BE036

Entry Mode Strategies and Foreign Subsidiaries' Performance: the Empirical Evidence from a Retail Industry in Thailand

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Abstract

Thailand is one of the major economies in ASEAN as a result of the increase in the size of the middle class, rapid urbanization, the low unemployment rate, and tourism. However, empirical study regarding the entry mode-performance relationship in a retail industry in Thailand is still lacking. Therefore the study attempts to examine the entry mode-performance relationship of foreign subsidiaries of multinational enterprises in a retail industry in Thailand. The empirical findings indicated that the major joint ventures (foreign ownership 50%-94%) tended to have superior profitability performance in terms of return of asset (ROA) than those that hold greater or lesser foreign ownership percentage, and the wholly-owned subsidiaries (foreign ownership 95%and above) tended to outperform the minor joint ventures (foreign ownership 25%-49%) profitability performance in term of return on sales (ROS) Thailand's retailing market context.

Keywords: Entry Mode, Multinational Subsidiaries, Financial Performance, Retail, Thailand

1. Introduction

Thailand is one of the major economies in ASEAN. As of 2017, Thailand was ASEAN's second largest economy in terms of GDP (US$ 423 billion), with almost 70 million consumers with a GDP per capita of US$ 6,126. Although the population of Thailand is not as large as Indonesia, the Philippines, or Vietnam, the spending power of Thai consumer is 1.5 times greater than Indonesian consumers, double that of Filipino consumers and triple the spending of Vietnamese (World Bank, 2018). In addition, Thailand is also reported as the third largest ASEAN retail market, behind Indonesia and the Philippines, with a retail market volume of US$ 140 million

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in 2017 and a growth rate of 8.62% compared to 2016 (Frost & Sullivan, 2016). It is expected to become the second largest retail market among the major ASEAN countries, a compound average growth rate of 8.9% between 2015 and 2018, and total retail sales are likely to reach to reach US$155 billion in 2018 (Frost & Sullivan, 2016). In the period of 2018-2020, the average growth rate of Thailand's retail market is estimated to be approximately 11% (Chonticha, 2016). The increase in domestic consumption has been driven by the rising numbers of middle-class consumers, rapid urbanization, a growing number of expatriates and tourism (Hodgson, 2015).

Although the few empirical studies on the post-entry performance of multinational enterprise (MNE) in the context of Asian emerging countries have made significant contributions to the topic, several limitations still remain. Firstly, the previous studies conceptualize "joint venture strategies" as companies where the proportion of foreign investment is between 25% and 95%, which is too broad. Secondly, there are insufficient studies regarding entry mode performance in retail industries. Thirdly, although Thailand is the most productive retail market for multinational retailers in ASEAN (Jarukamjorn, Kapasuwan, & McCullough, 2018), but the entry mode performance in retail industries in Thailand is neglect. Therefore, the purpose of this study is to extend foreign market entry mode literature by analyzing the relationship between the entry mode strategies and the performance of foreign subsidiaries of multinational enterprises in a retail industry in Thailand. Therefore, it addresses the research question: Does the entry mode strategies affect the financial performance of foreign subsidiaries of multinational enterprises in a retail industry in Thailand? and How do entry mode strategies affect the financial performance of foreign subsidiaries of multinational enterprises in a retail industry in Thailand? The study contributes to the literature as follows. First, the study divides joint venture entry modes into two categories according to the percentage of foreign ownership, minor joint venture and major joint venture, to evaluate the impact of the degree of foreign ownership on the financial performance of foreign subsidiaries. Second, the study focuses on Thailand, as it is a highly productive retail market in ASEAN (Jarukamjorn, et al., 2018).

The rest of the article is organized into five sections. First, the entry mode strategies and the entry mode-performance relationship are discussed, and the hypotheses are posed. Second, the research methodology is described. Third, the analysis

results are reported. Fourth, the empirical findings are discussed. Fifth, the theoretical contributions, managerial implications and limitations of the study are concluded.

