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Corruption and Multinational Companies' Entry Modes. Do Linguistic and Historical Ties Matter?

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Abstract

Extant literature on FDI entry modes and corruption tend to convey the idea that corruption leads to the choice of low equity, i.e. joint-ventures with local partners, or non-equity modes, namely export and contracting, in order to avoid the contact with corrupt state officials. Recently, some studies argument that despite corruption, linguistic and historical ties between home and host countries guide MNCs to prefer high equity modes. Focusing on a rather unexplored setting, the African countries, most specifically the PALOP (*Países Africanos de Língua Oficial Portuguesa*), which includes countries with both very high (e.g., Guinea-Bissau, and Angola), high (e.g., Mozambique, Sao Tome and Principe) and middle (e.g., Cape Verde) levels of corruption, and that maintain quite close linguistic and historical ties with Portugal, we found that FDI entry mode is associated to the less corrupt markets. Thus, our results do not support the content that cultural and historical links are likely to perform an intermediating role in helping, through fostering foreign direct investment, African countries to overpass the dismissal growth that some have been facing in the last decades. On the contrary, our findings highlight the pressing need for these countries to combat corruption if higher economic growth via FDI attraction is envisioned.

Keywords: Corruption, Emerging Economies, Entry mode

JEL-Codes: F21; F23; K42

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1. Introduction

Multinational companies (MNCs) are increasingly influenced by institutional instability, perceived risk and uncertainty in their process of investing in emerging economies (Uhlenbruck *et al*., 2006). Extant literature suggests the existence of a negative correlation between inflows of FDI and corruption (Uhlenbruck *et al*., 2006; Javorcik *et al*., 2009). Specifically, the analysis is centered on quantifying FDI flows and to assess how firms adapt their entry mode to existing corruption (Straub, 2007).

In such contexts, evidence is found that firms prefer joint-ventures to wholly owned subsidiaries (Rodriguez *et al*., 2005; Uhlenbruck *et al*., 2006; Straub, 2007; Javorcik *et al.*, 2009; Demirbag *et al.*, 2010). Regardless whether firms face petty bureaucratic or high-level political corruption (Straub, 2007), and the level of pervasiveness and arbitrariness of corruption (Rodriguez *et al.*, 2005; Uhlenbruck *et al*., 2006; Demirbag *et al.*, 2010), existing empirical studies suggest that corruption influences the entry mode, particularly towards the choice of non-equity modes or partnering. More recently, however, some evidence was found that in case of positive relationships between home and host country MNCs revealed preference for wholly owned subsidiaries (Demirbag *et al.*, 2010).

It is important to underline that these studies that analyze the relationship between corruption and its impact on MNCs' choice of entry mode focused mainly on Eastern Europe (Javorcik *et al.*, 2009) and Asia (Demirbag *et al.*, 2010) or took a general overview based on a cross-country composition (Uhlenbruck *et al.*, 2006; Straub, 2007). Similar analyses encompassing African countries have been rather neglected in this regard.

Among African countries, a sub-set of countries, the PALOP (*Países Africanos de Língua Oficial Portuguesa*), includes countries with both very low (e.g., Guinea-Bissau, and Angola), low (e.g., Mozambique, São Tome and Principe) and middle (e.g., Cape Verde) levels of transparency as perceived by the Corruption Perception Index (Transparency International, 2009). Given the close relationship ties between Portugal and the PALOP based on linguistic and historical factors, and following Demirbag et al.'s (2010) argument, it would be scientifically pertinent to analyze the extent to which PALOP's corruption levels influence the entry modes of Portuguese MNCs in these countries.

The empirical analysis undertaken in the present study aims therefore to assess the extent to which Portuguese MNCs' entry modes in PALOPs corroborates Demirbag's (2010) thesis.

Moreover, it contributes to the scarce literature on corruption and MNCs' entry models by analyzing an under explored context, the PALOP.

This paper is structured as follows. In Section 2 we revise existent literature on theories and determinants of MNCs' entry modes and on corruption, deepening the analysis of existent articles about the impact of corruption on MNCs' entry mode. In Section 3 we detail the methodological considerations of the study: data gathering procedures, questionnaire, target firms (Portuguese firms that internationalized to the PALOPs), and the specification of the econometric model which will permit to quantify the net impact of corruption on entry mode choice. In Section 4 results of the econometric estimations are discussed and, finally, in Conclusions we summarize the main points of the research.

2. Corruption and MNCs' Entry Modes. Literature Review1

2.1. Defining Corruption

Being one of the most widespread political problems worldwide (Frischmann, 2010), in recent years there has been considerable empirical research on the causes and effects of corruption (Goel *et al.*, 2010). The World Bank has estimated that more than 1 trillion USD is paid in bribes each year and that countries that fight corruption, improve governance and the rule of law, what could increase per capita incomes by 400 percent (Dreher *et al.*, 2007).

