September 2014

Multinational Enterprise Parent-Foreign Subsidiary Governance

Bassam Elias Farah
The University of Western Ontario

Supervisor
Professor Paul W. Beamish
The University of Western Ontario

Graduate Program in Business

A thesis submitted in partial fulfillment of the requirements for the degree in Doctor of Philosophy

© Bassam Elias Farah 2014

Follow this and additional works at: https://ir.lib.uwo.ca/etd

Part of the Business Administration, Management, and Operations Commons

Recommended Citation
https://ir.lib.uwo.ca/etd/2357

This Dissertation/Thesis is brought to you for free and open access by Scholarship@Western. It has been accepted for inclusion in Electronic Thesis and Dissertation Repository by an authorized administrator of Scholarship@Western. For more information, please contact tadam@uwo.ca, wlswadmin@uwo.ca.
MULTINATIONAL ENTERPRISE PARENT-FOREIGN SUBSIDIARY GOVERNANCE

by

Bassam Elias Farah

Graduate Program in Business Administration

A thesis submitted in partial fulfilment of the requirements for the degree of Doctor of Philosophy

The School of Graduate and Postdoctoral Studies
Western University
London, Ontario, Canada

© Bassam Elias Farah, 2014
ABSTRACT

This dissertation investigates how a multinational enterprise’s (MNE) corporate headquarters governs its foreign subsidiaries. It draws on agency theory, prospect theory, and corporate governance literatures to develop a framework that describes select MNE parent-foreign subsidiary governance mechanisms expected to predict foreign subsidiary performance, measured as foreign subsidiary survival and profitability.

To test this framework, I first conducted a pilot Canadian study. It was followed by the main multi-country study. The Canadian study used mixed methods. It analyzed quantitative data, compiled from different sources, and qualitative data, collected through personal interviews with subsidiary managers. The main multi-country study used survival analysis, multinomial logistic regression, and binary logistic regression techniques to perform various analyses on large longitudinal datasets and sub-datasets for the years 2000-2008 collected from a variety of sources.

The Canadian study showed that Japanese MNE parents of Canadian foreign subsidiaries that had high survival likelihoods were governed through non-linearly higher MNE parent ownership (increasing logarithmic relationship), the use of greater numbers of expatriates (increasing logarithmic relationship), and the adoption of lower levels of risk (decreasing s-shaped relationship), by their MNE corporate headquarters.

The main multi-country study confirmed most of the findings of the Canadian study and provided new findings that demonstrated that foreign subsidiaries that were more likely to survive also tended to be governed by regional headquarters (RHQ) in addition to corporate headquarters (CHQ). It also showed that MNE parent ownership
and the number of expatriates in a foreign subsidiary interact with each other. They thus tend to complement and/or substitute for each other as MNE parent-foreign subsidiary governance mechanisms predicting foreign subsidiary survival. Further, it showed that although these select MNE parent-foreign subsidiary governance mechanisms (ownership, expatriates, risk, and RHQ) predict a foreign subsidiary’s survival likelihood, they do not predict a foreign subsidiary’s profitability. This suggests that the use of MNE parent-foreign subsidiary governance mechanisms may improve the survival but not necessarily the profits of foreign subsidiaries. Implications for agency theory, prospect theory, classical corporate governance, and MNE parent-foreign subsidiary governance research as well as implications for directors and managers are discussed.

**Keywords**

MNE parent-foreign subsidiary governance; parent-subsidiary governance; subsidiary governance; subsidiary control; agency theory; prospect theory; corporate governance; governance mechanisms; ownership; expatriates; risk; regional headquarters (RHQ); multi-method; mixed-method; performance; survival; profitability; interviews; Japan; Canada; multi-country; MNE; MNC.
DEDICATION

To my wife, Rida Elias,

my three children, Elias Bassam Farah, Amal Farah, and Sara Farah,

my parents, Elias Toufic Farah and Amal Saikali, and

my parents-in-law, Mitri Elias and Leila Jreije.
ACKNOWLEDGMENTS

I want to thank the following people for all the wonderful help they provided throughout my PhD journey, without your help I would not have been able to complete this thesis!

I want to thank my supervisor, Dr. Paul W. Beamish, for all the different kinds of support he provided (intellectual, financial, and otherwise) not only throughout my PhD journey but also throughout my wife’s, Rida Elias’, PhD journey as well. Without your support this work wouldn’t have been completed, let alone completed on time. Moreover, I want to thank Maureen Beamish for your continuously encouraging and welcoming attitude. You and Paul are an inspiring and exemplary couple and family.

I also want to thank my proposal & thesis committee members, namely, Dr. Jean Louis Schaan, Dr. Glenn Rowe, Dr. Andreas Schotter, Dr. Shahbaz Sheikh, & Dr. Lance Brothers for all their invaluable comments and feedback on this thesis. I really appreciate all the time you spent to help me improve my work.

I also want to thank the Canadian Foundation for Governance Research (CFGR) from which I received a $15,000 award to conduct this research. I want to thank all of the CFGR’s and the Institute of Corporate Directors’ (ICD’s) members and staff, particularly Robert Bertram, David Beatty, Christian Buhagiar, and Maureen Finlan for their mentorship and support.

I also want to thank all Ivey faculty members who were of great support for me throughout my PhD program, particularly Dr. Oana Branzei, Dr. Tima Bansal, Dr. Rod
White, Dr. Debbie Compeau, Dr. June Cotte, Dr. Mat Thompson, Dr. Brian Pinkham, Dr. Alison Konrad, Dr. Shih-Fen Chen, Dr. Simon Parker, Dr. Mary Crossan, Dr. Chris Higgins, Dr. Brad Corbett, Dr. Claus Rerup, and Dr. Mark Zbaracki.

I also want to thank all Ivey librarians and staff who consistently went out of their way to help with books, articles, databases, and administrative stuff. Particularly, I want to thank Dolly Borsato, Elizabeth Marshall, Alie Visser, Patrick Nelligan, Anna Potrawiak, Meagan Seale, Linda Dittmer-Pino, Mahilah Rafek, the IT and LTR team members, and the caretakers especially Grace, Aisha, and Bob.

