Multinational Enterprise Investment:
Investor Response to Entry Mode and Foreign Country Risks

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May 19, 2003

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Although multinational enterprises can choose between alternative foreign direct investment (FDI) modes and foreign countries constitute several different types of investment risk, prior research has focused on single entry modes and/or a limited set of country risk factors. This study considers FDI in the context of multiple entry modes and a broader set of country risk factors than has been previously examined. Based on 344 FDIs established between 1986-1997, our results suggest that country risks and entry modes have differential bearings on investors' expectations. Wholly-owned modes are generally preferred although investors reward joint ventures under certain financial, economic, political, and cultural conditions.

Keywords: multinational enterprise
entry mode
foreign direct investment
country risk
political risk
cultural distance

Although some theorists have suggested that country-level factors are important considerations in multinational enterprise (MNE) strategy (e.g., Dunning, 1998, Kostova and Zaheer, 1999), most organizational theories focus on internal firm characteristics, paying less attention to the environments in which these organizations operate (Sundaram and Black, 1992). While a recent trend in research has been to develop a more nuanced analysis of various country environment risk factors that have an impact on FDI (see e.g., Brouthers and Brouthers, 2000, Henisz, 2000, Merchant and Schendel, 2000), "a significant shortcoming in much of the existing risk…literature is the emphasis on particular uncertainties rather than a multidimensional treatment of uncertainty" (Miller, 1992). Further, while some research has used composite measures of country risk, these risk measures mask the ways in which specific risks affect outcomes (Miller, 1998).

Not only is our current understanding of MNE FDI risk behavior incomplete, but also recent evidence suggests that changes in host country political, economic, and regulatory environments are at the center of an unprecedented expansion of global investment and that the propensity to use certain foreign entry modes are concurrently changing in response[1] (UNCTAD, 2000). This research, therefore, was designed to address these gaps by developing a multidimensional model of the differential impacts of different MNE FDI modes in the context of several types of investment risk. The results of this study would be of interest to scholars of FDI and the MNE as well as to managers involved in foreign investment strategy.

THEORETICAL UNDERPINNINGS

Internalization theory, the dominant perspective on the MNE, suggests that firms expand their operations into foreign countries when they possess rare and valuable resources or capabilities for which arm's length markets are inefficient (Buckley and Casson, 1976, Rugman, 1981). FDI is

[1] the UNCTAD reports that in 1995, nearly 4,600 inter-firm agreements were concluded compared with about 1,790 in 1990.

undertaken by successful firms that produce a differentiated product and control the essential knowledge about that product's market that can be transferred across national boundaries at low cost. Thus, in contrast to uninational firms, the distinguishing feature of MNEs is that they operate at the intersections of different country environments (Sundaram and Black, 1992). While many elements of MNE strategy are similar to complex uninational firms, the requirement to manage across diverse environments is a fundamental element of MNE strategy and performance.

While the demand to manage at the intersection of diverse country environments is a central element of MNE management, most research has not challenged what Boddewyn and Brewer (1994) have called the "space assumption." That is, an MNE's operational environments are diverse and organizations are affected by these environments (or spaces). When the relevant aspects of foreign environments are not considered, researchers implicitly assume country environments to be homogenous or that the differences are not relevant. Variance in country-level conditions have been found, however, to create a differential effect on MNE subsidiary performance (Bartlett, 1986, Nohria and Ghoshal, 1994, Roth and O'Donnell, 1996). Following Dunning (1998), the basic proposition advanced here is that the interaction between the risks to which MNEs are exposed by operating in foreign markets (e.g., political, cultural, financial, and economic) and alternative FDI entry modes (i.e., joint ventures and wholly-owned subsidiaries) have an important influence in MNE performance outcomes. Thus, if we are to enhance our understanding of the MNE, we must improve our understanding of the concurrent effects of risk and entry mode.

While country environments could be analyzed in many ways, this research will adopt the typology suggested by Parsons' (1971) who divided societies into several basic subsystems: collectives organized for differentiated goal attainment (i.e., the political system), roles designed to govern the efficient management of resources (i.e., the economy), and values that effectively maintain

patterns of interaction (i.e., cultural conditions)[2]. Since the relationships among these social subsystems are very complex, preventing Parsons' (1971) divisions from ever being very neat, they provide, nonetheless, an effective theoretical perspective to delineate the similarities and differences between sovereign nations. This approach is also supported by prior research given that the most common country attributes examined by scholars are politico-regulatory environments (Delios and Henisz, 2000, Henisz, 2000), levels of economic development (Vachani, 1991, Woodward and Rolfe, 1993), and cultural conditions (Brouthers and Brouthers, 2000, Chang and Rosenzweig, 2001).

Of the lenses available to examine the effects of management risk, agency theory has become a dominant perspective as it is a powerful tool to analyze the risk-sharing problem that arises when the desires or goals of the principal and agent conflict (Jensen and Meckling, 1976) and when cooperating parties have different attitudes towards risk (Eisenhardt, 1989). The principal-agent model addresses the conflicts that arise when agents are more risk averse than principals given that agents are unable to diversify their employment risk whereas principals are capable of diversifying their investments. The focus of agency theory on the tradeoffs between risk and reward is important because organizations have uncertain futures that are affected by various risks. On the basis of these theoretical underpinnings, the next section will examine the literature to develop a fuller description of what is already known about the impact of foreign risk and entry mode on MNEs.

LITERATURE REVIEW

The interaction between entry mode and foreign risk exposure has been the subject of a great deal of attention. Agency problems have been analyzed in diversifying acquisitions (e.g., Morck and Yeung, 1992) and, more recently, in joint venture (JV) formation and dissolution (Reuer and Miller, 1997). The majority of these studies, however, have examined the *choice* of entry mode as affected by

[2] Parsons' (1971) set of societal subsystems also includes the system that integrates norms of behavior (i.e., community and/or family) but this element was not examined here since the extent and nature of family ties is not pertinent in this research.

individual country-level attributes such as political risk (e.g., Delios and Henisz, 2000, Henisz, 2000, Reuer, 2001), market risk (e.g., Aulakh and Kotabe, 1997, Erramilli and Rao, 1993) and cultural distance (e.g., Brouthers and Brouthers, 2000, Chang and Rosenzweig, 2001, Makino and Neupert, 2000). While the factors that bear upon managers' choices are an important area of study, an area that has received much less attention is the impact of alternative modes and country environmental risk factors on expected FDI economic outcomes. Given that a basic concern of strategy research is that of explaining differential firm outcomes, the relationship between entry mode, environmental risk, and economic outcomes is of central concern to MNE managers as well as scholars focused on international business.

Despite the relative lack of research on FDI modes and risk on performance, a number of important issues have been revealed by previous work. Perhaps the most carefully analyzed element of exposure to foreign uncertainty is that of national culture and most studies have indicated that greater cultural distance is detrimental to the firm. Barkema, Shenkar, Vermeulen, and Bell (1997), for example, examined 1,493 foreign expansions of 25 large Dutch firms between 1966-1994 and found that the longevity of international JVs decreases with cultural distance. Similarly, Li and Guisinger (1991) indicated that US affiliates whose foreign parents are from culturally dissimilar countries are more likely to fail than those from culturally similar countries, based on their sample of 85 foreign-owned non-financial firms in the US that either filed for bankruptcy protection or were involuntarily liquidated during 1978-1988. Datta and Puia (1995) also found that high cultural distance leads to lower excess stock returns in their sample of 112 large cross-border acquisitions undertaken by US firms between 1978-1990. Overall, empirical research has supported the intuitive suggestion that greater cultural differences constitute a greater risk to firm outcomes.

Political risk has also been the subject of prior research on the relationship between foreign entry and performance. It is most often defined as the possibility of political change and the feasibility of policy change by the host-country government (Miller, 1992) and can encompass many actions including exchange controls, civil strife, limits on remittances, government interference with the terms of a contract, discriminatory taxation, etc., (Howell and Chaddick, 1994). Research on the impact of political risk on MNE economic outcomes remains unclear, as results have been inconsistent. Cosset and Suret (1995), for example, analyzed 2,400 companies in 36 countries and found that investing in politically risky countries improves the risk-return characteristics of a portfolio. Henisz (2000), on the other hand, suggested that higher levels of political risk tend to increase the likelihood of a local JV partner manipulating the system for its own benefit at the expense of the MNE. Further, Merchant and Schendel (2000) reported that political risk did not have a statistically significant effect on the abnormal stock returns in their sample of 101 international JV announcements. Similarly, in Reuer's (2001) sample of 139 IJVs in 24 countries and 36 industries, political risk was found to have only a weakly significant impact on abnormal stock returns. Thus, no consensus has emerged in the literature on the relative impact of political risk and mode of operation on FDI outcomes.