According to the significant impact and the numerous studies on corruption, there are lots of definitions of this phenomenon (Detzer, 2010). The most common is the one used by the World Bank, describing corruption as "the abuse of public office for private gain".[2] Transparency International has a very similar designation, defining it as "the misuse of entrusted power for private gain".[3] Another often cited, but less clear and focused definition is corruption as the "behavior which deviates from the formal duties of a public role because of private regarding […] pecuniary or status gains, or violates rules against the exercise of certain types of private regarding influence" (Nye, 1989: 966 *in* Frischmann, 2010: 2).

These definitions may differ slightly in their formulation, nevertheless there is consensus in lots of studies (Dey, 1989; Mauro, 1998; Treisman, 1998; Dietrich, 2010; Reiter *et al.*, 2010)

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1 This section is based on a deeper and more detailed survey by Grande and Teixeira (2011).

2 "Helping Countries Combat Corruption: The Role of the World Bank", in. http://www1.worldbank.org/publicsector/anticorrupt/corruptn/cor02.htm, accessed on 20th November 2010.

3 "How do you define corruption?", in http://www.transparency.org/news_room/faq/corruption_faq, accessed on 20th November 2010.

that corruption refers to acts in which the power of public office is used for personal gain in a manner that contravenes the rules of the game (Jain, 2002).

Another issue arising in the analysis of corruption is the question how to measure this occurrence. The most well-known corruption indicator is the Corruption Perceptions Index (CPI), published annually by Transparency International (Berg, 2001).

Another method for constructing composite indicators of corruption is given by the International Country Risk Guide (ICRG) (Mauro, 1998; Dietrich, 2010). Alternatively, Demirbag *et al.* (2010), who focus on the specific type of corruption, bribery, use the bribe ratio to measure this behavior. In studies like this the measurement is used as a representative indicator for corruption (Henderson, 2010) or, more precisely, the pervasiveness of corruption (Demirbag *et al.*, 2010).

Besides the mentioned methods of measuring corruption, there is a diversity of corruption and bribery indexes elaborated from different entities such as the World Economic Forum (Friedman *et al.,* 2000), the International Monetary Fund (García *et al.*, 2009) and the World Bank (Javorcik *et al.*, 2009).

2.2. MNCs entry modes

2.2.1. Defining MNCs entry modes

International entry modes represent the third most researched field in international management, being directly related to MNC's international activity (Canabal *et al.*, 2008). Entry modes vary largely in its scale of entry (Peng, 2009), being mostly divided into two categories: equity and non-equity (Tian, 2007).

Equity entry modes include joint-ventures and wholly-owned subsidiaries. The former consists in a sharing arrangement between a foreign MNC and a local firm, where resources, risk and operational control are divided between the partners (Julian, 2005), whereas the latter might involve both greenfield investments that consists in establishing a new firm and acquisitions of already existing firms (Razin, 2007). In the case of equity mode the resource commitment, i.e. the scale of entry, is very high because there is a direct establishment in the foreign market (Hill *et al.*, 2009).

Non-equity modes are exports and contractual agreements like licensing, franchising, turnkey projects and R&D contracts. In this case the scale of entry is lower because the relations with the foreign market do not imply a direct establishment (Peng, 2009).

2.2.2. Main theoretical approaches and determinants of MNCs entry modes

It is important to recall that most of theories on FDI and MNCs intent to explain why firms involved themselves in several types of internationalization processes. In general, the very distinct theoretical approaches (early studies FDI; the neoclassical trade theory; ownership advantages; aggregate variables; ownership, location and internalization advantage (OLI) framework; horizontal and vertical FDI; the knowledge-capital model; risk diversification models; and policy variables – cf. Faeth, 2009), are not directly and explicitly aimed at explaining MNCs' entry modes but instead their focus is on highlighting key determinants of foreign direct investment. By adapting the existing theoretical approaches on FDI and internationalization, we provide a distinct systematization, mixing existing contributions under the transaction cost analysis, the broader theoretical framework, the Dunning's eclectic paradigm, and the institutional approach.

Transaction cost analysis has been widely used by researchers to examine determinants of entry mode choices (Chen *et al.*, 2002). Most theorists who study this cost-related approach favor the establishment of joint-ventures (Madok, 1998), because it reduces significantly the high financial efforts related to other entry modes(Raff *et al.,* 2009) and helps to fill the information gap due to socio-cultural differences (Chun, 2009).

