Impacts of Institutional Distance and Strength of Market Conforming Values in the Host Country on Ownership Mode Choice of MNEs

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ABSTRACT

Emerging economies in Central and Eastern Europe (CEE) and Asia are receiving growing attention from international business researchers due to increased foreign direct investment (FDI) activity in those countries. This paper addresses the impacts of institutional distance and strength of market conforming values in the host country, on ownership mode choice of MNEs in emerging economies of CEE and Asia. This study is one of the first to address ownership mode choice of MNEs from Nordic region using the concepts of institutional distance and strength of market conforming values in the host country. Based on the analysis of 511 FDIs made by 148 Finnish firms in CEE and Asian countries during 1990-2007, the results of our study differ from some of the findings of previous studies. We found out that high formal institutional distance results in the preference for wholly owned subsidiaries which is opposite to our hypothesis and findings of most previous studies. As expected, we found the presence of strong market conforming values in the host country results in formation of wholly owned subsidiaries. However, we did not receive significant statistical support for the expected impacts of informal institutional distance on the ownership mode choice of MNEs.

KEY WORDS: Formal Institutional Distance, Informal Institutional Distance, Ownership Mode Choice, Strength of Market Conforming Values.

1 Introduction

Multinational enterprises (MNEs) entering foreign markets through FDI can establish their operations either by forming wholly owned subsidiaries or international joint ventures with the local partners (e.g. Delios & Beamish 1999; Chang & Rosenzweig 2001; Brouthers & Hennart 2007). This decision is termed as ownership mode choice and is one of the widely researched topics in international business literature (Brouthers & Hennart, 2007). MNEs are increasingly investing in emerging economies of CEE and Asia, due to attractive market potential and growth chances offered by them (UNCTAD 2009). It is important to note that the national economies of the countries are shaped by the formal and informal institutions (North, 1990; Peng et al., 2008), which govern the behavior of the firms. Previous literature mentions that even in developed economies, there are differences in terms of how competition is organized and market institutions operate (Hall & Soskice, 2001; Khanna, 2005; Whitley et al., 2005; Peng et al. 2008). In case of emerging economies, the institutions differ significantly from those in developed economies (Peng, 2003; Khanna, 2005). Consequently, while entering these new international markets, MNEs need to adjust to the requirements of formal and informal institutions which are different from the institutions in their home market (Estrin et al., 2009). The differences in formal and informal institutions (i.e. institutional distance) can significantly impact the strategies and performance of MNEs in these emerging economies (Hoskisson et al., 2000; Meyer, 2004; Wright et al., 2005; Peng et al., 2008; Estrin et al., 2009). Therefore, institutional distance emerges as a major consideration for MNEs entering these new international markets.

This study is one of the first attempts to empirically address the ownership mode choice of MNEs using the concepts of institutional distance and the strength of market conforming values in the host countries together. We enrich the application of institution-based view of international business strategy, by specifically addressing the element of strength of market supporting institutions in the host country along with studying influences of formal and informal institutional distance on the ownership mode choice of MNEs. Moreover, most of previous studies addressing institutional distance's influence on MNE strategies used the classification of institutions by Scott (1995) into regulative, normative and cognitive pillars. Our study is one the few using the classification of institutions based on North's (1990) categorization of formal and informal institutions rooted in new institutional economics to study ownership mode choices of MNEs. We empirically test the developed hypotheses using data based on FDIs made by Finnish firms in emerging markets of CEE and Asia during the time period 1990-2007.

The measures of both formal and informal institutional distance, as well as strength of market conforming values in the host country, in our study are based on yearly data from world competitiveness yearbooks. Therefore we do not use institutional indicators of only one year to study ownership mode choices over a longer time period which has been done in some past studies. This approach provides us a chance to better incorporate the institutional transition taking place in host emerging economies during the study time period.