On the other hand, very little research exists on the impact of economic and financial risk on outcomes, such as MNE stock market value, in the strategy and international business literature although there appears to be a growing interest in this phenomenon among managers (Miller, 1998). The concepts of financial and economic uncertainty are broad, encompassing fluctuations in the overall level of economic activity and prices. To date, most studies have examined the extent of foreign exchange risk and the management practices used to deal with this exposure (Miller and Reuer, 1998). Further, the small amount of research that has assessed the impact of economic and financial exposure on performance has resulted in decidedly mixed findings. Uhlenbruck and De

Castro (2000), for example, analyzed 170 privatization acquisitions of Central and Eastern European businesses by Western firms and found that returns on assets and sales were higher on average in more economically volatile countries (i.e., in Russia versus less economically risky East Germany). On the other hand, Glaum, Brunner, and Himmel (2000) discovered that corporate exposure to the US dollar by 71 German corporations was inconsistent over the period 1974-1997. In addition, Bartov and Bodnar (1994), and Choi and Prasad (1995) both found little support for the hypothesis that the share prices of US firms are systematically influenced by exchange rate changes. Taken together, researchers have not yet reached a common understanding of the effect of financial and economic risk on the MNE.

As summarized in Table 1, the majority of what has been discovered about MNE behavior and performance derives from studies that have isolated either JVs (e.g., Merchant and Schendel, 2000), acquisitions (e.g., Uhlenbruck and De Castro, 2000), or have considered only one type of foreign risk exposure (e.g., Barkema, Bell, and Pennings, 1996, Cosset and Suret, 1995, Li and Guisinger, 1991) and only occasionally two elements of country risk (e.g., Reuer, 2001). As suggested by Brouthers (1995) and Miller (1992), however, actions taken to minimize one type of risk—an element of economic risk such as exchange-rate volatility for example—may actually increase exposure to another type of risk, such as political risk. While some researchers have attempted to address this issue by developing more inclusive, although subjective, measures based on managerial perceptions of uncertainty (see e.g., Brouthers, 1995, Miller, 1992, 1993), our intention is to examine objective measures of theoretically distinct elements of foreign exposure. This study, therefore, was designed to consider both direct investment entry modes available to MNEs (i.e., JVs and wholly-owned modes) in the context of a more complete set of distinct and separate elements of foreign risk exposure (i.e., economic, financial, political, and cultural) than has been considered in prior research.

insert Table 1 about here

CONCEPTUAL DEVELOPMENT AND HYPOTHESES

The effects of economic risk, financial risk, and entry mode on FDI outcomes. Managers' attempts to avoid economic risks underlie, in part, the noted "home bias" in economic activity (McCallum, 1995). One explanation that has been advanced in the literature to explain why there is both a lagged response to exchange rates as well as a disproportionately large dampening effect of physical distance on economic activity has to do with information discontinuities (Rangan, 2000). In the pursuit of new economic opportunities, firms engage in a process of search for potential exchange partners and deliberation on the quality of what is to be exchanged and the manner in which obligations will be discharged in the future. Within this process, physical distance and the existence of national borders still engender sharp information discontinuities for most firms and their managers (Nordstrom and Vahlne, 1994). Search and deliberation become, therefore, more challenging given that the increased difficulty and cost to acquire the potentially scant information and the more risky the outcome expected to be (Aharoni, 1966). As a result, countries of low information cost for US MNEs (e.g., Canada) tend to attract a disproportionately large share of US foreign investment; in fact, these low information cost countries typically continue to be prominent among the activities of an MNE even after the firm has expanded in more disparate countries (Kravis and Lipsey, 1980).

While the avoidance of uncertain international economic and financial environments is clearly an option for managers, prior research has found that exposure to foreign markets—particularly those that may be perceived initially as being very risky—is positively associated with firm performance. According to Pantzalis (2001), for example, the average market valuation (i.e., Tobin's *q*) of MNEs with operations in less developed economies is significantly higher than that of MNEs whose subsidiaries are not located in developing regions. On this basis, most shareholders would prefer that

firms attempt to appropriate the value of their proprietary assets even in economically uncertain markets. Managers, on the other hand, would prefer to try to find ways to overcome uncertainties and mitigate risks to take advantage of these latent economic opportunities.

A prominent method that managers use to deal with host country economic uncertainty is to increase their connections with other firms to share risk (Gatignon and Anderson, 1988). In fact, JVs have been shown to be an effective device for reducing the uncertainties that arise from unpredictable demand conditions by improving market access, reducing innovation time-span, and by combining technologies (Hagedoorn, 1993). While JVs may achieve the MNE managers' objectives of mitigating risk, this behavior may not be completely aligned with shareholder preferences. This agency problem stems from the fact that managers cannot diversify their employment risk whereas the individual shareholder can diversify investment risks. The preferences of shareholders would be to be exposed to larger risk exposures if there exists the real potential for proportionately larger gains from the MNE's proprietary assets. Thus, in the case where these intangible assets are easily transferable across borders, JVs would be increasingly unattractive to shareholders.

Prior research has found that strong technical assets predispose MNEs to seek full control (Gatignon and Anderson, 1988) and that technologically more advanced firms are less likely to use JVs (Smarzynska and Wei, 2000). Thus, greenfield investment is the optimal mode of entry when there is a technological gap between the host country firms and the MNE (Mueller, 2000) and is usually preferred by MNEs entering into less developed markets (Meyer, 1998). In fact, the use of JVs in foreign manufacturing operations by US MNEs appears to be an inverse function of the firm's relative size in its industry (Stopford and Wells, 1972) and firms that are industry leaders tend to have fewer JVs than do their smaller, "non-dominant" rivals (Franko, 1989). Further, firms that enter into JVs come disproportionately from the ranks of smaller firms with lower market shares who often have

not clearly differentiated their products from industry leaders (Franko, 1989). The announcement of a JV may be perceived, therefore, to be a negative signal to investors that the firm's proprietary assets are not sufficiently strong to warrant FDI. Prior research appears to support this reasoning as it has been often found that overall investor reactions to JVs with foreign firms is negative (see e.g., Chung, Koford, and Lee, 1993), given that the intended intraorganizational synergies that underlie MNE value creation are difficult to realize through JVs (Stopford and Wells, 1972). In line with this argument, the following hypotheses are suggested:

Hypothesis 1: Investors will react more positively to the announcement of a wholly-owned subsidiary than a joint venture in markets of greater economic risk.

Hypothesis 2: Investors will react more positively to the announcement of a wholly-owned subsidiary than a joint venture in markets of greater financial risk.

The effect of political risk and entry mode on FDI outcomes. Given that the economic and financial attractiveness of a foreign market can often be negated by political realities (Simpson, 1984), it is important to understand the impact of politics on FDI choices. While the theoretical literature has suggested that a government's inability to enter into long-term commitments should be surmountable [e.g. it can offer fiscal incentives prior to the investment like upfront subsidies or short-run tax holidays (Persson and Tabellini, 1990)], research has generally supported the view that political stability and a credible commitment to the maintenance of property rights increases the attractiveness of investment (Lee and Mansfield, 1996).

While political risk appears to have decreased in many markets (Diamonte, Liew, and Stevens, 1996), foreign firms are often at greater risk when making an investment that threatens local incumbents. A local firm's strong connections with local political actors can be used to influence a malleable host country government to act in their favor (Zelner and Henisz, 1999). Investors are, therefore, wary of locating facilities in politically hazardous countries (Delios and Henisz, 2001) and

are more likely to enter countries where the policy regime is relatively easy to predict (Loree and Guisinger, 1995).

Although to decline investment opportunities in nations with high levels of political uncertainty is always an option available to managers, prior research has found that diversification among politically risky countries can be attractive as it improves the risk-return characteristics of optimal portfolios. The most striking benefit of the inclusion of politically risky countries in an international portfolio has been shown by Cosset and Suret (1995) to be a reduction in overall portfolio risk. Given that investing in politically risky countries holds out opportunities for success, a key question facing the MNE, therefore, is the choice of entry mode to best deal with this risk.

