Determinants of International Advertising Agencies Entry Taiwan Market - the Evidence form 1985-2005

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ABSTRACT

Since Taiwan government released the restrictions on foreign capital share holding proportions in 1984, international advertising agencies entered Taiwan market to establish their subsidiaries. The advertising market has been totally erosion by foreign firms within twenty years after 1984 in Taiwan. Thus Taiwanese advertisement firms need a method to break through such badly status. The Southeast Asia market is in state of development for Taiwanese advertising firms to enter. So analyze the entry mode of international advertising agency as reference indicators to Taiwanese advertisement firms.

This study measured the range difference between established time and entering Taiwan market time, cultural differences, five years average growth rate of GDP per capita, five years average growth rate of FDI in origin country, and the change rate of the competitor numbers in 1984 as the independent variables. The entry mode divided into ownership or not as the dependent variable. To apply logistic regression models to test the relations between the selected variables in this study. Outcomes indicate that cultural differences factor and five years average growth rate of GDP per capita factor bear significant factor loading while the others yielded insignificant results.

Emerging countries in Asia such as Vietnam and Thailand reveal similar development background with Taiwan. If advertising firms are willing to invest in these markets, it is suggested that firms enter with ownership, especially when the underlying countries' GDP growth rates are high.

Keywords: entry modes, international advertising agency

INTRODUCTION

In the field of international management, entry mode represents the third researched area after foreign direct investment and internationalization (Werner, 2002). This researched theme includes the issues of the entry mode choices, international equity ownership structure, and consequences of entry mode decisions. Multinational corporations (MNCs) face the vital strategic decision relate with their subsidiaries' equity ownership when they entered the foreign market with a high control ownership base or with a low control ownership base (Anderson and Gatignon, 1986). Early research into the entry mode of firms primarily assumed that once a firm establishes its subsidiary in a foreign market, it rarely changes its ownership structure unless it faces the environment change (Yan and Luo, 2001). However, recent studies reveal that firms change their equity ownership frequently (Chung and Beamish, 2006). They change their equity ownership structure for performance and survival in environment change of host country.

This study probes into the evolution causes in equity structure of foreign advertising MNCs in Taiwan. International advertising agencies entered the Taiwan market for Taiwan government released the restrictions on foreigner share holding proportions since 1984. Then these foreign advertising agents controlled the whole Taiwan advertising market within twenty years. The local Taiwanese advertising firms need a way to break through such imbalance status. It is similar to early development stage of Taiwan market that Southeast Asian market is in state of progressing. So this study analyzes the equity structure of the international advertising agency how to spread from developing countries to newly industrialized countries as the reference indicator of the local advertising firms of Taiwan.

The contribution of this study in two ways: (1) investigated the establishment of international subsidiaries and focused on the longitudinal evolution of subsidiaries; and (2) the longitudinal evolution of MNCs based on institutional theory framework is examined using a sample of Europe, US and Japan advertising firms. International subsidiaries are challenged by isomorphic pressures from different institutional environments.

This study will proceed as follows. First, we define new institutionalism such as isomorphism, institutional environment, international and external legitimacy. Second, we develop our hypotheses, based on institutional theory. Third, we describe the research methodology. Fourth, we demonstrate the empirical results and suggest topics for discussion. Finally, we provide our conclusions and our suggestions for future research.

LITERATURE REVIEW AND HYPOTHESES

The most commonly used theory in entry mode studies was transaction cost economics (i.e. TCE) (Canabal and White, 2008). However, there are some insufficient of TCE in explaining foreign operations. TCE has difficulties in explain the effect of cultural differences. The TCE framework does not specify the firm's ongoing operations and subsequent structural changes following the initial entry. The new institutionalism perspective emphasizes that organizational institutionalization is mainly a symbolic act, and suggests that organizations adopt certain practices and procedures for legitimacy reasons rather than for efficiency (Powell and DiMaggio, 1983). Institutional theory is just as a supplement of the TCE at interpretation in dynamic environment. This theory suggests that firms entering a new market will imitate host country local firm actions or competitor actions in that same market in order to legitimize their operations and market presence (Davis et al., 2000; Kostova & Zaheer, 1999; Yiu & Makino, 2002).

