Negotiating entry modes:

Partial Acquisitions in Transition Economies

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Abstract

Multinational enterprises often acquire stakes in an existing enterprise when entering emerging economies. This paper examines the determinants of entry mode choices with a special focus on these partial acquisitions, which have received little attention in the scholarly literature.

Recent research suggests that a buyer prefers partial acquisitions, when a seller possesses asymmetric information advantages. However, other studies have suggested that partial acquisition result from sellers' preference for partial divestment. We propose a different perspective that is grounded in the influence of stakeholders on the transfer of ownership rights and find that partial acquisitions are preferred when negotiations are subject to significant stakeholder interference.

Keywords*:* partial acquisitions, entry mode choice, resource transfers to subsidiaries, asymmetric information, digestibility.

1. Introduction

Emerging economies create different sorts of challenges for multinational enterprises (MNE) as they adapt their strategies to the local context (Hoskisson et al., 2000; Wright et al., 2005; Meyer & Peng, 2005), and indeed develop entirely new business concepts and strategies to take advantage of business opportunities in these contexts (Dawar & Chattopadhay, 2002; London & Hart, 2004; Meyer & Tran, 2006).

An important part of the adaptation is the choice of entry mode, which establishes the basis for the development of the local subsidiary (Hennart & Park, 1993; Brouthers & Brouthers, 2000; Meyer, 2001). Entry modes are commonly segmented into equity based and non-equity based modes (Pan & Tse, 2000). The former are considered to be irreversible (Elango & Sambharya, 2004), which has important implications for the trade off between, among other factors, control, investment risk (Luo, 2001) and legitimacy in the host country (Lu & Xu, 2006). We thus investigate these equity based entry modes, in particular the probably least analyzed form of equity-based mode, partial acquisition (PA).

MNEs face two important decisions when they wish to enter with an equity-based mode; the level of equity control and whether to acquire an existing enterprise or build a new start up (Brouthers & Brouthers, 2000). Scholars have analyzed these decisions using a variety of conceptual models: Some studies focus on the relationship between control and commitment by studying the choice between a joint venture (JV) and full ownership (Andersen & Gatignon, 1986; Luo, 2002; Brouthers & Hennart, 2007). Others investigate the make or buy decision inherent in the choice between greenfield and acquisition (Hennart & Park, 1993; Brouthers & Brouthers, 2000; Harzing, 2002) or the choice between an acquisition and a JV (Hennart & Reddy, 1997). A small number of integrative studies simultaneously study the choice between acquisition, JV and greenfield (Kogut & Singh, 1988; Chang & Rosenzweig, 2001; Elango &

Sambharya, 2004).

Partial acquisitions in turn have received comparatively little attention in the literature, with only three empirical studies (Barkema & Vermeulen, 1998; Chen & Hennart, 2004; Duarte & Garcia-Canal, 2004). Of these, only Barkema and Vermeulen (1998) model the choice between all four equity-based modes; acquisition, greenfield, JV and partial acquisitions. This omission of the specific features of partial acquisitions in entry mode research may affect the validity of past empirical studies (Chen & Hennart, 2004) and may explain some of the mixed empirical findings. By lumping together partial acquisitions and acquisitions the important role of ownership control is ignored. Similarly, the failure to distinguish between partial acquisitions and JVs ignores the critical aspects involved in the choice between building a new venture and acquiring an existing established enterprise. In previous studies, partial acquisitions are found to be associated with more risky and culturally distant countries (Barkema & Vermuelen, 1998; Duarte & Garcia-Canal, 2004). We therefore investigate PAs, using a unique original survey dataset of foreign entrants in Poland, Hungary and Lithuania, taking into consideration the specific contextual issues when developing our arguments.

In particular, recent studies in transition economies suggest that partial acquisitions are an important entry mode in its own right (Tsang, 2003; Meyer & Tran, 2006). Partial acquisitions are particularly important in these contexts because stakeholders other than owners continue to play an important role, and governments continue to interfere in private business affairs in order to serve perceived public interests. Therefore, we explicitly consider the mode choice outcome a result of a bargaining process rather than an endogenous decision by the foreign entrant, when we seek to answer the question; what is the role of partial acquisitions in transition economies?

Moreover, the study of partial acquisitions may shed new light on an important theoretical debate in the entry mode literature, namely the relative merits of the digestibility motive and the asymmetric information motive on entry mode choice (Balakrishnan & Koza, 1993; Hennart & Reddy, 1997; Hennart & Reddy, 2000; Reuer & Koza, 2000; Reuer & Koza, 2000b; Chen & Hennart, 2004). We contribute to this debate by exploring the role of asymmetric information in a transition economy context; we argue that the nature of the information asymmetry may be different than what is assumed in prior empirical research, which leads to different outcomes. We therefore suggest that cautious sellers, rather than buyers, motivate partial acquisitions.