JVs are commonly used when local regulations require them (Fladmoe-Lindquist and Jacque, 1995) or when assistance is needed in dealing with the host government (Teece, 1986). When bureaucratic corruption is prevalent, for example, firms tend to shift towards JVs (Smarzynska and Wei, 2000) since corruption makes the local environment less transparent, increasing the value of a local partner to a foreign investor. In general, where information is difficult and expensive to come by, and in host country environments in which requirements for adaptation and information are greater (e.g., less developed and socialist countries), the appropriateness of an MNE forming a JV is reinforced (Beamish and Banks, 1987).

A central problem with the JV mode, however, is that the goals of the partners might well be incongruous due to the divergent stakeholder interests including those of the host government (Boiset and Child, 1988). If the foreign firm desires to lower labor costs, for example, host governments may prefer to maximize the local benefits, a practice known in China as “milking the JV” (Shan, 1991). In addition, foreign investors with sophisticated technology may worry about technological leakage and are thus less inclined to form a JV (Smarzynska and Wei, 2000). Moreover, as local political hazards

increase, the potential that the host-country JV partners will manipulate the political systems for their own benefit at the expense of the MNE increases as well, thus favoring wholly-owned market entry modes (Henisz, 2000). The choice of wholly-owned subsidiaries (WOS) may also serve as a signal to the investment community of strong managerial capabilities, the result of experience and capability to mitigate political hazards (Delios and Henisz, 2001). Based on these arguments, the following hypothesis is put forward:

Hypothesis 3: Investors will react more positively to the announcement of a wholly-owned subsidiary than a joint venture in markets of greater political risk.

The effect of cultural distance and entry mode on FDI outcomes. The ability of the MNE to transfer capabilities has become a fundamental strategic imperative (Nohria and Ghoshal, 1997), yet expertise and technical know-how are more difficult to exploit across diverse cultural contexts (Bartlett, 1986). Cultural uncertainties result from the difficulties inherent in predicting the likelihood and direction of collective action when people are faced with discrepancies between their own values and those embodied in or enacted by the institutions in their lives (Dunn, 1983). As cultural distance increases, the challenges for the organizational control system become more difficult and expensive potentially leading to agency problems (Roth and O'Donnell, 1996) since the local interests of subsidiaries may not always be completely aligned with the MNE as a whole (Nohria and Ghoshal, 1994).

As MNEs expand, they are inherently exposed to increasing cultural risk, although MNEs attempt to mitigate this process by expanding within more familiar settings (Delios and Henisz, 2001, Johansson and Vahlne, 1977). In addition, as MNEs establish themselves in culturally uncertain environments, they often choose the JV mode (Gatignon and Anderson, 1988, Kogut and Singh, 1988) in an effort to seek expertise on local conditions (Yoshino, 1976). Thus, the received view suggests that the performance of JVs versus WOSs should be superior in environments of greater

cultural distance. The counter argument advanced here, however, is that investors prefer the wholly-owned mode over JVs for several reasons. Given that cultural distance leads to basic differences in organizational design and competitive strategy (Biggart and Guillen, 1999), the JV form is often not conducive to a high degree of product-exchange and trade with home-country or other parts of an MNE system (Guillen, 2001). Further, entry through WOSs may avoid the post-merger indigestion that is often associated with JVs (Kogut and Singh, 1988) as a result of problems of imposing management systems and redesigning marketing policies (Anderson and Gatignon, 1986). In addition, firms have a strong economic incentive to avoid JVs since wholly-owned modes allow the firm to maximize the returns available on its ownership-specific advantages.

From an agency perspective, although the MNE's management may have an incentive to minimize cultural risk by entering into a JV, the goals of the MNE's shareholders are often better served via modes that allow full control over their valuable internal assets. To this end, prior research has found that that investors are less likely to respond positively to JV formation between firms that have extensive international experience (Hu, Chen, and Shieh, 1992). Further, the findings of Barkema et al., (1996), have suggested that when an MNE has assumes greater equity control over a foreign operation, the longevity of these foreign entries is enhanced. Taken together, these arguments suggest that JVs are a natural managerial response to cultural risk but that, in light of the well known problems with JV operation (see e.g., Inkpen and Beamish, 1997), these entry modes are often regarded as a solution that is transitional at best that can rarely create competitive advantage (Porter, 1990). Thus, MNE's FDI announcement of a venture into culturally distant markets via the wholly-owned mode could be seen as a positive signal of managerial competence, international experience, and the presence of strong internal assets. Based on this reasoning, the following hypothesis is suggested:

Hypothesis 4: Investors will react more positively to the announcement of a wholly-owned subsidiary than a joint venture in markets of greater cultural distance.

METHODS

Data. The data used in this study was derived from several sources, the primary source being the annual surveys published between 1986 and 1997 by *Kaigai Shinshutsu Kigyou Souran*, a publication of Toyo Keizai Shinposha (Toyo Keizai, 1999), a major supplier of archival data on Japanese firms. The annual surveys identify the parent MNE(s) and details on the FDI including entry mode, location, and timing. The stock market's reaction to the FDI announcements was determined by deriving the precise date on which each given investment was announced by searching the Lexus-Nexus data base for the first report of the project in the English language Asian press. On this basis, we found announcements for 474 investments, 259 of which were JVs and 215 were WOSs[3]. We also excluded those firms for which we did not have stock price information for 180 days preceding and following the announcement. This screen left 344 investments including 164 JVs and 132 WOSs.

These firm-level data were supplemented by the International Country Risk Guide's (ICRG) measures of country-level risk that are published monthly by Political Risk Services. These data have been used in prior empirical research (e.g., Diamonte, et al., 1996, Heaney and Hooper, 1999) and also are used by over 80% of the world's largest global companies (as ranked by Fortune magazine) to assist in their investment decisions; therefore, these data are considered to be valid and reliable. In addition, various firm-level and industry-level data for the control variables were obtained from Datastream and The Analyst's Guide (Daiwa Institute of Research, 1999), respectively.

Variable Measurement

Cumulative Abnormal Returns (CAR). The dependent variable was derived using an event study methodology. We estimate the relationship between a firm's stock price and the market index

[3] An investment is considered wholly-owned if the percent ownership retained by the Japanese parent is 95% or greater; all other shared-ownership investments were classified as JVs.

over the period from 180 to 30 days before the announcement using the model: $r_{i,t} = \alpha + \beta r_{m,t} + \varepsilon_{i,t}$ where $r_{i,t}$ is the return for the firm making the announcement (firm *i*), $r_{m,t}$ is the return on the market index, β is the estimated relationship between firm *i*'s return and the market return over this period, and $\varepsilon_{i,t}$ is the residual. We compare the resulting expected price performance to the actual performance immediately surrounding the announcement of the FDI (for a full and detailed explanation, see McWilliams and Siegel, 1997). The abnormal component of the market's reaction to these announcements was estimated using daily returns calculated for each of the MNEs using price and dividend information from Datastream, market information from the Nikkei 225 index, and the 3-month Euro-yen interest rate as a proxy for the Japanese risk-free rate.

To ensure that we have identified the abnormal returns associated with the announcement, we chose an event window long enough to capture the impact of the event but short enough to exclude confounding effects; we considered several windows that allowed for the possibility that the FDI announcement information arrived in the Japanese language press shortly before the English language press as well as windows that allowed the Japanese market sufficient time to digest the information and incorporate it into prices. Although all windows tested yielded substantively the same results, we present only the results for an 8-day window (i.e., t - 2 days to t + 5 days) as this seemed the most reasonable in our judgment to allow information to flow and be digested. Within our 8-day window, abnormal returns were calculated according to the following equation: $AR_{i,t} = r_{i,t} - E[r_{i,t}]$ for $t \in [-2, +5]$ where $E[r_{i,t}]$ is the expected return for the firm's stock based on our estimated model: $E[r_{i,t}] = a + br_{m,t}$. Further, we were careful to ensure that there were no other major announcements in the English language press within 30 days of the FDI announcement and we considered various window widths to ensure that our results were robust.

To determine the statistical significance of these abnormal returns we use the cumulative abnormal returns (CAR) around the announcement: $CAR_i = \sum_{t=-2}^{5} e_{i,t}$ where $e_{i,t}$ is the estimated abnormal return. If the market believes the announced investment will increase the value of the firm, the CAR for event *i* would be greater than zero. The statistical significance of the CAR was determined using the *J*-statistic: $J = \left(\frac{N(L-4)}{L-2}\right)^{1/2} \overline{SCAR(L)}$ where N is the number of events, L is the number of days in the event window, and SCAR(L) is the average of the scaled CAR defined as: $\overline{SCAR(L)} = \frac{1}{N}\sum_{i=1}^{N} CAR_i / \sigma_i$ where σ_i is the standard deviation of the $e_{i,t}$'s in the event window. Since these test statistics may be sensitive to outliers, as a robustness check we perform a non-parametric sign test that compares the percentage of positive CAR to what we would expect if there were an equal probability of observing a positive or negative CAR. The results of this test were virtually identical to the *J*-statistics reported below, thus confirming their validities, but are not reported here to conserve space.