I also want to thank all the interviewees (CEOs, board of directors’ members, top management team members, and executives) who took time out of their very busy schedules to participate in this thesis. I will keep your names confidential as promised but I want you to know that I appreciate your participation in my thesis.

I also want to thank all of my fellow PhD colleagues and friends, without your help, encouragement, and motivation this journey would have been impossible. Particularly, I want to thank Matt Tietz, Samer Abdelnour, Sara Hajmohammad and Safa Vakili, Majid & Fateme Eghbali-Zarch, Maya Kumar, Vanessa Hasse, Ramzi Fathallah, Megan Zhang, Yamlaksira Getachew, Karin Schnarr, Charan Bagga, Mike Sartor, Yves Plourde, Ying-Ying Hsieh, Michael Roberts, Nathan Lupton, Duckjong Shin, Maryam Zadeh, Esther Maier, Karen MacMillan, Fei Zhu, Asad Shafiq, Bahareh Tehrani, Lucas Wang, Clara (Yanfei) Hu, Chya-Yi Liaw, Krista Pettit, Meredith Woodwark, Salar Ghamat, Daina Mazutis, Natalie Slawinsky, Fouad Mirzaei, Jeannette Eberhard, Jennifer Jeffrey, Juan Wang, Michael Wood, Mazi Raz, Mat Wong, Reza Mahjoub, and Mehdi
Hossein Nejad. I also want to thank my good old friends Fares Saadeh, Anis Tabanji, and Nina Wakim who have always been there for me when I needed them the most, and my very new friend who seems like a very good old friend now especially that we share a lot in common, Anica Zeyen. To all of you I appreciate our friendship so much.

Thanks also go to our neighbors and relatives in London, Ontario, namely, to Dragan and Tamara Sredojevic and to Walid Busaba and his wife Manal Saikali. Thanks for making our life in London seem more like home.

A big thanks also goes to my wonderful family in Ajax and the Greater Toronto Area. To the Saikalis: Khalo Michel, Nada, Wassim, Afrida, Adib, Nisreen, Claudia, Hana, Zeina, Fadi Michael, and their families. Thank you for being more than parents and siblings to us in every way here in Canada and for making Canada feel more like home. To the extended Farah, Saikali, Jreige, and Elias families, thank you for all your help and encouragement throughout my PhD journey.

Great thanks go to my fantastic parents and family in Lebanon, Qatar, Ukraine and around the world who were always happy to come to Canada or go to Lebanon to help us when we needed them the most. Thanks to the most loving parents Elias and Amal Farah and Mitri and Leila Elias. No matter how much I thank you it won’t be enough. I am blessed to be your son! I hope I’ll be as good a parent as you are! Thanks also to the most loving brothers and sisters: Rana Farah, Toufic Farah, Stevania Elias, Elie Elias, Rodrigue Elias, and your families. Many thanks for all the help you provided and are still providing. I am very lucky to be your brother!
Huge thanks go to my awesome children Elias Farah, Amal Farah, and Sara Farah. You may not know it, because you always wanted to see me more and sometimes I couldn’t be with you because I was working, but you are my source of inspiration and you are what keeps me going. My biggest hope is to be able to help you have a life that would be easier than mine! A grand thank you here goes to Wilma Baliosan for taking care of our children when my wife and I had to work.

A most special thank you goes to my wife Rida Elias. Bibi, if the children are my source of inspiration, you are my guardian angel. Without you guarding and supporting my every step of this journey, none of my efforts would have borne fruit. I learned from you that everything happens for a reason, that with faith everything will be alright, and that we need to enjoy life even when things don’t seem to be going great. Thank you Bibi, not only for being a great PhD colleague but also for being a fabulous wife and mother as well. Rida I love you so much and thank you wholeheartedly.

I am sure I only thanked and acknowledged only a small number of people. I am sure there are many whose name is not in here but whose influence is reflected in this work. To all of you, thanks a million.
# TABLE OF CONTENTS

Abstract ........................................................................................................... ii
Dedication .......................................................................................................... iv
Acknowledgments ............................................................................................. v
Table of Contents ............................................................................................. ix
List of Tables .................................................................................................... xii
List of Figures .................................................................................................. xiii

Chapter 1 ......................................................................................................... 1

1. Introduction .................................................................................................. 1
   1.1. Purpose of this Dissertation .................................................................... 3
   1.2. Definition and Landscape of Classical Corporate Governance ............... 5
   1.3. Internal Classical Corporate Governance Participants and Mechanisms .... 8
   1.4. MNE Parent-Foreign Subsidiary Governance Phenomenon, Definition, and
       Mechanisms ............................................................................................... 11
   1.5. Agency Theory and Prospect Theory ....................................................... 14
   1.6. Thesis Studies and Organization ............................................................... 15

Chapter 2 ......................................................................................................... 18

2. Literature Review and Hypotheses Development ...................................... 18
   2.1. Ownership (as an MNE Parent-Foreign Subsidiary Governance Mechanism) and
       Performance .............................................................................................. 23
   2.2. Expatriates (as an MNE Parent-Foreign Subsidiary Governance Mechanism) and
       Performance .............................................................................................. 29
2.3. Risk Orientation (as an MNE Parent-Foreign Subsidiary Governance Mechanism) and Performance ................................................................. 36
2.4. Regional Headquarters (as an MNE Parent-Foreign Subsidiary Governance Mechanism) and Performance ................................................................. 44
2.5. Expatriates Moderate the Effect of Ownership on Survival ......................... 47

Chapter 3 ............................................................................................................ 52
3. Pilot Canadian Study: Methods and Results .................................................. 52
   3.1. Methods ...................................................................................................... 52
       3.1.1. Quantitative Approach ........................................................................ 53
       3.1.2. Qualitative Approach ......................................................................... 57
   3.2. Results ........................................................................................................ 60
       3.2.1. Quantitative Results ............................................................................ 61
       3.2.2. Qualitative Results ............................................................................. 70

