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Determinants of Foreign Direct Investment Project Scale: New Evidence from Vietnam

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Abstract: This paper analyzes empirically the determinants of FDI project scale in Vietnam, using a unique dataset which contains all information of 5267 FDI projects during 2005-2016 period. By pointing out the limitations of previous researches that fail to consider FDI project issues, this paper contributes to the current literature with a better understanding of the factors influencing initial start-up size of FDI. In empirical analysis, the scale of FDI project is found to depend on type of market entry, such as type of ownership and the adjustment of project scale and on entry mode strategy, namely type of investment, business industry, year of project establishment, project registered operation time. The study is also found that the investor's characteristics also affect the size of project. In other words, investors from Asia will set up larger scale projects in Vietnam than those from Europe or Africa and Latin America. From policy perspective, it also recommends policies for Vietnamese government to enhance FDI project scale.

Keywords: scale of FDI project; entry model; financial constraints; type of market entry

1. INTRODUCTION

Recently, foreign direct investment (FDI) attraction in Vietnam has a tendency to decrease in number of projects and capital attracted. In addition, FDI projects in Vietnam are generally of small and medium scales. The average capital size in 2014 was only 9.4 million USD, lower than the average size of FDI projects in general 14 million USD (Vietnam Ministry of Planning and Investment, 2014). A noteworthy point is that, after reaching a peak of about 23 million USD in 1996, the capital size per project has been reduced year by year (Vietnam Ministry of Planning and Investment, 2003). So what is the reason of influence on the attraction of FDI and what are the factors affecting the size of FDI projects in Vietnam? These two questions are significant to be solved in the present time. Although there are many researches on FDI in Vietnam, there is no study conducted at micro data of FDI projects. Francesca Melillo (2012) points out two reasons why there is not much research into the determinants of the initial size of an

project. First, the concept of initial size of project is too complex, and the second is the challenge in research methodology and in finding data for research. The objective of this article is to analyze the determinants of FDI project scale and to suggest policies for Vietnamese government to attract large-scale projects. This study employs a unique dataset of each FDI project from Vietnam Ministry of Planning and Investment. This dataset allows new FDI projects to be identified. In the next section we present a brief literature review, section 3 present a short model to illustrate the determinant of FDI projects, and Section 4 analyze empirical results. Section 5 concludes.

2. LITERATURE REVIEW

Research on the determinants of foreign direct investment project scale is rather limited up to now. Only a few empirical studies have built the basis about the facts we know today. From the theory, there are few factors can affect to the initial start-up size of firms such as industry characteristics, founder's human capital, entry mode strategy, type of market entry and financial constraints

Industry characteristics

Studies on firm revenue have identified a number of factors relating to industry characteristics that explain why a firm enter into the market and their size of entry. These characteristics including industry growth, labour costs, minimum efficient scale, type of industry and turbulence inside the industry (Gottschalk et al, 2009). Industry growth is an indicator of business opportunity and influencing the decision to enter the industry of investors. Mata and Machado (1996), Görg and Strobl (2002) found that firms tended to increase their initial size to make a profit in high growth industries. Similarly, the size of an industry is found to have positive impacts on firm initial start-up size. In addition, industry type is an indicator of production scale, cost scale, labor intensity or other factors. Some industries such as services, software production usually have a small initial size (Gottschalk *et al.*, 2009).

Founder's human capital

Before the research of Geroski (1995), most of the literature on start-up firm size focus on industry characteristics. Geroski (1995) find that beside industry characteristics, initial size of a firm is considerably influenced by the founder characteristics. Generally, the characteristics of the founder are related to two types: (i) capability and (ii) financial ability. Factors related to the capacity of the founder include education, experience or age. High educational attainment will help the founder gain more knowledge about the market, and this makes them more confident in establishing larger scale projects at the beginning (Mata, 1996; Gottschalk *et al.*, 2009). Beside that, the financial ability also has a great influence on the project size. Holtz-Eakin *et al.* (1994), Hvide and Møen (2010) as well as Evans and Jovanovic (1989) all agree that if the founder has good personal financial capabilities the size of the original establishment will be larger.

