

# The Effect of Uncertainty on FDI Entry Mode Decisions: The Influence of Family Ownership and Involvement in the Board of Directors

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Family business literature offers contradictory views on the role that family owners play in internationalization of the business. Whether family owners restrain or facilitate firm's internationalization, is a matter of continued debate. This study aims to settle that dispute, with data from 681 publicly listed, Taiwanese companies. The authors look at the problem from the 'Transaction Cost Economics (TCE)' perspective and examine how uncertainty influences FDI entry mode decisions. Specifically, the authors probe how these decisions are influenced by family ownership and involvement in the board of directors. This summary presents the gist of the study, its findings and implications.

## Uncertainty in FDI Entry Mode Choice

When firms decide to enter a foreign country market, they have two entry mode options available: **1. Full equity approach of wholly owned subsidiary** (complete investment made by the family firm) and **2. Shared equity arrangement of joint ventures** (investment shared with local businesses/ other entities). Firms need to carefully choose one of the entry modes. Whether family owners hesitate or facilitate internationalization depends on the uncertainty they encounter. Therefore, uncertainty is considered a key driver of internationalization entry mode choice.

According to the Transaction Cost Economics (TCE) perspective, the choice of market or relational contract is dependent on the governance structure that minimizes transaction costs.

The authors argue that when uncertainty is high, the family firm is likely to exhibit lower level of commitment to the foreign market. In contrast, when uncertainty is low, the firm is likely to have high levels of enthusiasm and commitment to internationalization.

## Choosing between a Joint Venture and a Wholly Owned Subsidiary

The authors suggest that the choice between a joint venture and a wholly owned subsidiary is actually a *tradeoff between* the family's *control* over its international business and *risk* arising from resource commitment to the international market.

In markets with high uncertainty, joint venture is more likely to be the mode of entry because the venture partner brings local knowledge, skills, capabilities and superior understanding of the market. Joint venture facilitates *risk* sharing and makes provision for an easy exit (if circumstances so force).

On the other hand, in markets where uncertainty is low, family firms may opt for wholly owned subsidiaries to seize market opportunity and exercise greater *control*.

In addition, the authors also argue that with high levels of family ownership and involvement in the board of directors, the firm is likely to opt for wholly owned subsidiary for its international operations.

### **The Study and its Findings**

The hypotheses framed by the authors were statistically tested with the help of data from 681 publicly listed, Taiwanese companies.

The key findings of the study were the following:

- When uncertainty decreases, firms with high levels of family involvement (in the board of directors) were more likely to choose to setup wholly owned subsidiaries.
- Family owners' involvement on board facilitated internationalization of the firm. However, this was only found to be true in cases where there was low internal uncertainty.

- The influence of family ownership on firm's internationalization choices was not clearly established.

Thus, the family management's desire to maintain control over the business was found to have driven their internationalization decisions. These were greatly influenced by the level and nature of uncertainty they faced.

### **Practical Implications**

The study has significant implications for family firms. Internationalization of family firms is a multi-layered phenomenon, which is greatly influenced by the level of uncertainty the firms face. Similarly, family firm's internationalization decisions also depend on the extent of family's involvement in board of directors.

Family firms would make more effective internationalization decisions if they plan ahead to reduce uncertainty and enhance family involvement in board of directors.

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