We argue that a partial acquisition is a response to contractual difficulties involved in protecting the interests of local owners and stakeholder. Therefore, study aims to contribute to the literature by incorporating the influence of sellers and stakeholders on the entry mode bargaining process.

2. Theoretical framework

For clarity, we define a greenfield operation as a wholly owned new venture (Figure 1). An acquisition is defined as obtaining full ownership control (>95%) of an existing local firm. A JV is defined as the establishment of a new venture between a foreign owner with no less than 10% of the equity stake and a local Co-owner, while a partial acquisition is defined as the acquisition of a stake in an existing local firm of at least 10% but less than 95% of equity.

***** Figure 1 approximately here *****

Firms engaging in FDI may have to augment their existing resources and capabilities to the needs of the host market (Caves, 1996; Anand & Delios, 2002). This can be done by internally developing the resources or capabilities needed, by buying them in factor markets or in the market for corporate control. From a resource based view a firm would prefer to enter by greenfield operation, when it is possible to develop the necessary resources or capabilities internally or acquire them through factor markets. When this is not possible, either because organizational routines inhibit the development of new capabilities (Teece, 1987; Anand & Delios, 2002) or because factor markets are saddled with asymmetric information and opportunism problems (Williamson, 1975), firms would use the market for corporate control.

The most straightforward use of the market for corporate control is to fully acquire another firm that has the resources required to successfully operate in the host country. However, Hennart and Reddy (1997) argue that firms tend to be complex organizations with a broad range of resources. Often, the acquirer desires only selected resources that are commingled with a range of undesired resources. A full acquisition would burden the acquirer with a bundle of resources that may have little value to the acquirer or even have a detrimental effect on the acquirer's performance. To overcome this "digestibility" problem, Hennart and Reddy (1997) argue that firms could effectively establish a jointly owned new venture with resource contributions from both parent companies. This would allow the transfer of desired resources that cannot easily be separated from the organisational boundaries and at the same time create an effective hostage in the form of asset specific investments to safeguard against opportunistic behaviour. JVs then serve as a vehicle to reduce the ex-post integration costs when desired resources are highly commingled with undesirable resources.

An alternative argument by Balakrishnan and Koza (1993) and by Reuer and Koza (2000) suggests that JVs are primarily motivated by ex-ante valuation problems caused by asymmetric information and adverse selection between the buyer and the seller. They argue that sellers would be more able to estimate the true value of an asset in their possession than potential buyers. However, it is difficult for sellers to credibly convey information on the value to a buyer, because they may lack incentives to be truthful and conversely the buyer has no reason to trust them

(Akerlof, 1970). An agreement by the parties to enter into a JV may alleviate the asymmetric information problem. The willingness to undertake asset specific investments in the JV serves as a signalling device, conveying to the buyer the seller's commitment and belief in the value of its resources. Moreover, JVs "*enable the two firms to combine resources in a piecemeal fashion such that the learning that follows allays the adverse selection problem that can arise from initial valuation uncertainties in an outright acquisition*" (Reuer & Koza, 2000). Moreover, they suggest that both arguments are valid, but they maintain that a preference for JV can exist without indigestibility, but not without asymmetric information.

On the other hand, Hennart and Reddy (2000) suggest that asymmetric information can explain the use of partial acquisitions. Moreover, Chen and Hennart (2004) argue that despite increased management costs associated with co-ownership and control (Luo, 2002; O'Connor, Luo & Lee, 2001) partial acquisitions may be preferred over full acquisition when asymmetric information and adverse selection problems leads both seller and buyer to price opportunistically. They argue that ex-ante valuation problems may be resolved if the current owner retains a share in the firm that effectively functions as a hostage. Only owners that are confident in the future prospects of their company would be willing to retain a share. Even if the ex-ante valuation problems could be resolved the current owner may engage in ex-post opportunistic behaviour that could adversely affect the performance of the acquired firm (Chen & Hennart, 2004). This could be done either through neglect e.g. by withholding important information or by engaging in competing business. By retaining the seller as a co-owner, the two parties align their interests, thus curbing the incentive to act opportunistically.

Similarly, Meyer (2002) suggests that partial acquisitions may be a means to align the interest of an MNE and the host government in acquisitions related to the privatization of state enterprises. Governmental agencies often have indirect means to influence the prosperity of a business. Aligning their interests with the private sector interests of a foreign investor would thus reduce the likelihood of surprise adverse interferences. Thus, partial acquisitions can facilitate the trade-offs in markets for corporate control that are plagued by asymmetric information and adverse selection problems, and at the same time discourage ex-post opportunistic behaviour by the seller (Chen & Hennart, 2004).