Starting from the micro-level, of Dunning's eclectic paradigm the ownership dimension highlights firm-level determinants such as income-generating assets and firms' ability to coordinate them with other assets abroad (Cantwell, 2003). Given the perspective on firms' abilities, we might associate the firm's competences, skills and assets from the resource-based theory (Hill, 2009) to this approach (Luo, 1999). In concrete, for firm-specific assets (Madok, 1998; Sreenivas *et al.,* 2000) such as technology intense resources (Sun, 1999; Javorcik *et al*., 2009) and inventive/R&D intense activities (Bhaumik *et al*., 2005; Chung, 2009), the mostly preferred entry mode is the establishment of wholly-owned subsidiaries (WOS). This is justified on the basis that firm-specific resources and activities need a high level of control (Edwards *et al*., 1998; Chen *et al.,* 2002), which would not be possible in a joint-venture (JV) where knowledge has to be transferred to the partner (Chiao *et al*., 2010; Yiu *et al.,* 2002; Martin *et al*., 2003). MNCs with cumulated knowledge in internationalization are less likely to rely on the support of a joint-venture partner, because they already have the needed know-how to do business abroad (Mutinelli *et al*., 1998). In contrast, when a MNC does not have any experience, JV can be used to complement internal R&D resources and to exchange knowledge on an interfirm basis level (Mutinelli *et al*., 1998).

The internalization approach from Dunning's Eclectic Paradigm stems from the removal of the market relationship between an importer and an exporter, which provokes high transaction costs for the internationalized MNC (Peng, 2009). This theory is based on the advantages that are created when a MNC enters foreign markets via FDI, avoiding entry costs and trade barriers (Cantwell, 2005) (see Transaction Cost Approach).

In the location-specific approach extracted from Dunning's Eclectic Paradigm, cultural distance is a dominant determinant of entry mode choice. Culturally distant markets favor MNCs entry via WOS, rather than by JV (Chen *et al.*, 2002; Pennings *et al.*, 2004; Drogendijk *et al.*, 2006). Also high potential industries (Chen *et al.*, 2002) and competition intense markets (Elango *et al.*, 2004; Müller, 2007), guide MNCs to choose WOS as the optimal entry mode. Nevertheless, to gain access to industry-specific assets such as R&D capabilities (Belderbos, 2003) and complementary assets (Hennart, 2009) MNCs use joint-venture partners as intermediaries to guarantee their availability.

Preference for JV establishments exists for intense socio-cultural differences between home and host countries (Sun, 1999; Chun, 2009). Linguistic distance (Demirbag *et al.*, 2009) influences entry modes in the same direction; specifically, MNCs overcome such "cultural barriers" through the support of local JV partners (Sun, 1999). These partners are often embedded in local networks which are advantageous for foreign MNCs' performance (Yeung *et al.*, 2000). FDI, in general, is preferred when entering large markets (Horstmann *et al.*, 1996; Eicher *et al.*, 2005) and when countries have low development levels (Lehner, 2009; Al-Kaabi *et al.,* 2010).

Focusing now on the more macro level approaches, namely the institutional approach, the determinants of firms' entry mode include items such as political risk (Henisz, 2000; Ketata, 2006), perceived uncertainty due to risky environments (Taylor *et al*., 2000; Ahmed *et al.,* 2002; Li *et al*., 2007) and institutional differences (Luo, 2001; Chiao *et al*., 2010). In these cases the preferable entry mode choice is WOS. One reason of this choice may be the protection from manipulative JV partners, whose knowledge about the institutional environment is more detailed than that of foreign investors (Henisz, 2000). JV can also function as a protection from governmental intervention (Luo, 2001) and political constraints oriented to foreign firms (Yiu *et al.,* 2002; Demirbag *et al.,* 2009). Facing corruption, JV would help to avoid excessive transaction costs related to corruptive government officials (Javorcik *et al*., 2009), can minimize the lack of familiarity with host countries' institutions

(Meyer, 2001) and decrease uncertainty due to political differences (Bianchi *et al*., 2006; Slangen *et al.*, 2008).

Other authors argue that entry into corruptive host countries should be based on non-equity modes (Rodriguez *et al.,* 2005; Straub, 2007), such as export and contracting (licensing, franchising and turnkey projects), to protect foreign investors from eventually corruptive joint-venture partners (Slangen *et al.*, 2009).

Summarizing the contributions reviewed above and framing them into main trends of entry mode choices we can state that there is a main inclination for equity mode choice when taking into account the Eclectic Paradigm theory, whereas the non equity mode choices are more in line with the institutional approach. This is in part explained by the fact that institutional theory focuses mainly on constraining determinants while the Eclectic Paradigm highlights the benefits of MNCs' internationalization.

2.3. Corruption and MNCs' entry modes

The few studies that simultaneously focus on corruption and entry modes (e.g., Uhlenbruck *et al*., 2006; Straub, 2007; Paul *et al*., 2008; García *et al*., 2009; Javorcik *et al*., 2009; Slangen *et al*., 2009; Demirbag *et al*., 2010) permits the observation that there is a diversity of measures utilized in order to quantify corruption and a variety of analyzed entry modes. Indeed, corruption is rarely defined and measured the same way.