Chapter 4 ........................................................................................................... 74
4. Main Multi-Country Study: Methods and Results ......................................... 74
   4.1. Multi-Country Survival Analysis .............................................................. 74
       4.1.1. Methods .............................................................................................. 74
       4.1.2. Results .............................................................................................. 79
   4.2. Multi-Country Profitability Analyses ....................................................... 89
       4.2.1. Methods .............................................................................................. 89
       4.2.2. Results .............................................................................................. 92

Chapter 5 ........................................................................................................... 96
5. Discussion ............................................................................................................................... 96
  5.1. Research Implications ..................................................................................................... 97
  5.2. Practical Implications ...................................................................................................... 102
  5.3. Limitations and Future Directions ................................................................................ 105
Appendices ............................................................................................................................... 109
Appendix A: Ethics Approval Notice ....................................................................................... 109
Appendix B: Introduction Letter and Consent Form ................................................................. 110
Appendix C: Interview Guide .................................................................................................. 112
References ................................................................................................................................. 114
Curriculum Vitae ....................................................................................................................... 130
LIST OF TABLES

Table 1.1 Hypotheses Considered in the Pilot and Main Studies .................................. 17
Table 3.1 Descriptive Statistics and Pearson Correlations ........................................... 63
Table 3.2 Hierarchical Extended Cox Regression Predicting Subsidiary Exit .............. 64
Table 4.1 Descriptive Statistics and Pearson Correlations ........................................... 81
Table 4.2 Hierarchical Extended Cox Regression Predicting Subsidiary Exit .............. 82
Table 4.3 Multinomial Logistic Regression Predicting Subsidiary Profitability in 2005. 94
Table 4.4 Binomial Logistic Regression Predicting Subsidiary Profitability in 2005 .... 95
LIST OF FIGURES

Figure 1.1 Scope of Classical Corporate Governance ........................................... 7

Figure 1.2 Focal Internal Corporate Governance Mechanisms ................................ 10

Figure 1.3 MNE Parent-Foreign Subsidiary Governance Mechanisms Studied in this Thesis .................................................................................................................. 13

Figure 2.1 Relationship between Risk Orientation (as an MNE Parent-Foreign Subsidiary Governance Mechanism) and Subsidiary Survival .................................................. 43

Figure 3.1 Relationship between Risk Orientation (as an MNE Parent-Foreign Subsidiary Governance Mechanism) and Subsidiary Exit Likelihood ........................................ 69
CHAPTER 1

1. INTRODUCTION

International corporate governance (ICG) research has grown rapidly in recent decades (Aguilera & Jackson, 2010). However, most research in this area focuses on comparing and contrasting governance systems across countries or regions (Denis & McConnell, 2003). Yet, surprisingly limited attention has been given to MNE corporate governance and particularly the governance of foreign subsidiaries by their multinational parents (Luo, 2005) (for exceptions see Brellochs (2007), Kim, Prescott, & Kim (2005), and Costello (2002)).

MNEs dominate the global economy and are becoming ever more internationalized. Many foreign subsidiaries, although they may be wholly owned by their MNE parent, are themselves gigantic enterprises. For example, as of December 2012, Toyota Motor, the world’s eighth largest company by revenues (265.7$b) on the Fortune Global 500 (Fortune, 2013), had 52 overseas manufacturing companies in 27 countries and regions. It operated huge foreign subsidiaries in Canada, the U.S., Latin America, Europe, Russia, China and other countries. Thus shedding more light on MNE corporate governance practices and particularly on the governance of foreign subsidiaries by their MNE parents is both necessary and important (Luo, 2005; Starbuck, 2014).

Senior consultants from the Entity Governance and Compliance team at PricewaterhouseCoopers observe that “Quite often when you look at corporate governance failings, they’ve occurred at the subsidiary level” (Gibson, Elsdon, &
Johnson, 2013). One recent example that illustrates this observation is the governance failure at Wal-Mart’s largest foreign subsidiary, Wal-Mart de Mexico. During April 2012, news broke that executives at Wal-Mart de Mexico had bribed Mexican authorities in previous years to ease expansion in that country and that executives at the company’s headquarters in Bentonville, Arkansas, had been alerted to the bribery but did not take action because of concerns about possible legal, reputational, and financial harm to the company (Barstow, 2012). Such examples suggest that poor MNE parent-foreign subsidiary governance can threaten the performance of foreign subsidiaries and their MNE parents.

Perhaps one of the most well-known recent cases that supports Gibson et al.’s (2013) observation is the 2010 MNE parent-foreign subsidiary governance failure that contributed to BP’s Gulf of Mexico oil disaster and its ramifications on the performance of BP’s US subsidiary and the BP corporation as a whole (Tricker, 2012). BP’s Gulf of Mexico oil spill cost BP Exploration & Production Inc., BP’s Texas-based subsidiary responsible for Gulf of Mexico oil exploration and production, the death of 11 of its employees and the blowout of its Gulf of Mexico Macondo’s well. It also cost the BP corporation more than $4.5 billion in fines and penalties, the largest criminal resolution in U.S. history (Goldenberg & Rushe, 2012). Furthermore, it resulted in a downgrade in BP’s credit rating (Logendran, 2010) and a sharp decline in its stock price, a drop of around 50% in its share value in 50 days (Smith, 2011). In addition, on 25 June 2010 BP’s shares reached a low of $26.97 per share costing BP a total loss of $100 billion in market value (Hays & Schnurr, 2010).
There is an abundance of research on classical (or domestic) corporate governance and international corporate governance (for literature reviews see Daily, Dalton, and Cannella (2003b), Denis (2001), Shleifer and Vishny (1997), Aguilera and Jackson (2010), Denis and McConnell (2003)). Moreover, there is an abundance of research linking classical corporate governance / international corporate governance and performance (e.g. Larcker, Richardson, and Tuna (2007); Bhagat and Bolton (2008); Renders, Gaeremynck, and Sercu (2010); Brav, Jiang, Partnoy, and Thomas (2008); Kaplan (1997); Gompers, Ishii, and Metrick (2003); Ho (2005)). In contrast, there is limited research on MNE parent-foreign subsidiary governance (Luo, 2005) and there is virtually no research examining the impact of MNE parent-foreign subsidiary governance on foreign subsidiary survival and profitability. This dissertation is an initial attempt to fill this gap in the literature.