Our paper starts with the discussion about theoretical background addressing different approaches to studying institutions and institutional environment. We continue the discussion by addressing the impacts of formal and informal institutional distance and strength of market conforming values in the host country on the ownership mode choice of MNEs at the time of market entry. The theoretical discussion offered in this paper sets bases for the development of hypotheses of this study. This is followed by discussion about empirical design of the study including data collection, sample description and the statistical method used in this study. The hypotheses are tested using a dataset of Finnish FDIs in CEE and Asia during 1990-2007. The findings of study are also compared with the findings of relevant previous studies. Finally the paper concludes with providing discussion, limitations of the study and the directions for future research.

2 Theoretical Background and Hypotheses

Institutions play a significant role in international business, because the costs associated with national legal, professional and administrative systems determine attractiveness of an international location for MNEs. Therefore, the institutions affect the capacity of a firm to interact with the players in new market and also influence the relative transaction and coordination costs of production and ownership decisions in a particular location (Dunning & Lundan, 2008; Henisz & Delios, 2001, 2002). The approaches to studying institutions have been influenced by the different fields of social sciences, mainly *economics* (North, 1990; Aoki, 2001) and *sociology* (Meyer & Rowan, 1977; DiMaggio & Powell, 1983). The level of analyses and the research objectives influence the conceptualization of institutions in different studies (Aoki, 2001; Peng & Khoury, 2009). Therefore different variants of institutional perspectives and theories have been used in management and organization studies (Scott, 2008). In the field of international business research, mostly institutional theory (Scott 1995) and new institutional economics (North 1990) have been used by different researchers to study impact of institutions and institutional differences on the strategies of firms. In this study we aim to follow North's (1990) classification of institutions into formal and informal dimensions rooted in new institutional economics. Peng and Khoury (2009) label this classification as institution-based view of international business strategy. We agree with Peng (2003), Peng et al. (2008) and Peng and Khoury (2009) that for international business research, the arguments from both economic and sociological perspectives of institutions are important. Scott (1995, 2008) has also referred to the integration of North (1990) ideas in his work on institutional pillars. Formal institutions in North (1990) classification are same as regulative institutions in Scott (1995) classification. Moreover, informal institutions in North (1990) classification address the sociological dimension of institutional environment and encompass both normative and cognitive pillars of Scott (1995) study. Therefore, this categorization of institutions is used in our study.

North (1990: 3) defines institutions as 'the humanly devised constraints that structure human interaction'. This perspective of institutions has its roots in microeconomics and influenced by the studies about institutional development and change in different economies (North, 1990, 2005; Aoki, 2001). North's (1990) definition of institutions as being the 'rules of the game' has significantly influenced the character of strategy research in international business in the last one decade (Wright et al., 2005; Peng & Koury, 2009). This perspective of the institutions stresses what institutions are, and how they affect organizations. Therefore, institutions are recognized to constrain the actions of actors in the pursuit of their interests (Deeg & Jackson, 2008). In international business, the effectiveness of country level institutions has a vital influence on the strategies of firms. The literature review reveals that this perspective of institutions has been used in the studies that focus on the effects of differences in the efficiency of country level institutions on the firm's strategies. This theoretical approach has been used in the studies addressing influences of institutions on entry mode choice and FDI decisions of MNEs (e.g. Globerman & Shapiro, 2003; Meyer & Peng, 2003; Delios & Henisz, 2003; Trevino & Mixon, 2004; Chung & Beamish, 2005; Dikova & Van Witteloostuijn, 2007; Estrin et al., 2009) and diversification strategies of MNEs (e.g. Peng et al., 2005; Peng & Delios, 2006). Further on, some studies using this perspective also addressed the impacts of formal and informal institutions on firm strategies and institutional development in different transitions economies (e.g. Khanna & Palepu, 2000; Meyer, 2001; Peng, 2003; Mathews, 2006; Lee & Oh, 2007; Peng et al., 2008).