Demirbag *et al.* (2010: 214), analyzing the pervasiveness of corruption defined as "the average firm's likelihood of encountering corruption in its normal interactions with state officials", quantifies bribes with Transparency International's bribe payers index (BPI). Other authors like Javorcik *et al.* (2009) and Slangen *et al.* (2009) use a junction of several indicators. In concrete, Javorcik *et al.* (2009) employ the corruption index from the World Development Report, which is based on a survey undertaken by the World Bank, completing it with the corruption index used in Kaufmann *et al.* (1999) and a corruption perception index reached by a questionnaire made by the German journalist, Peter Neumann. This, according to Javorcik *et al.* (2009), provides more precise results concerning to different types of corruption. Slangen *et al.* (2009) measure corruption through Kaufmann *et al.*'s (2004) analysis of several hundreds of variables measuring governance quality. Also García *et al.* (2009) merge the Corruption Perception Index (CPI) with the International Monetary Fund's (IMF) indices to include corruption (measured by the CPI) as well as political stability (considered by the IMF) in their study. Straub (2007) does not diversify the sources of corruption’s measurement, but includes different indexes of the International Country Risk Guide (corruption index and index of bureaucratic quality) in order to distinguish between bureaucratic and political corruption in his analysis.

According to the entry modes studied in these articles we observe that there are two main groups. On the one side, we have the analysis of WOS versus JV (Javorcik *et al.*, 2009; Slangen *et al.*, 2009; Demirbag *et al.*, 2010) and, on the other side, studies focusing on FDI (WOS and JV) versus non-equity modes (e.g., Rodriguez *et al.*, 2005; Uhlenbruck *et al.*, 2006; Straub, 2007; Paul *et al.*, 2008).

A general observation regarding each of the analyzed articles demonstrates that corruption discourages the establishment of wholly-owned subsidiaries (WOS). Nevertheless, in specific cases like large-sized operations, cultural proximity (Demirbag *et al.*, 2010) and high-technological firms (Javorcik *et al.*, 2009) MNCs may enter via WOS in order to protect their firm-specific assets from for example joint-venture partners or because the cultural environment is very similar to the home countries. Rodriguez *et al.* (2005) also purposes this entry mode in presence of pervasive corruption that can encourage MNCs’ involvement in corruption to achieve legitimacy but, at the same times, might cause internal conflicts within MNCs internal norms. In this sense the articles which oppose wholly-owned subsidiaries (WOS) to joint-ventures (JV) consider this second option as advisable being a strategic mean for integration in social networks and to enforce MNC’s external legitimacy (Demirbag *et al.*, 2010) and to avoid excessive transaction costs (Javorcik *et al.*, 2009). According to Slangen *et al.* (2009) this option may protect MNCs from external uncertainties but creates internal uncertainties originated by the local partner.

Regarding the articles which analyzed the opposition FDI versus non-equity modes, the establishment of a JV appears as a viable option in case of arbitrary corruption in order to protect themselves from discriminating policies towards foreign firms (Uhlenbruck *et al.*, 2006), to avoid direct contact with corrupt government officials and to achieve legitimacy via networking (Rodriguez *et al.*, 2005). The third and dominant option of these studies consists in entering corrupt markets via non-equity modes. According to Straub (2007), petty bureaucratic corruption causes a shift towards non-equity modes because firms try to avoid bribes related to ownership and high-political corruption also favors this entry mode in order to preserve asymmetric information. Uhlenbruck *et al.* (2006) and Rodriguez *et al.* (2005) argue that in presence of pervasiveness, even when combined with arbitrariness, MNCs choose non-equity modes to avoid the costs related to corruption. Using Paul *et al.*’s (2008) arguments we can affirm that when the host country exhibits greater progress towards market-oriented reforms and being highly liberalized, MNCs tend to enter via high equity modes, but in more risky environments it is advisable to enter via contracting, or generally via non-equity modes such as exports, franchising or licensing.

Multinational companies (MNCs) are increasingly influenced by institutional instability, perceived risk and uncertainty in their process of investing in emerging economies (Uhlenbruck *et al*., 2006). Extant literature suggests the existence of a negative correlation between inflows of FDI and corruption (Uhlenbruck *et al*., 2006; Javorcik *et al.*, 2009). Specifically, the analysis is centered on quantifying FDI flows and to assess how firms adapt their entry mode to existing corruption (Straub, 2007).

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Most of the studies that analyze the relationship between corruption and its impact on MNCs' choice of entry mode focused mainly on Eastern Europe (Javorcik *et al.*, 2009) and Asia (Demirbag *et al.*, 2010), or took a general overview based on a cross-country composition (Uhlenbruck *et al.*, 2006; Straub, 2007). Similar analyses encompassing African countries are, to the best of our knowledge, non existent.

