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The Possibility of the Market Entry Sequence of the MNE following the Perspective of Transaction Cost; Case Study of Japanese Home Electronics Makers in China

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I Introduction

Still now the significance of transaction cost is often discussed when the multinational enterprise (hereafter, left out as MNE) chooses internalization such as exporting manufactured goods from its home country and / or setting up a wholly-owned subsidiary in a host country.

Among much review of the validity of transaction cost theory, the authors have seldom explored the role of exporting plants in choosing the further entry modes in a host country market even if it has become obvious that home manufacturers preferred the host country to its home country as a production site.

Here we can assume that exporting a plant from a MNE to a local firm in a host country may substitute to exporting a product by this MNE, as the local firm will increase its production volume enough to satisfy the large local demand, which causes the MNE to decrease exporting volume of its product. In this meaning, exporting a plant may be characterized as a driving factor toward externalization. That is why exporting a plant seems to be counted as one transaction cost related factor. But this judge should be made sure in terms of recognizing the fact that the MNE concludes a licensing agreement with a local manufacturer because this local one needs to make high quality and multi-functional products by introducing higher level of a product technology after its facility starts an operation. Therefore, when the MNE makes a decision on releasing its technology to a local manufacturer under a licensing agreement

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after exporting a plant instead of making a foreign direct investment (FDI) in production, we understand such a type of exporting a plant is perfectly thought as externalization and thus the MNE might be compelled to face a sort of transaction cost.

On the other hand, we can postulate exporting a plant may induce foreign direct investment (hereafter, left out as FDI) toward a local country because the managers of MNE come to know the local workers' learning abilities of its production technology which the MNE wanted releasing in order to set up its own production site in the local country after exporting a plant to a local manufacturer. The managers may hold belief and confidence in making their subsidiary succeed in operation by knowing there are much local employees qualified to use its technology transferred by the MNE. In this meaning, exporting a plant becomes a driving force for increasing FDI from the MNE. In this situation, exporting a plant is considered to be an internalization related factor, that is, free from causing transaction cost.

In this paper we intend to explore which view should be taken about the role of exporting a plant before a MNE enters into a local market country in terms of either FDI or licensing based on the case study of Japanese Home Electronics Makers in China.

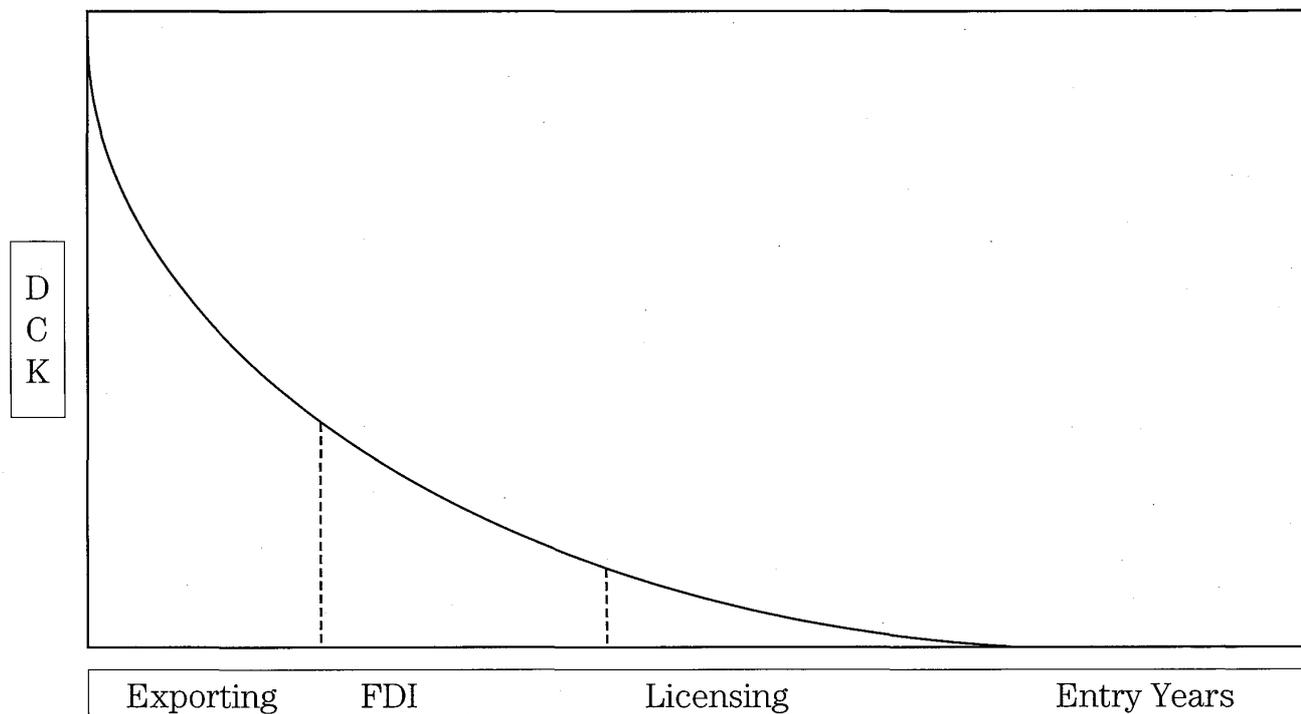
II Basic assumption for judging the cases