Entry mode strategy

Sharma and Erramilli (2004) have the definition of entry mode “a structural arrangement that allows a firm to implement its product market strategy in a host country either by carrying out only the marketing operations (e g via export modes), or both production and marketing operations thereby itself or in

partnership with others (contractual modes, joint ventures, wholly owned operations)”. According to Root (1987), a foreign market entry mode is an institutional arrangement that brings products, services, technology of a company into a foreign country. Until now, there are few studies about the impacts of entry mode strategy on initial size of FDI projects, and the research of Gottschalk et al (2009) is the one to illustrate those. However, Gottschalk et al (2009) mainly focus on innovation-based market entry strategies. This means that if the firm enters the market with new technology or with innovative products, the size of the establishment will be larger.

Type of market entry

Type of market entry is closely related to entry mode strategy. Type of market entry can be understood as whether the founder is also the manager or the firm is established by an individual or group of investors. Establishing an enterprise with a group of investors or an investor also influences the size of the initial establishment. In fact, if an enterprise is founded with a group of founders will have greater advantages in terms of investment capital, management capacity and market knowledge, its firm size tends to be larger than enterprises setting up by an individual.

Financial constraints

Financial constraints are mainly related to a number of factors such as the ability to finance a loan, the contribution of capital from financial institutions, the other organizations, foreign investors, the government or parent company. Newly established enterprises with strong financial support are more likely to increase their initial size than the others (Colombo and Grilli, 2005). Similarly, the paper of Du and Girma (2009) yield a result that initial start-ups firms in China will have larger size if they are financed through bank loans, foreign capital contributions, and state capital contributions.

3. RESEARCH MODEL AND RESEARCH DATA

3.1. The research model

As mentioned in the literature section, scale of FDI projects may be affected by five main factors: industry characteristics, founder characteristics, type of market entry, financial constraints, entry mode strategy of foreign investors.

By using cross data regression of 5267 FDI projects during 2005-2016 period in Vietnam, we will find the empirical determinants of FDI projects.

3.2. Measuring Variables

Dependent variables: Scale of FDI project is measured by total capital investment in a project (unit: USD)

Independent variables

(i) industry characteristics: This variable represents the business sectors that foreign investors has invested in Vietnam. Different sectors vary in the size of the investment due to the required capital. If the foreign investors invest in the real estate industry (sector L), the education and training (sector P) and mining (sector B) will receive a value of 1, otherwise receive the value of 0. The main reason for the

combination of these three sectors together is because these industries receive huge investment capital recently compared with the rest. We expect that this variable has positive impact on FDI project scale.

(ii) founder characteristics: Before the research of Geroski (1995), most of the literature on start-up firm size focus on industry characteristics. Geroski (1995) find that beside industry characteristics, initial size of a firm is considerably influenced by the founder characteristics. Generally, the characteristics of the founder are related to two types: (i) capability and (ii) financial ability. Factors related to the capacity of the founder include education, experience or age. Beside that, the financial ability also has a great influence on the project size. In this research, we contribute to the literature by analyzing the regional and cultural differences in investment decisions. We include three dummy variables to represent for the founders's nationality from Europe, Asia, or Africa & Latin America. If investors from European or Asian countries are expected to set up larger-scale FDI projects than those from Africa and Latin America.

(iii) type of market entry: Entry strategies are expected to have a crucial influence on start-up size, because objectives of market entry largely determine the resources a firm requires. Type of market entry contains two variable: type of ownership and adjustment of project scale

We add the "type of ownership" variable as a proxy for "type of market entry". The variable receives 1 the project establishes Joint Stock Company, other type of ownership receive 0.

Adjustment of project scale is a dummy variable. It will receives value 1 if the project has increased the capital investment, and 0 if the project scale is not adjusted.

(iv) financial constraints: Financial constraints are mainly related to a number of factors such as the ability to finance a loan, the contribution of capital from financial institutions, the other organizations, foreign investors, the government or parent company. Newly established enterprises with strong financial support are more likely to increase their initial size than the others (Colombo and Grilli, 2005). In this study, we include "the contribution of capital from Vietnam" as a proxy variable for financial constraints. This variable is measured by the ratio of capital contribution from Vietnam to total capital investment.