1.1. Purpose of this Dissertation

This dissertation studies the phenomenon of MNE parent-foreign subsidiary governance. It goes beyond studying the corporate governance structures of domestic companies or MNE-parents themselves, such as the parent’s ownership structure, the parent’s board structure, and the parent’s executive compensation structure, to study the corporate governance mechanisms between the MNE parent and its foreign subsidiaries and their impact on foreign subsidiary survival and profitability. A foreign subsidiary company refers to a partially or wholly owned company that is 1) part of a larger corporation with headquarters in another country, and 2) incorporated under the laws of
the country it is located in (BusinessDictionary.com, 2014). Thus this thesis attempts to answer the following research questions: (1) how do MNE parents govern their foreign subsidiaries to ensure better performance measured as foreign subsidiary survival and foreign subsidiary profitability, and (2) why they govern these foreign subsidiaries that way.

To answer these research questions this study starts with the MNE parent-foreign subsidiary governance phenomenon then draws on agency theory (Berle & Means, 1932; Fama & Jensen, 1983a, 1983b; Jensen & Meckling, 1976), prospect theory (Kahneman & Tversky, 1979; Thaler, Tversky, Kahneman, & Schwartz, 1997; Tversky & Kahneman, 1986, 1992), classical corporate governance, and MNE parent-foreign subsidiary relationships literatures to develop a theoretical framework to help better explain this phenomenon.

In developing this theoretical framework and deciding which MNE parent-foreign subsidiary governance mechanisms would impact foreign subsidiary performance the most, I followed three steps. First I observed and scanned the broad classical corporate governance phenomena and landscape. Then I focused on internal classical corporate governance and its mechanisms. Finally I drew parallels between internal classical corporate governance mechanisms and MNE parent-foreign subsidiary governance mechanisms to develop the theoretical model that I use to help better explain the parent-subsidiary governance phenomenon. This process is described in more detail in the following three sections.
1.2. Definition and Landscape of Classical Corporate Governance

Robert Tricker, the founder-editor of the research journal *Corporate Governance: An International Review* in 1993, defines corporate governance as “the way power is exercised over corporate entities. It covers the activities of the *board* and its relationships with the *shareholders* or members, and with *those managing the enterprise*, as well as with the external auditors, regulators, and other legitimate stakeholders [italics added] (Tricker, 2012: 4).” He adds that “Corporate governance is different from management. Executive management is responsible for running the enterprise, but the governing body ensures that it is running in the right direction and being run well. Directors are so-called because they are responsible for setting the organization’s direction, formulating strategy, and policymaking. Further, the board is responsible for supervising management and being accountable. Overall, the board is responsible for the organization’s decisions and its performance (Tricker, 2012: 4).” Based on his corporate governance definition, Tricker (2012: 32) then provides a schematic depiction of the classical corporate governance landscape and its participants (see Figure 1.1).

Taking a closer look at Figure 1.1, one can divide the participants in the classical corporate governance space into internal classical corporate governance participants (i.e. participants internal to the domestic company) and external classical corporate governance participants (i.e. participants external to the domestic company). Internal classical corporate governance participants include shareholders, board of directors (BOD), and management. External classical corporate governance participants include stock markets for listed companies, finance markets (equity and debt), market
intermediaries, external auditors, contractual stakeholders (e.g. employees, suppliers, customers, etc.), government and other corporate regulators, media, and societal influence and other stakeholders.
Figure 1.1 Scope of Classical Corporate Governance
1.3. **Internal Classical Corporate Governance Participants and Mechanisms**

Given that “central to corporate governance thinking and practice are the shareholders, the board of directors, and the management. [And that] …corporate governance codes focus on this set of players, as does much company law (Tricker, 2012: 31)” and given that I believe that companies can shape their external circumstances through their internal behaviors, this thesis focuses on internal corporate governance participants and mechanisms as compared to external corporate governance participants and mechanisms. Generally in the internal classical corporate governance space, shareholders appoint board members to oversee the management of the company they own. Thus, shareholders mainly govern the company they own through their ownership-level mechanism and through their other board-level mechanisms. The ownership-level mechanism refers to the ownership concentrations of the shareholders in the company they own. The board-level mechanisms include BOD special committees (e.g. risk committee, audit committee, compensation committee, nominating committee, governance committee, etc.), capital structure (e.g. debt, equity), organizational structure (e.g. functional structure, multidivisional structure (M-form structure), matrix structure, etc.), executive compensation (e.g. fixed/variable, money/shares/options, short/long term targets), employee participation, etc.

Ownership, BOD, risk, and organizational structure are among the most important mechanisms used to govern companies. As a result, I focus on the ownership (i.e. ownership concentration), BOD, risk (i.e. risk committee and capital structure / debt
level), and organizational structure internal classical corporate governance mechanisms shown in Figure 1.2.
Figure 1.2 Focal Internal Corporate Governance Mechanisms

Internal classical CG Mechanisms (Ownership & BOD):
- Ownership concentration
- BOD
  - Special Committees (Risk Committee)
  - Capital structure (debt, equity)
  - Organizational structure

Shareholders ➔ Management ➔ Performance
1.4. MNE Parent-Foreign Subsidiary Governance Phenomenon, Definition, and Mechanisms

The purpose of this thesis is to investigate the MNE parent-foreign subsidiary governance phenomenon, more particularly, how MNE parents govern their foreign subsidiaries to ensure better foreign subsidiary performance. To develop a framework that describes the MNE parent-foreign subsidiary governance mechanisms expected to impact foreign subsidiary performance one has to define MNE parent-foreign subsidiary governance before moving to the third previously mentioned step, drawing parallels between internal classical corporate governance mechanisms and MNE parent-foreign subsidiary governance mechanisms.

Luo (2005) defines MNE governance as “the system that not only monitors the relationship[s] between executives and stakeholders (including shareholders) but also directs … [an MNE’s] various globally dispersed businesses and pinpoints the distribution of power, rights and responsibilities among critical participants in the corporate-level [and subsidiary-level] decision-making process that affects worldwide corporate affairs [italics added]”.