From these perspectives joint ventures or partial acquisitions substitute a full acquisition either as a consequence of ex-ante valuation problems or ex-post operational problems. Since sharing control raises governance costs (Luo, 2002) it is clear that in the absence of digestibility and asymmetric information problems, the preferred mode choice would be a full acquisition. While a JV may resolve ex-ante valuation problems caused by asymmetric information, this does not necessarily make this mode the optimal choice. Without digestibility problems the preferred long-term solution should be full integration of the companies in question.

In a partial acquisition, the acquirer takes control of some shares and may, as valuation problems are resolved, venture on to fully integrate the acquired firm. Arguably it would be more costly to coordinate the two parent companies and a JV operation between them, which may develop its own distinct organisational culture. This suggests that a preference for JV may exist without asymmetric information, but not without digestibility problems.

Hence the asymmetric information argument would appear to offer the best available explanation for partial acquisitions. Yet, it is not without problems. The notion that local sellers understand the value of the assets better than the potential acquirer is tentative. This issue is of particular concern in transition economies. These economies typically lack effective market mechanisms for the transfer of ownership rights, which limits local owners' ability to gauge the value of their assets. Moreover, the local owners only truly know the value of their assets in their current use. They may not know the potential value of their brand or product line when placed in its first best use and supported by sophisticated marketing techniques. Similarly, the value of a dominant market position or an extensive distribution network may be unknown to the owners of an inefficient firm. This may particularly be a problem when the seller is a privatisation agency. Tsang and Yip (2007) argue that local governments and managers may even deliberately under price assets in order to gain personal advantages from a sale, thus accelerating the pricing problem. Consequently, local owners' concern of selling 'too cheap' may motivate partial acquisitions rather than the MNE's fear of paying too much. In other words, the sale of assets may be subject to a "reverse" information asymmetry problem, as buyers possess superior information of the value of the target firm's assets.

A related challenge in transition economies is the influence of stakeholders during the negotiation process. Antal-Mokos (1998) and Meyer (2002) provide several examples of ex-ante negotiations that have failed or been drawn out due to intervention by other stakeholders in the process. Contractual conditions often include a non-financial component, such as guarantees not to close plants or to lay off employees, which may later create impediments to restructuring. Moreover, in JV contracts the partners agree in detail the rights and duties of each party to the venture, while partial acquisition agreements may be less clear. This can be an advantage in situations where powerful rent-seeking stakeholders are able to derail the ex-ante negotiations. By opting for a partial acquisition, sensitive issues may be postponed, thus avoiding prolongation or even failure of the negotiations.

Similarly, it m,ay be easier to gain local legitimacy for a partial acquisition, for instance by labelling it as a strategic alliance, which reduces the risk of intervention by rent-seeking stakeholders. This is particularly important for project of high public visibility or where a governmental agency is a partner to the negotiations because the latter may be subject to political pressures (Antal-Mokos, 1998). On the other hand, public opinion may perceive a full acquisition by a foreign firm with some misgivings, even in developed market economies (Crystal, 2003). Therefore, foreign investors may consider partial acquisitions the fastest way to gain access to a market and to secure early mover advantages. Thus, Jakobsen (2006) finds that *early* entry through partial acquisition enhances the performance of a new operation.

Postponing agreements on critical business aspects allows the parties to settle details when uncertainty and information asymmetries have been reduced, which facilitates agreement. Foreign investors generally enter transition economies with the expectation that the institutional environment will improve over time; hence they expect that future negotiations are conducted in a less uncertain environment. Moreover, the interests and bargaining power of stakeholders is expected to change over time. At the same time, foreign investor in a partial acquisition may gain legitimacy in the local context and gather allies, which may reduce politically motivated opposition.

We therefore proceed to develop our hypothesis based on the view that owners and stakeholders seek to protect their interests. Since the transition economy environment is often highly uncertain it is costly to protect these interests by means of contracts (Williamson, 1975) and therefore retaining some influence through local ownership would be preferred.

3. Hypothesis development

The theoretical discussion above suggests that asymmetric information between buyer and seller, and the resulting bilateral bargaining situation, are core to an explanation of why firms choose partial acquisitions rather than more conventional modes of investment. Large asymmetries of information between buyers and sellers with respect to the value of the assets of the firm can inhibit acquisition deals. Alternatively, firms may design specific strategies, such as a partial acquisition, to protect their interests.

In an acquisition, two types of information asymmetries emerge. The seller has superior knowledge concerning the actual operations of the firm (Chen and Hennart, 2004). On the other hand, the buyer has superior knowledge concerning the potential contribution of the firm's resources to the buyers operations. The literature has focused on the former effect, yet the latter may also be important. If the buyer wants to use the resources of the acquired firm in ways that create higher rents than their current usage, e.g. by creating synergies with existing operations, the buyers maximum price may be substantially above the sellers minimum price. Thus, a substantial scope for negotiation emerges.