(v) entry mode strategy of foreign investors used in this research contain variables as follows: type of investment, year of project establishment, project operation duration, FDI projects involved in export activities or doing domestic business

Type of investment: Usually FDI enterprises invest in Vietnam in four forms, that is 100% foreign owned capital, BOT investment, business cooperation contract (BCC), and joint venture. Among these forms, 100% foreign owned capital accounts for a large share of investment, and followed by joint ventures. The type of BOT and business cooperation contract receive small number of investment projects. In this study, we include type of investment as a dummy variable to examine whether difference investment would have difference projects scale. This variable equal 0 if type of investment is 100% foreign owned capital, otherwise it gets value 1.

Year of project establishment: This is also a dummy variable that compare the size of the project establishment over the years, as well as to control the economic conditions change. We include 2 dummy variables. If time in 2005-2010 period, dummy variable equal 1, otherwise 0. The 2011-2016 period variable is used as a treatment group. The period 2005-2010 is expected to have a higher level of FDI project size than the latter phase since in this period Vietnam entered the WTO.

Project operation duration: This variable is expected to have a positive coefficient when it comes into regression. This is because the longer the project duration, investors are more likely invest a larger scale.

FDI projects involved in export activities or doing domestic business: this dummy variable receives value 1 if the project investment has exporting purpose, and 0 if it is not exported. We expect the projects involved in exports would have larger scale of establishment than projects doing domestic business.

3.3. Study data

We use a unique dataset which provides information of 5267 FDI projects invested in Vietnam during 2005-2016 period. The data sample was extracted from database of Ministry of Planning and Investment. Data collection is done by a simple random sampling method. Sample of FDI projects are broken down by year, as follows:

Table 1
Number of FDI projects by year

<i>Year</i>	<i>Number of FDI projects</i>	
	<i>Frequency</i>	<i>Percentage</i>
2005	271	5.15
2006	235	4.46
2007	393	7.46
2008	461	8.75
2009	337	6.40
2010	348	6.61
2011	407	7.73
2012	421	7.99
2013	486	9.23
2014	480	9.11
2015	638	12.11
2016	790	15.00
Total	5267	100

Source: Vietnam Ministry of Planning and Investment

4. EMPIRICAL RESULTS AND ANALYSIS

4.1. Summary the characteristics of FDI projects by type of ownership, business sector and type of investment

Data in table 1 shows that the number of FDI projects investing in Vietnam tends to increase over the years. In the period 2005 to 2010, Vietnam has witnessed the remarkable increase of FDI inflows since this is the period Vietnam joined the WTO.

Table 2
FDI projects by type of investment

<i>Type of investment</i>	<i>FDI projects</i>	
	<i>Frequency</i>	<i>Percentage</i>
100% foreign owned capital	4070	77.27
Joint venture	1166	22.14
BOT, BT, BTO investment	6	0.11
Business Cooperation Contract	25	0.47
Total	5267	100

Source: Vietnam Ministry of Planning and Investment

As we can see from table 2, the FDI projects registered in Vietnam mainly took the form of 100% foreign owned capital, this form accounted for 77.27% of total number of projects. Joint ventures accounted for 22.14% (with 1166 projects), BOT and business cooperation contracts accounts for a small proportion of project investment.

Table 3
FDI projects by type of ownership

<i>Type of ownership</i>	<i>FDI projects</i>	
	<i>Frequency</i>	<i>Percentage</i>
Joint stock company	457	8.78
Private enterprise	924	17.75
Single member limited liability company	2515	48.31
Two member limited liability company	1308	25.12
Partnership	2	0.04
Total	5.206	100

Source: Vietnam Ministry of Planning and Investment

From the position of entrepreneur, it is interesting to note that the number of Joint stock companies only accounts for one-third in comparison with that of single member limited liability companies and two member limited liability companies.

There are at least 3 shareholders and no limitation on number of shareholders, which is compulsory in Joint stock companies. This is because the joint stock company is a capital company, the more shareholders are, the higher the capital is mobilized. It is the outstanding advantage of the joint stock company compared to the limited liability company. However, the management issues and operation of joint stock companies are extremely complicated.

A limited liability company is a hybrid legal entity having certain characteristics of both a corporation and a partnership. Therefore, the management and operation of the company is not too complicated. In addition, the limits of transferring of shares in limited liability companies also helps to secure the business secrets of limited liability companies than joint-stock companies. This is especially important for newly

established foreign investment projects. From the above reasons, the number of limited liability companies outperforms that of joint stock companies.