Building on Luo’s definition, I define MNE parent-foreign subsidiary governance as the system that directs and monitors the relationships between a foreign subsidiary and its stakeholders (among which the MNE parent is typically a major stakeholder / shareholder) and identifies the distribution of power, rights, and responsibilities among
key participants in the MNE parent-foreign subsidiary decision-making process that affects the MNE parent’s and foreign subsidiary’s affairs.

Based on this definition, plus agency theory, prospect theory, and the previously discussed focal internal classical corporate governance mechanisms, I develop the *MNE parent-foreign subsidiary governance framework* in Figure 1.3 that describes MNE parent-foreign subsidiary governance mechanisms that are parallel to the internal classical corporate governance mechanisms in Figure 1.2 and that are expected to impact foreign subsidiary performance.

In Figure 1.3, *ownership* (which refers to the MNE parent’s ownership in the foreign subsidiary), *expatriates* (which refers to the expatriates in the foreign subsidiary), *risk* (which refers to the risk orientation of the foreign subsidiary), and *regional headquarters* (which refers to whether the foreign subsidiary is governed by a RHQ) are respectively parallel to *ownership concentration, BOD, risk committee and capital structure*, and *organizational structure* in Figure 1.2. In the case of expatriates and BOD, I consider them parallel because I consider individual expatriates as having a foreign subsidiary governance role similar to individual directors’ corporate governance role.
Figure 1.3 MNE Parent-Foreign Subsidiary Governance Mechanisms Studied in this Thesis
1.5. Agency Theory and Prospect Theory

Agency theory was used to select the MNE parent-foreign subsidiary governance mechanisms expected to impact foreign subsidiary performance and to develop hypotheses relating these MNE parent-foreign subsidiary governance mechanisms to foreign subsidiary performance. To develop my hypotheses I use agency theory to argue that, relative to MNE parents with foreign subsidiaries that are less likely to survive, MNE parents with foreign subsidiaries that are more likely to survive, use higher ownership and expatriates and tend to use RHQ as MNE parent-foreign subsidiary governance mechanisms. MNE parents use these governance mechanisms to align the interests, goals, and outcomes of their foreign subsidiaries with theirs to reduce parent (principal)-subsidiary (agent) agency problems, which are expected to increase their foreign subsidiaries survival. I also use agency theory to argue that although these MNE parent-foreign subsidiary governance mechanisms may impact foreign subsidiary survival, they may not necessarily predict subsidiary profitability.

I draw on prospect theory to explain why risk orientation impacts foreign subsidiary survival but not necessarily foreign subsidiary profitability. I use prospect theory for three reasons. The first is to explain that firms follow three risk orientations, namely, extreme risk-averting orientation, moderate risk-taking orientation, and excessive risk-seeking orientation. The second is to argue that firms following the moderate risk-taking orientation are assumed to be rational actors whereas firms following the extreme risk-averting orientation and the excessive risk-seeking orientation
are assumed to be boundedly rational actors. The third is to argue that within each orientation some firms behave in an even more rational manner than their peers while others behave in an even more biased manner than their peers. More details about this are provided in the hypothesis development for risk orientation.

1.6. Thesis Studies and Organization

To answer the previously mentioned two research questions I conduct two studies, a pilot Canadian study and a main multi-country study. The pilot Canadian study utilizes a Canadian sample and analyzes the relationships between ownership, expatriates, and risk orientation (but not RHQ) relative to survival. This study follows a multi-method approach. To answer the first research question I gather archival data on the ownership, expatriates, and risk orientation mechanisms that Japanese MNEs use to govern their Canadian subsidiaries and build a survival model to test my hypotheses and present my quantitative results. To help answer the second research question I conduct interviews with Canadian subsidiary board members, CEOs, and top management team (TMT) members. I then analyze these interviews and present my qualitative results.

The main multi-country study utilizes a multi-country sample and analyzes the relationships between ownership, expatriates, risk orientation, and RHQ relative to survival and profitability. This study addresses the first research question using a very large sample of Japanese MNEs with foreign subsidiaries in a range of countries and regions. Here, I test the impact of the selected MNE parent-foreign subsidiary governance mechanisms on foreign subsidiary survival and profitability.
I investigate the impact of MNE parent-foreign subsidiary governance mechanisms on both foreign subsidiary survival and foreign subsidiary profitability for several reasons. First, I believe that profitability tends to be a shorter term measure of performance while survival tends to be a longer term measure of performance. That is because in this thesis subsidiary profitability is conceptualized and measured as a subsidiary’s financial performance *in a specific year* whereas subsidiary survival is conceptualized and measured as, whether and for how long, a subsidiary survives *over the years*.

Second, although Mitchell (1994) and Barkema, Shenkar, Vermeulen, and Bell (1997) justify their use of survival as a performance measure based on its moderate correlation with subsidiary profitability, Makino and Beamish (1998) and Delios and Beamish (2001) show that these two performance measures are distinct and do not necessarily co-vary. Third, I want to compare the effect of MNE parent-foreign subsidiary governance mechanisms on survival with their impact on profitability because I believe that these same governance mechanisms may predict foreign subsidiary survival but not necessarily foreign subsidiary profitability.

The rest of this thesis is organized as follows. Chapter Two develops the arguments for the six general hypotheses, related to ownership, expatriates, and risk orientation, that I test in the quantitative and qualitative pilot Canadian study. It also develops the arguments for two additional general hypotheses related to RHQ and an interaction hypothesis that I additionally test in the main multi-country study.

Chapter Three includes the methods and results of the pilot Canadian study. Chapter Four includes the methods and results of the main multi-country study. Chapter
Five includes the discussion of the Canadian and multi-country studies. Table 1.1 presents the different hypotheses that are considered in the pilot and main studies.