2. Literature Review and Hypotheses

2.1 Entry Mode Theoretical Perspectives

The choice of market entry mode is a critical strategic decision that multinational enterprises (MNE) employ to enter foreign markets (Brouthers & Hennart, 2007). Shen, Puig, and Paul (2017) defined foreign entry mode approach as "*the way that a firm wants to carry out its business activities and the degree of engagement in a foreign market, either by export, joint venture, or establishing its own subsidiaries"*. The most commonly used theories in the entry mode studies in the past three decades are Resource-based view theory, Institutional theory (IT), Transactional cost economy theory (TCE), and the Eclectic Paradigm or OLI framework (OLI), (Zhao, Ma, & Yang, 2017). ***Resource-based view theory*** states that the firm-specific advantages are established by developing or acquiring a set of valuable, unique and differentiated resources and capabilities that are difficult to imitate or substitute (Brouthers & Hennart, 2007). RBV focuses on the firm or subsidiary level (Ekeledo & Sivakumar. 2004). According to resource-based theory, multinational enterprises with strong resource and capability advantages, such as firm size or international experience, can freely choose any entry mode strategies regardless of the liability of foreignness and the liability of newness (Hansen & Gwozdz, 2015). ***Institutional theory*** explains how multinational enterprises operate in an institutional context in which there is interaction between economic, political and social factors (Canabel & White III, 2008). Institutional theory focuses on the country or regional level. This theory suggests that the institutional environment in a foreign country determines the rules of competition for MNEs, which influence MNE foreign market entry mode strategies (Brouthers & Hennart, 2007). ***Transactional cost theory*** is the most commonly-used theory in entry mode and performance studies (Zhao, Ma, & Yang, 2017). TCE focuses on the transactional cost level (i.e.. operation and production costs) and states that MNE strategies must minimize the costs and inefficiency associated with entering and operating in a foreign country (Canabal & White III, 2008). Transactional cost theory predicts that when high asset specificity is combined with high transaction frequency or high environmental uncertainty, foreign direct investments or equity entry modes are more efficient (Seggie, 2012). ***Eclectic Paradigm or OLI Framework***

combines the insights of three key entry mode theories, resource-based (ownership advantages), institutional (location advantages), and transactional cost (internalization advantages) theories (Brouthers & Hennart, 2007). OLI theory views the multinational enterprises network as a coordinated system of value-added activities and views the industry as the source of competitive advantage, not the firm. It explains why a multinational enterprise should establish a foreign operation or foreign direct investment (FDI) rather than indirect investment. According to the OLI, the foreign market entry strategies of multinational enterprises vary according to the type of industry and the motive of FDI (Dunning, 1998). For example, a multinational enterprises in a service industry (e.g. retail, tourism) may seek high potential and growth market, while those in a manufacturing industry may seek low cost of labor and raw materials.

2.2 The Equity Entry Mode Strategy

The foreign direct investment or equity entry modes are focused in this study. It can be categorized into two major forms: joint ventures and wholly-owned subsidiaries (Li, Guo & Xu, 2017). ***Joint venture*** is defined as a subsidiary where a multinational enterprise and a local enterprise share ownership, control, and risks in the foreign country in which the subsidiary is established. ***Wholly-owned subsidiary*** is defined as a subsidiary where the multinational enterprise (MNE) has full ownership, control, and risk in the foreign country in which the subsidiary is established. Chang, Chung, and Moon (2013) defined a wholly-owned subsidiary as a subsidiary that holds at least 95% foreign ownership of the equity, and a joint venture as a subsidiary where foreign ownership is between 25 percent and 95 percent of the subsidiary's equity. They also divided joint ventures into two groups: minor joint venture (foreign ownership between 25 percent and 50 percent of the equity) and major joint venture (foreign ownership more than 50 percent of the equity). According to the Civil and Commercial Code of Thailand for limited companies, the percentage of equity ownership is classified into four groups: 21%, 26%, 51%, and 76% of the total capital investment. However, only equity shareholders with 26% of equity ownership and above reserve the right to operate and supervise a company in Thailand (Wanmahachhai, 2018).

