzing an under explored context, the PALOP.

This study is structured as follows. In Section 2 we revise existent literature on theories and determinants of MNCs' entry modes and on corruption, deepening the analysis of existent articles about the impact of corruption on MNCs' entry mode. In Section 3 we detail the methodological considerations of the study: data gathering procedures, questionnaire, target firms (Portuguese firms that internationalized to the PALOPs), and the specification of the econometric model which will permit to quantify the net impact of corruption on entry mode choice.

Chapter 1. Corruption and MNCs' entry modes. A review of the literature

1.1. Initial considerations

As our analysis aims to examine the impact of corruption on MNCs' entry mode choices, in first place we need to define the concepts of corruption and entry modes. Secondly, it is necessary to investigate the distinct determinants of the entry mode choice and explore the effect they have on this decision.

The present chapter presents a literature review of extant articles on this subject. The next section (Section 1.2) puts forward a definition of corruption. Section 1.3 details the MNCs' entry mode choices, defining the several entry modes and exploring their existing determinants and their effects on this choice. In Section 1.4 we analyze the literature where both concepts – corruption and entry modes- are combined in order to frame the effect corruption has on MNCs' entry mode decisions.

1.2. Defining corruption

Being one of the most widespread political problems worldwide (Frischmann, 2010), in recent years there has been considerable empirical research on the causes and effects of corruption across countries (Goel and Nelson, 2010). The World Bank has estimated that more than 1 trillion USD is paid in bribes each year and that countries that fight corruption, improve governance and the rule of law, what could increase per capita incomes by 400 percent (Dreher *et al.*, 2007).

According to the significant impact and the numerous studies on corruption, there are lots of definitions of this phenomenon (Detzer, 2010). In order to represent this diversity of definitions and the type of measurement, Table 1 serves to exemplify this scenario through some studies on corruption.

The most common definition is the one used by the World Bank, describing corruption as “the abuse of public office for private gain”.¹ Transparency International has a very similar designation, defining corruption as “the misuse of entrusted power for private gain”.² Another often cited, but less clear and focused, definition is corruption as the “behavior

¹ “Helping Countries Combat Corruption: The Role of the World Bank”, in.

<http://www1.worldbank.org/publicsector/anticorrupt/corruptn/cor02.htm>, accessed on 20th November 2010.

² “How do you define corruption?”, in. http://www.transparency.org/news_room/faq/corruption_faq, accessed on 20th November 2010.

which deviates from the formal duties of a public role because of private regarding [...] pecuniary or status gains, or violates rules against the exercise of certain types of private regarding influence” (Nye, 1989: 966 *in* Frischmann, 2010: 2). Also Friedman *et al.* (2000: 462) have a more complex manner of describing this occurrence: in their view corruption can be characterized by “illegal activities that represent costs imposed on business by bureaucrats from which the government obtains no revenue and which do not generate any positive benefits for society”.

Table 1: Examples of studies on corruption

Definition of corruption	Proxies	Studies (date)
Corruption is defined as the misuse of public office for private gain.	Corruption Perceptions Index (TI ⁱ)	Treisman, 1998; Reiter and Steensma, 2010
	Corruption Index (ICRG ⁱⁱ)	Mauro, 1998; Dietrich, 2010
Corruption as bribery.	Bribe ratio (questionnaire)	Henderson and Kuncoro, 2011
Corruption is defined as illegal activities that represent costs imposed on business by bureaucrats from which the government obtains no revenue and which do not generate any positive benefits for society.	Bribery Index (GCS ⁱⁱⁱ)	Friedman <i>et al.</i> , 2000
	Corruption Perception Index (GCS ⁱⁱⁱ)	
	Corruption Perceptions Index (TI ⁱ)	
	Corruption Index (ICRG ⁱⁱ)	

Notes: ⁱ TI: Transparency International; ⁱⁱ INCR: International Country Risk Guide; ⁱⁱⁱ GCS: Global Competitiveness Survey

All these definitions may differ slightly in their formulation, nevertheless there is consensus in lots of studies (Dey, 1989; Mauro, 1998; Treisman, 1998; Dietrich, 2010; Reiter and Steensma, 2010) that corruption refers to acts in which the power of public office is used for personal gain in a manner that contravenes the rules of the game (Jain, 2002).

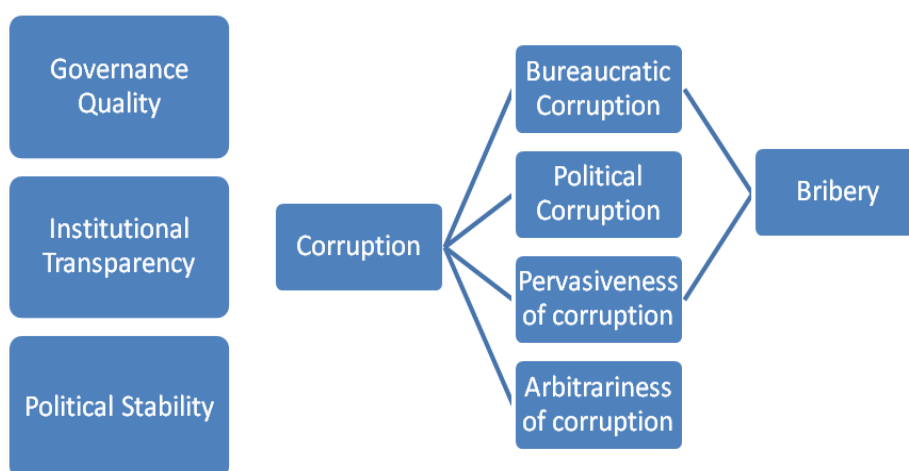


Figure 1: Taxonomy of corruption

Note: Own elaboration.

As we can observe in Figure 1, corruption has a very broad scale being present in lots of approaches of the institutional environment. It is an integrated part of governance quality, institutional transparency and even political stability, because it interferes directly with each of these approaches, influencing them on average negatively (Slangen and Hennart, 2008; Chiao *et al.*, 2010).

Besides the general definition of corruption, it is important to subdivide this concept into two very different types, i.e. into political corruption and administrative or bureaucratic corruption (Jain, 1998; Straub, 2008). Political corruption is when political decision-makers use the political power they are armed with, to sustain their power, status and wealth (Amundsen, 1999). Taking place at the high levels of the political system, this type has a much stronger impact and is much more pervasive than bureaucratic corruption (Rodriguez *et al.*, 2005; Uhlenbruck *et al.*, 2006; Straub, 2008) make a different division distinguishing between pervasiveness of corruption which reflects the degree to which corruption is dispersed broadly (institutionalized) throughout the public sector in a country and arbitrariness which reflects the degree of uncertainty and capriciousness associated with public sector corruption. Bureaucratic corruption as well as pervasiveness of corruption reflect entirely the phenomenon commonly known as bribery (Straub, 2008; Demirbag *et al.*, 2010), that is when private actors make payments to public officials to obtain a benefit or to avoid harm, and when these are pocketed by the recipient or used for partisan political purposes (Jain, 1998).

Economic literature on corruption tends to focus on bribery (Berg, 2001). In this sense there are many studies that analyze bribery denominating it as corruption (Klitgaard, 1989; Lien, 1990; Henderson and Kuncoro, 2011). Rose-Ackerman (1999), for example, does not seem to distinguish between the two, and Wei (1999: 4) focusing on the public sector, simply defines corruption as “government officials abusing their power to extract/accept bribes from the private sector for personal benefit.”

Another issue arising in the analysis of corruption is the question how to measure this occurrence. The most well-known corruption indicator is the Corruption Perceptions Index (CPI), published annually by Transparency International (Berg, 2001). In the CPI, evaluated countries are assigned a number from 1 (worst) to 10 (best) representing the “degree to which corruption is perceived to exist among public officials and politicians” (Transparency International, 2009). This index is often used in studies on corruption in order to include it as a

quantified indicator in a theoretical model (Treisman, 1998; Friedman, 2010; Reiter and Steensma, 2010).

Another method for constructing composite indicators of corruption is given by the International Country Risk Guide (ICRG) (Mauro, 1998; Dietrich, 2010). This measurement comprises 22 risk variables, representing three major components of country risk, namely economic, financial and political (Hoti, 2003).

Demirbag *et al.* (2010), who focus on the specific type of corruption, bribery, use the bribe ratio to measure this behavior. It is calculated by the total bribe value divided by total income in the same period (Berg, 2001). In studies like this the measurement is used as a representative indicator for corruption (Henderson and Kuncoro, 2011) or, more precisely, the pervasiveness of corruption (Demirbag *et al.*, 2010).

Besides the mentioned methods of measuring corruption, there is a diversity of corruption and bribery indexes elaborated from different entities such as the World Economic Forum (Friedman *et al.*, 2000), the International Monetary Fund (García and Fernández, 2009) and the World Bank (Javorcik and Wei, 2009). The measurement methodology uses to be the same utilized in the CPI or by the ICRG, nevertheless they are clearly different because there is a variance of the selected variables, the analyzed years, and the sample of countries. Because it covers generally lots of countries (more than 150) and there is data for a large period (1995-2010) CPI tends to be the preferable indicator for countries' corruption.³

1.3. The MNCs' choice of entry modes

1.3.1. Defining MNCs entry modes

International entry modes represent the third most researched field in international management, being directly related to MNC's international activity (Canabal and White, 2008). Entry modes vary largely in its scale of entry (Peng, 2009), being mostly divided into two categories: equity and non-equity (Tian, 2007) (see Figure 2).

Equity entry modes include joint-ventures and wholly-owned subsidiaries. The former consists in a sharing arrangement between a foreign MNC and a local firm, where resources, risk and operational control are divided between the partners (Julian, 2005),

³ "Surveys and Indices", in. http://www.transparency.org/policy_research/surveys_indices/about, accessed on 11th December 2010.

whereas the latter might involve both greenfield investments that consists in establishing a new firm and acquisitions of already existing firms (Razin and Sadka, 2007). In the case of equity mode the resource commitment, i.e. the scale of entry, is very high because there is a direct establishment in the foreign market (Hill and Jones, 2009).

Non-equity modes are exports and contractual agreements like licensing, franchising, turnkey projects and R&D contracts. In this case the scale of entry is lower because the relations with the foreign market are based on contracts that do not imply a direct establishment (Peng, 2009).