The differences in home and host country institutional environments i.e. institutional distance considerably impacts the strategies of MNEs (e.g. Kostova & Zaheer, 1999; Xu & Shenkar, 2002; Eden & Miller 2004; Gaur & Lu 2007). Since last few years, we observe an increase in the use of institutional distance concept as a critical measure of the differences between the countries by international business scholars addressing country differences across countries and their impacts on firm's strategies since last one decade (e.g. Kostova, 1997; Kostova & Zaheer, 1999; Kostova & Roth, 2002; Xu & Shenkar, 2002; Xu et al., 2004; Gaur & Lu, 2007; Estrin et al., 2009; Chao & Kumar, 2010). Institutional distance has been classified into the regulative, normative and cognitive (cultural – cognitive) dimensions based on Scott (1995, 2008) categorization of institutions (e.g. Xu & Shenkar, 2002; Yiu & Makino, 2002; Xu et al., 2004; Gaur & Lu, 2007). However, recently Estrin et al. (2009) classified institutional distance into formal and informal institutional distance to study entry mode choices of MNEs following the classification of institutions by North (1990). We also aim to use this classification of institutional distance, as it is more suitable for international business studies (see e.g. Peng & Khoury, 2009) and it also incorporates Scott (1995) institutional pillars in it.

Formal Institutional Distance: Formal institutional distance refers to the differences between the legal institutions, laws and regulations of the host country and home country of foreign investing firm (North, 1990; Trevino & Mixon, 2004). These existing laws and rules in a particular host country tend to promote certain types of business behaviors and strategies, while restricting others. These laws and regulations in many cases are rather clearly stated (Scott, 2008), so it is relatively easier for MNE to understand and grasp (Xu & Shenkar, 2002). The formal and regulatory institutions in a country mostly operate on a standardized base with availability of similar centralized options such as Federal Court in USA in case of a conflict (e.g. Lenartowicz & Roth, 2001). This can help MNEs to understand them rather quickly compared to informal institutions which are more embedded in nature. However, the host country governments can use their legal and regulative power to restrict the strategic choices of foreign firms (North, 1990). Therefore, some past studies have shown that legal restrictions on foreign ownership discourage formation of wholly owned subsidiaries (Gatignon & Anderson, 1988; Henisz 2000).

It is important to note that systematic variations exist in the effectiveness of regulative and legal systems across countries. Researchers refer to the fact that these institutional variations in regulative systems and their effectiveness often result from different legal origins (e.g. Beck et al., 2003) and different paces of legal development in the countries (Pistor et al., 2000). When MNEs enter unfamiliar or different legal context, they have to adapt their business practices such as their contracts with employees, agents and distributors (Chang & Rosenzweig, 2001). The previous empirical studies have also shown that foreign firms established international joint ventures, when the differences in the formal (regulative) institutions are higher between the home and host countries of MNEs (e.g. Delios & Beamish, 1999; Yiu & Makino, 2002; Xu et al., 2004). Therefore, we hypothesize that

Hypothesis 1: *MNEs prefer international joint venture formation when the formal institutional distance is high between the home and host countries.*

Informal Institutional Distance: Informal institutions are humanly devised constraints that are embedded in the shared norms, values and beliefs in a society (North, 1990, 2005; Estrin et al., 2009). These shared norms specify the legitimate means to pursue the objectives defined by the values in a society (Scott 2003). Knowledge about informal institutions is often tacit in nature and requires intensive cross cultural communication (Estrin et al., 2009). Moreover, informal institutions are embedded in the local context and key local organizations, certification authorities and general society establish them (Scott, 2008). These informal institutions of different countries also influence the economic behavior of the firms. For example Michailova and Hutchings (2006) showed that informal institutions strongly influence the transfer and management of knowledge across subsidiaries of the firms.