2.3 Entry Mode and Performance

Previous studies have shown that the entry mode-performance relationship exists (Zhao, Ma, & Yang, 2017). Many studies found a relationship between the equity entry mode (wholly-owned subsidiaries and

joint venture) and the performance of the multinational enterprise or their subsidiaries in European countries (Cordeiro Osagavara, & Masiero, 2017), in large emerging markets such as China and India (Chang, Chung, & Moon, 2013; Johnson & Tellis, 2008; Murry, Ju, & Gao, 2012), or small with high potential countries such as countries in Central and Eastern Europe (CEE) or ASEAN (J. Perks, Hogen, & Shukla, 2013; Larimo & Nguyen, 2015; Suwannarat, 2013). However, the empirical findings on the equity entry mode-performance relationship have been mixed and inconsistent (Dikova & Brouthers, 2016; Shaver, 2013). Some scholars found the wholly-owned subsidiary or high degree of control entry mode led to enhanced performance (Chang, et al, 2013; Johnson & Tellis, 2008; Murry et al., 2012). Others found conflicting results and found that the joint venture entry mode outperformed wholly-owned investment in emerging markets (Cordeiro et al., 2017; Larimo & Nguyen, 2015; Suwannarat, 2013). Even though a firm that adopted the joint venture entry mode would bear the risk of termination due to the complexity in managing a joint venture relationship (Makino, Chan, Isobe, & Beamish, 2007; Suwannarat, 2013), a partnership with a local company was found to help the company to understand the local market and to gain faster access to local suppliers (Lu & Xu, 2006; Magnusson, Westjohn, & Boggs, 2009).

The establishment of the ASEAN Economic Community (AEC) in 2015 provided great opportunities not only for international foreign investors, but also for intra-ASEAN region investors because of the rise in the maximum percentage for foreign investment to 70%. These offer intra-ASEAN investors the opportunity to hold majority equity ownership and have a high degree of control over their foreign subsidiaries (Japan External Trade Organization, 2015). However, research into the entry mode-performance relationship in the retail industry, especially in the ASEAN region is lacking (Evans, Movonda, & Bridson, 2008).

Hence, based on previous studies and above discussion, the following hypotheses are proposed:

H1: There is a relationship between the foreign market entry mode strategies and the financial performance of foreign subsidiaries in terms of profitability in the retail industry in Thailand.

H2: There are the differences in the relationship between foreign market entry mode strategies and the financial performance of foreign subsidiaries in terms of profitability in the retail industry in Thailand.

3. Materials and Methods

This study attempts to study how the foreign market entry mode strategies influence multinational subsidiaries' performance. The conceptual framework presents the foreign market entry strategies that may influence foreign subsidiaries performance for firms operating in the retail industry in Thailand, based on prior literature on international business and entry mode perspectives. The independent variable is the foreign market entry mode, which encompasses three strategies governing the degree of foreign investment: minor joint venture, major joint venture, and wholly-owned subsidiary. The independent variables are the profitability ratios that are commonly used to evaluate the financial performance of foreign subsidiaries in terms of three aspects: return on equity (ROE), return on asset (ROA), and return on sales (ROS). The conceptual framework of this study is presented in Figure 1.