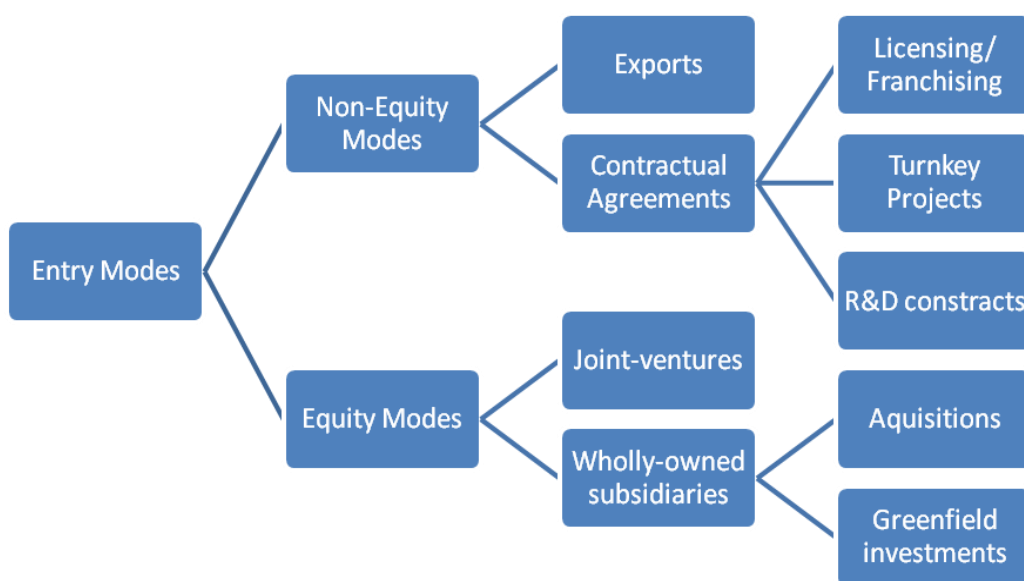


Figure 2: Taxonomy of entry modes

Note: Own elaboration.

1.3.2. Main theoretical approaches and determinants of MNCs entry modes

An exploratory bibliographic search in the Scopus database using as search keywords ‘MNCs’ entry modes’⁴ permitted to frame MNCs’ entry mode literature and put forward the main aspects related to the subject. Out of 126 articles which refer MNCs’ entry modes, 68 articles dealt with the issues of the determinants of MNCs’ choice of the entry mode.⁵ These articles were read and classified into main theoretical approaches (cf. Tables 2-7).

⁴ Scopus is the world’s largest abstract and citation database of peer-reviewed literature and quality web sources. It nearly 18,000 titles from 5,000 publishers worldwide (Source: <http://www.info.sciverse.com/scopus/about>, accessed on 27 October 2010).

⁵ The 58 excluded articles focused on various issues related to entry modes but which ignored the impact of certain determinants on entry mode choice. Specifically, some studies analyze the inverted effect, i.e. the impact of entry mode choice on other issues, for example on the domestic market structure (Haller, 2009) or on subsidiaries performance (Pangarkar and Lim, 2003; Ogasavara and Hoshino, 2007); others highlight the optimal location choice of FDI (Ma and Delios, 2007) and optimal entry mode timing (Cui and Lui, 2005).

It is important to recall that most of theories on FDI and MNCs intent to explain why firms involved themselves in several types of internationalization processes. In general, the very distinct theoretical approaches (early studies FDI; the neoclassical trade theory; ownership advantages; aggregate variables; ownership, location and internalization advantage (OLI) framework; horizontal and vertical FDI; the knowledge-capital model; risk diversification models; and policy variables – cf. Faeth, 2009), are not directly and explicitly aimed at explaining MNCs' entry modes but instead their focus is on highlighting key determinants of foreign direct investment. By adapting the existing theoretical approaches on FDI and internationalization, we provide a new systematization (cf. Tables 2-7), mixing existing contributions under the transaction cost analysis, the broader theoretical framework, the Dunning's eclectic paradigm, and the institutional approach.

Transaction cost analysis has been widely used by researchers to examine determinants of entry mode choices (Chen and Hu, 2002) (Table 2). Most theorists who study this cost-related approach favor the establishment of joint-ventures (Madok, 1998), because other entry modes require a higher financial effort (Slangen and Hennart, 2008; Raff *et al.*, 2009). The direct costs, responsible for this shift, are, for example, entry costs like tariffs (Madok, 1998) or exit costs like the disadvantageous sale of a firm or equipment (Slangen and Hennart, 2008). The entry via JV reduces significantly these financial efforts (Raff *et al.*, 2009) and helps to fill the information gap due to socio-cultural differences (Chun, 2009). Facing indirect costs pointed out in the transaction cost approach, trade barriers, for example, lead to a direct establishment (WOS or JV) in order to avoid trade with the host country (Eicher and Kang, 2005). In contrast, when market imperfections dominate the industry, a moderate involvement is advisable (Mok *et al.*, 2002). Having only studied the option of Acquisition and Greenfield investments, Fatica (2010) argues that, when entry costs are very high, MNCs prefer Acquisitions to Greenfield investments and that for intermediate levels of entry costs they might choose a Greenfield investment, or a Acquisition in case that they already have a JV.

Thus, such studies do not stand square on the main research agenda of the present study and it were therefore excluded from the analysis.

Table 2: Approaches and determinants of MNC's entry mode choices – the Transaction Cost Approach (TCA)

Determinants		Impact on MNC's entry mode	Studies (date)
Direct costs	Fixed costs	In order to minimize fixed costs related to Greenfield, mergers and acquisitions, MNCs tend to enter foreign markets via JVs .	Raff <i>et al.</i> , 2009
	Exit costs	MNCs are more likely to enter a foreign market through JVs , because they require fewer resources and have lower exit costs than WOS.	Slangen and Hennart, 2008
	Entry costs	To avoid high entry costs, MNCs tend to rely on a partner entering foreign markets via JVs . When entry costs are very high, MNC's prefer acquisitions to Greenfield investments.	Madok, 1998 Fatica, 2010
Indirect costs	Trade barriers	Markets with high entry barriers favor entry via FDI , rather than export as long as FDI fixed costs are not too large.	Eicher and Kang, 2005
	Market imperfections	In the presence of high costs due to market imperfections, MNCs prefer to conduct their business activities through non-equity modes .	Mok <i>et al.</i> , 2002

Starting from the micro-level, of Dunning's eclectic paradigm (Table 3) the ownership dimension highlights firm-level determinants such as income-generating assets and firms' ability to coordinate them with other assets abroad (Cantwell and Narula, 2003).

Given the perspective on firms' abilities, we might associate the firm's competences, skills and assets from the resource-based theory (Hill and Jones, 2009) to this approach (Luo, 1999). In concrete, for firm-specific assets (Madok, 1998; Sreenivas and Pangarkar, 2000) such as technology intense resources (Sun, 1999; Javorcik and Wei, 2009) and inventive/R&D intense activities (Bhaumik and Gelb, 2005; Chung, 2009), the mostly preferred entry mode is the establishment of wholly-owned subsidiaries (WOS), via greenfield or acquisition investments. This is justified on the basis that firm-specific resources and activities need a high level of control (Edwards and Buckley, 1998; Chen and Hu, 2002), which would not be possible in a joint-venture (JV) where knowledge has to be transferred to the partner (Chiao *et al.*, 2010; Yiu and Makino, 2002; Martin and Salomon, 2003). Chen (2010) proposes an alternative for WOS, namely technology licensing, where the control level over the assets supposedly remains the same. In the case we have internationally experienced firms there is a preference for WOS (Tseng and Lee, 2010; Chiao *et al.*, 2010). Indeed, MNCs with cumulated knowledge in internationalization are less likely to rely on the support of a joint-venture partner, because they already have the needed know-how to do business abroad (Mutinelli and Piscitello, 1998). In contrast, when a MNC does not have any experience, JV can be used to complement internal R&D

resources and to exchange knowledge on an interfirm basis level (Mutinelli and Piscitello, 1998).

Table 3: Approaches and determinants of MNC's entry mode choices – the ownership dimension of the eclectic paradigm

Determinants	Impact on MNC's entry mode	Studies (date)	
Intangible assets	Firm's capabilities	In competitive markets with technological dynamism, MNCs prefer WOSs than JVs to remain competitive.	Madok, 1998
		MNC's with a strong market linking capability are more likely to use WOSs to enter a market than JVs.	Tseng and Lee, 2010
		When MNC's competitive success depends on its capabilities, JVs are used to complement internal R&D resources and to exchange knowledge interfirms.	Mutinelli and Piscitello, 1998
	Firm-specific assets	When firm-specific assets are transferred MNCs choose WOS , to protect them from opportunistic JV partners.	Sreenivas and Pangarkar, 2000
		MNCs with strong firm-specific assets (less need for complementary assets, R&D capability) enter via WOSs .	Chiao <i>et al.</i> , 2010
		WOSs are more likely chosen than JVs, to maintain higher control over firm-specific assets.	Chen and Hu, 2002
	International experience	Experienced MNCs tend to enter foreign markets via WOSs , thanks to cumulative learning.	Mutinelli and Piscitello, 1998; Chiao <i>et al.</i> , 2010
	Necessity of control	When firm-specific activities need a high level of control, MNCs tend to avoid JVs, preferring WOSs .	Edwards and Buckley, 1998
	Technology intense assets	MNCs with high technological resources prefer entering markets via WOSs , rather than by JVs.	Sun, 1999
		Technology licensing is an adequate entry mode for MNCs with technology intense assets.	Chen, 2010
To avoid technology spillovers to domestic firms, the optimal entry modes for technology intense MNCs are direct entry modes (WOSs) .		Chung, 2009	
High-technological firms prefer WOS to protect intangible assets.		Javorcik and Wei, 2009	
Greenfield investments are dominant when MNC's technological intensity is high.		Kuemmerle, 1999; Bhaumik and Gelb, 2005; Dikova and van Witteloostuijn, 2007	
Managerial knowledge		Transfer of management know-how is more likely in WOSs and JVs , but not with contracts and export.	Meyer, 2001
Knowledge based assets		To protect knowledge based assets from misappropriation, MNCs enter foreign markets via WOS .	Martin and Salomon, 2003
Tangible assets	Resource competitiveness	When a MNC possesses adequate resources to compete in a foreign market, it is more likely to enter by Greenfield than by acquisition .	Anand, 2002
	Proprietary assets	To avoid the risk of unwanted dissemination of their proprietary assets or their rents to the JV partners, MNCs are likely to choose WOS .	Yiu and Makino, 2002;
	Human resources	Firm size was found to be a non-significant determinant of entry mode choice.	Esperança <i>et al.</i> , 2006

The internalization approach from Dunning's Eclectic Paradigm stems from the removal of the market relationship between an importer and an exporter, which provokes high transaction costs for the internationalized MNC (Peng, 2009). This theory is based on the advantages that are created when a MNC enters foreign markets via FDI, avoiding entry costs and trade barriers (Cantwell and Narula, 2003) (see Transaction Cost Approach).