Key Concepts of Institutional Theory

Firms adopt their behaviors and practices in order to consider legitimate rather than to achieve efficiencies (Meyer and Rowan, 1977). DiMaggio and Powell (1983) presented the isomorphic processes cause organizations to become increasingly similar and isomorphism stems from three sources of coercive isomorphism, mimetic isomorphism and normative isomorphism. Regulative systems, normative systems, and cognitive systems are the three pillars of the institutional environment suggested by Scott (1995). Another important key concept is legitimacy. External legitimacy means isomorphic pressures exerted from the subsidiary's local host environment. The internal legitimacy means the isomorphic pressures exerted from the headquarters and the headquarters' institutional environment.

Subsidiary Structure Change

Firms prioritize external legitimacy before internal legitimacy in order to gain the external legitimacy first so sacrifice some internal legitimacy when they enter the foreign market (Xu and Shenkar, 2002; Xu at al., 2004). Although the firm is willing to sacrifice some internal legitimacy during the initial entry period in favor of external legitimacy, it is expected that after the initial entry the subsidiary will gradually be integrated into the MNCs system and move toward internal legitimacy. Therefore, the initial entry state can be called the external legitimacy state whereas subsequent structural reorganizations are expected to move the firm toward greater internal legitimacy. This point is supported by Gaur et al. (2007). They concluded that external legitimacy is most important in the early stages of subsidiary establishment, whereas subsequent efforts focus on internal consistency.

Subsidiary performance. Organizational theorists have suggested that the need for structural change arises due to poor performance (Chandler, 1962; Cyert and March, 1963; Child, 1972). Poor performance is a signal that the current mode of operation is not effective, which means the firm will attempt to adapt to meet the demands of the environment (Donaldson, 2001). Empirically supported the idea that international joint ventures are more likely to change the ownership and control structure as a result of poor performance (Chung and Beamish, 2006). Based on above arguments, we propose the first hypothesis as follows:

Hypothesis 1. Subsidiary performance has a negative relationship with subsidiary structural change.

Market legitimacy difference. Firms observe and imitate the strategic behavior of competitors who occupy the same strategic niche in the market (Garcia-Pont and Nohria, 2000). Also the firms are likely to locate a new affiliate in markets already densely populated. Lu (2002) examined Japanese firms' behavior and found that firms' entry mode choices depend on both intra-organizational as well as inter-organizational imitative behavior. The success rate of first mover firms has a strong influence on the degree of mimetic behavior that followers firms pursue (Lu, 2002). Although few studies examined mimetic behavior in the ownership structure of firms subsequent to the initial entry decision, but it seems reasonable to believe that a mimetic isomorphic process will continue after the initial establishment. So the second hypothesis set as follows:

Hypothesis 2. Market legitimacy difference is positive related with subsidiary structural change.

Institutional difference. To gain legitimacy in institutionally different markets, it is expected that firms will establish their subsidiaries in a manner that allows the local partner with a high level of influence (Westney, 1993; Xu and Shenkar, 2002; Xu et al., 2004).By allowing the local partner a high degree of influence, the foreign entrant aims to maximize external legitimacy. However, there will be a sacrifice of internal legitimacy. In the study of Guar et al. (2007) found subsidiary human resource strategies evolve over time so the older subsidiaries utilize a higher ratio of expatriate workers. Since high institutional differences require greater adaptation at the initial entry to gain external legitimacy, so these subsidiaries will have lowest degree of internal consistency. Thus, we expect institutional difference will have a positive relation with structural change.

Hypothesis 3. Institutional difference is positively related with subsidiary structural change.

DATA AND METHODS

Data and Samples

This study is based on information collected form the advertising agencies' online data, Advertising Age's annual survey of US and Advertising Annual Report of Taiwan from 1986-2005. The data of MNCs advertising agencies foreign subsidiaries in Taiwan is longitudinal database of professional advertising firms. The data contains top five advertising groups with WPP, Omnicom, IPG, Publics Group, and Dentsu in the world with thirty-one affiliates in Taiwan. This research is combined with country-level and industry-level variables to test hypotheses presented. Each agency reports its foreign activities including the structure of its foreign subsidiaries and sales data for each subsidiary.