Table 1.1 Hypotheses Considered in the Pilot and Main Studies

<table>
<thead>
<tr>
<th>Hypothesis</th>
<th>Pilot Canadian Study: Canadian sample with survival as dependent variable</th>
<th>Main Multi-Country Study: Global sample with survival and profitability as dependent variables</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>H1a:</strong> An MNE parent’s ownership in a foreign subsidiary has a positive nonlinear logarithmic effect on that foreign subsidiary’s survival.</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td><strong>H1b:</strong> An MNE parent’s ownership in a foreign subsidiary has a negligible effect on that foreign subsidiary’s profitability.</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td><strong>H2a:</strong> The number of expatriates in a foreign subsidiary has a positive nonlinear logarithmic effect on that foreign subsidiary’s survival.</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td><strong>H2b:</strong> The number of expatriates in a foreign subsidiary has a negligible effect on its profitability.</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td><strong>H3a:</strong> The relationship between parent risk orientation and foreign subsidiary survival is nonlinear (declining s-shaped), with the slope negative for parents with an extremely risk-averse orientation, positive for parents with a moderate risk-taking orientation, and negative for parents with an excessively risk-seeking orientation (see Figure 2.1).</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td><strong>H3b:</strong> An MNE parent’s risk orientation has a negligible effect on its foreign subsidiary’s profitability.</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td><strong>H4a:</strong> Foreign subsidiaries of parents with regional headquarters (RHQs) in the regions where these foreign subsidiaries operate are more likely to survive than their counterparts of parents without RHQs in the regions where they operate.</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td><strong>H4b:</strong> Foreign subsidiaries of parents with regional headquarters (RHQs) in the regions where these foreign subsidiaries operate do not necessarily financially perform better than their counterparts of parents without RHQs in the regions where they operate.</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td><strong>H5:</strong> Expatriates modify the effect of ownership on foreign subsidiary survival; the effect of MNE parent ownership on foreign subsidiary survival is stronger (weaker) when the number of expatriates in the foreign subsidiary is lower (higher).</td>
<td></td>
<td>✓</td>
</tr>
</tbody>
</table>
CHAPTER 2

2. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

With MNEs’ increasing internationalization and dominance in the global economy, it has become more pressing to study MNE governance in general and MNE parent-foreign subsidiary governance in particular. However, despite its importance, MNE governance and MNE parent-foreign subsidiary governance research was almost nonexistent before the 2000s (Delios, 2011). Furthermore, despite calls for papers on MNE governance (e.g. Delios, 2011; Luo, 2005; Rahman, 2011; Strange, Filatotchev, Buck, & Wright, 2009) research in these areas has grown only slowly since then, perhaps due to the limited availability of MNE governance data. What follows is a literature review of the few studies on MNE and foreign subsidiary governance.

In a quantitative empirical study, Lippert and Rahman (1999) find that CEO compensation of domestic companies (DCs) is more aligned with equity performance than that of multinational corporations (MNCs). They further find that DCs and MNCs use corporate governance constructs and mechanisms differently.

Kim et al. (2005) conceptually argue that MNE parent-foreign subsidiary governance must respond to different levels of agency problems related to varying strategic roles of foreign subsidiaries. They further argue that varying governance structures for each foreign subsidiary leads to better overall MNE performance.

Kiel, Hendry, and Nicholson (2006), also in a conceptual paper, propose four governance frameworks for subsidiary companies: (1) Direct Control, (2) Dual
Reporting, (3) Advisory Board, and (4) Local Board. They then provide recommendations on when each would lead to improved overall MNE performance.

Brellochs (2007), in a qualitative PhD thesis based on agency theory’s predictions, finds that there are three categories of subsidiary governance mechanisms. He argues that the mechanisms in the categories aimed at reducing goal incongruence and managerial discretion are more important than those in the category aimed at decreasing information asymmetry. Furthermore, he finds that a subsidiary’s governance mechanisms are contingent on the subsidiary’s local environment and the MNE group that the subsidiary is part of.

Finally, Costello and Costello (2010), in a quantitative empirical study, find that there are three types of subsidiary governance bundles, those that respectively depend on parent-centered governance mechanisms, subsidiary-centered governance mechanisms, and parent- and subsidiary- centered governance mechanisms. They argue that the MNE’s international strategy, its subsidiary’s importance, its subsidiary’s environmental uncertainty, and its subsidiary’s age are factors that help predict what type of subsidiary governance bundle an MNE will use to align the interests of its headquarters with those of a particular subsidiary.

In this thesis I draw on agency theory following Filatotchev and Wright’s (2011) call for a greater focus on agency theory to understand corporate governance in MNEs. Most of the empirical literature on classical (domestic) corporate governance is grounded in agency theory and focuses on associating different corporate governance mechanisms with performance (Filatotchev & Wright, 2011). This study extends agency theory to link
different MNE parentsubsidiary governance mechanisms with foreign subsidiary survival and profitability, a phenomenon that has been under-researched.

Agency theory attempts to explain the agency problem, that is, the principal-agent problem, the agency relationship, the mitigation of the agency problem, and agency costs (Clarke, 2004; Dalton, Hitt, Certo, & Dalton, 2007; Fama & Jensen, 1983a, 1983b; Jensen & Meckling, 1976). It assumes that principals and agents are selfinterested rational utility-maximizers and thus have divergent interests. The agency problem arises when agents pursue their self-interest at the expense of the maximization of the utility of their principals. The agency relationship is defined as the implicit or explicit contract under which the principal engages the agent to perform some service on his/her behalf which involves delegating some decision making authority to the agent (Clarke, 2004). To mitigate the agency problem, agency theory attempts to align the agent’s interests with those of the principal by analyzing the optimal contract form and the optimal governance structure (Eisenhardt, 1989).

The two most discussed agency problems are moral hazard and adverse selection. Moral hazard arises when the principal cannot observe or monitor the agent’s actions. Adverse selection arises when the principal cannot evaluate whether the agent’s actions are in the principal’s best interests (Eisenhardt, 1989). Fundamentally, the agency problem in general and the moral hazard and adverse selection problems in particular, are problems of information asymmetry (Shapiro, 2005).