Table 4: Approaches and determinants of MNC’s entry mode choices – the internalization dimension of the eclectic paradigm

Determinants		Impact on MNC’s entry mode	Studies (date)
Direct costs	Entry costs	To avoid high entry costs, MNCs tend to rely on a partner entering foreign markets via JVs .	Madok, 1998
		When entry costs are very high, MNC’s prefer acquisitions to Greenfield investments.	Fatica, 2010
Indirect costs	Trade barriers	Markets with high entry barriers favor entry via FDI , rather than export as long as FDI fixed costs are not too large.	Eicher and Kang, 2005

In the location-specific approach extracted from Dunning’s Eclectic Paradigm, cultural distance is a dominant determinant of entry mode choice (cf. Table 5). According to Chen and Hu (2002: 196) “[c]ulture is shared values and beliefs. Cultural distance is the difference in these values and beliefs shared between home and host countries. Large cultural distances lead to high transaction costs for multinationals investing overseas”.

Table 5: Approaches and determinants of MNC’s entry mode choices - the location dimension of the eclectic paradigm

Determinants		Impact on MNC’s entry mode	Studies(date)
Cultural differences between home and host country	Cultural distance	When cultural distance is large, MNCs prefer WOSs over JVs .	Chen and Hu, 2002
		Culturally distant markets favor WOSs , rather than JV , because cooperation expectations are low.	Pennings and Sleuwaegen, 2004
		High levels of cultural distance increase the likelihood that MNCs choose Greenfield over acquisitions.	Drogendijk and Slangen, 2006
		There was no evidence found, that cultural distance influences MNCs entry modes.	Demirbag <i>et al.</i> , 2009
	Socio-cultural distance	The socio-cultural distance between home and host country discourages MNCs to invest in WOS , preferring JVs .	Sun, 1999
		MNCs tend to hold a lower equity share and to depend on a local partner (JV) when entering a socio-culturally distant country.	Chun, 2009
Linguistic distance	The greater the linguistic distance between home and host country, the more likely MNCs choose a JV over a WOS .	Demirbag <i>et al.</i> , 2009	
Industry-specific assets	Competition intensity	When markets are very much or very little competitive, Greenfield is preferred, while for intermediate values acquisition.	Müller, 2007
		In high concentrated markets, MNCs tend to enter via Greenfield , because acquiring existent firms is too expensive.	Elango and Sambharva, 2004
	R&D Intensity of the industry	MNCs enter R&D intense industries via JVs or acquisitions to gain access to overseas capabilities.	Belderbos, 2003
		MNCs prefer to establish JVs rather than establishing WOSs as the R&D intensity of the industry increases.	Demirbag <i>et al.</i> , 2009
Complementary assets	To gain access to location-specific complementary assets, MNCs often choose JV to enter these markets.	Hennart, 2009	
Location-specific assets	Economic strength of local partners	The presence of strong local partners conducts MNCs to choose JVs , because they usually have extensive local networks.	Yeung and Li, 2000
	Location-specific advantages	By identifying location-specific advantages, firm’s choose mostly integrated entry modes (WOS , JV , Strategic Alliances).	Brouthers <i>et al.</i> , 1996; Moon, 1997
	Market size	FDI (compared with contracting) is the desirable mode of entry when entering a large market.	Horstmann and Markusen, 1996
		In large markets MNCs are more likely to enter via acquisitions .	Eicher and Kang, 2005
Market attractiveness as gateway to other markets	MNC’s entry mode is motivated not only by the entering market potential, but also by its ability to serve as a gateway to other neighbor markets. In this case a MNC would intensify its involvement via, for example, FDI .	Javalgi <i>et al.</i> , 2010	

Culturally distant markets favor MNCs entry via WOS, rather than by JV (Chen and Hu, 2002; Pennings and Sleuwaegen, 2004; Drogendijk and Slangen, 2006). Also high potential industries (Chen and Hu, 2002) and competition intense markets (Elango and Sambharya, 2004; Müller, 2007), guide MNCs to choose WOS as the optimal entry mode. Nevertheless, to gain access to industry-specific assets such as R&D capabilities (Belderbos, 2003) and complementary assets (Hennart, 2009) MNCs use joint-venture partners as intermediaries to guarantee their availability.

Focusing now on the more macro level approaches, namely the institutional approach (Table 6), the determinants of firms' entry mode include items such as political risk (Henisz, 2000; Ketata, 2006), perceived uncertainty due to risky environments (Taylor *et al.*, 2000; Ahmed *et al.*, 2002; Li and Rugman, 2007) and institutional differences (Luo, 2001; Chiao *et al.*, 2010). In these cases the preferable entry mode choice is WOS. One reason of this choice may be the protection from manipulative JV partners, whose knowledge about the institutional environment is more detailed than that of foreign investors (Henisz, 2000). On the other hand, entering into a market allied to a local partner can minimize the lack of familiarity with host countries' institutions (Meyer, 2001) and decrease uncertainty due to political differences between host and home country (Bianchi and Ostale, 2006; Slangen and Hennart, 2008). JV can also function as a protection from governmental intervention (Luo, 2001) and political constraints oriented to foreign firms (Yiu and Makino, 2002; Demirbag *et al.*, 2009). Facing corruption, JV would help to avoid excessive transaction costs related to corruptive government officials (Javorcik and Wei, 2009).

FDI is favored when entering markets with weak Intellectual Property Rights protection systems (An *et al.*, 2008) and difficult access to business information (Moner-Colonques *et al.*, 2008).

Other authors argue that entry into corruptive host countries should be based on non-equity modes (Rodriguez *et al.*, 2005; Straub, 2007), such as export and sub contracting (licensing, franchising and turnkey projects), to protect foreign investors from eventually corruptive joint-venture partners (Slangen and van Tulder, 2009).

Table 6: Approaches and determinants of MNC's entry mode choices – Institutional approach

Determinants	Impact on MNCs entry mode	Studies (date)	
Host countries' institutional quality	Political risk	In presence of political hazards, MNCs tend to choose WOSs (or majority-owned plants) to protect themselves from potentially manipulative JV partners. SMEs are more likely to choose equity-based modes (JV or WOS) when entering risky markets.	Henisz, 2000 Rasheed, 2005
	Perceived risk	When MNCs perceive risky environments, it is more likely to enter via WOS (acquisition or Greenfield).	Ketata, 2006
		MNCs tend to opt for high control modes (WOS) when the risk of doing business in the host country is high.	Taylor <i>et al.</i> , 2000
	Intellectual Property Rights	For small and medium-sized firms the preferred entry in countries with weak protection of IPR is establishing a JV with an existent MNC (JV).	Acs <i>et al.</i> , 1997
		When IPR are not well protected MNCs prefer establishing a WOS .	Luo, 2001
		Weak intellectual property rights reinforce exporting , and decreases FDI, relative to licensing, in industries with shorter rent-extraction times.	An <i>et al.</i> , 2008
		Markets with weak IPR increase the probability of MNC's entry via export .	An <i>et al.</i> , 2008
	International risk (political, financial, etc.)	When IPR are poorly protected, the preferred entry mode is a JV .	Che and Facchini, 2009
		When MNCs perceive high risk levels, it is more likely to enter the market via high control modes (WOSs).	Ahmed <i>et al.</i> , 2002
	Governmental intervention	JVs are preferred if perceived governmental intervention is high.	Luo, 2001
		MNCs are more likely to form a JV with local partners than establish a WOS as the degree of regulative and normative pressures in a host country increases.	Yiu and Makino, 2002
	Corruption	MNCs adapt to the pressures of corruption via short-term contracting and JVs .	Uhlenbruck <i>et al.</i> , 2006
		High levels of corruption reduce the possibility of MNC's entry via WOS or direct franchising, increasing entries via JV .	García and Fernández, 2009
		In the presence of arbitrary and pervasive corruption, MNCs tend to enter foreign markets by non-equity modes .	Rodriguez <i>et al.</i> , 2005
		In more risky environments it is advisable to enter via contracting, i.e. non-equity modes .	Paul and Wooster, 2008
		MNCs prefer JVs to avoid excessive transaction costs related to corruptive government officials.	Javorcik and Wei, 2009
		By entering corruptive markets, MNCs should enter via JVs .	Li <i>et al.</i> , 2009
		Facing corruptive markets, a MNC should enter via JV .	Demirbag <i>et al.</i> , 2010
MNCs often choose JV over WOS to protect themselves from external uncertainties, but in this case they may expose themselves to internal uncertainties.		Slangen and van Tulder, 2009	
Countries with high-political corruption are most frequently entered via non-equity modes .		Straub, 2007	
Governance quality (= low external uncertainty)		MNCs are more likely to enter countries with a low overall governance quality through JVs rather than through WOSs.	Slangen and Hennart, 2008
Local policy/ political constraints	The more restricted political measures are the more likely MNCs choose JVs over WOSs.	Demirbag <i>et al.</i> , 2009	
Costs	High tariffs may act as an entry barrier, conducting MNC's entry mode towards export , rather than acquisition.	Tekin-Koru, 2009	
Local content requirement	Export is more likely to be adopted for a high LCR level than FDI.	Qiu and Tao, 2001	

(...)

Table 6: Approaches and determinants of MNC's entry mode choices – Institutional approach

Determinants		Impact on MNCs entry mode	Studies (date)	
Distance between home and host country	Uncertainty (institutional differences)	When uncertainty is high, MNCs prefer enter via WOSs , because they contribute to uncertainty reduction.	Li and Rugman, 2007	
		When MNC's perception of institutional differences is high, it tends to enter by WOSs .	Chiao <i>et al.</i> , 2010	
	Political differences	Facing remarkable political differences in the entering market, MNCs should consider JVs instead of solely entry modes (WOSs).	Bianchi and Ostale, 2006	
	Psychic distance	JVs are more feasible in distant locations, because the lack of proximity and familiarity hampers MNC's entry without reliance on a local partner.	Meyer, 2001	
	Entry barriers	To overcome entry barriers, such as liability of foreignness, it is more likely that MNCs enter by acquisitions or JVs .	Elango and Sambharya, 2004	
	Access to information/performance under uncertainty	Due to asymmetric information between home and host firms, foreign MNCs prefer enter the market via FDI (WOS or JV) , rather than export.	Moner-Colonques <i>et al.</i> , 2008	
	Industry structure		In less developed banking markets, internationalized banks prefer entry via acquisition .	Lehner, 2009
			MNCs choose WOSs over JVs, when entering high potential industries.	Chen and Hu, 2002
		In less developed markets, MNCs prefer enter via mergers and acquisitions than via Greenfield, in order to enable market development.	Al-Kaabi <i>et al.</i> , 2010	

We found some determinants that are not classifiable within our theories, but that also, according to extant empirical literature, have an impact on entry mode choice (cf. Table 7). Indeed, entry modes can be influenced by the nature of MNCs activity (Williams and Deslandes, 2008). Specifically, firms from the service sector are more likely to opt for FDI entry modes (WOS or JV).