Previous international business studies have addressed the differences in informal institutions as normative distance (Xu et al., 2004; Kaynak et al., 2007), informal institutional distance (Estrin et al., 2009), and social acceptance in the host country (Li et al., 2007). Informal norms are unwritten, are tacit, and may or may not contrast sharply with formal norms, imposed by the legal and judicial systems (Scott, 2003: 136). Therefore, it can be difficult for MNE to understand the dynamics of informal institutions of host country on its own, especially if they differ a lot from the home country. In this case, MNEs may prefer to form joint ventures with local firms, for better understanding the informal institutional environment of the host country. According to Estrin et al. (2009), greenfield investors have less local knowledge to draw upon and may find it harder to access the business practices and norms embedded in the local firms. In case of high informal institutional distance between home and host country of MNE, the need for communicating with key stakeholders and access to local business networks becomes more important. This could be achieved by formation of an international joint venture with a local firm by the MNE. Hence, we hypothesize that

Hypothesis 2: *MNEs prefer international joint venture formation when the informal institutional distance is high between the home and host countries.*

Strength of Market Conforming Values in the Host Country: MNEs' FDI decisions are considerably influenced by the effectiveness of market economy institutions of their host countries (e.g. Sethi et al., 2003). The quality of institutions and strength of market conforming values in the host country are likely to be important determinants of the MNE's wholly owned or joint venture entry decisions. In many emerging economies, the market conforming values are relatively weaker due to poor institutional infrastructure compared to the developed (mostly western) economies (Khanna, 2005). This is largely because the institutional rules supporting market economy are absent, insufficient (Hitt et al., 2004), or poorly enforced (Khanna & Palepu, 1997; Hoskisson et al., 2000). Moreover, the problems like lack of reliable market information, efficient intermediary institutions, predictable government actions, and an efficient bureaucracy also exist in many emerging economies (Khanna & Palepu, 2000). As a result, foreign firms entering those markets need to rely on networking and relationships with local authorities (e.g. Henisz, 2000; Henisz & Zelner, 2005).

Market conforming values in any host country are strengthened from the implementation of financial market and economic policies (Collier & Gunning, 1999), the efficiency of intermediation system (Khanna & Palepu, 2000), acceptance of market conforming values in the society (Li et al., 2007), and the reduction of the extent of corruption (Mauro, 1997; Rodriguez et al., 2005). When market conforming values are strong in a particular host country, it results in reducing uncertainty for the investing foreign firms as well as lowering transaction and operating costs (Khanna & Rivkin, 2001; North, 1990). The results by Child and Tsai (2005) indicate that when firms operate favorable external circumstances, they tend to commit more resources to the host country. Therefore, the host countries with developed institutional infrastructure representing strong market conforming values provide a favorable institutional context for MNEs. The study by Chung and Beamish (2005) found that in presence of favorable institutional context; wholly owned subsidiaries are preferred by the MNEs. Hence, we hypothesize that

Hypothesis 3: *MNEs prefer wholly owned subsidiary formation when the market conforming values in the host country are strong.*

Research Methodology

Data Collection and Sample Description: The empirical material for this study is based on the database of Finnish FDIs developed and continuously updated during last many years. This database of Finnish FDIs is based on annual reports of 100 large Finnish firms in the manufacturing sector listed in Helsinki Stock Exchange and supplemented with the reports from Finnish business press and direct contact with those firms. Therefore, we believe that this database is reliable and representative of the FDIs made in manufacturing sector by the Finnish MNEs.

The study sample consists of 511 FDIs in the manufacturing sector made by 148 Finnish firms in emerging economies of CEE and Asia during the time period 1990-2007. The host emerging economies in our sample from CEE region include Estonia, Lithuania, Latvia, Russian Federation, Ukraine, Czech Republic, Slovak Republic, Poland, Romania, Hungary, and Slovenia. While from Asia, our sample consists of emerging economies like South Korea, Indonesia, India, China, Malaysia, Thailand and Turkey. The ownership mode of the sample firms in target countries consisted of 274 international joint ventures and 237 wholly owned subsidiaries. The establishment mode of the sample FDIs consisted of 303 greenfield investments, while 208 acquisitions. Moreover, the international experience of sample firms ranged from 1 (first) investment to 148 international investments with average of 31,5 investments abroad. The target country experience ranged from 0 years to 25 years with an average of 2,19 years of target country experience of the sample firms. Finally, the number of FDIs in the sample ranged from a minimum of 15 in 1990 to a maximum of 45 in 2005, with average FDIs of 28 per year.