Many subsidiaries began operations prior to the beginning of the annual survey in 1986. This exist the potential to bias the result of empirical testing. To avoid this problem, the sample is limited to subsidiaries in Taiwan were formed after 1986. Complete data is available for thirty-one subsidiaries of US, Europe and Japan advertising agencies that were established during the time period of interest. This database provides a unique opportunity to examine isomorphic pressures from multiple institutional environments that foreign subsidiaries are subject to.

Variables and Measurement

Initial Subsidiary Structure. The dependent variable, subsidiary ownership structure, reflects headquarter in level of control over the foreign subsidiary. A higher equity ownership means that the firm headquarters has more control, whereas lower equity ownership means that the local partner has increased control.

Institutional Differences. Beckeman's suggested that psychic distance, which defined as language differences and so on may influence foreign investment patterns and modes. The role of differences between the home and host market has been one of the most studied variables in international business research (1956:58). The most common method of capturing cultural distance is the index created by Kogut and Singh (1988) based on Hofstede's (1980) four dimensions of culture. Shenkar suggested that the Hofstede index suffered from theoretical and methodological assumptions that could not be tested (2001:519). Kirkman et al. corroborate this idea and emphasize the fact that Hofstede's data was collected nearly forty years ago and that large cultural change has taken place in recent decades that his data does not reflect (2006:285). Hofstede (2001) suggests that the institutional environment of a country is a product of the dominant cultural values system. The institutions of a country are the crystallization of that country's cultural values. However, at the core of culture are the basic norms and values that differ across groups. These basic differences in values present themselves in different artifacts, products, and institutions. Due to the superiority of the Hofstede construct in comparison with more recent studies of cultural and institutional differences, this study use the traditional Hofstede-based construct first developed by Kogut and Singh (1988) to capture the degree of institutional differences.

Market Attractiveness. By extending previous research in market attractiveness (Kuemmerle, 1999; Mitra and Golder, 2002)this study measure the attractiveness of a market as the composite of GDP per capita, total GDP, GDP per capita growth, and total GDP growth. The variable is drawn from The World Development Indicators.

Global Legitimacy. Global legitimacy is defined as the worldwide recognition and acceptance of the firm. Following the definition by Hillman and Wan (2005), this can be proxy by the level of international diversification of the firm. Internationally diverse firms are likely to be perceived by the focal market as having a positive reputation, success experience, and global approval. From the data in Advertising Age, it is easy to extract the ratio of foreign sales to total sales. Also it is possible to get a count measure of how many markets each firm operates a subsidiary in.

Legitimacy Spillover. This variable is not concerned with how these firms first established their operations but rather how their subsidiaries are structured at the time of the new entry. Structural precedence or legitimacy spillover measures the average operating mode of all other foreign subsidiaries in a specific market the year prior to the establishment of a new subsidiary.

Firm Size. In this study, firm size as a control variable. Larger firms may also possess greater bargaining power thereby facilitating higher levels of ownership and control. We controlled this potential effect by including each firm's annual worldwide sales. This is consistent with past research which has used firm sales as a proxy for size (Gomez-Mejia and Palich, 1997).

RESULTS

Prior to testing the hypotheses, this study presents a Pearson correlations matrix in Table 1. Although there are significant correlations between constructs, none approach the level that renders concerns about multicollinearity. Except for global legitimacy, the bivariate correlations are significant in the expected direction.

TABLE 1

Correlations Matrix

Variables	1	2	3	4	5	6
1. Ownership structure	1					
2. Institutional differences	-0.35**	1				
3. Legitimacy spillover	0.72**	-0.32**	1			
4. Market attractiveness	0.31**	-0.25**	0.28**	1		
5. Global legitimacy	-0.19**	0.18**	-0.26**	-0.15**	1	
6. Firm size	-0.35**	0.29**	-0.45**	-0.28**	0.54**	1

** P<0.01

To test the hypothesis, regression analysis at the subsidiary level was used. In this study, the DV has three levels in a rank order, which justifies the use of ordinal regression. Institutional differences remain negative and significant ($p<0.05$) in support of Hypothesis 1. Of the other main effects, market attractiveness is not significant. However, legitimacy spillover is positive and significant ($p<0.01$), whereas global legitimacy is negative and significant ($p<0.05$). P-values between 0.05 and 0.1 are often considered marginally significant. 0

Firm size was included as a control variable although its effect was not significant when other explanatory variables were included in the model. In Model 1, which included only firm size and cross-cultural differences, there was a significant effect, although contrary to expectations, there was a negative relationship. Overall, all models indicate a good fit of the data. The Pearson chi-square is non-significant (p=.889), which is recommended and the pseudo r-square in Model 3 indicates that the variables account for a substantial 46% of the variance in entry mode choice. The results are presented in Table 2.