Here we introduce to develop a theoretical model which can be applied to a selection of foreign market entry modes by the MNE over time.

Figure 1 shows the sequential market entry model depending on the dissipation cost of knowledge in which the MNE can internalize or externalize alongside the degree of its dissipation risk of knowledge over time, when summing up Rugman's theory (1981) of the MNE. Rugman emphasizes that the MNE should retain its specific advantage of the knowledge for itself until it becomes to lose such an advantage, considering the higher dissipation risk caused by transferring its knowledge to a rival company at an earlier stage of the product life cycle.

On the other hand, Root, F. R. (1982) suggests a manufacturing firm should enter a foreign market in terms of exporting throughout licensing to finally FDI, as the firm is enforced to take much risk unique to each foreign country in the first stage of entering the market. When choosing FDI, the company must internationally transfer huge managerial resources compared with licensing as well as controlling how to transfer its resources and what degree of the resources should be transferred throughout what channel. In this way Root stresses the uncertainty of foreign business environment. Therefore Root's model is typically termed as the internationalization approach opposed to the internalization approach.

Then we consider the determinants of entry modes sequences by some Japanese home electronics makers as follows.

Figure 1 Internalization Approach proposed by Rugman

Notes) DCK = Dissipation cost of knowledge

Source) Fujisawa drew this figure after summing up the theoretical essence proposed by Rugman, A. (1981).

We adopt such an explanative factor as the continuity of entry modes (sequence of entry modes). Concerning this factor, we identify the concept such as the alternative vs. complementary relationship between Internalization (FDI) & externalization (licensing).

The substitutive entry modes sequence by a parent of the MNE is defined as either an externalized type or an internalized type. The former begins with licensing and then switches to FDI. The latter starts FDI before licensing. By contrast, the complementary entry modes sequence shows an externalized advantage type which licensing is first selected, secondly FDI takes place, thirdly licensing is concluded, and FDI is performed again, while an internalized advantage type is also realized in developing the sequence from FDI through licensing to FDI and then to licensing again.

III Case Study from Japanese Home Electronics Makers entering into China

Before observing some research data it should be postulated that Japanese home electronics makers entering into China would have favored internalization rather than externalization, even though Chinese government has exerted strong control over Japanese makers in their equity ownership ratio, remittance to Japan and business

fields etc.