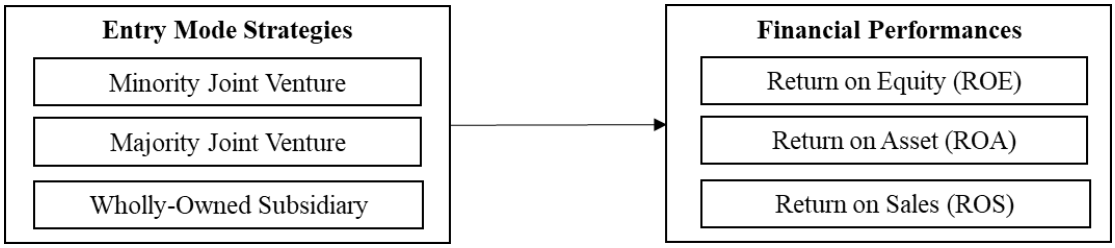

Figure 1 The conceptual framework of the study

The research method is quantitative with historical data analysis. The analysis is conducted at the subsidiary level. The percentage of foreign ownership (entry mode strategy) and financial performance are derived from the database of the Department of Business Development (DBD) of Thailand. The sample group was determined by applying a non-random sampling technique with five criteria. Firstly, the firm must be operating in retail trade. Secondly, the foreign firm must have at least 25% of the equity. Thirdly, the firm must have investment capital equal to or greater than 100 million THB. Fourthly, the firm must have registered as a limited company or a public company limited in Thailand before 2013. Lastly, the firm must have been operating in Thailand in 2017. The final sample includes 154 firms from 36 countries, including 40 firms from ASEAN countries, 66 firms from Asian countries, 32 firms from European countries, 8 firms from the United State of America, 1 firms from Australia, and 7 firms from other countries. Top three ranking in terms of number of

subsidiaries are Singapore, Japan, and Hong Kong, while top three ranking in term of revenue performance the United Kingdom, Japan, and Singapore. The independent variable is the entry mode strategy measured by the percentage of foreign ownership in three categories, minor joint venture (foreign ownership between 25%-49% of the equity), major joint venture (foreign ownership between 50%-94% of the equity), and wholly-owned subsidiary (foreign ownership equal or greater 95% of the equity). The dependent variable is the objective financial performance, measured by three financial indicators under profitability analysis ratios including return on equity (ROE), return on asset (ROA), and return on sales (ROS). Return on equity (ROE) is the ratio of net income (profit) to total shareholder equities. The ROE ratio measures profitability by evaluating the ability of the firm to manage the shareholders' equity to generate net income (profit). Return on asset (ROA) is the ratio of net income (profit) to total assets. The ROA ratio measures profitability by evaluating the ability of the firm to manage its total assets to generate net income (profit). Return on sales (ROS) or the net profit margin is the ratio of net income (profit) to sales. The ROS ratio measures profitability by evaluating the ability of the firm to manage total sales after deducting operating costs and expenses to generate net income (profit).

The assumptions of the statistics test was assessed to validate the appropriateness of the analytical tool. As independent variables were the categorical data measurement (Ordinal level) by grouping and putting a meaning to the entry mode strategies and dependent variables were the continuous data measurement (interval level), a parametric statistic approach, the one-way analysis of variance (ANOVA) was suitable to test hypothesis of the study. However the assumption of independent, normality, and homogeneity of variance between the groups were violated in the parametric one-way ANOVA, a non-parametric equivalent of ANOVA, the Kruskal-Wallis test, was appropriate to use in this study (Kruskal & Wallis, 1952). Consequently the Kruskal-Wallis one-way ANOVA using the Statistical Package for the Social Sciences (SPSS) software version 24 was applied to test the relationship between the entry mode strategies and performance, and the Bonferroni Correction approach, which controlled for Type I errors across tests, was applied to evaluate the pairwise differences between each of the foreign market entry decision groups (Armstrong, 2014).

4. Empirical Results

The sample of the study was 154 foreign subsidiaries operating retail industries in Thailand during 2013 – 2017. It comprised 43 minor joint ventures, 17 major joint ventures, and 94 wholly-owned subsidiaries. The dominant entry mode of firms in the sample group is wholly-owned subsidiary (61%), followed by minority joint venture (28%) and majority joint venture (11%). The researcher collected 753 panel data points from 154 multinational retailers.

With reference to H1, the study aims to examine the relationship between the entry mode strategies and the financial performance of foreign subsidiaries in a retail industry in Thailand. According to Table 1, the Kruskal-Wallis H one-way ANOVA was conducted to test the null hypothesis in which the distribution of three profitability indicators was the same across entry mode strategies in retail industries in Thailand. The test revealed differences in the medians for financial performance in terms of the return on asset (ROA) and the return on sales (ROS), which were statistically significant at the level of 0.05 across the three entry modes that the foreign subsidiaries decided to adopt in entering a retail industry in Thailand. The test indicated that the differences in the median for return on investment (ROA) across the three entry modes were significant with, X^2 (2, N = 753) = 8.505, *p*-value = 0.014, and the differences in the median for return on sales (ROS) across the three entry modes were significant with, X^2 (2, N = 753) = 7.578, p-value = 0.023. However, the differences in the median for return on equity (ROE) across the three entry modes were not significant at the level of 0.05. Therefore, hypotheses H1 was partially supported.