This situation is likely in transition economies, especially if the acquisition is related to the privatization process (Meyer, 2002). Foreign investors may often be in a better position to assess the value of a firm under conditions of a modern market economy than for instance privatization agencies with the legacy of state-ownership and central planning. While traditionally the market mechanism in advanced economies may be good at capturing rent derived from perceived synergies for the existing shareholders through high acquisition premiums, emerging markets lack the fundamental market supporting institutions, and hence the sellers must device alternative means to secure a share of the rent. Sellers would thus prefer an acquisition arrangement that gives them a stake in the firm's future revenues, such as a partial or staged sale. Consequently, this reverse information asymmetry would lead sellers to prefer partial acquisitions.

Hence, in the presence of reverse asymmetric information advantages, the acquirer's past commercial experiences in the host country does not reduce the asymmetric information problem but rather signals to the current owner(s) the acquirer's superior capacity to value the target, thus inducing the current owner(s) or a group of owners not to sell outright, in the hope that they can free ride on the acquirer's efforts. Hence we propose that:

Hypothesis 1: *Previous host market knowledge is positively associated with entry by partial acquisition rather than full acquisition.*

For MNEs that have already established foreign investment operation, an additional consideration becomes paramount. Any new operation would normally aim to extend the existing one, for instance by increasing market share or by deepening the local supply chain. Therefore, for investors undertaking follow-up investments, the interaction between the existing and the new operations is essential.

If foreign investors obtain full control over new operations, they would be able to proceed with the integration of the old and the new operation. If however they have to share control, as in a partial acquisition, they would find it considerably more difficult to integrate the two operations. Thus, subsequent investments are less likely to be with shared ownership, as found for instance by Kogut and Singh (1988).

Moreover, MNEs often undertake subsequent investments to increase their market share with the aim to attain market leadership in previously fragmented markets. They may thus pursue a strategy of multiple acquisitions to reach a desired level of market coverage and power (Meyer & Tran, 2006) and to realise economies of scale in production, marketing and distribution. Such a strategy, however, requires operational integration of the acquired units, which is easier without residual outside shareholders. Therefore we expect partial acquisitions to be less relevant for follow-up investments compared to full acquisitions:

Hypothesis 2: *If the foreign parent already has direct investment in the host country, subsequent investments are less likely to be partial acquisitions rather than full acquisitions.*

A different form of international experience has attracted considerable scholarly attention, namely experience in international business as such (rather than specific to a country). Theoretical arguments suggest that inexperienced investors would more often use JVs as means to learn international business practices, and to access complementary resources. Moreover, a JV provides a local partner who would help to adapt to local conditions and to gain local legitimacy (Lu & Xu, 2006). While some empirical studies support the notion that less experienced foreign investors prefer shared ownership (Gomes-Casseres, 1990; Meyer, 2001), Barkema and Vermuelen (1998) found no direct link between international experience and the propensity to choose full acquisition over partial acquisition. In general the overall evidence from this literature is highly inconclusive (Harzing 2002).[1]

In part the mixed evidence may be due to the failure to distinguish between JVs and partial acquisitions, which both have shared ownership. Since partial acquisitions may be chiefly motivated by the interests of the local owners and stakeholders, this learning argument may only apply to JV where both partners contribute resources and share the running of the company. Thus we predict:

> ***Hypothesis 3:*** *The greater the international experience of the parent company the less likely it will choose to enter by Joint Venture rather than a partial acquisition (or any other entry mode).*

Entry strategy research has paid considerable attention to the size of the envisaged local operation. Greenfield operations take more time to grow, as foreign investors have to recruit staff and build operations from scratch, which is a time-consuming process. Thus, investors are more likely to use acquisitions rather than greenfield entry when aiming to establish large operations (Hennart & Park, 1993; Brouthers & Brouthers, 2000; Harzing, 2002) or large plants (Elango & Sambharya, 2004).

The acquisition of large targets may be particularly important for investors seeking to build a leadership role in local markets, which is a particularly important motive in transition economies (Meyer 2002; Meyer & Tran, 2006). Acquisitions offer faster and easier market access than greenfield entries (Gil et al., 2006). Large new ventures may experience high costs, as they have to invest aggressively in marketing to build volume turnover and to fill production capacities. Moreover, leaving behind a large local firm also leaves a window of opportunity for late movers to enter the market and gain a substantial market position thereby negating potential first mover advantages (Lieberman & Montgomery, 1998). Thus, for multiple reasons, we would expect foreign investors aiming for a substantial operation to prefer acquisition or partial acquisition as an entry mode.

Full acquisitions of large firms however face distinct obstacles, especially in highly politicized contexts. Firms owned fully or in part by the state or by employees may attach greater importance to employment guaranties, or other commitments that would ensure the long-term continuation of the firm. In order to secure a full acquisition a foreign acquirer would often have to surrender a significant degree of strategic flexibility through contractual arrangements. Even when this is not the case, external stakeholders such as the national government, local municipalities or the media may aim to influence and/or slow the negotiation process (Antal-Mokos, 1998). They may insist that a local co-owner retains an equity stake to secure local interests, and thus obstruct full acquisitions (Meyer, 2002). The larger the local firm, the higher

[1] Harzing (2002) provides a thorough review of empirical results on this issue.

would be the profile of the takeover negotiations in the host community and the greater the likelihood that stakeholders would intervene. Consequently, we expect that the larger the local firm the more likely the deal will be structured as a partial acquisition.