There are three broad types of agency costs: 1) “residual loss” (Fama & Jensen, 1983b) refers to costs which represent the financial loss that the principal incurs when the agent pursues his/her self-interest at the principal’s expense, 2) monitoring costs refer to
costs that the principal incurs to decrease the aberrant activities of the agent, and 3) bonding costs refer to costs that the agent incurs to compensate the principal in case the agent acts in ways that harm the principal (Clarke, 2004; Fama & Jensen, 1983b).

Typically, the principal incurs monitoring costs to decrease the information asymmetry between himself/herself and the agent and thus minimize residual loss. Monitoring costs incurred by the principal are effective when they are less than the benefits gained from reducing residual loss.

I extend agency theory to explain MNE parent-foreign subsidiary governance relationships and their impact on the survival and profitability of foreign subsidiaries of MNE parents. MNE parent-foreign subsidiary relationships can be considered principal-agent relationships since MNE parents (i.e. principals) delegate decision-making authority and responsibility to foreign subsidiaries (i.e. agents) (Nohria & Ghoshal, 1994). Physical, legal, political, and other distances make it even more difficult for MNE parents than for domestic parents to observe and monitor their subsidiaries’ actions, let alone assess whether these actions are in these parents’ best interests (Gong, 2003); thus, exacerbating the adverse selection and moral hazard agency problems even more than in traditional domestic companies.

I also draw on prospect theory to explain why and how the risk orientation MNE parent-foreign subsidiary governance mechanism impacts foreign subsidiary survival and profitability. Kahneman and Tversky (1979) first proposed prospect theory to argue that the choices that individuals make in risky situations are not always consistent with the basic assumptions and predictions of the most commonly accepted economic theory of rational choice, namely the expected utility theory developed by Von Neumann and
Morgenstern (1944). Kahneman and Tversky (1979) showed that, contrary to expected return theory’s principles, individuals are boundedly rational (Holmes, Bromiley, Devers, Holcomb, & McGuire, 2011) rather than perfectly rational and thus don’t always make perfectly rational decisions (Tversky & Kahneman, 1983) and that subjective probabilities (Kahneman & Tversky, 1972) and framing (Tversky & Kahneman, 1981, 1986) influence individuals’ decisions under risk. Moreover, they demonstrated that individuals’ use of decision heuristics lead to biases that impact their decisions (Tversky & Kahneman, 1974).

They thus showed that how individuals interpret and frame their choices, as gains or as losses, influences how much risk they will take. For instance, they found that framing an investment decision as a loss (10% investment loss) will put someone in a domain of loss, and framing the same investment decision as a gain (90% investment profit) will put someone in a domain of gain. If an individual frames an outcome as a loss, (s)he will assume more risk to avoid that outcome than if (s)he framed the identical outcome as a gain. Therefore, prospect theory’s major insight is that people hate to lose even more than they love to win and that this will systematically bias their attitudes toward risk (Mercer, 2005).

Subsequent researchers extended prospect theory’s ideas from the individual level to the firm level (for examples see: Bowman, 1982; Fiegenbaum & Thomas, 1988; Jegers, 1991). I extend these ideas even further to the MNE parent-foreign subsidiary level to explain the impact of risk orientation, a parent-subsidiary governance mechanism, on foreign subsidiary survival and profitability.
To govern their foreign subsidiaries, MNE parents can employ different MNE parent-foreign subsidiary governance mechanisms. In the following sections I explain how MNE headquarters use the MNE parent-foreign subsidiary governance mechanisms of ownership, expatriates, risk orientation, and RHQ to govern their foreign subsidiaries and impact their foreign subsidiaries’ performance.

2.1. Ownership (as an MNE Parent-Foreign Subsidiary Governance Mechanism) and Performance

Connelly, Hoskisson, Tihanyi, and Certo (2010) note that “Firm ownership is an increasingly influential form of corporate governance.” Judge (2011) suggests that ownership plays a pivotal role in corporate governance. Daily, Dalton, and Rajagopalan (2003a) edited a Special Research Forum on Governance through Ownership to further research on ownership as a governance mechanism. Schaan (1983) shows that MNE parents can influence and control their foreign subsidiaries through the use of several control mechanisms. Anderson and Gatignon (1986) suggest that among the several used foreign subsidiary control mechanisms, the level of an MNE parent’s ownership in its foreign subsidiary is still generally considered one of the most important potential foreign subsidiary control and influence mechanisms. Therefore, I consider an MNE parent’s ownership in a foreign subsidiary as an important MNE parent-foreign subsidiary governance mechanism.

Ownership generally refers to “the right to exclusive use of an asset. The owner of an asset normally has the right to decide what use shall be made of it, and cannot be
deprived of it except by law. The state, however, claims the right to regulate the use of
many assets, and to tax income derived from them” (Black, 1997, p. 340). In the MNE
context, ownership refers to the MNE parent’s exclusive rights to use its shares (assets) in
its foreign subsidiary. Two major ways MNE parents use their ownership in their foreign
subsidiaries are as a *strategic governance mechanism* (Alces, 2008; Doz & Prahalad,
1984; Xu, Pan, & Beamish, 2004) and a *structural governance mechanism*.

I argue that MNE parent ownership in a foreign subsidiary has a positive effect on
the survival of the foreign subsidiary but does not necessarily have an effect on the
profitability of the foreign subsidiary. That is because generally an MNE-parent
(principal) with higher ownership in a foreign subsidiary (agent) is expected to have more
incentive and influence, than a counterpart with lower ownership, to minimize parent-
subsidiary agency costs and agency problems but may not necessarily be able to
maximize foreign subsidiary revenues. Minimizing agency costs and agency problems
consequently increases the survival likelihood but not necessarily the profitability of the
foreign subsidiary.

Classical corporate governance research suggests that concentrated owners, such
as institutional investors and large block holders, have more incentive and influence to
better monitor and govern their companies than their minority investor counterparts
(Chakraborty & Sheikh, 2008; Shleifer & Vishny, 1986). This is because first they have a
sufficiently larger investment at stake (Daily et al., 2003a) and second they cannot easily
divest their sufficiently larger investment in a firm not meeting their performance
expectations (Lane, Cannella, & Lubatkin, 1998). Analogously, and for similar reasons,
generally an MNE parent with a higher ownership concentration in its foreign subsidiary
is expected to have more incentive and influence to better monitor and govern its foreign subsidiary than a counterpart with a lower ownership concentration in its foreign subsidiary. However, having more incentive and influence to better govern its foreign subsidiary due to higher ownership, by no means suggests that an MNE parent with lower ownership in its foreign subsidiary cannot use other mechanisms to control its foreign subsidiary (Schaan, 1988). Thus my statement is understandably general and exceptions can be found.