Measurement of Formal and informal institutional distance and strength of market conforming values: We calculate formal and informal institutional distance and strength of market conforming values in the host country measures using country-level indicators related to formal and informal aspects of institutional environment from various editions of the World Competitiveness Yearbook (1995-2007) published by IMD Switzerland. World Competitiveness Yearbooks have also been used by many past studies addressing country differences in institutional environments (e.g. Delios & Beamish, 1999; Gaur, Delios & Singh, 2007; Gaur & Lu, 2007). We calculate the formal and informal institutional distance by subtracting the score of host country in from the score of Finland in the year when FDI was made or score in nearest available year. We would like to mention that for the FDIs made in all our host countries during time period 1990-1994, we use the data of the year1995.

We would also like to mention that same scores are used for Lithuania and Latvia, as Latvia has not been included in the annual surveys administered by IMD. Moreover, for all FDIs made in Lithuania and Latvia, the data from year 2007 has been used because no data before that was available. For FDIs made in Estonia during 1990-2001, the data from year 2001 has been used as Estonia was not included in annual survey of IMD before that year. Similarly, for Romania, the data from year 2003 was used for FDIs made in 1990-2003, as it was not included in IMD annual survey before that. Our study is the one of the first ones to have different institutional distance scores for different years when FDI was made during the sample time period, rather than taking institutional distance scores based on indicators of one year as done in some past studies (e.g. Xu et al., 2004; Kaynak et al., 2007). Table 1 provides the details of operationalization of institutional indicators in our study.

Table 1: Measurements of institutional indicators

Indicator	Survey Item from World Competitiveness Yearbooks (1995-2007)
Formal Institutional Score	Competition legislation is preventing unfair competition (Scores from 1-10).
Informal Institutional Scores	National Culture is open to foreign ideas (Scores from 1-10).
Strength of Market Conforming Values	Foreign Investors are free to acquire control in local firms (Scores from 1-10).

Variables Description: We use equity ownership level as the dependent variable, which is coded 1 in the case the foreign subsidiary is an international joint venture (IJV) (less than 95% ownership in the foreign subsidiary) and 0 in the case if it is a wholly owned subsidiary (WOS) (more than 95% ownership in the foreign subsidiary). In line with the literature and previous studies, we use a number of control variables both at the country and firm level, in order to enhance the validity of the results. These control variables include international experience of the firm, target country experience of the firm, economic growth in the host country, country risk, and establishment mode choice (greenfield investment vs. acquisition). Table 2 provides description of study variables, along with the codes and relevant references of data sources.

Table 2. Operationalization of the Variables

Variable Name	Code	Operationalization
Formal Institutional Distance	FORMDIST	Difference in host country score from Finland in the item: *Competition legislation is preventing unfair competition* (Scores from 1-10) (Source: World Competitiveness Yearbooks) in the year of investment / score in nearest available year.
Informal Institutional Distance	INFORMDIST	Difference in host country score from Finland in the item: *National Culture is open to foreign ideas* (Scores from 1-10) (Source: World Competitiveness Yearbooks) in the year of investment / score in nearest available year.
Strength of Market Conforming Values	ACQFRED	Country Scores in the item: *Foreign Investors are free to acquire control in local firms* (Scores from 1-10) (Source: World Competitiveness Yearbooks) in the year of investment / score in nearest available year.
International Experience	INTEXP	The number of earlier manufacturing FDIs made by the firm (Source: FDI Database).
Target Country Experience	TCEXP	The length of earlier manufacturing experience in target country (no. of years) (Source: FDI Database).
Economic Growth	ECONGROWTH	The annual growth of GDP in the target country, in the year of investment (Source: UNCTAD).
Country Risk	CORISK	The target country risk in the year preceding the investment based on Euro money country risk ratings (Source: Euromoney country risk ratings).
Establishment Mode Choice	ESTMODE	0=Greenfield investment, 1= Acquisition (Source: FDI Database).