Hypothesis 4*: The larger the new subsidiary, the more likely is has been established by partial acquisitions rather than any other mode of entry.*

4. Methodology

Data

We use data from a questionnaire survey of foreign owned firms in three transition economies: Poland, Hungary and Lithuania. The survey has been conducted as a joint project in cooperation with a team of local researchers in each of the three countries in 2003. Where appropriate the survey was translated into local languages.

The base population was constructed by combining local databases. The questionnaire was then sent to the chief executive of firms where contact information was available, which in most cases was followed up by phone contact and personal interviews to achieve a desired rate of response. Relative to the base population of all foreign investors, the sample includes 10 percent for Poland, 11 percent in Hungary and 22 percent in Lithuania. After eliminating observations with missing values, a total sample of 322 foreign owned subsidiaries remains.

While common method bias always remains a potential source of problems in a questionnaire based studies we employed techniques suggested by Podsakoff et al. (2003) to mitigate such biases. In particular, the dependent variable, mode choice, is a factual classification that is not sensitive to subjective perceptions as for instance Likert scale data are.

The firms included were primarily established during the period 1990-2000 and had at least 10 employees and a foreign ownership participation of no less than 10%. These criteria were selected to eliminate administrative or representation offices and ensure that only fully operating firms are in the sample. The majority, 62 percent of the local subsidiaries, reported that they had less than 100 employees in 2001, 31 percent reported between 100 and 1000 and the remaining 7 percent reported that they had more than 1000 employees. The sample is thus broadly representative for both smaller and larger enterprises. The survey includes firms in a wide range of industries and reflecting the main countries of origin in the region, namely Germany, the Nordic countries, other Western European countries and North America.

The sample contains a substantial proportion of all four entry modes, which allows empirical analysis of the four-way choice: Greenfield operations represent 44 percent of all observed entries, acquisitions 23 percent, JVs 21 percent and partial acquisitions 12 percent. This pattern differs from earlier studies of entry mode. Most studies of entry mode choice in the US report a dominant share of acquisitions, for instance in the Elango and Sambharya (2004) study 210 out of 336 observations were acquisitions. On the other hand, studies on China data have observed a large majority of shared ownership modes (Luo, 2001; Luo, 2002), though this may have diminished in recent years.

Dependent variables and statistical methods

To test our hypotheses we model the entry mode choice as a multinominal logistic regression (M-Logit) with entry mode as a dependent variable. The entry mode variable takes the values greenfield, acquisition, JV and partial acquisition respectively.

Independent variables

To test hypotheses 1, we include a dummy variable previous *host market knowledge*. Similarly, hypotheses 2 is tested by the dummy *follow-up investments*, which indicates whether or not the subsidiary is the parent companies first FDI in the host country. Both dummies are derived from yes-no questions in the questionnaire survey.

To test hypotheses 3 we include a measure for the international experience of the foreign parent firm. Similar to Barkema and Vermeulen (1998), we proxy *international experience* using the natural logarithm of the number of countries the parent company had affiliates in at the time of the investment. A large number of foreign affiliates indicate that the parent has considerable experience with foreign market entry.

Following Kogut and Singh (1988), we proxy *subsidiary size* by the natural logarithm of the number of employees. We choose the number of employees for the last year of operation reported, to eliminate a potential problem that a new venture might have little or no activities in its first year of operation. A simple means test indicate that partial acquisitions on average have been laying off employees consistent with restructuring needs, whereas greenfields and JVs tend to have grown over time. The last year is thus more useful to measure persistent size differences. This measure is used to test hypothesis 4.

Control variables

Equity based entry modes other than greenfields are generally associated with augmenting the foreign parent's resource base (Anand & Delios, 2002). We therefore include a measure of *foreign parent resources* reliance as a control variable. The respondents where asked to report the three most critical resources for the subsidiary success during its first years of operation. This question was followed up with another asking the respondent to rate on a percentage scale the contribution of these resources from various sources e.g. a local partner, the foreign parent or other local sources. A weighted measure of the parent's relative contribution of resources was created, attaching the greatest weight to the most important resource and subsequently less importance to secondary and tertiary resources.

$$\underline{\sum (r1)*0.5+(r2)*0.3+(r3)*0.2}$$

Similarly, firms that pursue efficiency oriented FDI will usually rely on host country factor endowments as well as their own resources in efficient management and production technology. They will rarely need country specific resources like local market knowledge or access to distribution networks. Furthermore, host governments generally look more favourably on export oriented FDI, which tend to give efficiency seeking MNE's greater leverage in the choice of entry mode (Luo, 2001). To control for this effect, we coded all firms that received more than 80 percent of their revenues from export as *export intensive*.