Additionally, firm's international strategies lead to a certain entry mode, being Acquisitions more likely for multidomestic companies and Greenfields for global companies (Harzing, 2002). Finally, MNCs with more diversified products are likely to enter foreign markets through acquisition, while MNCs which focus on its main line of business enter through Greenfield (Mudambi and Mudambi, 2002).

Table 7: Approaches and determinants of MNC's entry mode choices – Others

Determinants	Impact on MNCs entry mode	Studies (date)
Product diversification	MNCs with more diversified products are likely to enter foreign markets through acquisition , while MNCs which focus on its main line of business enter through Greenfield.	Mudambi and Mudambi, 2002
Nature of MNCs activity	Concerning to service-oriented nature (very firm-specific assets) of MNC's activity, there is a tendency of entering foreign markets via FDI .	Williams and Deslandes, 2008
International strategy and objectives	Acquisitions are more likely for multidomestic companies and Greenfields are more likely for global companies.	Harzing, 2002

Summarizing the contributions reviewed above and framing them into main trends of entry mode choices, starting on equity modes and evolving to non equity modes, Figure 3 shows that market imperfections, as well as Intellectual Property Rights protection, costs and local content requirement tend to be mostly related to pure non equity modes, such as exports.

MNCs which enter into markets where corruption is highly diffused prefer mainly non equity modes or joint-ventures, rather than purely equity modes, such as Greenfield investments or acquisitions. Governmental intervention directs MNCs to join a local partner, rather than establishing a firm on its own.

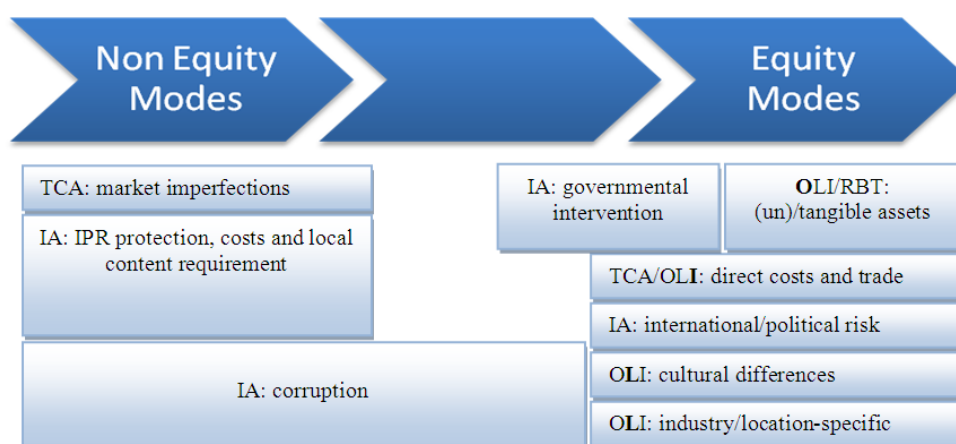


Figure 3: Entry mode choice- overall tendency

Legend: TCA – Transaction Cost Approach; IA – Institutional Approach; OLI- ownership dimension; OLI- location dimension; OLI- internalization dimension from the Eclectic Paradigm

Note: Own elaboration

To the extent that Dunning’s Eclectic Paradigm focuses traditionally on ownership, location and internalization advantages (Dunning and Gray, 2003), the tendency of this theory is more directed to the choice of equity modes. The justification relates with the fact that in order to maintain these ownership, location and internalization advantages within the firm, it is advisable to entry via establishment of wholly-owned subsidiaries.

Thus, generally speaking, there is a main inclination for equity mode choice when taking into account the Eclectic Paradigm theory, whereas the non equity mode choices are more in line with the institutional approach. This is in part explained by the fact that institutional theory focuses mainly on constraining determinants while the Eclectic Paradigm highlights the benefits of MNCs’ internationalization.

1.4. Corruption and MNCs’ entry mode. Is there a linkage?

The few studies that simultaneously focus on corruption and entry modes (e.g., Uhlenbruck *et al.*, 2006; Straub, 2007; Paul and Wooster, 2008; García and Fernández, 2009; Javorcik

and Wei, 2009; Slangen and van Tulder, 2009; Demirbag *et al.*, 2010) perform a quantitative analysis, formulating hypothesis and testing them with an econometric model (cf. Table 8). Specifically, Rodriguez *et al.* (2005), analyzing the impact of corruption on MNCs entry strategies also fit in this set, but differentiate their study by making a qualitative literature review.

Focusing first on the quantitative studies we observe that there is a diversity of measures utilized in order to quantify corruption. Indeed, corruption is rarely defined and measured in the same way. Demirbag *et al.* (2010: 214), analyzing the pervasiveness of corruption defined as “the average firm’s likelihood of encountering corruption in its normal interactions with state officials”, quantifies bribes with Transparency International’s bribe payers index (BPI). This index is based on a questionnaire where executives were asked about the propensity of foreign firms that do business abroad to pay bribes or to make undocumented extra payments to public officials (Mak, 2007). To calculate the BPI, the answers were converted to a score from 0 (low) to 10 (high) in order to elaborate a ranking reflected by the average score (Demirbag *et al.*, 2010). Other authors like Javorcik and Wei (2009) and Slangen and van Tulder (2009) use a junction of several indicators (cf. Table 8). In concrete, Javorcik and Wei (2009) employ the corruption index from the World Development Report, which is based on a survey undertaken by the World Bank, completing it with the corruption index used in Kaufmann *et al.* (1999) and a corruption perception index reached by a questionnaire made by the German journalist, Peter Neumann.⁶ This, according to Javorcik and Wei (2009), provides more precise results concerning to different types of corruption. Slangen and van Tulder (2009) measure corruption through Kaufmann *et al.*’s (2004) analysis of several hundreds of variables measuring governance quality. This measurement was drawn from 25 sources such as the ICRG, the Economic Freedom Index, the World Bank’s Country Policy and Institutional Assessments, and the World Economic Forum’s Global Competitiveness Report. Kaufmann *et al.* (2004) identified six dimensions along which countries differ from one another in terms of their governance quality. Slangen and van Tulder (2009) adopted these dimensions, using them as proxies for corruption in their analysis.

⁶ This index measures the proportion of exports by certain German firms to a host country that involved corrupt payments. The index value of 1 corresponds to 10% of transactions involving corrupt payments, 2 to 20% and so on (Javorcik and Wei, 2009).

Table 8: Corruption's impact on MNCs entry mode choice: a synthesis of the literature

Entry Modes	Definition of corruption	Proxy	Methodology	Effect	Author (date)
WOS vs. JV	Pervasiveness of corruption: the average firm's likelihood of encountering corruption (bribes) in its normal interactions with state officials	Bribery Index (TI ⁱ)	Multi dimensional framework	WOS -	Demirbag <i>et al.</i> , 2010
		Perceived risk (questionnaire) corruption index (ICRG ⁱⁱ)		JV + WOS - JV + WOS - JV +	
Franchising via WOS; via JV; via contract (FVC); Master Franchising (MF)	No concrete definition is made, but how it is measured by TI, corruption may be faced as: the misuse of entrusted power for private gain	Corruption Perception Index (TI ⁱ)	Binary logistic regression	WOS -	García and Fernández, 2009
		Political Stability Index (IMF ⁱⁱⁱ)		JV - FVC + MF - WOS + JV - FVC + MF -	
WOS vs. JV	Corruption is faced as an act that makes local bureaucracy less transparent and acts as a tax on foreign investors	Corruption index (WDR ^{iv})	Single-equation probit	WOS -	Javorcik and Wei, 2009
		Corruption index (Kaufmann <i>et al.</i>) Perceived corruption (questionnaire)		JV + WOS -/0 JV +/0	
WOS vs. JV	Corruption reflects the degree to which public power is exercised for private gain	Voice and accountability ^v	Multivariate regression	WOS +	Slangen and van Tulder, 2009
		Political stability ^v		JV - WOS + JV -	
		Government effectiveness ^v		WOS + JV -	
		Regulatory quality ^v		WOS + JV -	
		Rule of law ^v		WOS + JV -	
Equity (EQ) vs. Non-Equity modes (NEQ)	This study focuses on country stability and the progress with market-oriented reforms and liberalization (\neq corruption).	Cumulative Liberalization Index	Two Stage Model	EQ + NEQ -	Paul and Wooster, 2008
		Risk of government repudiation of contracts (ICRG ⁱⁱ) corruption index (ICRG ⁱⁱ)	Multivariate regression	EQ - NEQ + EQ - NEQ +	Straub, 2007
Bureaucratic corruption acts as an additional tax for foreign investors.	Index of bureaucratic quality (ICRG ⁱⁱ)	EQ - NEQ +			
WOS; JV; contracting (CON)	Corruption is defined as the abuse of public power for private benefit. Pervasiveness of corruption reflects the degree to which corruption is diffused broadly in the public sector. Arbitrariness reflects the degree of uncertainty and capriciousness associated with public sector. Pervasiveness and arbitrariness of corruption as defined above.	Political risk (PRS Group)	Multivariate regression	WOS -	Uhlenbruck <i>et al.</i> , 2006
		Pervasiveness of corruption (WBES ^{vi})		JV + CON + WOS - JV -	
		Arbitrariness of corruption (WBES ^{vi})		CON + WOS -/0 JV -/0 CON +/0	
		Junction of pervasiveness and arbitrariness (WBES ^{vi})		WOS - JV - CON +	

Legend: + positive effect with statistical significance; +/- positive effect without statistical significance; - negative effect with statistical significance; -/0 negative effect without statistical significance.

Notes: ⁱ TI: Transparency International; ⁱⁱ ICRG: International Country Risk Guide; ⁱⁱⁱ IMF: International Monetary Fund; ^{iv} WDR: World Development Report; ^v WGI: Worldwide Governance Indicators; ^{vi} WBES: World Business Environment Survey

Also García and Fernández (2009) merge the Corruption Perception Index (CPI) with the International Monetary Fund's (IMF) indices to include corruption (measured by the CPI) as well as political stability (considered by the IMF) in their study. Straub (2007) does not diversify the sources of corruption's measurement, but includes different indexes of the International Country Risk Guide (corruption index and index of bureaucratic quality) in order to distinguish between bureaucratic and political corruption in his analysis.