Given the well known historical and linguistic proximity that some group of African countries, the PALOP (*Países Africanos de Língua Oficial Portuguesa*), maintains with Portugal (Lloyd-Jones and Pinto, 2003), and the fact that the levels of transparency are in this group (with the exception of Cape Verde) quite worrisome, reflecting a high degree and widespread corruption,[4] it would be scientifically pertinent to analyze the extent to which

[4] Among 178 countries, Angola ranks 168th, with a score of 1.9, Guinea Bissau 154th, with 2.1, Mozambique 118th with 2.7, and Sao Tome Principe 101st with 3.0 in the 2010 Corruption Perceptions Index. Note that the score ranks from 10 (very clean) down to 0 (highly corrupt), being considered that countries with a score equal or inferior to 3.0 suffer from pervasive and widespread corruption (Transparency International, 2011).

PALOP's corruption levels influence the entry modes of Portuguese MNCs in these countries. More specifically, given the traits of the countries in analysis we can test Demirbag et al.'s (2010) argument in a new set of countries, the African ones, most notably the PALOP.

Thus, we would expect that despite the widespread levels of corruption, which according to the extant literature would advice MNCs to follow a non equity entry mode (namely export, contracting), given the historical and linguistic proximity between Portugal and the PALOP, Portuguese MNCs entry mode might occur preferably through equity modes (FDI).

3. Methodological considerations

Similarly to other studies, which analyze the role of the several determinants on MNCs' entry mode options (e.g., Uhlenbruck *et al.*, 2006; Straub, 2007; Slangen *et al.*, 2009), the present study resorts to a multivariate econometric model, more specifically, a logistic regression to assess how corruption affects firms' entry modes in countries characterized by widespread levels of corruption (the PALOPs) and that maintains historical and language affinities with the MNCs' home country (Portugal).

Based on the literature, MNCs entry mode choices depend on four main groups of determinants, namely on the three dimensions of Dunning's Eclectic Paradigm (or OLI model) and the institutional approach. We left out the Transaction Cost Approach because, as earlier noted, its determinants are included in the internalization dimension of the OLI model.

Our 'dependent' variable, MNC entry mode, is a dummy which assumes the value 1 in the case the firm chooses (for a given market) to entry through FDI and 0 otherwise (non equity modes).

Given the nature of the dependent variable (binary), the empirical assessment of MNCs FDI propensity is based on the estimation of the general logistic regression, which in turn is based on the existing literature on the determinants of entry modes, surveyed in Section 2. In order to have a more straightforward interpretation of the logistic coefficients, it is convenient to consider a rearrangement of the equation for the logistic model, in which it is rewritten in terms of the odds of an event occurring. Writing the logistic model in terms of the log odds, we obtain the logit model

$$\log\left(\frac{\Pr ob(FDI)}{\Pr ob(Non-equity)}\right) = \beta_0 + \underbrace{\beta_1 RD\_Int + \beta_2 Firm\_size + \beta_3 Firm\_Int\_\exp}_{Ownership} + \underbrace{\beta_4 Openness}_{Internalization} +$$

$$+ \underbrace{\beta_5 Market\_size + \beta_6 Cultural\_\Pr ox}_{Location} + \underbrace{\beta_7 Legal\_\mathrm{Re}st + \beta_8 Polit\_stability + \beta_9 Corruption}_{Institutional\_context} + \varepsilon_i$$

The logistic coefficient can be interpreted as the change in the log odds associated with a one-unit change in the independent variable. Then, *e* raised to the power β_i is the factor by which the odds change when the i^{th} independent variable increases by one unit. If β_i is positive, this factor will be greater than 1, which means that the odds are increased; if β_i is negative, the factor will be less than one, which means that the odds are decreased. When β_i is 0, the factor equals 1, which leaves the odds unchanged. In the case where the estimate of β_9 emerges as positive and significant for the conventional levels of statistical significance (that is, 1%, 5% or 10%), this means that, on average, all other factors remaining constant, the 'preferable' entry mode by Portuguese MNCs in countries/markets with higher perceived corruption levels is FDI, which would go in line with Demirbag *et al.*'s (2010) argumentation.

The descriptive statistics of the variables model and the matrix of correlations are presented in Table 1. The estimates of the βs are given in Table 2.

Our unit of analysis is not the firm or the market but instead the firm *and* the market – the same firm can internationalize for one single country or for all the (5) countries (Angola, Cape Verde, Guinea Bissau, Mozambique, and Sao Tome Principe) in analysis.

The population surveyed was all (562) Portuguese firms that, according to AICEP Portugal Global, a government business entity, which focuses on FDI and the promotion of the internationalization processes of Portuguese companies, internationalize for the 5 PALOP countries.[5]

We construct and implement a direct email questionnaire to all the firms which beside firms main characteristics it included questions regarding firms' entry modes in each of the market in analysis (in the event they had in fact entry) and their perceptions about some key institutional factors (specifically, the importance of legal restrictions, linguistic and historical proximity, and corruption perception in the choice of the entry mode).