Furthermore, we include control variables for host country, home region of the parent, and industry. To avoid singularities in the Hessian matrix we reduced the number of industry groups and home regions. The industry of the affiliate is coded as *Manufacturing*, *Utilities and mining*, *Trade*, *Financial services* or *Other services*. We divided the home region of the parent companies into *Nordic countries*, *Germany*, *other Western European* countries, *North America* and all *Other countries*.

Since transition economies are undergoing rapid changes in the institutional environment, it is to be expected that there may be time trends in the entry mode choice (Estrin, Ionascu & Meyer, 2004). Moreover, past experiences of other entrants from the same home country might affect the MNE's choice of entry mode. To control for these time effects we interact the number of years since the affiliate was established with the host country and the home region of the parent company. This procedure generates multiple time trends that control for all other factors that are time or country specific.

***** Table 1 approximately here *****

Table 1 reports descriptive statistics and the correlation matrix of the variables in this analysis. The table shows that, with a few exceptions, the pair wise correlations between the variables are quite low (<0.3). Since firms with past FDI in the host country is expected to have host market knowledge the pair wise correlation between previous *host market knowledge* and *follow up investments* is relatively high (0.45). None of the pair wise correlations are so high that we would expect a serious multi-collinearity problem though.

***** Insert Tables 2 and 3 approximately here *****

5. Results and hypothesis tests

The results of the M-logit regression on the determinants of entry mode choice are presented in Table 2 and 3. A positive sign in Table 2 indicates a greater likelihood of choosing the entry mode in question compared to the base mode Greenfield. The same regression is reproduced in Table 3 with acquisitions as the base case such as to extract information on the significance of effects viz. acquisitions as well. The overall model fit is good with a pseudo R^2 of 0.52. The model correctly classified 62 percent of the observations. For our hypotheses, it is particularly relevant that the model is also good at classifying partial acquisitions with 42 percent correctly classified, which is more than three times that which could be predicted by a random choice model.

In support of hypothesis 1, we find that prior *host market knowledge* is positively associated with entry by partial acquisitions. We argue in hypothesis 1 that buyers may benefit from *reverse* asymmetric information advantages. Sellers in transition economies had little experience with valuation of assets and lacked effective market institutions e.g. stock markets. Previous commercial experience in the country may signal to the seller that the buyer has a good understanding of the true value of the asset. Consequently, the seller(s) will be more reluctant to divest its entire stake in the firm preferring to wait and see how things develop. An alternative or complementary explanation of the observed effect could be that foreign firms with local experience are more likely to recognize the potential for ex-ante conflicts and may be more willing to accept partial ownership.

On the other hand, prior *host market knowledge* is found to be negatively associated with JVs. In line with the digestibility argument, this suggests that firms enter by JV when they desire access to local market knowledge and resources related to the management of business activities in the local context, without being burdened by undesirable resources that would be obtained through a full merger.

The results indicate that follow up investments are less likely to be by partial acquisition, thus supporting hypothesis 2. As expected, firms are less willing to accept partial control when they engage in subsequent acquisitions. Subsequent acquisitions tend to be motivated by a desire to strengthen and consolidate a market position in the host country. The presence of other owners in the individual subsidiaries complicates the foreign parent's ability to integrate activities in the host country, thus limiting the scope for positive synergies. Furthermore, the local owners may be more willing to sell their holdings when faced with intensifying foreign competitive pressure.

We find that internationally experienced firms were less likely to enter by JV compared to any other entry mode, thus supporting hypothesis 3. The results also suggest a fundamental difference in the underlying motivation for the choice of JV and partial acquisitions. Whereas the choice of a JV is motivated by the desire to gain a local partner to help compensate for the foreign parent's lack of international experience, this is not the case for partial acquisitions. The choice of partial acquisition is thus not motivated by a deficiency within the MNC in terms of resources or capabilities, but rather by deficiencies in the contracting environment.

As predicted in hypothesis 4, *subsidiary size* is strongly positively associated with partial acquisitions. As expected, both acquisitions and partial acquisitions are on average significantly larger than Greenfield projects (Table 2) and in addition partial acquisitions are larger than full acquisitions (Table 3). Our study thus presents strong evidence that firms prefer to acquire large enterprises rather than to build them from scratch. The process of building a large organization from scratch may be to slow and difficult for many investors. It tends to be easier to buy into a new market, particularly when local assets are available for sale, which was mostly the case due to the extensive privatization campaigns undertaken by the host countries in the period.