To be more important, the patent law hasn't been sufficiently enacted by Chinese government and even now the emulation of modern technologies and novel products can't be strictly prohibited by the law, which is an important impetus for the MNE to prefer internalization to externalization. As Oxley (1999) stressed, China lacks the legal institution which protects intellectual property rights of foreign owned companies, while the moral hazard of Chinese tends to often cause reselling the technology to the third party in addition to illegal imitation. When such an opportunistic behavior appears with a high probability, most of Japanese makers don't want to set up minority ownership type of joint ventures as well as concluding licensing agreements. In addition to responding to such a dissipation risk of technologies, Chinese market attractiveness such as a big size and its high growth ratio supports internalization, too.

That is why most of Japanese makers might have favored internalization in order to hedge the dissipation risk and an opportunistic attitude after a licensing contract is agreed between both parties, without deeply taking a high pressure from Chinese government and its changeable policy toward many MNEs into consideration.

Historically looking at the attitude of Chinese government, let us define more than 50% of equity ownership by a Japanese manufacturer is counted as internalization. In effect Chinese government has restricted the ownership ratio of foreign parent companies when setting up their subsidiaries in China except for strategically important industry firms. That is why the equality and majority ownership ratios can be identified with internalization, which is very unique to China, while less than 49.99% of a Japanese parent in its joint venture belongs to an externalization pattern.

In the second it is critically needed to discriminate two types of strategic motives termed as a global strategy type (i.e. export-oriented strategy from production sites) vs. a local market-oriented strategy (i.e. developing Chinese market). As a matter of

Table 1 Hitachi's Color TV in China

Entry Year	Parent's Ownership Ratio	Entry Modes
1979		Exporting Plant (Exp. Plant)
1979		Exp. Plant
1984		Licensing
1985		Exp. Plant
1986		Licensing
1989	60%	FDI / Exp. Plant
1990		Licensing

Source) <http://www.cheaa.com/>, HP of each company, *Directory of Japanese Foreign Subsidiaries* published by Toyo Keizai 2005., etc. Mr. Luo Min cooperated in collecting these data. The below tables use the same sources as Table 1.

Table 2 Matsushita's Color TV in China

Entry Year	Parent's Ownership Ratio	Entry Modes
1979		Exporting Plant
1983		Exp. Plant
1984		Exp. Plant
1985		Exp. Plant
1986		Exp. Plant
1987		Exp. Plant
1987	50%	FDI
1988		Exp. Plant
1990		Exp. Plant
1993		Licensing
1994	55%	FDI
1995	70%	FDI
1995		Licensing
2001	55%	FDI

Table 3 Toshiba's Color TV in China

Entry Year	Parent's Ownership Ratio	Entry Modes
1978		Exporting Plant
1983		Exp. Plant
1984		Exp. Plant
1985		Exp. Plant
1986		Exp. Plant
1987		Exp. Plant
1994		Licensing
1996	65%	FDI
2002	51%	FDI
2003	100%	FDI

fact, the global strategy type is equal to be complementary and the local market-oriented tends to be substitutive, because the former requires many location sites of local manufacturing subsidiaries as well as a few or several licensing agreements. In this way, as the scope of foreign business activities becomes wider and diversified, the MNEs are inclined to formulate global strategy.

From table 1 to table 3, three color TV manufacturers' entry sequences into China are shown. For Hitachi, color TV business has been developed in China by the

complementary externalization ahead of internalization pattern, while Matsushita's color TV in China shows the complementary internalization ahead of externalization pattern supporting the Internationalization approach. Toshiba's color TV in China illustrates the substitutive externalization ahead (of FDI) Pattern true for the Internationalization approach.