Statistical Method: We have used stepwise binary logistic regression to test our hypotheses because the dependent variable is dichotomous. Binomial logistic regression model is formally expressed as

$$P\ (y_i=1) = 1\ /\ 1+ \exp\ (-a-X_iB)$$

Where y_i is the dependent variable, X_i is the vector of independent variables for the ith observation, a is the intercept parameter and B is the vector of regression coefficients. We used recent version of SPSS i.e. PASW for the regression analysis. As in our study, the dependent variable has value 1 if the ownership mode choice is international joint venture, then a positive regression coefficient indicates that a particular variable increases the probability of joint venture formation by the MNEs.

Appendix 1 shows the descriptive statistics and correlations of the variables used in the study. We do not observe any significantly high correlations between the variables except between economic growth in the host country and country risk. Therefore, we conduct the analysis of variance inflation factor (VIF) as recommended by Wetherill (1986) due to the fact that our analysis involves more than 3 variables. Wetherill (1986) points out that in the near dependency the correlations between relevant pairs of variables need not to be large. This is where VIF should not be larger than ten. The VIF values for our variables are even lower than 5, therefore multicollinearity problem is not expected in our dataset.

Results and Discussion

We assess the explanatory power of our model by using chi-square statistics. Large chi-square values and small *p* values indicate a good fit. The predictive ability of our model can be assessed by the correct classification rate. The logit models of our study have a higher correct classification rate than the chance rate of 50%, which is calculated using the *proportional chance criterion* which is $a^2 + (1-a)^2$, where *a* is a proportion of international joint ventures (54%) in the sample. Our models show correct classification rate of 57,9% to 64,4%; therefore showing 7,9% to 14,4% improvement. We further believe that our models have significant predictive capability which is evident from the gradual increase in Negelkerke R^2 values from model our models 1 to 4.

In Table 3, the Model 1 presents the results of the binary logistic regression depicting the impacts of control variables on the ownership mode choice of MNEs. The most significant control variables are establishment mode and economic growth, which are both significant at $p<0.05$ level in models 1 to 3 and at $p<0.01$ level in model 4. The significance of establishment mode can explained by referring to the fact that ownership and establishment mode choices of MNEs are related decisions. Further on, the negative sign of economic growth shows that MNEs preferred to establish wholly owned subsidiaries in the countries with high economic growth rate. The countries with high economic growth rate offer attractive market opportunities to the MNEs. Therefore, it can be argued that MNEs decided to reap the benefits themselves by committing more resources and forming wholly owned subsidiaries. Three control variables are i.e. international experience, target country experience and country risk, are non-significant in our results. It is important to note that the host countries in our sample comprise of emerging markets of CEE and Asia. As these market are in the process of transition to market economy and represent very different market structures than developed western markets; therefore non-significance of general international experience is quite understandable. Moreover, the economies of CEE and some in Asia also, opened up quite late (mostly after 1990) for the foreign firms. Therefore, the investing foreign firms had little target country experience even if they invested again there, which can possibly explain non-significance of target country experience.

Table 3. Logistic regression estimates Ownership Mode Choice (international joint venture=1)

Variables	**Model 1**: Control variables	**Model 2**: Formal Institutional Distance	**Model 3**: Informal Institutional Distance	**Model 4**: Strength of Market Conforming Values
International Experience	,001	,000	,000	,000
Target Country Experience	-,029	,015	,014	,013
Country Risk	,000	-,010	-,013	-,10
Establishment Mode	,440**	,451**	,470**	,609***
Economic Growth	-,046**	-,048**	-,047**	-,062***
Formal Institutional Distance		-,523***	-,569***	-,694***
Informal Institutional Distance			,156	-,007
Strength of Market conforming values				-,189***
Constant				
N (IJV)	511(274)	511(274)	511(274)	511(274)
Model x^2	21,142	43,655	45,586	54,756
–2 Log likelihood	684,573	662,060	660,129	650,959
Nagelkerke R^2	,054	,109	,114	,136
Correctly classified (%)	57,9	60,5	62,0	64,4

Significance; *** p <0.01, ** p < 0.05, *p< 0.1.