[5] The original database had 653 firms but 46 firms claim not having any presence in PALOP and in 45 cases de email did not reached the recipient. Thus, our 'effective' population is 562 firms.

Around ¼ of the surveyed firms answer the questionnaire and, considering that 65% of them internationalize for more than one PALOP country, it resulted the gathering of 321 valid observations.

Descriptive results (cf. Table 1) based on the sample in analysis convey that Portuguese MNCs' 'propensity' for FDI as a 'preferable' entry mode in PALOP is positively and significantly related to firm size and the importance attributed to legal restrictions and political stability. That is, in a bivariate statistical analysis, larger MNCs and those that perceive legal restrictions and political stability as key factors when choosing their entry mode, tend on average to opt for equity based entry mode (i.e., FDI) in alternative to export and/or contracting. In contrast, firms that present higher international experience as measured by the number of countries to whom they internationalize or the years that passed since they first internationalize, tend to opt for non-equity entry modes, namely export.

Regarding the relation between the independent variables, results evidence that years of experience in internationalization and number of countries to which the firm internationalize are positively and significantly related revealing that firms that internationalize for a larger number of countries tend to have started their internationalization processes longer time ago. Given this high correlation it is advisable to estimate the 'theoretical' model using one of the two proxies of internationalization experience. Thus, we estimate Model I (cf. Table 2) using 'number of countries in which the firm is present' as the proxy for internationalization experience whereas in Model II we use 'number years experience in internationalization'.

Although some correlations between the independent variables are strong (namely, between the corruption perception index and the openness indicator) these are not high enough to undermine the estimation of the proposed model.

Table 1: Correlation matrix

Variables	Proxy	Mean	Std. Deviation	1	2	3	4a	4b	5	6	7	8	9	10
1. FDI vs.Non equity	FDI vs Exports (1=FDI)	0.262	0.440	1										
2. R&D intensity	R&D to sales ratio	0.104	0.194	0.031	1									
3. Firm's size	Number of employees (ln)	3.887	1.556	0.094*	-0.157*	1								
4. International experience	Number years experience in internationalization (ln)	2.208	0.971	-0.111**	-0.066	0.456***	1							
	Number of countries in which the firm is present (ln)	2.055	1.060	-0.273**	-0.060	0.491***	0.482***	1						
5. Openness of the host economy	(Exports+Imports)/GDP (ln)	-0.099	0.233	0.071	0.027	-0.081	-0.062	-0.148***	1					
6. Host market size	GDP per capita	6.629	0.734	0.022	-0.037	-0.082	-0.062	-0.120**	0.340***	1				
7. Cultural proximity	Proportion of firms that stated that linguistic and historical ties between home and host country were important or very important in the decision to enter the market	0.875	0.331	0.031	0.020	-0.101	-0.033	-0.051	-0.05	-0.026	1			
8. Legal Restrictions	Proportion of firms that stated that the entry mode choice was quite influenced by legal restrictions in the country	0.268	0.444	0.136**	-0.106*	-0.078	-0.097*	-0.037	0.015	0.047	0.122**	1		
9. Political stability	Governance Quality - Worldwide Governance Indicators	0.648	0.478	0.127**	-0.077	-0.078	-0.053	-0.100*	-0.005	0.055	0.196***	0.313***	1	
10. Corruption	Corruption Perception Index (CPI) (ln)	0.998	0.360	-0.043	-0.051	0.024	0.017	0.061	-0.427***	0.323***	0.035	0.023	0.055	1

Note: *** (**)[*] statistically significant at 1%(5%)[10%]; N=321=no. of firms (144)*no. of markets.

4. Econometric results

According to the goodness of fit measures (Hosmer and Lameshow test and % corrected), the two estimated models represent the 'reality' quite well.

As expected, larger and more innovative Portuguese MNCs tend, on average, *ceteris paribus*, to choose FDI as their preferable entry mode in PALOP. In this sense we corroborate Demirbag *et al.*'s (2010) finding that the larger the number of employees (in its case proxy for the size of operation) the more likely is the foreign investor to choose an equity entry mode. Also supported by our empirical results are the findings of Sun (1999), Chung (2009) and Javorcik and Wei (2009) that evidence that high technological firms prefer high equity modes in order to protect their intangible assets.