Paul and Wooster (2008) focus on liberalization and market-oriented reforms, using the Operations Risk Index and the Country Liberalization Index in order to quantify the effects on MNCs entry mode choices.

According to the entry modes studied in these articles we observe that there are two main groups. On the one side, we have the analysis of wholly-owned subsidiaries versus joint-ventures (Javorcik and Wei, 2009; Slangen and van Tulder, 2009; Demirbag *et al.*, 2010) and, on the other side, studies focusing on FDI (wholly-owned subsidiaries and joint-ventures) versus non-equity modes (e.g., Rodriguez *et al.*, 2005; Uhlenbruck *et al.*, 2006; Straub, 2007; Paul and Wooster, 2008). Only García and Fernández (2009) falls out of this scheme concentrating just on franchising and subdividing this entry mode into franchising via direct establishment (WOS), franchising via joint-venture, direct franchising via contract and franchising via a local intermediary (Master Franchising). Besides being a different approach in relation to the observed general tendency we can transpose this analysis with the other authors' because it contains the same structure of direct establishment, partnering and contracting.

A general observation regarding each of the analyzed articles demonstrates that corruption discourages the establishment of wholly-owned subsidiaries (WOS). Nevertheless, in specific cases like large-sized operations, cultural proximity (Demirbag *et al.*, 2010) and high-technological firms (Javorcik and Wei, 2009) MNCs may enter via WOS in order to protect their firm-specific assets from for example joint-venture partners or because the cultural environment is very similar to the home countries. Rodriguez *et al.* (2005) also purposes this entry mode in presence of pervasive corruption that can encourage MNCs' involvement in corruption to achieve legitimacy but, at the same times, might cause internal conflicts within MNCs internal norms. In this sense the articles which oppose wholly-owned subsidiaries (WOS) to joint-ventures (JV) consider this second option as advisable being a strategic mean for integration in social networks and to enforce MNC's external legitimacy (Demirbag *et al.*, 2010) and to avoid excessive transaction costs

(Javorcik and Wei, 2009). According to Slangen and van Tulder (2009) this option may protect MNCs from external uncertainties but creates internal uncertainties originated by the local partner. Thus, it may be more adequate to choose an entry mode which requires less involvement in the host-country.

Regarding the articles which analyzed the opposition FDI versus non-equity modes, the establishment of a joint-venture (JV) also appears as a viable option in case of arbitrary corruption in order to protect themselves from discriminating policies towards foreign firms (Uhlenbruck *et al.*, 2006), to avoid direct contact with corrupt government officials and to achieve legitimacy via networking (Rodriguez *et al.*, 2005). Transposing the results of García and Fernández (2009) we can state that entering markets characterized by high levels of corruption increases the possibility of entry allied to a local partner (joint venture or master franchise) due to the associated assistance by managing the environment in socio-economic and political aspects.

The third and dominant option of these studies consists in entering corrupt markets via non-equity modes. According to Straub (2007), petty bureaucratic corruption causes a shift towards non-equity modes because firms try to avoid bribes related to ownership and high-political corruption also favors this entry mode in order to preserve asymmetric information. Uhlenbruck *et al.* (2006) and Rodriguez *et al.* (2005) argue that in presence of pervasiveness, even when combined with arbitrariness, MNCs choose non-equity modes to avoid the costs related to corruption. Using Paul and Wooster's (2008) arguments we can affirm that when the host country exhibits greater progress towards market-oriented reforms and being highly liberalized, MNCs tend to enter via high equity modes, but in more risky environments it is advisable to enter via contracting, or generally via non-equity modes such as exports, franchising or licensing.

Following Demirbag *et al.*'s (2010) argument that, even in the presence of corruption, due to historical and linguistic ties between home and host country, MNCs entry mode choice tend to move towards high equity-modes (mostly WOS). In this sense, we will include wholly-owned subsidiaries and joint ventures in our study in order to find out if this argument is supported. With the intention of elaborating a most complete analysis we will also incorporate non-equity modes, focusing mainly on the opposition: FDI versus non-equity mode.

Chapter 2. Corruption and MNCs' entry modes: methodological considerations

2.1. Initial considerations

Recall that our study aims at testing to what extent corruption in the PALOPs influences Portuguese MNCs' entry mode choices in those markets. Given the scarcity of data regarding this phenomenon, we construct and implement a direct questionnaire to Portuguese MNCs that internationalize for these markets.

In the present chapter we detail the data set used, the proxies for the variables of the model and the methodology used to estimate such a model. More specifically, the next section (Section 2.2) details the econometric specification and puts forward the theoretical model. Section 2.3 frames the construction of the proxies for the relevant variables and Section 2.4 describes the data source used.

2.2. The 'theoretical model'

Based on the literature review (cf. Chapter 1), and given the aim of our study – to assess the role of corruption on the entry mode choice of Portuguese MNCs in the PALOPs – the 'theoretical model' is:

$$\text{FDI/non - equity mode} = f \left(\begin{array}{l} \underbrace{\text{R \& D_intensity; Firm_Size; International_experience;}}_{\text{ownership}} \\ \underbrace{\text{Economy's_Openness; Market_Size; Cultural_proximity;}}_{\substack{\text{internalization} \qquad \qquad \qquad \text{location}}} \\ \underbrace{\text{Legal_rest rictions; Governance_quality; Corruption}}_{\text{institutional}} \end{array} \right)$$

According to our 'theoretical model' the key determinants of MNCs' entry mode (specifically, FDI vs non-equity) include: 1) the ownership dimension, namely the R&D intensity of the firm , firm size, and the international experience of the firm; 2) the internalization dimension reflected on the level of the host economy's openness; 3) the location dimension which encompasses the host market size and the cultural proximity between home and host country; 4) the institutional dimension, which includes legal restrictions from the host government, host country's governance quality and Corruption.

2.3. The proxies for the variables

Concerning to the ownership dimension of Dunning's Eclectic Paradigm we choose, in line with Straub (2007) and Paul and Wooster (2008), the R&D intensity as proxy for intangible or firm-specific assets, determinants which are clearly predominant in this approach (Table 3). Following the literature (e.g., Javorcik and Wei, 2009) we compute the ratio of a firm's R&D expenditure to the value of sales. This data will be collected through direct questionnaire (cf. Appendix 1) including a question on the percentage of the firm's R&D expenditure of its total net sales. In order to include the firm's size and its international experience, our questionnaire will also ask about the number of employees, the year in which the firm internationalized, and the number of countries where they operate.

The internalization dimension from the Eclectic Paradigm will be represented by the host countries openness to trade. It will be measured, as in Javorcik and Wei (2009), by the sum of exports and imports as a share of GDP as it gives us an average on indirect costs related to entry barriers in the market. In order to cover a more extended period we extracted the indicators from 2005 till 2009 from the African Development Bank Group Database, elaborating a mean value.

The third dimension from the Paradigm, related to location advantages, is proxied by host market size and cultural proximity. The host market size is measured by GDP per capita (Straub, 2007). Also in this case we use a mean value from the years 2005-2009 of the GDP per capita at constant 2000 USD extracted from the World Bank Database. Cultural proximity is measured through our questionnaire asking the entering firms the importance (in a Likert scale of 1 to 7) of common linguistic and historical ties between the home country (Portugal) and the host country (PALOPs) for the decision to enter into the selected markets. This proxy is included in our study being a clearly dominant determinant of this approach and because we aim at corroborating Demirbag *et al.*'s (2010) argument on the linguistic and historical distance. Accordingly, in the event there are strong cultural ties between our home and host countries, it is expected that it influences the entry mode choice moving it towards high equity modes, namely wholly-owned subsidiaries, even in the presence of highly corrupted environments.

Regarding the institutional approach, we focus on the legal restrictions and governance quality. Legal restrictions are included here as entry mode choices vary in presence of host

country's imposition (García and Fernández, 2009; Slangen and van Tulder, 2009). Thus firms will be asked to evaluate (in a Likert scale of 1 to 7), for each market, to what extent their entry mode choice was influenced by legal restrictions from the host government. In what concerns governance quality's indicator, it will be measured by the Worldwide Governance Indicators produced by Daniel Kaufmann (Brookings Institution), Aart Kraay (World Bank Development Economics Research Group) and Massimo Mastruzzi (World Bank Institute). This index reports aggregate and individual governance indicators for 213 economies over the period 1996–2009, for six dimensions of governance: voice and accountability; political stability and absence of violence; government effectiveness; regulatory quality; rule of law; control of corruption.⁷

Table 9: Proxies for the key variables of the ‘theoretical model’ of MNCs’ entry mode option

Determinants	Proxy	Studies (date)	Source	
Eclectic Paradigm: ownership	R&D intensity	Percentage of R&D spending of total sales value	Paul and Wooster, 2008; Straub, 2007; Javorcik and Wei, 2009	questionnaire
	Firm's size	Number of employees	Demirbag <i>et al.</i> , 2010	questionnaire
	International experience	Years of international performance Number of countries	García and Fernández, 2009 Slangen and van Tulder, 2009	questionnaire questionnaire
Eclectic Paradigm: internalization	Openness of the host economy	$\frac{X + M}{GDP}$	Javorcik and Wei, 2009	African Development Bank Group
Eclectic Paradigm: location	Host market size	GDP per capita	Straub, 2007	World Bank
	Cultural Proximity	Importance of cultural proximity (scale from 1-7)	Demirbag <i>et al.</i> , 2010	questionnaire
Institutional Approach	Legal Restrictions	Importance of Legal Restrictions (scale from 1-7)	Slangen and van Tulder, 2009	questionnaire
	Governance Quality	Importance of Governance Quality (scale from 1-7)	Slangen and van Tulder, 2009	questionnaire
	Corruption	Corruption Perception Index (CPI)	García and Fernández, 2009	Transparency International

As earlier mentioned, we use Transparency International's Corruption Perception Index (CPI) as a proxy for the level of corruption in each country, being the only corruption index which covers the 5 countries in analysis. This is a measure of the degree to which corruption is perceived to exist in public officials and politicians in the country. In order to complement this proxy with the perception of our surveyed firms, we ask them (cf.

⁷ “The Worldwide Governance Indicators (WGI) project”, in. <http://info.worldbank.org/governance/wgi/index.asp>, accessed on 10th December 2010.

Questionnaire in Appendix) about the perceived corruption level and to what extent perceived corruption had influenced their entry mode choice.