Moreover the positive relationship between *subsidiary size* and partial acquisition may be caused by a tendency by stakeholders such as the state, municipal government and employees to intervene with the objective of derailing, slowing down or otherwise affecting the outcome of ex-ante ownership transfer negotiations (Meyer, 2002). The probability of stakeholder intervention is greater the larger their perceived interest, which would often be closely related to the number of jobs involved. In such cases, foreign firms may have a clear interest in limiting ex-ante negotiations by postponing negotiations on sensitive issues like layoffs.

The pattern of control variables is in line with our expectations. We find that the relative resource contribution of the parent company is positively and significantly associated with greenfield operations. Similarly, exporters were more likely to enter by greenfield operations. This generally supports the resource-based view that firms will seek to utilise or develop resources in-house and to the extent that this is not possible they will pursue complementary (local) resources through acquisition or a partnership with a local firm. Contrary to the WOS versus JV/PA division argued by Brouthers and Hennart (2007) this suggests that a more appropriate segmentation would be between greenfields and resource seeking modes.

Overall the joint effects of the time trends were not significant. For the home region dummies (not reported) North America stands out with a rather clear aversion against partial ownership. This result is generally similar to previous findings that have studied the impact of culture on the choice of entry mode.

6. Discussion

This study offers several contributions to the literature. It is one of the first studies to empirically investigate the factors that determine the choice to enter by partial acquisitions, and thus establishes that partial acquisitions have distinct features. Moreover, this study considers the influence of local owners and stakeholders in shaping the entry mode decision. These influences have important implications for the factors that govern the choice to enter by partial acquisition in transition economies, but also the direction of these. Consequently, we argue that information asymmetries may run counter to that which has previously been suggested (Chen & Hennart, 2004). Our results support this by showing that better informed foreign acquirer's does not contribute to reducing information asymmetries problems, but rather enhance them. We also explain the previously inconclusive evidence of the effect of international experience on shared versus full ownership. The theoretically expected effect applies only to joint ventures, and empirical studies that muddle the difference between partial acquisitions and joint ventures may thus fail to identify this effect.

It is one of the first studies in transition economies that simultaneously examine the factors that determine the choice of ownership level *and* the decision to make or buy. We demonstrate that it is fruitful to consider the choice of entry mode as a simultaneous choice along multiple dimensions. It is important to distinguish between not only levels of ownership control, but also whether the subsidiary should be acquired or build from scratch. A division between wholly owned and partially owned subsidiaries fails to capture the choice between acquiring existing assets and building new assets. Similarly, a failure to separate acquisitions and partial acquisitions ignores the important issue of control and governance. Yet, even combining the two sets of arguments may be insufficient to explain the choice of partial acquisitions.

Thus, our study suggests a clear distinction in the underlying pattern of entry mode choice, which is perhaps particularly important between joint ventures and partial acquisitions. We see that the lack of context specific "host market knowledge" and general business experience in an international context are key drivers for the choice of JV. Thus, JVs are primarily motivated by the operational concerns of the foreign investors regarding their ability to manage a cross border subsidiary in the specific host country context. Yet partial acquisitions are not driven by the same factors. They appear to be formed on the basis of comparative strength, i.e. the foreign investors in partial acquisitions are more likely to have previous host market. It is thus not the operational aspect that governs the choice of a partial acquisition, but rather partial acquisition emerges as a means to acquire a bundle of resources when there are forces at work that resists the transfer of these resources.

The study has some important limitations. Some entry mode choices may not be relevant in other countries because of legal constraints on e.g. full acquisition. In these regions, it may be especially important to distinguish between partial acquisitions and JV greenfields.

Some of the results may be specific to transition economies and cannot be generalized. The reverse asymmetric information motive might be particularly strong in transition economies.

Likewise, if a positive relationship between size and partial acquisitions is mainly attributable to a desire to avoid or postpone negotiations on non-financial contractual clauses, then this would be of less importance in more advanced economies where these are less common. Hence the transition economy context might explain the difference in the results between this study and the study by Barkema and Vermuelen (1998), which found that JVs were on average larger than full acquisitions and that the parents had greater international experience.

Future research is hoped to provide a more differentiated treatment of entry modes, recognizing the unique features of partial acquisitions. In particular, we propose to investigate a similar set of hypotheses on different countries. A further possibility for future research may be to re-estimate bimodal Logit regression equations presented in the literature on the same data, but replacing the Logit with an M-Logit model that incorporates partial acquisitions as a separate option. Another line of inquiry may investigate whether buyers or sellers are the principal motivators for the choice of partial acquisitions.