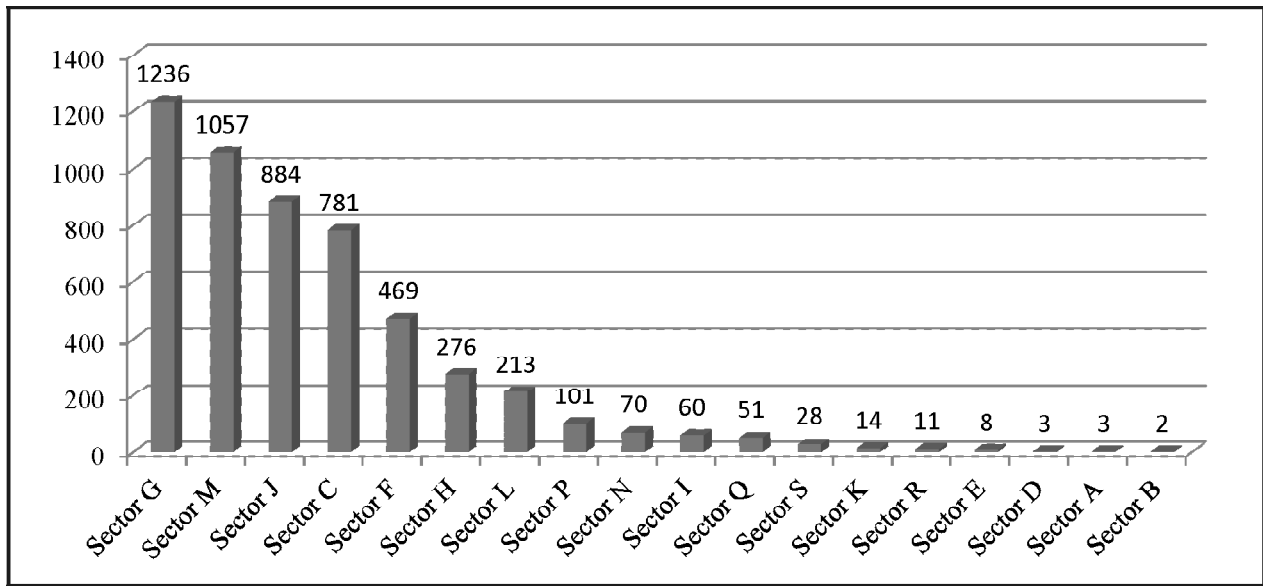


Figure 1: FDI projects by business sector

Sector A	Agriculture, forestry and fishery	Sector G	Wholesale and retail; repair of automobiles, motorcycles, motorbikes and motor vehicles	Sector M	Professional activities, science and technology
Sector B	Mining	Sector H	Warehouse transportation	Sector N	Administration and support services
Sector C	Manufacturing and processing industry	Sector I	Accommodation and catering services	Sector P	Education and training
Sector D	Production and distribution of electricity, gas, hot water, steam and air conditioning	Sector J	Information and communication	Sector Q	Health care and social work activities
Sector E	Water supply, waste water management and treatment	Sector K	Financial, banking and insurance	Sector R	Arts and entertainment
Sector F	Building	Sector L	Real estate	Sector S	Other service activities

Source: Vietnam Ministry of Planning and Investment

In terms of investment composition by sector, FDI projects are mainly implemented in industrial sector, which considerably contributes to the change of economic structure to industrialization. As depicted in figure 1, sector G (wholesale and retail; repair of automobiles, motorcycles, motorbikes and motor

vehicles) accounts for 23.74% of the total number of investment projects. Relevant to industry sector, sector M (Professional activities, science and technology) has the second highest number of projects (with 1057 projects), corresponding to 14.77% of the total number of projects. Sector C and J also receive high investment projects.

4.2. Statistical Description

Table 4
The statistical description of variables

<i>Variables</i>	<i>N</i>	<i>Min</i>	<i>Max</i>	<i>Mean</i>	<i>Std. D</i>
Investment capital (million USD)	5261	2390	3.5	5.2	6.54
Contribution of capital from Vietnam (%)	5261	0	99	3.9	12.35
Operation time (time)	5261	1	69	22.1	16.67
Adjustment of project scale	5261	0	1	0.08	0.27
Export or not	5251	0	1	0.97	0.15
Year of project establishment	5261	0	1	0.38	0.48
Type of investment	5261	0	1	0.22	0.41
type of ownership	5200	0	1	0.08	0.28
Business sector	5261	0	1	0.05	0.23
Investors from Asia	5261	0	1	0.57	0.49
Investors from Africa or Latin America	5261	0	1	0.01	0.12

Source: Author's calculation

Table 4 shows the statistical description of variables in the sample. The average capital investment of a project is 5.2 million USD, the average capital contribution of Vietnam is 3.9% and the average operation time of a project is 22 years.