We observe that formal institutional distance is highly significant (p<0.01) in models 2, 3 and 4. Moreover, the sign for formal institutional distance is negative, which shows increased probability of wholly owned subsidiary formation by MNE in ownership mode choice. This result is opposite to our hypothesis as well as the results of past studies (see e.g. Yiu & Makino, 2002; Xu et al., 2004), where it was posited that high formal (regulative) institutional distance results in firm's preference for international joint ventures. However, it is important to mention that many previous studies addressing institutional distance (differences) and ownership and entry mode choices concentrated on FDIs made by Japanese MNEs in their international markets (e.g. Yiu and Makino, 2002; Xu et al., 2004). We believe that this factor i.e. home country of investing MNEs has also influenced the result of those studies, as Japanese managerial attitudes towards FDI decisions like ownership mode choice are different from the Nordic ones. We would also like to refer to a recent study by Estrin et al. (2009) where it is mentioned that if local organizations are designed to fit very different formal institutional environment, then the resources that they offer to foreign firm are of less value than the costs involved of operating with partners from totally different legal system. The countries in our sample represented emerging economies from Asia and CEE that comprise of very different formal institutional environment compared to Nordic institutional environment that Finnish firms are used to. Hence, we consider that Finnish firms preferred to form wholly owned subsidiaries whenever it was legally possible for them despite high formal institutional distance, so that they can smoothly run operations in the host countries.

It is further observed that informal institutional distance is non-significant in models 3 and 4. The sign of informal institutional distance is positive in model 3 which is according to our expectation i.e. high informal institutional distance results in formation of international joint ventures. Moreover, the sign of informal institutional distance changes to negative in model 4; however still it is statistically non-significant. We do not receive the statistical support for hypothesis 2 and it is rejected.

Finally, the strength of market conforming values in the host country is highly significant at $p<0.01$ level and the sign is also according to our expectation i.e. negative. Therefore, strong market conforming values in the host country result in formation of wholly owned subsidiaries by the MNEs. Consequently, we accept hypothesis 3. Moreover, this finding is also in accordance with the findings of some previous studies where it was argued that strong market conforming values and favorable institutional environment results in formation of wholly owned subsidiaries by the MNEs (Chung & Beamish, 2005; Li et al., 2007).

Conclusions, Limitations and Future Research Directions

The purpose of our study was to examine the impacts of formal and institutional distance and strength of market conforming values in host country on the ownership mode choice of MNEs. Our dataset of 511 FDIs made by Finnish firms in CEE and Asian countries over the time period 1990-2007 allowed us to perform robust analysis of our hypotheses. Our study contributes to the application of institution-based view in foreign market entry literature by specifically addressing impacts of strength of market conforming values in host country along with formal and informal institutional distance on ownership mode choice of MNEs. The empirical context of Finnish FDIs in emerging economies of CEE and Asia is also useful because of relatively large differences in institutional environments of these countries from Finland. Moreover, as many similar studies in past used database of Japanese FDIs to study the impacts of institutional differences on MNE strategies (e.g. Xu et al., 2004; Gaur et al., 2007; Gaur & Lu, 2007), our different empirical settings provide newer and interesting findings.

In the empirical part, stepwise binomial regression is used to test our hypotheses. Our results indicate that high formal institutional distance results in formation of wholly owned subsidiaries by the MNEs, which is opposite to what we hypothesized. However, we do not receive significant statistical support for the impact of informal institutional distance on ownership mode choice of MNEs. We believe that the unique sample characteristics compared to past studies, specific host countries characteristics in relations to the transition process to market economy and as well as study time period contributes to these different results. Moreover, our study is one of the first ones to measure the institutional distance by referring to the differences in institutional scores of home and host countries in the year of investment or available data for the nearest year rather than using data for only year as done in many past studies. We believe that use of these measures which comprehend the institutional differences more realistically, also influenced our rather different findings, because in many of the host countries market economy institutions have developed during the sample time period. Therefore, by using these measures of institutional distance, we are able to incorporate the institutional transition and strengthening of market conforming values in many of the emerging markets. From our control variables, we found out that economic growth in the host country to significantly influence the formation of wholly owned subsidiary by MNEs, while establishment mode influences formation of joint ventures by the MNEs. Finally, our study found out the strength of market conforming values in the host country significantly influence the choice of wholly owned subsidiary by the MNEs which supports our hypothesis and results of some previous studies addressing similar issues.