2.4. Data gathering procedures

Our unit of analysis is not the firm or the market but instead the firm *and* the market – the same firm can internationalize for one single country or for all the (5) countries (Angola, Cape Verde, Guinea Bissau, Mozambique, and Sao Tome Principe) in analysis. In this sense we construct a questionnaire in Portuguese as this corresponds to the mother language of our target population. The questionnaire was sent via email, giving the respondents the possibility to respond via fax or by email.

The questionnaire is divided in two main parts. In the first one the MNCs are asked to provide firm-specific data such as the number of employees (to evaluate the size of the firm), the percentage of R&D spending of the total sales volume (to classify the R&D intensity), the year of internalization and the number of foreign countries in which they operate (to estimate the international experience).

The second part deals with the internalization process. Here the MNCs are asked to select one or more of the PALOP countries with which they have commercial relations and to identify the corresponding entry mode (wholly-owned subsidiary, joint-venture or export/contracting). Afterwards the firms are solicited to classify, on a scale from 0 (not applicable), 1 (not important) to 7 (very important), the influence of cultural proximity, political stability and legal restrictions on their entry mode choices. In order to gauge about our key variable corruption, in the last two questions the firms are asked to classify using the same scale, the perceived corruption level for each market/country with which they established commercial relations and the extent to which this perception has influenced their entry mode choice.

In order to obtain the population of our study - firms-countries to be surveyed -, we use a list, provided by the AICEP (*Agência para o Investimento e Comércio Externo de Portugal*), of firms that maintain commercial relations with the PALOP countries. This list encompasses 562 Portuguese MNCs that either have a direct establishment or export to one or more of these countries.

The questionnaire was sent to these firms by email on February 14, 2011. By February 16 we started calling the MNCs in order to ask if the questionnaire was received and if it was sent to the responsible department. In these two days 14 filled questionnaires were

received. During the period in which the calls were made (February 16-24, 2011) 45 additional questionnaires were received. After that we insisted in sending reminders from February 25 till March 4 that led us to get 85 more responses. On March 4 the whole data gathering process ended. Nevertheless until March 15, four more filled questionnaires were received. Summing up, 147 valid responses were received, representing a response rate of 26%. As our unit of analysis is not simply the firm or the market such responses provided us 334 firm-market observations, which are the basis for the empirical analyses performed in the next chapter.

2.5. The econometric specification

Similarly to other studies, which analyze the role of the several determinants on MNCs' entry mode options (e.g., Uhlenbruck *et al.*, 2006; Straub, 2007; Slangen and van Tulder, 2009), the present study resorts to a multivariate econometric model, more specifically, a logistic regression. In concrete, this estimation procedure enables us to assess how the various determinants, most noticeably corruption, affects firms' entry modes in countries characterized by widespread levels of corruption (the PALOPs) but that maintain historical and language affinities with the MNCs' home country (Portugal). Although the theory put forward that in presence of corruption, MNCs tend to entry through non equity modes, we aim at testing if that is the case when certain 'institutional' conditions (i.e., close cultural and historical links between host country and MNCs' country) are observed.

Our unit of analysis encompasses Portuguese MNCs investing in one or more markets from PALOP. Besides corruption, as referred earlier in the literature, MNCs' entry mode choices depend on four main groups of determinants (i.e., independent variables), namely on the three dimensions of Dunning's Eclectic Paradigm (or OLI model) – ownership, location and internalization dimensions- and the institutional approach. Our dependent variable 'FDI versus Export' is a dummy-variable which assumes the value of 1 when the chosen entry mode is FDI and the value 0 for Export.

Being our dependant variable a dummy the adequate estimation model is the logistic regression because we cannot expect a normal distribution and we need to interpret the results as probabilities - this would not be possible with a conventional (OLS) estimation technique.

The nature of the data observed regarding the dependent variable (dummy=1 if FDI and 0 if Export) dictates the choice of the estimation model. Conventional estimation techniques

(e.g., multiple regression analysis), in the context of a discrete dependent variable, are not a valid option. Firstly, the assumptions needed for hypothesis testing in conventional regression analysis are necessarily violated – it is unreasonable to assume, for instance, that the distribution of errors is normal. Secondly, in multiple regression analysis the predicted values cannot be interpreted as probabilities – they are not constrained to fall in the interval between 0 and 1.⁸ The approach used, therefore, involves analyzing each situation in the general framework of probabilistic models.

In the model of ‘propensity’ of FDI’, as referred earlier, it is believed (*cf.* Chapter 1) that a set of determinants, such as determinants from the ownership dimension from the Eclectic Paradigm (e.g., R&D intensity, firm size and international experience), determinants from the internalization dimension (namely the openness of the host economy), determinants from the location dimension (such as the market size and cultural proximity) and determinants from the institutional approach (e.g., legal restrictions, governance quality and corruption), are likely to influence MNCs’ entry mode choice towards FDI or export. These ‘explanatory’ variables are gathered in a vector X , which explains the outcome, so that:

$$Prob(Y = 1) = F(X, \beta) \quad \text{and} \quad Prob(Y = 0) = 1 - F(X, \beta).$$

The set of parameters β reflects the impact of changes in X on the likelihood of ‘FDI’.

The empirical assessment of the propensity of FDI is based on the estimation of the following general logistic regression:

$$P(FDI) = \frac{1}{1 + e^{-Z}};$$

$$\begin{aligned} \text{with } Z = & \beta_0 + \underbrace{\beta_1 R \& D _ \text{int} + \beta_2 \text{Size} _ \text{firm} + \beta_3 \text{International} _ \text{exp}}_{\text{ownership}} + \underbrace{\beta_4 \text{Openness} _ \text{market}}_{\text{internalization}} + \\ & + \underbrace{\beta_5 \text{Size} _ \text{market} + \beta_6 \text{Cul} _ \text{prox}}_{\text{location}} + \\ & + \underbrace{\beta_7 \text{Legal} _ \text{restrictions} + \beta_8 \text{Governance} _ \text{qualit} + \beta_9 \text{Corruption} _ \text{Perception} _ \text{Index}}_{\text{institutional}} + \\ & + \varepsilon_i \end{aligned}$$

⁸ The logistic regression model is also preferred to another conventional estimation technique, discriminant analysis. According to Hosmer and Lemeshow (1989), even when assumptions required for discriminant analysis are satisfied, logistic regression still performs well.

In order to obtain a more straightforward interpretation of the logistic coefficients, the logistic model can be rewritten in terms of the odds (ratio of the probability that the event occurs to the probability of the event not occurring) of an event occurring - the *logit* model becomes:

$$\log\left(\frac{\text{Pr ob}(FDI)}{\text{Pr ob}(Export)}\right) = \beta_0 + \underbrace{\beta_1 R \& D \text{ _ int} + \beta_2 \text{Size _ firm} + \beta_3 \text{International _ exp}}_{ownership} + \underbrace{\beta_4 \text{Openness _ market}}_{internalization} +$$

$$+ \underbrace{\beta_5 \text{Size _ market} + \beta_6 \text{Cul _ prox}}_{location} +$$

$$+ \underbrace{\beta_7 \text{Legal _ restrictions} + \beta_8 \text{Governance _ quality} + \beta_9 \text{Corruption _ Perception _ Index}}_{institutional} + \varepsilon_i$$

The logistic coefficient can be interpreted as the change in the log odds associated with a one-unit change in the independent variable. Then e raised to the power β_i is the factor by which the odds change when the i^{th} independent variable increases by one unit. If β_i is positive, this factor will be greater than 1, which means that the odds are increased; if β_i is negative, the factor will be less than one, which means that the odds are decreased. When β_i is 0, the factor equals 1, which leaves the odds unchanged.

Having already specified the methodological and econometric considerations the next chapter will detail the empirical results obtained by the statistical treatment of the gathered data.

Chapter 3. Corruption and MNCs' entry modes: empirical results

3.1. Initial considerations

This chapter details the results of the estimation of the econometric regressions used to infer the influence of the selected determinants on MNCs entry mode choices, most particularly corruption.

The descriptive results, i.e. the correlation between variables and the analysis of mean values based on the Kruskal-Wallis non-parametric test of differences in means, are reported and detailed in Section 3.2. The following section (Section 3.3) presents and discusses the results of the estimation of the regression, integrating them with previous results found in the existing literature.

3.2. Descriptive results

3.2.1. Global averages and correlation between variables

About 26% of the 334 firm-market relations of our sample evidence a preference for entering the selected markets via FDI. On average, the respondent firms spent 10% of their total sales on R&D and their size is of about 48 employees.

Concerning international experience, the firms have about 9 years of international experience and operate in around 8 foreign markets. Considering the markets in analysis we observe that their openness is on average of 1.1 what means that the weight of trade relations with foreign markets is quite significant. The mean value of their market size, i.e. the PIB per capita, is of about 755 USD - minimum and maximum values are, respectively, of 142 USD in Guinea-Bissau and of 1626 USD in Cape Verde.

Considering the classification of some factors from the inquired firms we can state that 86% of the firms consider cultural proximity as a key determinant of their entry mode choice, whereas only 27% affirm that legal restrictions were highly important. Around 66% of the respondent firms state that political stability influenced quite highly their entry mode decision.

Regarding corruption we observe that the markets analyzed present an average Corruption Perception Index of 2.7 (maximum value of 5.05 for Cape Verde and minimum value of 1.98 for Angola), which reflects a relatively high level of corruption - the maximum value for CPI is 10, indicating high (low) levels of transparency (corruption).

Descriptive results based on the correlation between the relevant variables (cf. Table 9) convey that Portuguese MNCs' 'propensity' for FDI as a 'preferable' entry mode in PALOP is positively and significantly related to firm size and the importance attributed to legal restrictions and political stability. That is, in a bivariate statistical analysis, larger MNCs and those that perceive legal restrictions and political stability as key factors when choosing their entry mode, tend on average to opt for equity based entry mode (i.e., FDI) in alternative to export and/or contracting. In contrast, firms that present higher international experience, as measured by the number of countries to which they internationalize, or the years that passed since they first internationalize, tend to opt for non-equity entry modes, namely export.

Regarding the relation between the independent variables, results evidence that years of experience in internationalization and the number of countries to which the firm internationalize are positively and significantly related revealing that firms that internationalize for a larger number of countries tend to have started their internationalization processes longer time ago. Given this high correlation it is advisable to estimate the 'theoretical' model using one of the two proxies of internationalization experience. Thus, we estimate Model I (cf. Table 2) using 'number of countries in which the firm is present' as the proxy for internationalization experience whereas in Model II we use 'number years experience in internationalization'.

Although some correlations between the independent variables are strong (namely, between the corruption perception index and the openness indicator) these are not high enough to undermine the estimation of the proposed model.