Political Risk. Our political risk variable is taken from ICRG for each country. These ratings are composites of a number of key factors that reflect the probability of both political as well as policy change within a given country. These Political Risk key factors include economic expectations versus realities, economic planning failures, political leadership, external conflict risk, corruption in government, military in politics, organized religion in politics, law and order tradition, ethnic tensions, political terrorism, civil war risk, political party development, democratic accountability, and bureaucracy quality. Each of these subcomponents is assigned a score on a 100-point scale with higher

scores indicating less risk and the final rating is obtained by summing up the weighted values of each subcomponent.[4, 5]

Financial Risk. Our financial risk measure is ICRG's assessment of a country's ability to finance its official, commercial, and trade debt obligations. The aggregate measure is obtained by summing the weighted 100-point scores of each element where the lower the risk point total the higher the risk. To determine Financial Risk, the following components were considered: loans in default or unfavorable loan restructuring, delayed payment of suppliers' credits, repudiation of contracts by government, losses from exchange controls, and expropriation.

Economic Risk. The economic risk measure is based on ICRG's collection of key elements, each on weighted 100-point scales that measure the health of a country's economy. Economic Risk is determined by ICRG by assigning risk points to the following components: annual inflation, foreign debt service as percent of GDP, international liquidity as months of import cover, foreign collection record, current account as percent of exports of goods and services, and parallel foreign exchange market indicator.

Cultural Distance. Our measure of cultural risk (i.e., cultural distance) adopts Kogut and Singh's (1988) index of cultural distance which is based on the deviation along the four dimensions of Hofstede's (1980) framework. The Cultural Distance index is represented algebraically as: $CD_k = \sum_{i=1}^{4} \left\{ \left(I_{i,k} - I_{i,Japan} \right)^2 / V_i \right\} / 4$ where CD_k is the cultural differences of the k^{th} country from Japan, I_{ik} represents the index of the i^{th} cultural dimension and the k^{th} country, and V_i is the variance of the index of the i^{th} dimension.

[4] Detailed information on the ICRG rating methods can be found online at http://www.icrgonline.com/icrgMethods.asp.

[5] To ensure item and construct reliability and validity, we examined our measures using a LISREL confirmatory factor analysis. The test results indicated that all measures were acceptable (details are not reported in detail to conserve space).

Proprietary Assets. Since it is important to account for MNEs' Proprietary Assets (see e.g., Dess, Gupta, Hennart, and Hill, 1995), these assets were measured by the capitalized value of research and development, goodwill, patents, trade marks, deferred charges, formation expenses and concessions, as reported by Datastream in the year of the FDI announcement.

Industry Profitability. Industry Profitability influences firm performance and was controlled using Datastream's industry average returns in the 6-month period immediately preceding the announcement. This measure compares the industry return in firms' primary areas of business (following e.g., Tallman and Li, 1996) relative to the overall Japanese market.

Firm Size. Since Firm Size may boost performance through, for example, facilitating access to lower cost of capital (Chang and Thomas, 1989), this variable was measured using the logarithm of the parent firm's annual sales, as obtained from Datastream, in the year preceding the FDI announcement.

Capital Structure. Capital Structure (i.e., the debt-to-total capital ratio) has been argued to affect firm performance (Jensen, 1989) and, therefore, it was included as a control. We use the ratio of debt-to-total capital obtained from Datastream.

International Experience. Several measures of International Experience were included as controls, all derived from the Toyo Keizai survey, since prior research has indicated that this factor increases the skill with which a firm's managers use internal reservoirs of knowledge and information (Pennings, Barkema, and Douma, 1994). These effects were captured by measuring the firm's logged cumulative experience in a given country and the MNE's average subsidiary age. An MNE's industry experience was also controlled through the logged cumulative years within a given 3-digit SIC.

International Involvement. Since greater International Involvement in foreign markets influences firm performance (Tallman and Li, 1996) this effect was controlled by measuring firms' foreign exchange reserves divided by annual sales.

Unobserved Heterogeneity. The probability of successful FDI may be influenced by Unobserved Heterogeneity in firm-specific characteristics and this effect was operationalized using Return on Assets since financial results reported in a prior period are a good indicator of internal resources and capabilities.

RESULTS

Summary Statistics. As summarized in Table 2, a bivariate correlation analysis reveals that annual sales is negatively correlated with the size of foreign exchange reserves suggesting that Firm Size and International Involvement may be measuring similar things. Further, Firm Size is positively correlated with country experience and with industry experience indicating that size and experience also overlap. Table 2 also shows a positive correlation between Economic Risk and Political as well as Financial Risk in addition to a positive correlation between Financial and Political risk. These statistics suggest that our risk factors are associated. Each of the correlations noted are, however, low to moderate indicating that the reliability of our statistical testing procedures is not threatened.

insert Table 2 about here

Influence of FDI announcements on CAR. Table 3 demonstrates the statistical significance of the CAR with an 8-day window around the FDI announcement. As shown in Model 1, the market appears to view FDI announcements positively ($J = 4.89$, $p < 0.001$) with WOSs being somewhat more positively viewed as compared to JVs ($J = 3.37$, $p < 0.001$ versus $J = 1.79$, $p < 0.1$, respectively). Since our four hypotheses are framed in the context of a comparison of WOSs and JVs, this is a

preliminary test suggesting that the market does, in general, appear to react more favorably to the announcement of wholly-owned FDI.

insert Table 3 about here

To understand better the possible impact of our different risk factors, we analyze differences across regions and compare the market reaction to announced FDI in each of the major geographical regions. In Model 2, for example, we find that FDI is viewed more positively in Asia (J = 3.80, $p < 0.001$) and North America (J = 5.95, $p < 0.001$) than Europe (J = -0.88, $p > 0.1$). Further, we see in Model 3 that JVs are viewed positively in Asia (J = 3.16, $p < 0.001$), but are viewed less positively in Europe (J = 0.95, $p > 0.1$) and in North America (J = -1.81, $p < 0.1$). On the other hand, for WOSs in Model 4 we see they are viewed very positively and significantly in North America (J = 7.01, $p < 0.001$), but there is no statistically significant market reaction in Europe (J = -1.22, $p > 0.1$) or Asia (J = -0.28, $p > 0.1$). These results suggest that there is, in fact, a significant role being played by the country risk environment in the market reaction to FDI. More precisely, it appears that the market views FDI most positively in countries that are geographically and culturally less distant from Japan (i.e., Asian countries) and are targeted towards large domestic markets. This view is further supported by the observation that JVs are only viewed positively by the market in Asia where the similarities between cultures and geographic proximity may facilitate JV operation. On the other hand, the only market for which WOSs were viewed positively was North America where the markets are large and the regulatory infrastructure is stable, encouraging investment. These results are generally supportive of our hypotheses since we find that the market reaction to announced FDI through a WOS is significantly more positive than the reaction to announced entry by JV.

Since our fundamental concern is with the market reaction to the different modes of FDI entry, we conduct some preliminary tests of our four hypotheses. First, we unpack the FDI announcements

by entry mode and our results show differences in the market reaction to each type of country risk. We find in Models 6 and 7, for example, that JVs and WOSs are both viewed more positively for smaller MNEs (J = 2.67, p < 0.01 versus 0.53, p > 0.1 and J = 3.70, p < 0.01 versus 1.31, p > 0.1 respectively). This suggests an overall Firm Size effect on the market reaction to FDI by entry mode.