7. Conclusion

A partial acquisition is the outcome of a negotiation between an acquirer and a group of seller(s) and stakeholders that seek to retain some influence on the future of the enterprise. The main implications for managers are that they should not confuse the motives for establishing a JV and those for establishing a partial acquisition. Firms can advantageously choose a Greenfield-JV operation with a local partner when they need to upgrade their capabilities to conduct business in the local context. On the other hand, a partial acquisition is not a means to enhance operational efficiency by joining up with a partner that possesses superior context specific managerial capabilities. For all practical purposes these capabilities reside at the level of the acquired subsidiary's management, not its owners. Rather, the key purpose of a partial acquisition is to facilitate an acquisition deal in situations where powerful stakeholders resist turning over full managerial flexibility to the acquirer. An acquirer can facilitate ex-ante negotiations and avoid or reduce the severity of long-term concessions by pursuing, or perhaps more appropriately "accepting", a partial acquisition.

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	New organization	Existing organization
Full equity control	Greenfield	Acquisition
Shared equity control	Joint venture	Partial acquisition

Figure 1. Ownership control and the make or buy decision.

Table 1. Descriptive Statistics and Correlation Table

		Mean	s.d.	X1	X2	X3	X4	X5	X6	X7	X8	X9	X10
X1	Foreign parent resources	38.43	33.72	1									
X2	Export intensity	0.20	0.40	0.07	1								
X3	Subsidiary Size(log)	0.00	1.65	-0.03	0.02	1							
X4	Hostmarket Knowledge	0.41	0.49	-0.04	-0.01	-0.00	1						
X5	Follow-up Investments	0.26	0.44	-0.07	-0.11**	0.14***	0.45***	1					
X6	International experience(log)	0.00	1.32	0.04	-0.08*	0.14***	0.12**	0.07	1				
X7	Affiliate age	7.67	3.08	0.09*	-0.13***	0.15***	-0.05	-0.12***	0.06	1			
X8	Poland	0.38	0.49	0.07	-0.13***	0.24***	0.08*	0.04	0.21***	0.08*	1		
X9	Lithuania	0.20	0.40	-0.11**	0.09**	-0.07	-0.21***	0.06	-0.15***	-0.26***	-0.39***	1	
X10	Hungary	0.42	0.49	0.02	0.05	-0.18***	0.09**	-0.09**	-0.10*	0.12***	-0.67***	-0.43***	1

Levels of significance: *** $p<0.01$, ** $p<0.05$, * $p<0.10$.

Table 2. Multinominal logit with Greenfield as the base.

	Acquisition	Joint venture	Partial acquisition
Intercept	-4.07*** (0.95)	-2.69*** (1.00)	-4.91*** (1.24)
Foreign parent resources	-0.02*** (0.01)	-0.03*** (0.01)	-0.03*** (0.01)
Export intensity	-0.91* (0.48)	-1.78*** (0.57)	-1.14* (0.66)
Subsidiary size	0.67*** (0.14)	0.21** (0.16)	0.98*** (0.18)
Host market knowledge	-0.22 (0.40)	-1.60*** (0.46)	1.08** (0.55)
Follow up investments	0.92** (0.45)	1.05* (0.54)	-0.75 (0.63)
International experience	-0.09 (0.14)	-0.44*** (0.17)	0.01 (0.19)
Hungary	0.99** (0.41)	-0.06 (0.45)	0.53 (0.56)
Lithuania	0.99 (0.65)	0.96 (0.65)	1.33 (0.91)
Industry Dummies**	Yes	Yes	Yes
Home region Dummies*	Yes	Yes	Yes
Host country xAffiliate age	Yes	Yes	Yes
Home region x Affiliate age	Yes	Yes	Yes
N	322	Correct classifications	61.50
Chi Square	211.78	Nagelkerke R^2	0.52

*** p<0.01, ** p<0.05, * p<0.10.

Table 3. Multinomial logit with Acquisition as the base.

	Greenfield	**Joint venture**	**Partial acquisition**
Intercept	4.07*** (0.95)	1.38 (1.09)	-0.84 (1.23)
Foreign parent resources	0.02*** (0.01)	-0.01 (0.01)	-0.01 (0.01)
Export intensity	0.91* (0.48)	-0.87 (0.60)	-0.23 (0.65)
Subsidiary size	-0.67*** (0.14)	-0.46*** (0.15)	0.31** (0.16)
Host market knowledge	0.22 (0.40)	-1.38*** (0.49)	1.30** (0.55)
Follow up investments	-0.92** (0.45)	0.13 (0.52)	-1.67*** (0.60)
International experience	0.09 (0.14)	-0.34** (0.18)	0.10 (0.19)
Hungary	-0.99** (0.41)	-1.04** (0.50)	-0.45 (0.57)
Lithuania	-0.99 (0.65)	-0.02 (0.69)	0.34 (0.89)
Industry Dummies**	Yes	Yes	Yes
Home region Dummies*	Yes	Yes	Yes
Host country xAffiliate age	Yes	Yes	Yes
Home region x Affiliate age	Yes	Yes	Yes
N	322	Correct classifications	61.50
Chi Square	211.78	Nagelkerke R^2	0.52

Significance levels: *** p<0.01, ** p<0.05, * p<0.10.