Table 9: Correlation matrix

Variables	Mean	Std. Deviation	1	2	3	4a	4b	5	6	7	8	9	10
1. FDI vs.Non equity	0.267	0.443	1										
2. R&D intensity	0.104	0.193	0.031	1									
3. Firm's size (ln)	3.873	1.541	0.093 [*]	-0.168 ^{**}	1								
4. International experience	a) Years of internationalization (ln)	2.216	0.956	-0.108 ^{**}	-0.053	0.446 ^{***}	1						
	b) Number of countries (ln)	2.042	1.045	-0.270 ^{***}	-0.069	0.496 ^{***}	0.473 ^{***}	1					
5. Openness of the host economy (ln)	-0.101	0.232	0.056	0.027	-0.079	-0.063	-0.144 ^{***}	1					
6. Host market size (ln)	6.627	0.740	0.041	-0.038	-0.082	-0.065	-0.118 ^{**}	0.336 ^{***}	1				
7. Cultural proximity (dummy)	0.862	0.345	0.064	0.047	-0.105 [*]	-0.056	-0.063	-0.043	-0.009	1			
8. Legal Restrictions(dummy)	0.270	0.444	0.107 ^{**}	-0.117 ^{**}	-0.067	-0.009 ^{**}	-0.035	-0.003	0.026	0.047	1		
9. Political stability (dummy)	0.659	0.475	0.134 ^{**}	-0.071	-0.084	-0.060	-0.114 ^{**}	-0.018	0.047	0.170 ^{***}	0.309 ^{***}	1	
10. Corruption (ln)	0.999	0.362	-0.015	-0.051	0.021	0.016	0.058	-0.472 ^{***}	0.332 ^{***}	0.041	0.025	0.063	1

Note: *** (**) [*] statistically significant at 1%(5%)[10%]; N=334=no. of firms (147 no. of markets).

3.2.2. Differences in means

Between markets

Considering the overall respondent sample, about 26% chose FDI as the entry mode into the given markets. In Mozambique the FDI propensity is above the global average, reaching 35%, followed by Angola with 29% and Cape Verde with 25%. In Sao Tome and Principe and Guinea-Bissau the bulk of the entries occur through export and other non-equity modes.

Analyzing the characteristics of the markets regarding the main variables included in our model (cf. Table 10), we realize that, based on the non parametric test of Kruskal Wallis,⁹ markets differ statistically in terms of mode of entry ($p\text{-value} < 0.05$), with, as earlier referred, Mozambique presenting the highest percentage (35%) of firms entering into the market via equity modes or FDI, which contrast with Guinea-Bissau's inexpressive figure (5%).

Table 10: Differences in means between host markets (Non parametric Kruskal Wallis Test)

Market	Angola	Cape Verde	Guinea-Bissau	Mozambique	S. Tome and Principe	Kruskal-Wallis (p-value)	
Entry Mode - % that entry via FDI	29.1	25.0	5.0	35.4	12.5	11.67 (0.020)	
R&D intensity (%)	10.8	8.5	11.7	11.3	10.3	2.75 (0.982)	
Number of employees	162.9	154.6	267.5	237.1	348.2	3.43 (0.418)	
International Experience	Years of international ization	12.8	13.3	15.0	14.9	17.3	2.73 (0.604)
	Number of countries	11.1	13.4	17.8	14.2	18.8	9.29 (0.054)
Openness of the host market	1.21	0.72	0.76	0.80	0.75	330.16 (0.000)	
Market Size	1160.0	1626.4	142.2	340.8	450.6	330.16 (0.000)	
Cultural Proximity	5.65	5.82	5.70	5.73	5.47	8.19 (0.822)	
Legal Restrictions	2.85	2.88	2.40	2.95	2.69	2.44 (0.888)	
Governance Quality	4.65	5.12	4.20	4.90	4.19	5.18 (0.027)	
Corruption Perception Index	1.96	5.05	2.03	2.65	2.80	316.3 (0.000)	

Concerning to the variables international experience (number of countries), openness of the host market, market size, governance quality and the Corruption Perception Index we can affirm that there is a statistical significant difference between the five analyzed markets.

⁹The non-parametric Kruskal Wallis test is based on the null hypothesis and tests if the sample comes from populations with the same distribution. It serves to assess whether there is evidence of statistically significant differences in the mean values of the analyzed variables (Maroco, 2010).

Firms that internationalized for S.Tome and Principe and Guinea-Bissau are those that present higher experience in terms of number of countries to where they are doing business. This contrasts with the less experienced group of firms that works in Angola. This latter country also stands out compared to the other markets when we focus on the openness of its economy (1.21), while the four remaining markets score poorly in this regard. Considering the market size, Angola (1160 USD) and Cape Verde (1626 USD) have a substantially higher GDP per capita than the rest of the analyzed markets. Relatively to the firms' perception of governance quality in the host market and its influence on their entry mode choice, Cape Verde (5.12) stands out with a higher perceived institutional quality nearly followed by Mozambique (4.90) and Angola (4.65). Guinea-Bissau and Sao Tome and Principe are perceived to have a lower quality in governmental affairs. Analyzing our main determinant, the Corruption Perception Index, we can state that Cape Verde (5.05), although presenting a fairly amount of perceived corruption (10 would represent the lowest level of corruption or highest level of transparency), evidences a statically significant lower corruption level compared to the other markets (that present an average of 2.4).

For all the remaining variables (R&D intensity, firm size, international experience, cultural proximity, and governance quality) their mean values do not differ significantly among the markets/countries in analysis.

Between entry modes

Based on the Kruskal Wallis test for the variable 'entry mode' (dummy variable which assumes the value 1 when the firm entries into the given market and 0 in the case the choice is export), we conclude that statistical differences ($p\text{-value} < 0.10$) exist regarding the following variables (cf. Table 11): firm size, international experience, and the perception of legal restrictions in the host market.

The firm size differs in a statistical significant way concerning to the entry modes. Approximately 23% of firms that entry via FDI are large (more than 250 employees) whereas in the case of exports only 10% of the firms are large. In contrast, just 29% of the medium sized firms (50-249 employees) enter via FDI while whole 41% of them chose exports as the preferable entry mode. Contrarily to expectations based on the Uppsala

theory,¹⁰ the analysis of the mean values of the international experience presents for both proxies - the years of internationalization and the number of countries - smaller means for the entry via FDI as compared to the entry through export. MNCs that enter the analyzed markets through equity modes, namely FDI, have, on average, 11 years of international experience and are present in about 10 markets, while the ones which export have around 15 years of experience in internationalization and operate in 15 foreign markets. In this sense, contrary to the expectations, are the less experienced firms that have a higher propensity of entering foreign markets via FDI.

In relation to the perception of cultural proximity between home and host country the mean value is higher for the entries through FDI than that of exports. This means that firms that chose FDI as their preferable entry mode tends, on average, to attribute higher relevance to cultural proximity.

Likewise, for the group of MNCs which choose FDI as an entry mode the legal restrictions are much more important than for the ones which decide to export.

Table 11: Differences in means between entry modes (Non parametric Kruskal Wallis Test)

Variable	Entry mode		Kruskal-Wallis (p-value)	
	FDI	Export		
R&D intensity (%)	11.36	10.01	40.821 (0.199)	
Firm Size (proportion of firms of a given size)	Large	0.25	0.10	10.632 (0.001)
	Medium	0.29	0.41	3.264 (0.045)
	Small	0.27	0.36	1.951 (0.158)
	Micro	0.19	0.13	1.622 (0.184)
International Experience	Number of employees	384.74	136.36	23.630 (0.262)
	Years of internationalization	10.93	15.09	8.340 (0.052)
	Number of countries	9.66	14.86	29.410 (0.000)
Openness of the host market	0.95	0.92	0.647 (0.163)	
Market Size	958.51	937.97	11.256 (0.981)	
Cultural Proximity	5.78	5.67	11.100 (0.085)	
Legal Restrictions	3.13	2.73	13.726 (0.054)	
Governance Quality	5.10	4.61	9.110 (0.138)	
Corruption Perception Index	2.82	2.93	0.647 (0.255)	

¹⁰ “The internationalisation process described as a gradual step-by-step commitment to sell and to manufacture internationally as part of a growth and experimental learning process is a model that is associated with the research on the internationalisation of Swedish manufacturing industry that has been carried out at the University of Uppsala.” (Johanson and Mattsson, 1988: 309)

3.3. Econometric estimations

According to the goodness of fit measures (Hosmer and Lameshow test and % corrected), the two estimated models represent the ‘reality’ quite well.

As expected, larger and more innovative Portuguese MNCs tend, on average, *ceteris paribus*, to choose FDI as their preferable entry mode in PALOP. In this sense we corroborate Demirbag *et al.*’s (2010) finding that the larger the number of employees (in its case proxy for the size of operation) the more likely is the foreign investor to choose an equity entry mode. Also supported by our empirical results are the findings of Sun (1999), Chung (2009) and Javorcik and Wei (2009) that evidence that high technological firms prefer high equity modes in order to protect their intangible assets.

Table 12: MNCs’ entry mode and corruption: logistic estimates (dependent variable: log odds of FDI vs Non-equity)

Determinants		Proxy	Model I	Model II
Eclectic Paradigm: ownership	R&D intensity	R&D to sales ratio	1.194*	0.928
	Firm’s size	Number of employees (ln)	0.566***	0.333**
	International experience	Number years experience in internationalization (ln)		-0.467**
		Number of countries in which the firm is present (ln)		-1.074***
Eclectic Paradigm: internalization	Openness of the host economy	(Exports+Imports)/GDP (ln)	17.729**	18.517**
Eclectic Paradigm: location	Host market size	GDP per capita	-3.582**	-3.626**
	Cultural proximity	Proportion of firms that stated that linguistic and historical ties between home and host country were important or very important in the decision to enter the market	0.302	0.354
Institutional Approach	Legal Restrictions	Proportion of firms that stated that the entry mode choice was quite influenced by legal restrictions in the country	0.600*	0.385*
	Political stability	Governance Quality - Worldwide Governance Indicators	0.488	0.588*
	Corruption	Corruption Perception Index (CPI) (ln)	11.242**	11.487**
	Constant		12.126*	12.106*
Number of observations (N)			334	334
			FDI	89
			Non-equity	245
Goodness of fit				
Hosmer and Lameshow Test (p-value)			2.202 (0.974)	7.321 (0.502)
% observations corrected			76.0	73.4

Note: *** (**) [*] statistically significant at 1%(5%)[10%]; N=334=no. of firms (147)*no. of markets.