The market reaction to FDI announcements is positive, overall, regardless of the levels of Political and Financial risk (see Model 8). However, the market reaction to announced FDI is more positive when in countries of higher Economic Risk (J = 4.91, p < 0.001 versus 2.56, p < 0.05) or for investments of lower Cultural Distance (J = 5.91, p < 0.001 versus -0.49, p > 0.1). These results suggest that the levels of Political and Financial Risk are not important factors in the market's perception when all FDI are considered together. Economic Risk and especially Cultural Distance, on the other hand, are very significant in the market's reaction to FDI. Further, Model 9 suggests that JVs are viewed more positively when the level of Political Risk is low, Economic Risk is high (J = 2.93, p < 0.01 and 3.86, p < 0.001, respectively), without regard to the levels of Financial Risk and Cultural Distance. On the other hand, in Model 10 we see that WOSs are viewed by the market more positively when the level of Political Risk is high (J = 4.64, p < 0.001), Economic Risk is low (J = 3.60, p < 0.001), Financial Risk is high (J = 3.60, p < 0.001) with low Cultural Distance (J = 5.25, p < 0.001). We also see that the market reaction to a WOS is more positive and statistically significant as compared to a JV when the levels of Political and Financial Risk are high, but is lower when the levels of Economic Risk and Cultural Distance are high. These patterns in market reactions suggest that investors prefer JVs when the level of Economic Risk is high—evidence that counters Hypothesis 1—but that the stock market prefers WOSs when the level of Financial Risk is high, providing support for Hypothesis 2. Further, market reactions suggest that WOSs are preferred when the level of Political Risk is high, a result that provides support for Hypothesis 3. On the other hand, when the Cultural

Distance is high, JVs are received more positively by investors, providing some disconfirming evidence to our Hypothesis 4.

Regression Analysis of Cumulative Abnormal Returns. Since the market reaction is likely to depend on a wide variety of factors, we supplement our above examination of the *J*-statistics to include tests that estimate the impact of other factors on the investor reactions. To do this we start with an estimation of the standard model: $\text{Reaction}_i = \beta' x_i + \delta \text{FDIMode}_i + \varepsilon_i$ where $Reaction_i$ is the CAR of the FDI announcement for firm i, x_i is the vector of variables that we propose helps to explain the expected outcome of the given FDI, and $FDI\ Mode_i$ is a dummy variable set to 1 for JV and 0 for WOS and ε_i is a residual term $\sim N(0, \sigma^2_\varepsilon)$.

Given that the error term, ε_i, will be systematically related to factors we may have missed in our set of explanatory variables, x_i, and the choice of FDI entry mode is endogenous to the firm our estimates of market reaction may be biased [for a discussion see Shaver (1998)]. To correct for this possibility, we use a modification of the two-step procedure originally proposed by Heckman (1979), requiring that we first estimate what factors may have influenced the firm's choice of FDI entry mode using a Probit model: $\text{FDI Mode}_i = \gamma' w_i + u_i$ where $FDI\ Mode_i$ is a dummy variable, and w_i is a vector of firm specific and country risk factors. Since a systematic relationship between ε_i and u_i may exist, our specification for the market reaction may be misspecified and in need of some adjustment. This issue can be addressed by using the estimated value of γ to estimate the following "treatment model": $\text{Reaction}_i = \beta' x_i + \delta \text{FDI Mode}_i + \theta\lambda_i + \eta_I$ where $\lambda_i = \phi(\gamma' w_i) / \Phi(\gamma' w_i)$ if $FDI\ Mode_i = 1$, $\lambda_i = -\phi(\gamma' w_i) / [1 - \Phi(\gamma' w_i)]$ if $FDI\ Mode_i = 0$, and $\phi(\gamma' w_i)$ and $\Phi(\gamma' w_i)$ are, respectively, the probability density function and cumulative distribution function of the standard normal distribution defined at $\gamma' w_i$. Since our hypotheses suggest that β is not the same across FDI entry modes, we then estimate versions of

the above equation for each entry mode, providing a better analysis of the factors that influence the market reaction to FDI announcements.

The next step is to estimate a Probit model to determine the statistical significance of our various risk factors on the entry mode decision. We find in Table 4 that individually all of the estimated coefficients of the risk factors (i.e., Economic, Financial, Political, and Cultural risks) are statistically significant. Because the estimated coefficients cannot be interpreted in the standard fashion and our use of the *t*-ratio to determine statistical significance may overstate the true level, we concentrate on the coefficient signs and use the indicated statistical significance as a guide. In each case, we find the probability of entering by means of a JV decreases as the level of country risk decreases.[6] The consistency of the signs across these factors suggests that our measures of risk play a significant role in the choice of entry mode. However, when all four measures are inserted into the model simultaneously, we find that the majority of the explanatory power for FDI entry mode is concentrated on the Political Risk factor followed by Economic Risk, and Cultural Distance with Financial Risk being much less significant. We find a high degree of predictive ability for our model—ranging between a predictive accuracy of 64% for the model with just the Cultural Distance and a high of 73% for just Political Risk.

insert Table 4 about here

Since we are interested in the market's evaluation of the announced FDI given the mode of entry, Table 5 presents the results from a test of the extent to which our environmental risk factors explain investor reaction while controlling for FDI. In this table, we present the results from the standard test of market reaction to the announced FDI controlling for the entry mode given our set of risk factors. These results demonstrate that the market generally reacts positively to the announcement of FDI by JV, but they are not statistically significant. It appears, nonetheless, that the market reacts

[6] Recall that higher country risk values indicate lower risk and that higher cultural distance values reflect greater distance.

positively to announced FDI as the level of risk decreases, as was expected.[7] Looking at the components of Economic, Financial, and Political Risk, in Table 6 we see that most of the subcomponents have a minor impact. For Economic Risk only the *state of the current account* is significant, whereas none of the Financial Risk subcomponents are significant, and only the *risk of external conflict* is significant of the Political Risk subcomponents.

insert Tables 5 and 6 about here

Table 7 extends our results by considering the possible interaction between the mode of FDI entry and the level of risk ($Reaction_i = \beta' x_i + \delta(FDIMode_i * Risk\ factor_i) + \eta_i$). The estimation of these models for each risk factor independently does not reveal statistically significant results; however, when all risk factors are considered together, some statistically significant relationships appear. For example, we find that Economic and Political Risk have significant relationships to the market's reaction to FDI. The market reacts more positively to the announcement if the Economic Risk is low but when the entry mode is a JV, this impact is negated. As a result, the market appears to prefer JVs when the level of Economic Risk is higher. The market appears to react positively to the announced FDI as the level of Political Risk is lower but less positively if the entry mode is a JV. As a result, it appears that investors prefer JVs when the level of Political Risk is higher. The results for the other risk factors are not statistically significant but based on the signs of their coefficients, it appears that the market prefers JVs when Financial Risk is lower. Thus, we see that there is a significant interaction between the mode of FDI entry, Economic Risk, and Political Risk and the significance of these results is similar to those suggested in Table 4 for the factors influencing FDI choice.

insert Table 7 about here

[7] Although not reported in detail in this manuscript, we also investigated the possible nonlinear impact of our country risk factors on firm CARs by allowing a dummy variable to enter in the cases where the values for the risk factors are either above or below the median value. We found that only political risk has a different relationship with firm CAR; the market reaction to FDI announcements when the level of political risk is low is significantly better than when it is high.

In Table 8, we consider the interaction between the different components of our risk factors and the mode of FDI entry given that relationships may have been lost through aggregation. For Economic Risk, we find a significant role played by *foreign collection record* and the *current account* where the market reacts positively to the announced FDI when these levels improve but are negated when the mode of entry is a JV. Even though many of the other Economic Risk subcomponents were not statistically significant, their signs were not consistent with this finding. This suggests that the individual Economic Risk subcomponents do not cause investors to prefer WOS over JVs when these risks are higher. While we do not find a significant role for any of the subcomponents of the Financial Risk, a large number of Political Risk factors are highly related to the market reaction to the announced FDI. The market reactions demonstrate that the market prefers JVs to WOSs when there are increases in the risks associated with *economic expectations*, *military in politics*, *religion in politics*, *political terrorism*, *civil war risk*, *bureaucracy quality*, and decreases in *law and order*. These relationships are inconsistent with our hypothesis that JVs are preferred to WOSs as the level of Political Risk increases.

insert Table 8 about here

The previous test illustrated how entry mode and risk interact; however, Shaver (1998) suggests that endogeneity of FDI modal choice may haven an impact on our results. As a result, Table 9 presents the results from the "treatment" model which corrects for this potential bias. In this table, we clearly see that the most significant factor is the λ coefficient that represents the endogeneity. The different risk factors do not have statistically significant explanatory power for the market reaction to the FDI announcement, nor does the mode of FDI entry despite the significantly increased R^2 values for these regressions when compared to those in Tables 5 and 6.