Table 4 Matsushita's Washing Machine in China

Entry Year	Parent's Ownership Ratio	Entry Modes
1982		Licensing
1984		Exp. Plant
1985		Licensing
1986		Exp. Plant
1992	51%	FDI
1994	70%	FDI
1994		Licensing
2004	100%	FDI

Table 5 Thoshiba's Washing Machine in China

Entry Year	Parent's Ownership Ratio	Entry Modes
1983		Exp. Plant
1987		Exp. Plant
2003	75%	FDI
2005	70%	FDI

Table 6 Hitachi's Washing Machine in China

Entry Year	Ownership Ratio	Entry Modes
1984		Exp. Plant
1985		Exp. Plant / Licensing
2002	60%	FDI

Judging from table 4 to 6, Matsushita's washing Machine in China shows the complementary externalization ahead of internalization pattern, while Toshiba has adopted the internalization focusing pattern best fit to the Internalization approach typically opposed to Hitachi's washing Machine in which the substitutive externalization ahead of FDI pattern is clearly recognized as a typical Internationalization approach.

Comparing table 7 with 8, Sanyo's refrigerator in China has followed the substitutive internalization focusing pattern belonging to the Internalization approach, although a

Table 7 Matsushita's Refrigerator in China

Entry Year	Parent's Ownership Ratio	Entry Mode
1984		Exp. Plant
1985		Licensing
1995	80%	FDI
1995	80%	FDI

Table 8 Sanyo's Refrigerator in China

Entry Year	Parent's Ownership Ratio	Entry Mode
1980		Exp. Plant
1985		Exp. Plant
2002	80%	FDI

Table 9 Matsushita's Air-conditioner in China

Entry Year	Parent's Ownership Ratio	Entry Modes
1981		Exp. Plant
1985		Exp. Plant
1993	67.8%	FDI
2001	100%	FDI

Table 10 Toshiba's Air-conditioner in China

Entry Year	Parent's Ownership Ratio	Entry Modes
1984		Exp. Plant
1993		Licensing
1995	20%	FDI
1995	20%	FDI

Table 11 Sanyo's Air-conditioner in China

Entry Year	Parent's Ownership Ratio	Entry Modes
1985		Exp. Plant
1992		Licensing
1993	98%	FDI
1994	95%	FDI
1994	55%	FDI
1995	55%	FDI
1996		Licensing
1996		Licensing

Table 12 Daikin's Air-conditioner in China

Entry Year	Parent's Ownership Ratio	Entry Modes
1996	60%, 70%	FDI
1997	70%	FDI
2001	100%	FDI
2003	65%, 100% (4 cases)	FDI

series of Matsushita's entry behavior is characterized the substitutive externalization ahead of FDI pattern following the Internationalization approach.

Contrasted with Matsushita's refrigerator in China, its air-conditioner has taken the substitutive internalization focusing pattern leading to Internalization approach shown by Table 9. From Table 10, Toshiba demonstrates the substitutive externalization ahead of FDI pattern belonging to the Internationalization approach. Sanyo's air-conditioner is identified with complementary externalization ahead of FDI pattern.

Daikin has adopted the definitive entry strategy in Chinese air-conditioner market by focusing on running majority ownership or wholly-owned subsidiaries, which mostly supports the internalization approach, for this company is a specialized maker in manufacturing some sorts of air-conditioners and strongly desires to protect a compressor technology integrated into each air-conditioner which is a core technology for Daikin.

This Daikin's type of market entry sequence can be termed as a focus on internalization, although in a strict meaning this entry method might differ from the substitutive internalization in that this method doesn't need an alternative method like a licensing.

As far as the comparison between Matsushita's and Toshiba's entering sequences into China is concerning, Matsushita tends to implement decision-makings toward complex strategies which are more complementary and relatively internalization-oriented for the sake of strong brand power effect with product technology. On the other hand, Toshiba tends to adopt much simple substitutive strategies in China, that is, relatively externalization in China.

In Figure 2, all cases we observed are plotted by a product business each target company operates in serving Chinese market.