Table 1 Results of the Kruskal-Wallis one-way Analysis of Variance Analysis

Financial Performance	Abbr.	N	Chi-Square[1/] (χ2)	Degree of Freedom	*Asymp.* Sig. [2/]
Return on Equity	ROE	753	4.148	2	0.126
Return on Asset*	ROA	753	8.505*	2	0.014
Return on Sales*	ROS	753	7.578*	2	0.023

Note: [1/]The test statistic (Chi-Square) is adjusted for ties.

[2/]Asymptotic significance (2-sided tests) are displayed. The significance level of 0.05 (* $p < 0.05$)

With reference to H2, the study aims to examine the differences in the relationships between the entry mode strategies and the financial performance of foreign subsidiaries in a retail industry in Thailand. As shown in Table 2, a post-hoc comparison using the Bonferroni Correction approach, which controlled for Type I errors across tests, was conducted to evaluate pairwise differences between each of the entry mode groups. The tests revealed differences in the medians of financial performance on each foreign market entry decision group as follows: first, the median difference for return on asset (ROA) between the minor joint venture versus the major joint ventures were statistically significant at the level of 0.05 (p-value < 0.012, adjusted using the Bonferroni correction), and the wholly-owned subsidiaries and the major joint ventures were statistically significant at the level of 0.05 (p-value < 0.038, adjusted using the Bonferroni correction), but the median differences for return on asset (ROA) between the wholly-owned subsidiary and the minor joint venture were not statistically significant at the level of 0.05. According to the study, the major joint ventures were more likely to outperform the minor joint ventures and the wholly-owned subsidiaries with an increased return on asset of 4.26% and 1.69%, respectively. Second, the median difference for return on sales (ROS) between the minor joint ventures and the wholly-owned subsidiaries was statistically significant at the level of 0.05 (p-value < 0.041, adjusted using the Bonferroni correction). However, the median differences for return on sales (ROS) between the major joint venture versus the minor joint venture and the wholly-owned subsidiary versus the minor joint venture were not statistically significant at the level of 0.05. According to the study, the wholly-owned subsidiaries were more likely to outperform the minor joint ventures with an increased return on sales of 1.075%.

Table 2 Results of the Bonferroni Corrected Comparison of Financial Performance between Entry Mode Groups.

Financial Performance	Entry Mode	Median Diff. (EM1 - EM2)	Test Statistic ($\chi 2$) [1/]	Std. Error	Std. Test Statistic	Adj. Sig. [2/]
I. Profitability Ratio						
Return on Asset (%)	Minor JV-WOS	-2.570	-17.36	18.37	-0.95	1.000
	Minor JV-Major JV	-4.260	-81.64*	28.28	-2.89	0.012
	WOS-Major JV	-1.690	64.28*	25.77	2.49	0.038
Return on Sales (%)	Minor JV-WOS	-1.075	-45.36*	18.37	-2.47	0.041
	Minor JV-Major JV	-0.935	-62.44	28.28	-2.21	0.082
	WOS-Major JV	0.140	17.08	25.77	0.66	1.000

Note: [1/]The test statistic (Chi-Square) is adjusted for ties.