The findings of the study have some useful implications of managers of firms from the Nordic region internationalizing to emerging economies of CEE and Asia. Based on our analysis, high formal institutional distance between Finland and the sample host countries result in formation of wholly owned subsidiaries. Moreover, we also found that high economic growth and strong market conforming values in the host countries also result in formation of wholly owned subsidiaries. The other aspects of organizational strategy are also influenced by these findings e.g. transfer of organizational practices to foreign subsidiaries of MNEs. MNE managers need to remember that the costs involved in operating with joint venture partners from totally different legal and formal institutional system can be quite high. Many emerging economies offer attractive opportunities depicted by high economic growth and also market conforming values are strengthening due to institutional development. Therefore, formation of form wholly owned subsidiaries could provide MNEs useful long term advantages despite high formal institutional distance at time of market entry. This would also allow for better conformity and transfer of organizational practices across foreign subsidiaries of MNEs.

Our study also has certain limitations. Firstly, we only address ownership mode choice in relation to decision between wholly owned subsidiary and international joint venture. We do not address majority, minority and 50/50 joint ventures separately. Secondly, our measures of formal and informal institutional distance, and strength of market conforming values in the host country are based on single items from executive opinion surveys by IMD. In future, the measures should include more items addressing formal and informal institutional environment comprehensively. This kind of operationalization of variables would also thoroughly address challenges that MNEs face by operating multiple institutional environments across the globe. Moreover, our study concentrates on FDIs made by Finnish firms in emerging economies of CEE and Asia, which could also be considered as a limitation. However, on the other hand, the focus on FDIs made by Finnish firms provides an interesting opportunity to analyze the impacts of institutional distance and strength of market conforming values on the ownership mode choice from the perspective of firms from a Nordic country.

For the future research, it is suggested to expand the sample size by also including the FDIs made by MNEs from other Nordic countries i.e. Sweden, Norway and Denmark, and study the impacts of institutional distance on their ownership mode choices. This would allow gaining a comprehensive understanding of the impacts of institutional distance on ownership mode choices and would help in generalizing findings from a Nordic perspective. Moreover, the impacts of institutional distance on ownership mode choice can be addressed in depth by future studies by differentiating between minority, majority and 50/50 joint ventures in the empirical analysis. Finally, the future research has the potential to test the impacts of institutional distance and strength of market conforming values in the host country on MNE’s divestment decisions from certain international markets, location choice of MNEs and management of mergers and acquisitions.

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Appendix 1: Descriptive Statistics and Correlations (N=511)

		Mean	Std.dev	1.	2.	3.	4.	5.	6.	7.	8.	9.
1.Ownership Mode	**Pearson Correlation**	,54	,499	1								
2. International Experience	**Pearson Correlation**	31,49	32,369	-,20	1							
3. Target country Experience	**Pearson Correlation**	2,19	3,842	-,058	,447*	1						
4. Country Risk	**Pearson Correlation**	52,90	15,087	-,113	,075	,045	1					
5. Establishment Mode	**Pearson Correlation**	,41	,492	,116	-,011	,092	-,096	1				
6. Economic Growth	**Pearson Correlation**	3,214	7,133	-,168*	,112	,157*	,669*	-,110	1			
7. Formal Institutional Distance	**Pearson Correlation**	3,088	,942	-,167*	,070	,307*	-,308*	,051	-,155*	1		
8. Informal Institutional Distance	**Pearson Correlation**	-,0369	,87883	-,031	,038	,110	,193*	-,076	,120*	,219*	1	
9. Strength of Market Conforming Values	**Pearson Correlation**	6,288	1,922	,012	-,125*	-,192*	-,035	,197*	-,196*	-,387*	-,489*	1

* $p < 0.01$ (two-tailed test).