Summing up all twelve cases quoted in this paper, it clearly appears to divide them into two tendencies in the broadest classification and four or five tendencies in a strictly meaning in relation to the sequence of entry modes by products of Japanese home electronics makers. Namely five cases belong to an internalization trend, while seven cases correspond with externalization. That is why the internalization approach is applied to five sequences, whereas the internationalization approach is adapted to seven

Figure 2 The Rule for Decision-making on Internalization vs. Externalization

		Sequence of Entry Modes	
		Complementary	Substitutive
Internalization Oriented		Matsushita: CTV	Daikin: Air-con
			Matsushita: Air-con
			Sanyo: Refrigerator
			Matsushita: Refrigerator
Externalization Oriented		Matsushita: Washing Mac.	Hitachi: Washing Mac.
		Hitachi: CTV	Toshiba: CTV
		Sanyo: Ai-con	Toshiba: Air-con

Source) Fujisawa drew this matrix figure based on the analysis of cases of Japanese home electronics makers entering into China.

sequences. Concretely speaking three cases belong to the complementary externalization type and just one is the complementary internalization. Four substitutive externalization cases and three substitutive internalization ones are identified. Only one (Daikin's air-conditioner) is discriminated from both of complementary and substitutive patterns. This sequence is identified with a focus on internalization in an accurate meaning, though it looks like following the substitutive internalization.

The reason why twelve cases are divided into five types of market entry sequences can be explained by such a role of exporting plants as pre-entering research function. Namely during exporting plants and after it, the MNE concerned try to test the attractiveness as a market and a production site like a feasibility study. In terms of exporting plants, the MNE can check Chinese workers' absorption capabilities in instructing how to use production technologies. Moreover some companies want to establish their subsidiaries after not only exporting plants but also releasing their product technologies to local firms in order to make sure Chinese workers' skill levels. By knowing their levels the MNE can start setting up a subsidiary in China. In this way the externalization happens to some product businesses and Japanese firms entering into China. For this type of MNE the dissipation risk of its specific asset embodied into its product is caused, but taken the place of such a risk, this MNE can reduce the uncertainty of Chinese product demand and labor market quality. Such a compensation is often seen in China like a business game.

IV Conclusion

Let us explore to link exporting plants to China from a MNE with the above classification of market entry sequences.

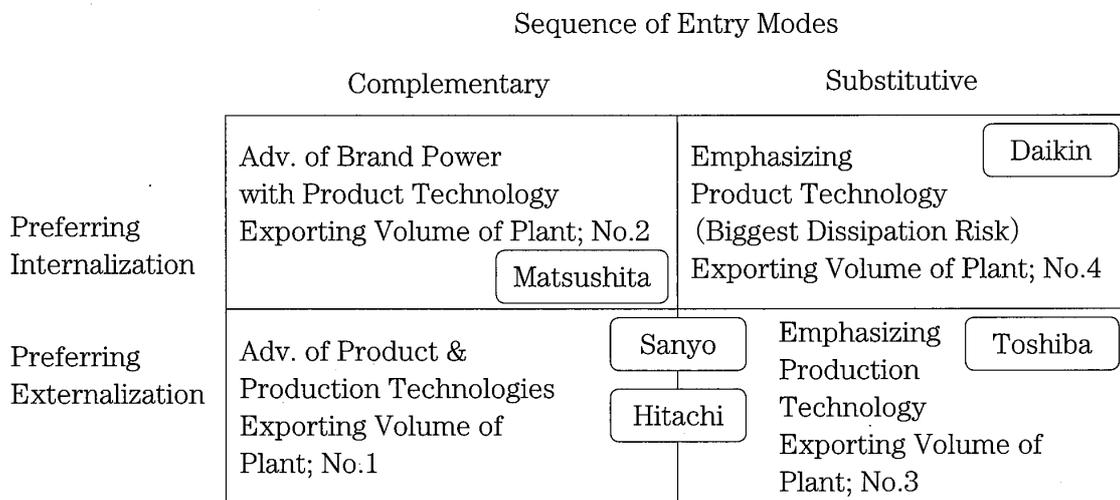
Judging from these results, it might become possible to make a rule for a decision-making of whether a MNE should select the internalization type or externalization type of market entry sequence in China after exporting its own plants to China depending on the competitive advantages of managerial resources retained by the MNE for itself.