Table 1: **MNCs' entry mode and corruption: logistic estimates (dependent variable: log odds of FDI vs Non-equity)**

Determinants		Proxy	Model I	Model II
Eclectic Pradigm: ownership	R&D intensity	R&D to sales ratio	1.194^{*}	0.928
	Firm's size	Number of employees (ln)	0.566^{***}	0.333^{**}
	International experience	Number years experience in internationalization (ln)		-0.467^{**}
		Number of countries in which the firm is present (ln)	-1.074^{***}	
Eclectic Paradigm: internalization	Openness of the host economy	(Exports+Imports)/GDP (ln)	17.729^{**}	18.517^{**}
Eclectic Paradigm: location	Host market size	GDP per capita	-3.582^{**}	-3.626^{**}
	Cultural proximity	Proportion of firms that stated that linguistic and historical ties between home and host country were important or very important in the decision to enter the market	0.302	0.354
Institutional Approach	Legal Restrictions	Proportion of firms that stated that the entry mode choice was quite influenced by legal restrictions in the country	0.600^{*}	0.385^{*}
	Political stability	Governance Quality - Worldwide Governance Indicators	0.488	0.588^{*}
	Corruption	Corruption Perception Index (CPI)/Transparency index (ln)	11.242^{**}	11.487^{**}
		Constant	12.126^{*}	12.106^{*}
		Number of observations (N)	**334**	**334**
		FDI	89	89
		Non-equity	245	245
		Goodness of fit		
		Hosmer and Lameshow Test (p-value)	2.202 (0.974)	7.321 (0.502)
		% observations corrected	76.0	73.4

Note: *** (**)[*] statistically significant at 1%(5%)[10%]; N=334=no. of firms (147)*no. of markets.

Quite unexpectedly, and in contrast to the extant literature (Mutinelli and Piscitello, 1998; Chiao *et al.*, 2010), the international experience of Portuguese MNC is negatively related with the (log odds of) FDI 'propensity', meaning that firms with higher international experience tend to enter into PALOP markets mainly by exports. This might be, as Slangen and van Tulder (2009) describe in their study, due to the fact that MNCs tend to enter new markets by the same method/way they have entered earlier into other markets - i.e. when a firm has experience in entering markets via export it is more likely that subsequent internationalization processes will take the same path.

Also in contrast to some of the extant literature (e.g., Javorcik and Wei, 2009) where the economy's openness does not appear to have a statistically significant effect on the entry mode choice, in this study the country's openness indicator emerges as quite relevant for our sample of firms. The estimate coefficient of the openness of the market, which stands, as a proxy for the host countries reception of trade and commerce, evidence that, on average, all the other factors remaining constant, markets which are relatively more open, reflecting lower transaction costs, tend to be associated with FDI modes of entry.

The location dimension received middle support from our data. Indeed, on the one side, the size of the market, proxy by the GDP per capita of the host country, emerged as negatively and significantly related with FDI propensity. This suggests that, on average, Portuguese MNC that entry in larger markets tend to resort to non equity modes (namely exports). Such results are in disparity with the extant literature (Horstmann and Markusen, 1996; Eicher and Kang, 2005), which in general claim that the larger the market size the higher the probability of entering via high equity modes. On the other side, and although, as earlier suggested by the non parametric test to the differences in means, firms that choose FDI as entry mode tend to attribute higher scores to cultural proximity, the multivariate estimations failed to give relevance to this determinant (a similar result nevertheless obtained by Demirbag *et al.,* 2009). This might in part be explained by the fact that the bulk (almost 90%) of our respondents considers the historical and linguistic linkages as important factors in the entry mode choice.

The estimations reproduced here highlight the crucial role of institutional factors in the explanation of MNCs entry modes. Indeed, legal restrictions, political stability (Model II), and utmost the level of corruption of the host country are statistically significantly related with MNC entry mode choices. In concrete, the Portuguese MNCs that perceive legal restrictions as very important for the choices regarding the entry mode in PALOP tend, on average, to have a higher propensity for FDI entry modes. Moreover, the estimate for the corruption variable is positive meaning that, controlling for all the other factors which are likely to affect MNC entry mode choices, Portuguese MNCs tend to opt for directly investing in the less corrupted (more transparent) markets, as reflected by an higher value of CPI. This confirms the general tendency of the extant literature (e.g., Rodriguez *et al.*, 2005; Uhlenbruck *et al.*, 2006; Straub, 2007; Paul and Wooster, 2008) which contents that in corrupt contexts it would be expected that MNC would prefer non equity entry modes. In this sense, our findings do not support Demirbag *et al.*'s (2010) thesis who underline that despite the (high) levels of corruption of host countries close historical and cultural links would push firms into equity entry modes.

5. Conclusions

The present paper intended to analyze how Portuguese MNC's choice of the adequate entry mode is affected by the extent of corruption in host countries, namely in those from PALOP.

Africa has becoming the new frontier for emerging market investors (Santiso, 2007). An analysis by *The Economist* (2011) finds that over the decade, no fewer than six of the world's ten fastest-growing economies were in sub-Saharan Africa, including Angola on first and Mozambique on eighth place of the ranking. This evolution of former under-developed markets leads foreign investors to find it increasingly difficult to ignore these markets, despite its - justified - reputation as a tough place for business because of political uncertainty, corruption, weak infrastructure and inconsistent regulation (The Economist, 2010).