[2/]Asymptotic significance (2-sided tests) are displayed. The significance level adjusted by the Bonferroni correction (*$p < 0.05$)

5. Discussion

The empirical findings of the study are concluded as follows: first, the entry mode strategy of foreign subsidiaries operating a retail industry in Thailand in the period of study is associated with financial performance. Second, in regard to the profitability ratio, the return on asset ratio (ROA) and the return on sales (ROS) have statistical significance in evaluating the entry mode - performance relationship of foreign subsidiaries in a retail industry in Thailand. In addition, the study also revealed that there was a difference in the relationship between entry mode strategies and the financial performance. Major joint ventures were found to outperform wholly-owned subsidiaries and minor joint ventures in terms of return on asset (ROA) performance. Wholly-owned subsidiaries were more likely to have better performance in terms of the percentage of return on sales (ROS) than minor joint ventures. In this regard, the result revealed that major joint ventures tend to have greater success in using their assets to generate earnings/net income (profit) than wholly-owned subsidiaries and minor joint ventures, and when comparing wholly-owned subsidiaries and minor joint ventures, wholly-owned subsidiaries tend to be more efficient at converting sales into actual profit than minor joint ventures.

In summary, the findings of the study are concluded as follows: first, in the context of Thailand's retail market, major joint ventures outperformed wholly-owned subsidiaries, and minor joint ventures in terms of the return on asset (ROA) and return on sale (ROS). It means that foreign subsidiaries that hold equity ownership of more than 50% tend to have greater ability to generate net income (profit) than those that hold 100% ownership or equity ownership lower than 50% (minority joint ventures). Second, the minor joint ventures were found to have the poorest financial performance in terms of profitability management when compared to both major joint ventures and wholly-owned subsidiaries. The findings of this study align with previous studies that predicted that a greater degree of ownership and control for foreign subsidiaries yields better performance (Evans, Movonda, & Bridson, 2008). However, the findings contradict Hui, Hoshino, Kumarasinghe, and Mohamad (2012) who reported that minor ownership was the best entry mode for manufacturing companies.

6. Conclusions

The study extends the entry mode performance literature as follows: the study covered the entry mode research gaps by categorizing the joint venture entry mode into two categories, minor joint venture and major joint venture, and examining the entry mode strategies in regard to the degree of ownership of the foreign subsidiary in three forms, minor joint venture, major joint venture, and wholly-owned subsidiary rather than focusing on binary equity entry mode choices (Joint venture vs wholly-owned subsidiary) (Martin, 2013). Second, the study examined the entry mode performance of foreign subsidiaries in a retail industry in a small emerging market in the ASEAN region, namely Thailand, as it is a small emerging and high productive retail market in ASEAN (Forst & Sullivan, 2016), and the empirical study of this area is still limited and inconsistent (Evans, Bridson, Byrom, & Medway, 2008).

The study has implications for entry into retail industries in Thailand as follows: first, even though many entry mode studies found that shared ownership and control entry mode leads to superior performance, the percentage of foreign ownership must be carefully considered when entering the retail sector in Thailand. According to the foreign investment policy of Thailand, foreign investors with capital investment of 100 million THB and above can choose to establish their foreign subsidiaries in the form of joint venture or wholly-owned subsidiary. The descriptive statistics revealed that 62% of foreign investors entered the retail market in Thailand in the form of wholly-owned subsidiary (100% equity ownership) followed by 27% for minor joint ventures (25%-49% of the equity ownership) and 11% for major joint ventures (50%-95% of the equity ownership) However, the findings of this study revealed that the major joint venture tended to be the most productive entry mode strategy when entering Thailand's retail market.

The study has several limitations that could benefit from further research. Firstly, the analysis has disaggregated moderating variables which may affect the post entry performance, such as subsidiary size, subsidiary age, host country characteristics, and others. Second, the study has disaggregated the difference in the characteristics of home and host countries, and their moderating impact on the entry mode–performance relationship. Third, this study uses a quantitative approach with a longitudinal research outline, and thus, the researcher might not pick up genuine circumstances, and the genuine inspiration for showcasing development. For example,

the basic desire to search out assets, markets, or efficiency must be uncovered to give a fuller comprehension of market development. Third, the study examine the entry mode – performance relationship in term of profitability aspect, the financial performance in other aspects such as the financial performance in terms of operation, liquidity, leverage management should help to understand the financial performance of foreign subsidiaries multidimensional perspective. Lastly, the study used a non-parametric statistical technique to examine the entry mode – performance relationship. Parametric statistical techniques should be used to enhance the empirical findings of this study.

7. References

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