Figure 3 shows such a rule. If a MNE establishes a stronger brand status and holds a higher level of product technology, it will develop a complementary strategy (global strategy) focusing on internalization.

When a MNE retains a very strong product technology but its brand power is weaker than that of a global player, this MNE had better not release its own product technology, as it may face biggest dissipation risk among 4 cells (zones) after concluding a licensing agreement or minority joint venture agreement. This type of the MNE belongs to in right upper cell in Figure 3. This MNE will succeed in entering foreign businesses particularly when adopting the substitutive and internalization type. Therefore this MNE has to prohibit from exporting plants for fear of dissipating a production technology as its market area is not so wide than a global strategy type of MNE. The production technology itself becomes more effective as it can be bound to a product technology into a production process in order to fabricate a high quality finished product.

In the left and bottom of the matrix in Figure 3, the MNE may show most aggressively exporting plants. This type of MNE has much confidence in its product technology and production one. Moreover this MNE can afford to release some sort of production

Figure 3 The Rule for Decision-making on Internalization vs. Externalization



Source) Fujisawa drew this figure.

technologies for the sake of having its own entrenched world market. For this the MNE belonging to the left and bottom of the matrix can perform the largest number of exporting plants.

Throughout these considerations we will present the final conclusion. Illustrated by Figure 4, three market entry modes such as exporting plant, FDI and licensing are discussed in one matrix. If a MNE exports low volume of plants to China or other countries, the internalization level of its managerial resources tends to be high as long as this MNE has superior product technologies and brand power.

By contrast, the MNE whose exporting volume of plants is a lot and heavy seems to depend on externalization as long as its product technology level is relatively low and brand power is also weaker. But even if exporting a lot of its own plants, as long as the MNE's product technology and brand power can be maintained at a relatively high level, this MNE probably pursue a moderate internalization strategy.

In this way it makes sense that a series of our analysis is very unique in that it suggests the role of exporting plants for a MNE thinking of entry modes before going directly in the local market.

Figure 4 Assumed Relationships among three Entry Modes

MNE's Managerial Resources	Exporting Plants	
	Light	Heavy
Product Tech	Internalization Level	
High	High	Moderate
Low	Moderate	Low
Brand Power	Internalization Level	
High	High	Moderate
Low	Moderate	Low

Source) Fujisawa drew this figure.

Finally this research underlies Fujisawa's theoretical model (2006) which revises Rugman's transaction cost based MNE theory and challenges checking the effectiveness of the renewed model in term of this case study. By testing this it makes a sense that the model has some predictive power because we can show a brand power can be reserved to the last as a competitive edge of a MNE and its competitive advantage has to be earlier lost in a production technology after exporting plants, while a product technology belongs to the middle position of weakening the MNE's strength between a brand power and a production technology shown by the theoretical formula.

This research paper may, however, lean to present the typological framework for

decision-making rule of the sequential MNE's market entry modes in terms of integrating the opposed concepts of internalization vs. externalization into the contrasted concepts of complementary vs. substitutive. This trial is meaningful in that all of entry sequences can be explained with this framework. Moreover this framework can provide the MNE planning of entering not only into China but also into many foreign countries with a decisive criterion after exporting its own plants. Thus our framework may have general applicability to the decision-making relating to many MNE's entry sequences.

This framework is, however, likely to lack an operational way, although it seems to be very difficult to introduce a mathematical model since our framework is constructed based on a case study. Of course refining the decision-making rule needs some mathematical formula.

Not only the limit of methodology but also new variables such as several types of information costs must be taken into consideration in order to provide a MNE with a more operational framework. By integrating both transaction-related information costs and non-transaction-related costs into a new framework for creating another decision-making rule which enables a MNE to decide and implement an earlier entry into a foreign market owing to reducing the market risk in a host country, this new model can add the general applicability to the present analysis.

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