The growing attractiveness of the region allied to strong cultural and historical ties between home and host countries tend to, according to some recent studies (e.g., Demirbag *et al.*, 2010), lead to a higher FDI propensity despite the existence of corruption.

Aiming at testing the role of corruption on firms' entry mode choices in contexts where substantial historical and cultural linkages exist, we focused our analysis on Portuguese MNCs that invest in the PALOP, a set of countries characterized by very high (e.g., Guinea-Bissau, and Angola), high (e.g., Mozambique, Sao Tome and Principe) and middle (e.g., Cape Verde) levels of corruption (Transparency International, 2009). In this vein, we constructed and implemented a direct questionnaire to 562 Portuguese firms that internationalized to the PALOP, from which we obtained 147 responses representing 334 firm-market observations.

Based on multivariate econometric model, our results show that more innovative firms tend, on average, to choose FDI as their adequate entry mode in the selected markets, which is in line with some earlier studies by Sun (1999), Chung (2009) and Javorcik and Wei (2009). This might be explained by the fact that high technological firms want to maintain higher control over their firm-specific assets (Sreenivas and Pangarkar, 2000; Chen and Hu, 2002). Moreover, we found that larger firms have a preference for high equity entry modes, which contrast with the study of Esperança *et al.* (2006), and might be explained by the analysis of distinct host countries. While Esperança *et al.* (2006) focus on Portuguese MNCs which invest in Spain, our study analyzes firms from the same home country but internationalizing to emerging African countries which present very distinct characteristics, namely the levels of corruption, political restrictions and economic and political instability. These and other factors as the physical proximity may be the reason why the results point into different directions. Additionally, we found that the openness of the host market favors the entry via FDI, what is somehow surprising, as this determinant did not appear to have a statistically significant effect in previous studies focusing on other (central and eastern European) emergent markets, such as the one of Javorcik and Wei (2009). Also in contrast with extant literature (e.g., Horstmann and Markusen, 1996), the host market size emerged as negatively related to the equity mode propensity, being more likely a (Portuguese) MNC to enter via exports in larger (PALOP) markets. Finally, we found that international experience is not associated to, as one would expect, high equity modes. This might be, as Slangen and van Tulder (2009) describe in their study, due to the fact that MNCs tend to enter new markets by the same method/way they have entered earlier into other markets - i.e. firms that are experienced in entering markets via export are more likely to follow the same path in subsequent internationalization processes.

In line with prior studies that point to a preference by firms for non-equity modes when entering corrupt markets (e.g., Rodriguez *et al.*, 2005; Uhlenbruck *et al.*, 2006; Straub, 2007; Paul and Wooster, 2008), our results evidence that, on average, Portuguese firms opt for non-equity modes, most specifically exports, when entering in more corrupted countries. Recall that according to Uhlenbruck *et al.* (2006) MNCs use non-equity modes as an adaptive strategy because this entry mode provides an opportunity to participate in economies where corruption is high while avoiding some of the costs related to corruption. Non-equity modes also protect the MNCs avoiding the direct contact with corruptive practices such as bribe paying (Rodriguez *et al.*, 2005). Beyond the bribes and extra taxes, the direct establishment in a corrupt market may affect MNCs' investment through its interaction with corrupt state officials. This increases the risk of expropriation reducing the informational advantage a FDI entering firm has (Straub, 2007).

Based on these results we failed to corroborate Demirbag *et al.*'s (2010) argumentation. Indeed, despite the vast majority of the firms (about 90% of our sample) underlined the importance of cultural ties with PALOP countries, perceived corruption emerged negatively and significantly correlated with the FDI propensity. In other words, PALOP countries characterized by lower perceived corruption tend to be most successful in attracting foreign direct investment. Thus, we demonstrate that in PALOP too, high levels of institutional quality tend to foster economic growth and development through its positive effects on FDI attraction.

Summing up, our findings highlight that despite the existence of strong cultural ties between home (Portugal) and host countries (PALOP), corruption stands as a critical obstacle to foreign direct investment. Recall that excluding Cape Verde, all the other PALOP present very low levels of transparency (with CPI below 3 out a maximum of 10). Given the widespread perceived corruption among PALOP our findings reflect a quite worrisome scenario for future growth prospect of these countries.

Our study clearly emphasizes that historical and cultural ties are not sufficient for overcoming the costs of institutional weaknesses, namely the widespread perceived corruption. We borrow Lawal's (2007) words when she sustains that corruption has been an impediment for the true and real development of African society. So, in order to benefit from the potential of foreign capital which contributes to economic development and integration with the global economy (Shrestha *et al.*, 2010), African countries in general, and the PALOP in particular, should implement serious measures to combat corruption, building a strong political system that inspires confidence and captures foreign investors.

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