insert Table 9 about here

One of the weaknesses of the treatment model is that it forces the values of the coefficients to be the same regardless of entry mode. Although the results in Table 9 allowed the market reaction to differ for the risk factors based on entry mode and this provided valuable insight, it is possible that the market reacts differently to the announcement of different modes of FDI entry based on the exposure to these risks. As shown in Table 10, we estimate our treatment model separately by FDI mode, finding that the market reacts differently to an FDI announcement depending on the entry mode and this does, in fact, change with the exposure to the different types of risk. The results for the estimations of the JVs (the left-hand panel of Table 10), reveal marginal significance for Financial and Political Risks, but the major impact on market reaction derives from the firm's *capital structure* where the market reacts more positively to JV announcements if the firm is more highly levered. However, we find that the market reacts most positively to WOS announcements as the level of Financial Risk decreases, but reacts negatively as the level of International Experience of the firm increases.

insert Table 10 about here

We come to similar conclusions when we consider the constituent components of our risk factors in Table 11. For Economic Risk, we find the market reacts more positively to a WOS as the country's *foreign collection record* improves (negatively to a JV in this case, but not statistically significantly), positively to both a JV and WOS as the *current account* improves and negatively to a JV as *foreign exchange restrictions* decrease. For Political Risk, the market reacts positively to both JV and WOS announcements as the *risk of external conflict* decreases, but the reactions to each entry mode differ across many other factors. Specifically, the market reaction to JVs are positive as the *level of political leadership* increases, *law and order tradition* decreases, but not significantly for WOS. On the other hand, the market reacts more positively to WOSs as the role of the *military in politics* is

lower, the *risk of civil war* is lower, and the *quality of bureaucracy* is lower, but these effects are not significant for JVs.

insert Table 11 about here

These results suggest that firms' entry mode decisions and different country risk factors have an impact on the market's reaction to the announced FDI. Due to entry mode endogeneity, it is difficult to assess these using simple techniques, thus we used a variety of different techniques to provide a more complete picture of the impact of different risk factors on both the FDI entry mode decision as well as the market's perception of the probability of success of the entry mode. Due to entry mode endogeneity, it is not surprising that our results have vastly different levels of significance across estimated models. When we start with the simple models, we find they have neither a large R^2 nor do the factors have statistically significant coefficients. However, as we consider models that more accurately allow the factors to have differential effects on the market reaction based on the entry mode, we find increasing statistical significance in our results. Thus it appears that we find that our factors play different roles in explaining the market reaction to the FDI announcement based on the mode of entry. We also find that the results allow us to investigate the role of our external risk factors on market's perception of the future value of different FDI, even after controlling for factors found to influence the value of FDI in other studies.

DISCUSSION AND CONCLUSION

The results in this study suggest that investors view MNE FDI in different ways depending on both the host country characteristics and the choice of entry mode. In general, our results indicate that the market views FDI positively, particularly for smaller MNEs. In fact, we find that the market views FDI announcements positively in countries in which Economic Risk is high, particularly when Cultural Distance is low. This Cultural Distance finding supports the mainstream view that the

increased risks of dealing across dissimilar cultures encourages and rewards JV formation above WOS modes (Barkema, et al., 1996, Barkema, et al., 1997, Barkema and Vermeulen, 1997).

Overall, however, the stock market does not view JVs in a positive light, preferring instead wholly-owned modes of entry in most environments. These results are consistent with some studies that have focused specifically on cooperative ventures and found that, in many cases, JVs do not have a positive impact on parent valuation (Chung, et al., 1993, Lee and Wyatt, 1990). Investments in which partial control is not relinquished to other firms are clearly preferred when Political and Financial Risks are high. Our results indicate that investors perceive dangers of cooperative ventures in politically uncertain environments. This result lends some support to the suggestion by Henisz (2000) and Shan (1991) that, as local political hazards increase, the potential that the host-country JV partner will manipulate the political system for their own benefit will also increase. This is not to suggest that MNEs are attracted to areas in which political unrest exists; instead, the results analyzed in this study suggest that under conditions of Politically Risk—assuming a business case can be made to justify investment—the stock market is more approving of WOSs than JVs.

At the same time, markets appear to recognize that, in certain environments, JVs are more suitable investment vehicles than are WOSs. Our results indicate that under conditions of high Economic Risk, for example, JVs are perceived by stock market investors to be superior modes of entry. Specifically, stock markets appear to view JVs favorably when in countries with a poor *foreign trade collection experience* (i.e., long delays for payment for imports and slow conversion by central bank of local into hard currency).

Caveats and Suggestions for Future Research. A central piece of this research was the concept of market response. A limitation of this research may be that this definition is too narrow, particularly for Japanese firms. Since firms may pursue multidimensional goals over time, MNEs may

be better viewed across a nexus of interests including various non-economic goals (e.g., employment stability, reputation enhancement, etc.). Future research could examine these alternative concepts of performance to determine whether they have a role in the relationships under study that may be particularly relevant in the context of Japanese organizations.

Since our sample is of large Japanese MNEs, another caveat is that the impact of FDI may be different in the context of Japanese firms as compared to MNEs from other countries-of-origin. In addition, our empirical results may be affected by the firms' processes of internationalization (i.e., incremental or through large leaps) and also by the way in which MNEs' subsidiaries are connected (e.g., pooled, sequential, or reciprocal) as per Thompson (1967). These issues may have important effects and can be addressed through longitudinal and case based studies, respectively. Finally, an important issue that was not addressed in this research is whether the ICRG measures of country risk capture these constructs well enough, notwithstanding the fact that these measures are well used in academic research and by large corporations. It may be that other factors play key roles and this empirical question can be addressed through future theoretical and empirical validation.

The findings reported in this study support the general assertion that FDI is a positive force in MNE economic growth. However, given that countries vary widely in their risk attributes, and that various entry modes are available to managers, this research indicates that MNE investors react differently to these varying combinations. Thus, the first contribution of this study is to provide a more nuanced assessment of country risk, including a fuller set of risk factors than has been simultaneously considered in prior research. A second contribution is that this research has examined these various country risk elements in the context of both possible modes of entry through direct investment, whereas prior research has generally chosen to consider either JVs or WOSs. A third contribution of this study is that it has examined a sample of non-Western firms—in contrast to the vast majority of

prior research on MNEs, which has been carried out on samples of Western-based firms, the US in particular. Research on Japanese MNEs continues to be clearly lacking given that Japan has long been the second largest economy and many of its organizations exert enormous influence on a variety of fronts. Finally, this research has added to our theoretical understanding of MNE by more carefully analyzing the "space assumption" suggested by Boddewyn and Brewer (1994) to be an area requiring greater focus.

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Table 1
Some Recent Studies on the Impact of Mode and Risk on "Performance"

		Entry Mode		*Foreign Risk Exposure*		
	Performance Measure	Joint Venture	Wholly-owned	Political Risk	Cultural Distance	Economic Risk
Barkema and Vermeulen (1997)	entry longevity	✓	✓		✓	
Barkema, Bell, and Pennings (1996)	JV termination	✓	✓		✓	
Barkema, Shenkar, Vermeulen, and Bell (1997)	longevity	✓	✓		✓	
Bartov and Bodnar (1994)	share price					✓
Choi and Prasad (1995)	share price					✓
Cosset and Suret (1995)	stock returns			✓		
Datta and Puia (1995)	stock returns				✓	
Glaum, Brunner, and Himmel (2000)	market value					✓
Jorion (1990)	share price					✓
Li and Guisinger (1991)	termination	✓	✓		✓	
Merchant and Schendel (2000)	stock returns	✓		✓	✓	
Reuer (2001)	stock returns	✓		✓	✓	
Uhlenbruck and De Castro (2000)	RoA, RoS			✓		✓

Table 2
Mean Values and Bivariate Correlations

	1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**Mean**
1. Political Risk	1.000											74.5
2. Financial Risk	0.779	1.000										43.7
3. Economic Risk	0.428	0.361	1.000									37.8
4. Cultural Distance	-0.048	-0.204	0.224	1.000								3.1
5. Proprietary Assets(¥ mill)	0.105	0.075	0.003	-0.096	1.000							11.2
6. Industry Profit (RoA%)	0.135	0.167	-0.007	-0.033	-0.128	1.000						7.7
7. Firm Size (¥ billion)	-0.074	-0.069	0.038	0.055	0.126	-0.025	1.000					2.7
8. Capital Structure (D:E)	-0.022	-0.074	-0.020	-0.039	-0.102	-0.217	-0.099	1.000				0.7
9. Country Exp (years)	0.113	0.189	0.053	-0.077	-0.014	-0.006	0.512	-0.050	1.000			546.6
10. Average Sub Age (yrs)	0.092	0.040	0.031	-0.054	0.086	0.060	-0.299	0.193	-0.137	1.000		5.1
11. Industry Experience(yrs)	-0.077	-0.023	0.009	0.040	0.023	-0.091	0.230	-0.077	0.070	-0.067	1.000	30.1
12. International Involve (¥ mill)	0.089	0.085	0.025	-0.097	-0.001	0.069	-0.534	0.295	-0.207	0.243	-0.196	-12.1