4.3. The results of the regression

The results of the analysis are summarized in Table 5. It is important to note that in cross sectional regression, heteroskedasticity may be a serious problem that we may face with. In order to overcome heteroskedasticity problem, white heteroskedasticity consistent covariance matrix is employed for each standard error of coefficient. Hence, we don't have to worry about heteroskedasticity problem at all. In addition, VIF (variance inflation factor) test also provides no evidence of multicollinearity in our model.

Model 1 begins by regressing log of capital investment as a function of two variables as type of ownership and adjustment of project scale. These two variables represent for type of market entry. We find that the variables have signs as our expectation. Type of ownership variable comes to the equation with positive sign and statistically significant at 5% level. This means that the type of enterprise established as a joint stock company will have large scale of investment about 0.23% than the others (such as private companies, one member limited liability companies and two member limited liability companies). Our finding is totally consistent with the results of Allen and Peter (1995) who contend that firms have larger

Table 5
Regression about determinants of scale FDI project

<i>Explanatory variables</i>	<i>Model 1</i>	<i>Model 2</i>	<i>Model 3</i>	<i>Model 4</i>	<i>Model 5</i>	<i>Model 6</i>
Constant	12.53* (0.027)	11.7* (0.13)	12.5* (0.02)	12.6* (0.02)	12.4* (0.04)	11.5* (0.13)
Type of ownership	0.23** (0.10)					-0.05 (0.11)
Adjustment of project scale	0.7* (0.09)					0.58* (0.09)
Type of investment		0.29* (0.06)				0.52* (0.08)
Year of project establishment		0.43* (0.05)				0.34* (0.05)
Project registered operation time		0.01* (0.001)				0.017* (0.001)
Export or not		0.16 (0.12)				0.15 (0.12)
Business sector			1.64* (0.16)			1.42* (0.14)
Contribution of capital from Vietnam				-0.001 (0.002)		-0.014 (0.002)
Investors from Asia					0.34* (0.05)	0.31* (0.05)
Investors from Africa or Latin America					-0.31 (0.24)	-0.2 (0.22)
No. of obs	5200	5261	5261	5261	5261	5200
Adjusted R ²	0.0116	0.0476	0.0441	0.0001	0.0094	0.1023

Notes: * denotes significant at 1% , ** denotes significant at 5%, *** denotes significant at 10% White heteroskedasticity consistent standard errors are reported in brackets Investors from Europe are the reference group

the financial resources, the more likely they choose the type of corporation that has more equity partners such as the joint stock company.

The adjustment of project scale variable enters equation with positive sign and statistically significant at 1% level. The result implies that, all other thing being equal, the average size of the project will increase by 0.7% to compare with unadjusted scale projects. This finding support for the theory of firm's growth and survival developed by Jovanovic (1982). That is, the size of project establishment depends on the confidence of the investor for the future. If investors are optimistic about the future, then will established large scale projects. In addition, this result is also parallel with the study of Cabral (1995) as well as Melillo et al (2012) who find that new firms usually start with small-scale operations and gradually expand their scale when possible.

In model 2, we include variables represent for entry mode strategy of foreign investors such as type of investment, year of project establishment, project registered operation time, FDI projects involved in export activities or not. Although coefficients of FDI projects involved in export activities or not is statistically insignificant, the signs of these variables are as expected. The regression results show that if the type of

investment is BOT, business cooperation contract or joint venture will establish 0.29% larger scale project to compare with 100% foreign owned capital investment type. This is explained that the project was established in the form of cooperation bringing many advantages to both Vietnamese investors and foreign investors. Our finding is totally consistent with the results of Kogut and Kulatilaka (1994).

Project registered operation time variable is found to have positive and statistically significant impact on FDI project scale. That is, when the project operation duration increase 1 year will increase the FDI project scale 0.01%.