TABLE 2

Table 2. Regression Results

	Independent Variables	Model 1	Model 2	Model 3
H1	Institutional differences	-0.31***	-0.14(0.07)**	-0.76(0.37)**
	Global legitimacy		-0.03(0.16)**	-0.6(0.33)*
	Market attractiveness		1.32(0.84)	1.12(0.87)
	Legitimacy spillover		4.66(0.50)***	2.95(1.02)***
H2	Global			0.18(0.1)**
H3	Market attractiveness			0.21(0.57)
H4	Legitimacy spillover			0.56(0.33)*
	Firm size	-0.01***	0.00(0.01)	0.00(0.01)
	Chi-square	1141.22	1066.87	1086.57
	R-square	0.18	0.46	0.47
	n	97	97	97

Standard errors in parentheses

*p<0.1, **p<0.05, ***p<0.01

To further illustrate the moderating effects of global legitimacy and legitimacy spillover on the relationship between institutional differences and ownership structure, this study examine the relationships. As shown in results, both have a negative slope, which indicates the main effect of institutional differences on ownership structure. However, for firms with a high level of global legitimacy, there is a lesser negative slope, which indicates that these firms sacrifice less internal legitimacy, by maintaining a high degree of ownership control, at higher levels of institutional differences compared with firms with lower levels of global legitimacy.

A similar effect appears when graphing the moderating effect of spillover differences. There is a negative slope depicting the relationship between institutional differences and ownership structure irrespective of whether there is a high or low degree of spillover difference. When existing firms in a specific market have already established a high level of external legitimacy, the entering firm is able to sacrifice less internal legitimacy in response to institutional differences. In comparison, in markets where there is a low level of legitimacy spillover, there is a stronger negative relationship between institutional differences and ownership structure.

DISCUSSION AND LIMITATIONS

Discussion

That the difference between the home and host market and its uncertainty has been identified as a core variable for transaction cost theory and internationalization theoretical perspectives in explaining the internationalization of MNCs. However, several limitations have suggested that these theoretical perspectives may not be able to fully predict the evolution of the MNCs. In response to these limitations in the received theories of the MNCs, this study has suggested and investigated an alternate theoretical lens. Institutional theorists have suggested that MNE subsidiaries are subject to multiple competing pressures. MNCs subsidiaries need to gain legitimacy from both the local environment, named external legitimacy, as well as being accepted by the subsidiary's headquarters named internal legitimacy. That means there is a potential conflict for subsidiaries balance the demand for both external and internal legitimacy. This study inducts the degree of institutional differences increase, the degree of equity ownership held by the entering firm decreases. This confirmed an important theoretical advancement in regards to the role of institutional differences on entry mode choice

Limitations

As discussed in the previous section, this study has significant theoretical and empirical evidence. However, there are a few limitations that need to be taken into account when interpreting the results of this study. The recognition of these limitations provides guidance in identifying areas for future research that can extend our theoretical understanding of the MNCs as well as empirical extensions that will help improve the generalize ability of this study. First, this is a one-industry study of professional service firms, advertising agencies, which are all headquartered in the US. This potentially limits the external validity of the study and this study needs to be replicated in additional contexts. But several previous studies examining legitimacy tradeoffs among MNE subsidiaries have done so in a Japanese MNE context (Xu et al., 2004; Gaur et al., 2007).

Much of the theory building and empirical examinations of MNCs have been focused on manufacturing firms. This study extends this by empirically examining a sample of professional service firms. Although the sample is narrowly focused, there are no reasons to believe that the theory developed in this study only applies for professional service firms. However, replication and extensions of this study in additional contexts, both in terms of geographic and industry scope are encouraged.

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