Table 3

J-statistics of Cumulative Abnormal Returns

		Model 1		
All FDI		4.89***		
All WOS		3.37***		
All JVs		1.79†		
		Model 2	**Model 3**	**Model 4**
		All FDI	JVs only	WOS only
Asia		3.80***	3.16***	-0.28
Europe		-0.88	0.95	-1.22
North America		5.95***	-1.81†	7.01***
		Model 5	**Model 6**	**Model 7**
		All FDI	JVs only	WOS only
Large MNEs[8]		1.03	0.53	1.31
Small MNEs		6.84***	2.67**	3.70***
		Model 8	**Model 9**	**Model 10**
		All FDI	JVs only	WOS only
Political Risk:	High	3.94***	-1.68†	4.64***
	Low	4.07***	2.93**	0.90
Financial Risk:	High	3.06***	0.16	3.60***
	Low	3.08**	1.60	0.23
Economic Risk:	High	4.91***	3.86***	2.27*
	Low	2.56***	-0.77	3.60***
Cultural Distance:	High	-0.49	1.09	-3.67***
	Low	5.91***	1.42	5.25***

†p < 0.10; *p < 0.05; **p < 0.01; ***p < 0.001 (two-tailed tests)

Table 4

Probit Model for FDI Entry Mode with Country Risk Variables

	Model 1	**Model 2**	**Model 3**	**Model 4**	**Model 5**
Constant	-1.046	1.185	2.723	-2.878	1.959
Economic Risk	-0.047***				0.033***
Financial Risk		-0.074***			0.001†
Political Risk			-0.071***		-0.078***
Cultural Distance				-0.066***	-0.121***
Firm Size	0.177***	0.138***	0.151***	0.191***	0.168***
Intangible Assets	-0.748	-0.417	-0.176	-0.952	-0.307
Average Subsidiary Age	-0.125***	-0.106***	-0.066***	-0.136***	-0.068***
Country Experience	0.000***	0.002***	0.002***	-0.001***	0.001***
Industry Experience	-0.001***	-0.001***	-0.002***	-0.001***	-0.002***
International Involvement	1.728	2.413	2.233	1.385	2.122
RoA (Unobserved Heterogeneity)	-0.014***	-0.012***	-0.012***	-0.013***	-0.010***
Industry Profitability	0.438	0.128	-0.092	0.469	-0.097
Capital Structure	0.303**	0.092	0.167	0.347**	0.195
χ^2	25.16***	42.98***	64.36***	22.21*	66.92***
Percent Correctly Predicted	67.65	71.85	73.11	64.29	71.01

†p < 0.1; *p < 0.05; **p < 0.01; ***p < 0.001 (two-tailed tests)

[8] large versus small firms are those that are above versus below the sample median in terms of annual revenue.

Table 5

Regression of CAR against Country Risk Variables

	Model 1	**Model 2**	**Model 3**	**Model 4**	**Model 5**
Constant	-17.755	-16.115	-15.763	9.218	-0.317
Economic Risk	0.160				0.051
Financial Risk		0.074			0.113
Political Risk			0.048		0.016
Cultural Distance				0.276	0.389
JV	0.857	0.966	1.063	0.084	0.661
Firm Size	0.280	0.329	0.296	-0.194	-0.125
Intangible Assets	0.249	-0.074	0.037	-0.911	-1.889
Average Subsidiary Age	0.769	0.864	0.783	-5.823**	-6.198**
Country Experience	0.054	-0.021	0.009	0.034	-0.076
Industry Experience	0.495†	0.513†	0.522†	0.526†	0.560**
International Involvement	-6.001	-5.829	-5.407	-2.785	-4.925
ROA	0.045	0.042	0.044	0.048	0.046
Industry Profitability	1.401	1.731	1.674	0.938	1.594
Capital Structure	2.536	2.642	2.591	2.953	3.338
R^2	0.026	0.024	0.024	0.042	0.053

†p < 0.1; *p < 0.05; **p < 0.01; ***p < 0.001 (two-tailed tests)

Table 6

Regression of CAR against Individual Country Risk Components

Political Risk Subcomponents		***Financial Risk Subcomponents***		***Economic Risk Subcomponents***	
Constant	-22.264†	Constant	-18.96†	Constant	-27.629†
Econ Expect vs Realities	0.285	Loan Default/Restructuring	-0.33	Inflation	-0.592
Economic Plan Failures	-0.876	Delayed Payment	-0.51	Foreign Debt Service	-0.625
Political Leadership	0.593	Repudiation of Contracts	1.211	International Liquidity	0.323
External Conflict Risk	1.369**	Exchange Controls Losses	0.258	Foreign Collection Record	1.081
Corruption in Gov't	-0.177	Expropriation	0.031	Current Account	2.186**
Military in Politics	0.735			Parallel Foreign Exchange Market	0.109
Org. Religion in Politics	0.656				
Law & Order Tradition	-0.631				
Ethnic Tensions	-0.527				
Political Terrorism	0.067				
Civil War Risks	0.745				
Political Party Develop't	0.054				
Bureaucracy Quality	-0.517				
JV	0.622	**JV**	0.722	**JV**	1.207
Controls:		**Controls:**		**Controls:**	
Firm Size	-0.092	Firm Size	0.209	Firm Size	-0.061
Intangible Assets	-2.758	Intangible Assets	-1.05	Intangible Assets	-0.425
Average Subsidiary Age	1.889	Average Subsidiary Age	2.235	Average Subsidiary Age	0.241
Country Experience	0.288	Country Experience	0.149	Country Experience	0.685
Industry Experience	0.525†	Industry Experience	0.417	Industry Experience	0.688†
Internation Involvement	1.977	International Involvement	-2.72	International Involvement	-3.215
RoA	0.086	ROA	0.069	ROA	0.062
Industry Profitability	0.897	Industry Profitability	2.051	Industry Profitability	3.030
Capital Structure	3.020	Capital Structure	2.465	Capital Structure	3.222
R^2	**0.097**		**0.036**		**0.091**

†p < 0.1; *p < 0.05; **p < 0.01; ***p < 0.001 (two-tailed tests)

Table 7

Regression of CAR against Country Risk Variables

	Model 1	**Model 2**	**Model 3**	**Model 4**	**Model 5**
Constant	-17.290	-15.263	-14.683	9.277	-3.473
Economic Risk	0.145				-0.452†
Economic Risk*JV interaction	0.020				0.422†
Financial Risk		0.056			0.095
Financial Risk*JV interaction		0.013			0.655
Political Risk			0.034		0.793**
Political Risk*JV interaction			0.009		-0.423
Cultural Distance				0.258	-0.133
Cultural Distance *JV interaction				0.040	-0.333
Firm Size	0.289	0.345	0.313	-0.196	-0.038
Intangible Assets	0.208	-0.145	-0.006	-0.910	-2.215
Average Subsidiary Age	0.742	0.773	0.724	-5.811**	-6.352***
Country Experience	0.050	-0.018	0.011	0.034	-0.172
Industry Experience	0.496†	0.515†	0.522†	0.524†	0.525†
International Involvement	-5.997	-5.618	-5.201	-2.754	-6.708
ROA	0.045	0.041	0.043	0.049	0.035
Industry Profitability	1.398	1.669	1.593	0.913	1.854
Capital Structure	2.554	2.645	2.597	2.956	3.928†
R^2	0.025	0.023	0.022	0.042	0.095

†p < 0.1; *p < 0.05; **p < 0.01; ***p < 0.001 (two-tailed tests)