Year of project establishment variable has a positive impact on the project scale. It means that the project was established in the period 2005-2010 would have 0.01% larger scale than the one in period 2011-2016. The reason is that there is a remarkable period of FDI inflows from 2005-2010, and it is also the time when Vietnam joined the World Trade Organization. In the period of 2011-2016, Vietnam's macroeconomics experiences many difficulties. There are two possible reasons for the declining trend of FDI projects. First, the unstable global economy has made businesses lack the resources to enter the market with greater scale. Second, the decline of macroeconomics conditions leads to decrease in market share; therefore, it demotivates business to extend the scale of initial investment.

In model 3, we add business sector variable into the regression. This variable is statistically significant at 1% level with positive sign. It means that investment projects in the real estate industry, education and training and the mining would have 1.64% larger scale than other industries. This result is similar to that conducted by Mata and Machado (1996), Görg and Strobl (2002) who argue the positive impacts of business sector to the initial establishment size. The larger the size of the business sector, the greater the chance of profit and competition, and therefore the larger scale required to successfully enter the market. In model 4, we do not find a statistical relationship between capital contribution from Vietnam and FDI project scale.

The next model 5 reports the regression results when we include the founder's characteristic into the model. The result indicates that an Asian investor will set up a project 0.34% larger than European investors, and 0.65% larger than African and the Latin American ones. This is because most of Asian countries greatly invest in Vietnam at top 10 with large scale projects (see table 6 below).

Table 6
Top 10 countries invested in Vietnam in 2016

<i>Country</i>	<i>Projects</i>	<i>Total investment</i>	<i>Average capital of project</i>
Korea	5.365	48,6 billion USD	9,3 million USD
Japan	3.117	39,8 billion USD	1,27 million USD
Singapore	1.643	38 billion USD	22,7 million USD
Taiwan	2.525	31,7 billion USD	1,25 million USD
Virgin Island	654	20 billion USD	3.05 million USD
Hong King	1.043	16,6 billion USD	1.5 million USD
Malaysia	547	13,9 billion USD	2,5 million USD
USA	816	10,9 billion USD	1,3 million USD
China	1.445	10,7 billion USD	0,7 million USD
Thai land	459	9 billion USD	1,9 million USD

Source: Vietnam Ministry of Planning and Investment

Model 6 is the results obtained when estimation uses all of the variables. Again, we find all variables have the sign as expected.

5. CONCLUSION AND RECOMMENDATIONS

5.1. Conclusion

This paper analyzes empirically the determinants of FDI project scale in Vietnam, using a unique dataset which contains all information of 5267 FDI projects during 2005-2016 period. By pointing out the limitations of previous researches that fail to consider size of FDI project issues, this paper contributes to the current literature with a better understanding of the factors influencing start-up size of FDI.

In empirical analysis, our research finds a robust and statistically significant association between type of market entry and scale of FDI project. Specifically, the type of enterprise established as a joint stock company will have large scale of investment about 0.23% than the others. Our finding is totally consistent with the results of Allen and Peter (1995) who contend that firms have larger the financial resources, the more likely they choose the type of corporation that has more equity partners such as the joint stock company. The adjustment of project scale variable enters equation with positive sign and statistically significant at 1% level. The result implies that, all other thing being equal, the average size of the project will increase by 0.7% to compare with unadjusted scale projects. This finding support for the theory of firm's growth and survival developed by Jovanovic (1982). In addition, the regression results show that if the type of investment is BOT, business cooperation contract or joint venture will establish 0.29% larger scale project to compare with 100% foreign owned capital investment type. Project registered operation time variable is found to have positive and statistically significant impact on FDI project scale. That is, when the project operation duration increase 1 year will increase the FDI project scale 0.01%. Investment projects in real estate, education and training and mining will have larger scale than the other industry 1.64%. Projects in 2005-2010 period will have larger scale than the later period. Last but not least, An Asian investor will set up a project larger than 0.34% from European investors, and set up a larger-scale project than investors from Africa and Africa. Latin America and 0.65%

5.2. Recommendations

The findings have significant implication for policymaker. First, the study implies that sound macroeconomic stability are always needed by the investors. Therefore, the government should have better policies to stabilize the economy in order to attract more FDI projects as well as to increase the scale of project establishment. Second, our findings have confirmed that project registered operation time has positive impacts on project scale. Hence, the government also needs to develop better strategies to encourage investors invest for a longer time.

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