Quite unexpectedly, and in contrast to the extant literature (Mutinelli and Piscitello, 1998; Chiao *et al.*, 2010), the international experience of Portuguese MNC is negatively related

with the (log odds of) FDI ‘propensity’, meaning that firms with higher international experience tend to enter into PALOP markets mainly by exports. This might be, as Slangen and van Tulder (2009) describe in their study, due to the fact that MNCs tend to enter new markets by the same method/way they have entered earlier into other markets - i.e. when a firm has experience in entering markets via export it is more likely that subsequent internationalization processes will take the same path.

Also in contrast to some of the extant literature (e.g., Javorcik and Wei, 2009) where the economy’s openness does not appear to have a statistically significant effect on the entry mode choice, in this study the country’s openness indicator emerges as quite relevant for our sample of firms. The estimate coefficient of the openness of the market, which stands, as a proxy for the host countries reception of trade and commerce, evidence that, on average, all the other factors remaining constant, markets which are relatively more open, reflecting lower transaction costs, tend to be associated with FDI modes of entry.

The location dimension received middle support from our data. Indeed, on the one side, the size of the market, proxy by the GDP per capita of the host country, emerged as negatively and significantly related with FDI propensity. This suggests that, on average, Portuguese MNC that entry in larger markets tend to resort to non equity modes (namely exports). Such results are in disparity with the extant literature (Horstmann and Markusen, 1996; Eicher and Kang, 2005), which in general claim that the larger the market size the higher the probability of entering via high equity modes. On the other side, and although, as earlier suggested by the non parametric test to the differences in means, firms that choose FDI as entry mode tend to attribute higher scores to cultural proximity, the multivariate estimations failed to give relevance to this determinant (a similar result nevertheless obtained by Demirbag *et al.*, 2009). This might in part be explained by the fact that the bulk (almost 90%) of our respondents considers the historical and linguistic linkages as important factors in the entry mode choice.

The estimations reproduced here highlight the crucial role of institutional factors in the explanation of MNCs entry modes. Indeed, legal restrictions, political stability (Model II), and utmost the level of corruption of the host country are statistically significantly related with MNC entry mode choices. In concrete, the Portuguese MNCs that perceive legal restrictions as very important for the choices regarding the entry mode in PALOP tend, on average, to have a higher propensity for FDI entry modes. Moreover, the estimate for the corruption variable is positive meaning that, controlling for all the other factors which are

likely to affect MNC entry mode choices, Portuguese MNCs tend to opt for directly investing in the less corrupted markets. This confirms the general tendency of the extant literature (e.g., Rodriguez *et al.*, 2005; Uhlenbruck *et al.*, 2006; Straub, 2007; Paul and Wooster, 2008) which contents that in corrupt contexts it would be expected that MNC would prefer non equity entry modes. In this sense, our findings do not support Demirbag *et al.*'s (2010) thesis who underline that despite the (high) levels of corruption of host countries close historical and cultural links would push firms into equity entry modes.

Conclusions

The present paper intended to analyze how Portuguese MNC's choice of the adequate entry mode is affected by the extent of corruption in host countries, namely in those from PALOP.

Africa has becoming the new frontier for emerging market investors (Santiso, 2007). An analysis by *The Economist* (2011) finds that over the decade, no fewer than six of the world's ten fastest-growing economies were in sub-Saharan Africa, including Angola on first and Mozambique on eighth place of the ranking. This evolution of former under-developed markets leads foreign investors to find it increasingly difficult to ignore these markets, despite its - justified - reputation as a tough place for business because of political uncertainty, corruption, weak infrastructure and inconsistent regulation (The Economist, 2010).

The growing attractiveness of the region allied to strong cultural and historical ties between home and host countries tend to, according to some recent studies (e.g., Demirbag *et al.*, 2010), lead to a higher FDI propensity despite the existence of corruption.

Aiming at testing the role of corruption on firms' entry mode choices in contexts where substantial historical and cultural linkages exist, we focused our analysis on Portuguese MNCs that invest in the PALOP, a set of countries characterized by very high (e.g., Guinea-Bissau, and Angola), high (e.g., Mozambique, Sao Tome and Principe) and middle (e.g., Cape Verde) levels of corruption (Transparency International, 2009). In this vein, we constructed and implemented a direct questionnaire to 562 Portuguese firms that internationalized to the PALOP, from which we obtained 147 responses representing 334 firm-market observations.

Based on multivariate econometric model, our results show that more innovative firms tend, on average, to choose FDI as their adequate entry mode in the selected markets, which is in line with some earlier studies by Sun (1999), Chung (2009) and Javorcik and Wei (2009). This might be explained by the fact that high technological firms want to maintain higher control over their firm-specific assets (Sreenivas and Pangarkar, 2000; Chen and Hu, 2002). Moreover, we found that larger firms have a preference for high equity entry modes, which contrast with the study of Esperança *et al.* (2006), and might be explained by the analysis of distinct host countries. While Esperança *et al.* (2006) focus on Portuguese MNCs which invest in Spain, our study analyzes firms from the same home

country but internationalizing to emerging African countries which present very distinct characteristics, namely the levels of corruption, political restrictions and economic and political instability. These and other factors as the physical proximity may be the reason why the results point into different directions. Additionally, we found that the openness of the host market favors the entry via FDI, what is somehow surprising, as this determinant did not appear to have a statistically significant effect in previous studies focusing on other (central and eastern European) emergent markets, such as the one of Javorcik and Wei (2009). Also in contrast with extant literature (e.g., Horstmann and Markusen, 1996), the host market size emerged as negatively related to the equity mode propensity, being more likely a (Portuguese) MNC to enter via exports in larger (PALOP) markets. Finally, we found that international experience is not associated to, as one would expect, high equity modes. This might be, as Slangen and van Tulder (2009) describe in their study, due to the fact that MNCs tend to enter new markets by the same method/way they have entered earlier into other markets - i.e. firms that are experienced in entering markets via export are more likely to follow the same path in subsequent internationalization processes.

In line with prior studies that point to a preference by firms for non-equity modes when entering corrupt markets (e.g., Rodriguez *et al.*, 2005; Uhlenbruck *et al.*, 2006; Straub, 2007; Paul and Wooster, 2008), our results evidence that, on average, Portuguese firms opt for non-equity modes, most specifically exports, when entering in more corrupted countries. Recall that according to Uhlenbruck *et al.* (2006) MNCs use non-equity modes as an adaptive strategy because this entry mode provides an opportunity to participate in economies where corruption is high while avoiding some of the costs related to corruption. Non-equity modes also protect the MNCs avoiding the direct contact with corruptive practices such as bribe paying (Rodriguez *et al.*, 2005). Beyond the bribes and extra taxes, the direct establishment in a corrupt market may affect MNCs' investment through its interaction with corrupt state officials. This increases the risk of expropriation reducing the informational advantage a FDI entering firm has (Straub, 2007).

Based on these results we failed to corroborate Demirbag *et al.*'s (2010) argumentation. Indeed, despite the vast majority of the firms (about 90% of our sample) underlined the importance of cultural ties with PALOP countries, perceived corruption emerged negatively and significantly correlated with the FDI propensity. In other words, PALOP countries characterized by lower perceived corruption tend to be most successful in attracting foreign direct investment. Thus, we demonstrate that in PALOP too, high levels

of institutional quality tend to foster economic growth and development through its positive effects on FDI attraction.

Summing up, our findings highlight that despite the existence of strong cultural ties between home (Portugal) and host countries (PALOP), corruption stands as a critical obstacle to foreign direct investment. Recall that excluding Cape Verde, all the other PALOP present very low levels of transparency (with CPI below 3 out a maximum of 10). Given the widespread perceived corruption among PALOP our findings reflect a quite worrisome scenario for future growth prospect of these countries.

Our study clearly emphasizes that historical and cultural ties are not sufficient for overcoming the costs of institutional weaknesses, namely the widespread perceived corruption. We borrow Lawal's (2007) words when she sustains that corruption has been an impediment for the true and real development of African society. So, in order to benefit from the potential of foreign capital which contributes to economic development and integration with the global economy (Shrestha *et al.*, 2010), African countries in general, and the PALOP in particular, should implement serious measures to combat corruption, building a strong political system that inspires confidence and captures foreign investors.

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As in any other research endeavor, our study is not absent of limitations and shortcomings and raised additional questions to the ones that it aimed answering.

Regarding the limitations one of the most obvious is the relatively low number of host countries involved and the similarity of cultural and historical links they maintain with the country of origin. It would be more adequate to include (African) countries that had strong and weak historical linkages with Portugal and then to assess whether historical linkages would mitigate the negative impact of corruption on FDI.

In term of research prospects, although our focus was on the role of corruption on firms' entry modes, namely FDI, an interesting and challenging path for future research would be to analyze the impact that incoming FDI has on the local conditions, most notably on the quality of the institutions.

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Appendix - Questionnaire



Os dados fornecidos serão tratados de forma agregada, estando garantida a confidencialidade dos mesmos. Agradecemos que tente responder a todas as perguntas. Por favor responda com X às questões de escolha múltipla.

Nome/designação da empresa

A. Dados da empresa

A1. Nº de trabalhadores: A2. Percentagem (%) de I%D no volume de vendas:

A3. Ano de internacionalização: A4. Nº de países em que a empresa opera:

B. Processo de Internacionalização

B1. Na lista que se segue, por favor, seleccione o(s) país(es) com que mantém relações comerciais

Angola Cabo Verde Guiné-Bissau Moçambique São Tomé e Príncipe

Se não mantiver relações comerciais com os países enumerados, o inquérito termina aqui.
Obrigada pela sua colaboração.

B2. Qual o modo de entrada que escolheu para entrar neste(s) país(es)?

	Subsidiária detida a 100%	Joint-Venture	Exportação/contratação
Angola	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cabo Verde	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Guiné-Bissau	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Moçambique	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
São Tomé e Príncipe	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Nas questões seguintes, por favor escreva o número que considera adequado no espaço disponibilizado.

B3. Classifique, numa escala de 0 (não aplicável); 1 (nada importante) a 7 (muito importante), o grau de influência que os seguintes factores tiveram na sua escolha do modo de entrada.

	Angola	Cabo Verde	Guiné-Bissau	Moçambique	São Tomé e Príncipe
Laços linguísticos e históricos entre Portugal e o(s) país(es) seleccionado(s)					
Estabilidade Política					
Restrições de propriedade					

B4. Como classifica o nível de corrupção no(s) país(es)? [0 (não aplicável); 1 (muito baixo) ... 7 (muito elevado)]

B5. Até que ponto o nível de corrupção influenciou a escolha da sua empresa quanto ao modo de entrada? [0 (não aplicável); 1 (nada) ... 7 (muitíssimo)]