Table 8

Regression of CAR against Individual Country Risk Components

Political Risk Subcomponents		***Financial Risk Subcomponents***		***Economic Risk Subcomponents***	
Constant	-20.620†	Constant	-18.98†	Constant	-30.544*
EconExpectvsReality	-1.641†	Loan Default/Restruct	-0.74	Inflation	-1.573
Economic Plan Fail	0.389	Delayed Payment	-1.14	Foreign Debt Service	-1.244
Political Leadership	0.792	RepudiationofContracts	1.314	International Liquidity	1.510
Ext Conflict Risk	0.813	Exch Controls Losses	1.144	Foreign Collection Record	2.782**
Corruption in Gov't	0.641	Expropriation	0.027	Current Account	2.487***
Military in Politics	3.565***			Parallel Foreign Exchange Market	0.143
Org Religion in Polit	-1.312				
Law&Order Trad	2.877†	**Entry Mode Interact:**		**Entry Mode Interaction:**	
Ethnic Tensions	-1.238	*Loan Default/Restruct*	0.352	*Inflation*	1.551
Political Terrorism	-2.242†	*Delayed Payment*	1.116	*Foreign Debt Service*	1.192
Civil War Risks	5.977***	*RepudiationofContracts*	0.044	*International Liquidity*	-2.063
Political Party Devel	0.741	*Loss from Ex Controls*	-1.37	*Foreign Collection Record*	-2.904*
Bureaucracy Quality	-7.34***	*Expropriation*	-0.12	*Current Account*	-0.483
				Parallel Foreign Exchange Market	0.195
Entry Mode Interaction:					
Econ Expect vReality	1.878†				
Econ Plan Failure	-1.352				
Political Leadership	0.280				
Ext Conflict Risk	1.109				
Corruption in Gov't	-0.464				
Military in Politics	-3.52***				
Org Religion in Polit	2.376†				
Law &Order Trad	-5.50***				
Ethnic Tensions	0.854				
Political Terrorism	3.062†				
Civil War Risks	-6.67***				
Politic Party Dev	-0.843				
Bureaucracy Quality	8.255***				
Firm Size	-0.328	Firm Size	0.251	Firm Size	0.048
Intangible Assets	-1.902	Intangible Assets	-0.96	Intangible Assets	-0.484
Ave Subsidiary Age	3.234	Ave Subsidiary Age	2.210	Average Subsidiary Age	0.192
Country Experience	0.690*	Country Experience	0.154	Country Experience	0.685
Industry Experience	0.465	Industry Experience	0.424	Industry Experience	0.764**
International Involve	18.896	International Involve	-1.25	International Involvement	-8.628
RoA	0.115**	ROA	0.066	ROA	0.071
Industry Profitability	2.930	Industry Profitability	1.928	Industry Profitability	3.361
Capital Structure	2.882	Capital Structure	2.468	Capital Structure	3.120
R^2	**0.206**		**0.039**		**0.117**

†p < 0.1; *p < 0.05; **p < 0.01; ***p < 0.001 (two-tailed tests)

Table 9

Treatment Model Regression of CAR against Country Risk Variables

	Model 1	**Model 2**	**Model 3**	**Model 4**	**Model 5**
Constant	-8.552	-9.122	-17.121	8.599	2.524
Economic Risk	0.031				-0.185
Financial Risk		0.026			-0.118
Political Risk			0.102		0.229†
Cultural Distance				0.433	0.519
JV	0.307	0.556	1.228	-0.308	1.209
Firm Size	0.274	0.281	0.338	-0.303	-0.311
Intangible Assets	0.624	0.526	0.333	0.262	0.211
Average Subsidiary Age	-0.094	-0.084	-0.121	-1.042†	-1.124†
Country Experience	0.000	0.000	-0.003	0.003	0.000
Industry Experience	0.012	0.012	0.013	0.012	0.015
International Involvement	-0.827	-0.882	-1.060	1.080	0.993
RoA (Unobserved Heterogeneity)	0.031	0.030	0.032	0.032	0.029
Industry Profitability	-3.033	-2.953	-2.033	-4.682	-3.289
Capital Structure	2.159	2.214	2.394	2.324	2.330
Lambda	-1.299***	-1.016***	-0.943***	-1.719***	-1.006***
R^2	**0.297**	**0.301**	**0.304**	**0.347**	**0.362**

†p < 0.1; *p < 0.05; **p < 0.01; ***p < 0.001 (two-tailed tests)

Table 10

Regression of CAR against Country Risk Variables

	JV					**WOS**				
	Model 1	**Model 2**	**Model 3**	**Model 4**	**Model 5**	**Model 1**	**Model 2**	**Model 3**	**Model 4**	**Model 5**
Constant	9.863	19.657	18.774	13.135	16.423	-48.997**	-67.564**	-67.376***	-0.562	-35.908†
Economic Risk	0.056				0.167	0.316				-0.205
Financial Risk		-0.115			-0.07		0.515**			0.608**
Political Risk			-0.081		-0.078			0.337**		0.219
Cultural Distance				0.425	0.066				0.158	0.834
Firm Size	-0.471	-0.61	-0.539	-0.551	-0.568	1.354†	1.736**	1.614*	0.628	0.677
Intangible Assets	-10.83	-8.975	-10.57	-10.18	-10.20	0.146	-2.555	-2.431	1.443	-2.501
Average Subsidiary Age	-4.685	-4.416	-4.294	-5.218	-4.919	5.339	5.422	4.882	-6.369†	-8.432**
Country Experience	0.435	0.602†	0.549†	0.496	0.604	-0.591	-1.039†	-0.887	-0.87	-1.265**
Industry Experience	0.441	0.404	0.378	0.433	0.346	0.443	0.402	0.459	0.46	0.541
International Involvement	-25.52	-0.97	-10.99	-15.63	-17.22	-4.62	-6.421	-6.697	-3.927	-9.692
ROA	0.072	0.068	0.067	0.072	0.067	0.012	-0.031	-0.012	-0.038	-0.142
Industry Profitability	1.204	-0.04	0.131	0.013	-0.442	2.666	3.767	4.289	3.254	6.519
Capital Structure	4.716**	4.111†	4.287†	4.741†	4.454†	-1.904	-0.967	-1.444	-1.595	-0.969
R^2	**0.075**	**0.085**	**0.086**	**0.08**	**0.098**	**0.066**	**0.107**	**0.105**	**0.069**	**0.269**

†p < 0.1; *p < 0.05; **p < 0.01; ***p < 0.001 (two-tailed tests)

Table 11

Regression of CAR against Individual Country Risk Components

Political Risk Subcomponents			***Financial Risk Subcomponents***			***Economic Risk Subcomponents***		
Main Effects:	*JV*	*WOS*	**Main Effects:**	*JV*	*WOS*	**Main Effects:**	*JV*	*WOS*
Constant	8.397	-70.642**	Constant	18.116	-68.52**	Constant	4.581	-73.035**
Economic Expectations vs Reality	-0.161	-0.885	Loan Default/Restructuring	-0.596	-0.286	Inflation	-0.396	-1.596
Economic Planning Failures	-1.17	0.368	Delayed Payment	-0.218	-0.931	Foreign Debt Service	-0.229	-0.182
Political Leadership	1.035**	0.452	Repudiation of Contracts	0.931	0.924	International Liquidity	-0.426	1.526
External Conflict Risk	1.498***	1.321†	Exchange Controls Losses	-0.165	1.068	Foreign Collection Record	-0.302	4.375**
Corruption in Government	0.075	-0.195	Expropriation	-0.417	1.78	Current Account	1.849***	2.048†
Military in Politics	0.22	2.631**				Parallel Foreign Exch Market	-0.042†	0.127
Org Religion in Politics	0.431	0.66						
Law & Order Tradition	-2.289**	2.526						
Ethnic Tensions	-0.42	-1.525						
Political Terrorism	0.824	-0.927						
Civil War Risks	-0.929	8.175***						
Political Party Development	-0.55	1.894						
Bureaucracy Quality	1.091	-7.5***						
Firm Size	-0.677†	0.197	Firm Size	-0.704†	1.519*	Firm Size	-0.839	1.424
Intangible Assets	-16.021	-3.06	Intangible Assets	-10.622	-2.613	Intangible Assets	-8.053	-1.633
Ave Subsidiary Age	-2.918	9.117*	Ave Subsidiary Age	-3.031	6.908	Average Subsidiary Age	-5.797	6.448
Country Experience	0.687*	0.654	Country Experience	0.756**	-0.575	Country Experience	1.162	-0.405
Industry Experience	0.472†	0.307	Industry Experience	0.327	0.31	Industry Experience	0.599	0.857
International Involve	24.43	7.207	International Involve	17.635	-0.718	International Involvement	47.855	-13.898
ROA	0.149**	0.1	ROA	0.088	0.052	ROA	0.077	0.068
Industry Profitability	-3.016	6.882	Industry Profitability	0.109	6.197	Industry Profitability	2.111	5.461
Capital Structure	4.96**	0.371	Capital Structure	3.509	0.063	Capital Structure	5.809*	-2.82
R^2	**0.192**	**0.305**		**0.096**	**0.115**		**0.192**	**0.157**

†p < 0.1; *p < 0.05; **p < 0.01; ***p < 0.001 (two-tailed tests)