Investors (stockowners) typically have two basic ways to improve firm performance: exit and voice (Hoskisson, Hitt, Johnson, & Grossman, 2002). MNE-parents can also utilize these two ways to improve their foreign subsidiaries’ performance. For example, an MNE-parent can sell its shares (exit) in a certain subsidiary to indicate its dissatisfaction with the subsidiary’s management or their behavior. However, divesting a subsidiary is expensive because subsidiary shares are usually not publicly traded and thus quite illiquid, which makes selling them costly. Therefore, parents, with significant ownership in their subsidiaries, usually have more incentive to exercise their voice. Investors, generally exercise their voice through shareholder activism (Smith, 1996) by campaigning and voting in shareholder meetings. MNE-parents, on the other hand, exercise voice through closely monitoring and directing their foreign subsidiaries’ behavior. They exercise voice in at least three ways. The first is through the voting of foreign subsidiary board members, many of whom are usually MNE-parent managers, on the subsidiary’s strategies, budgets, and policies. The second is through assigning expatriates, who are expected to be loyal to the MNE-parent, as
foreign subsidiary general managers or top management team members. The third is through setting policies and procedures for their foreign subsidiaries to follow.

I contend that an MNE-parent (principal) with higher ownership in a foreign subsidiary (agent) typically has more influence on directing and monitoring the purpose, goals, strategies, policies, and actions of the foreign subsidiary than a counterpart with lower ownership. With such influence the parent can restructure the subsidiary’s business activities or ownership or even change its charter (Birkinshaw & Hood, 1998) or influence managerial behavior (Connelly et al., 2010). In the event of restructuring, the parent can pursue financial, governance, operational, or ownership restructuring of the subsidiary. When changing a subsidiary’s charter, a parent can alter a subsidiary’s mandate (Roth & Morrison, 1992), responsibilities, business activities, markets served, products manufactured, technologies held, functional areas covered, or any combination thereof (Birkinshaw & Hood, 1998). While attempting to influence managerial behavior a parent can persuade, lobby, or sometimes even force subsidiary managers to follow certain courses of action. For instance, one of the participants interviewed for this study was a subsidiary governance senior officer at the headquarters of an MNE. He suggested that, at times, after making some acquisitions, the management of the MNE that he worked at had to ‘politely’ force the management of the acquired subsidiary to follow the acquirer’s policies and procedures.

With more incentive to monitor its foreign subsidiary than to divest it and with more influence to monitor and direct the subsidiary’s behaviors, an MNE parent with higher ownership is more likely to reduce a subsidiary’s moral hazard and to align a subsidiary’s interests with the parent’s interests than would a counterpart with lower
ownership. A lower foreign subsidiary moral hazard and a greater alignment of the parent’s and the subsidiary’s interests will lower parent-subsidiary agency costs and minimizes their agency problems (Jensen & Meckling, 1976; O’Donnell, 2000). Fama and Jensen (1983b) argue that reducing agency problems significantly contributes to the survival of different organizational forms. Similarly, I argue that minimizing parent-subsidiary agency problems considerably increases the survival likelihood of a subsidiary (Jensen, 1983).

Greater MNE parent ownership in a foreign subsidiary is expected to increase the survival of the foreign subsidiary, although this ownership-survival relationship is anticipated to be nonlinear logarithmic. The latter is because, as parent ownership increases and agency problems decrease, subsidiary self-serving behaviors decline. However they decline at a decreasing rate, as increments in the ownership levels in the lower end will have a larger impact in reducing potential for subsidiary self-serving behavior, and thus agency costs, than similar ones at the higher end. Therefore I contend that the law of diminishing marginal utility is at work here. For example, Gomes-Casseres (1990) notes that firms are likely to perceive a difference between 100 percent and 80 percent foreign ownership differently from a difference between 80 percent and 60 percent foreign ownership. Applying the law of diminishing marginal utility, I argue that increments at lower ownership levels (e.g. from 0% to 51%) are more sensitive than similar increments at higher ownership levels (e.g. from 52% to 100%) (Dhanaraj & Beamish, 2004).

Although I expect MNE parent ownership in a foreign subsidiary to have an effect on the survival of the foreign subsidiary, I do not expect it to necessarily have an effect
on the profitability of the foreign subsidiary for the following reasons. First, MNE parent ownership in a foreign subsidiary is expected to minimize MNE parent-foreign subsidiary agency costs and agency problems that are in turn expected to increase foreign subsidiary survival. However, ownership is not expected to maximize foreign subsidiary revenues, which are essential for increasing foreign subsidiary profitability. That is because in classical corporate governance, investors typically do not manage the day-to-day affairs of their firms, but elect directors who appoint top managers to do so. However, investors usually interfere when their firm is facing a crisis or possible bankruptcy, which sometimes may be the result of agency problems, but they generally do not interfere to maximize their firm’s revenues, they let the board and management do this job (Lane et al., 1998).

Second, a firm’s profitability is determined by its interaction with its product markets and its many factor markets, of which the capital markets are but one (Lane et al., 1998). Similarly, a foreign subsidiary’s profitability is determined by all these variables, of which its ownership structure is but one. Third, there is some evidence that ownership concentration and accounting measures of performance are independent (Demsetz & Lehn, 1985) which suggests that foreign subsidiary ownership and profitability (financial performance) would probably be independent as well. Therefore I hypothesize that:

_Hypothesis 1a: An MNE parent’s ownership in a foreign subsidiary has a positive nonlinear logarithmic effect on that foreign subsidiary’s survival._
Hypothesis 1b: An MNE parent’s ownership in a foreign subsidiary has a negligible effect on that foreign subsidiary’s profitability.

2.2. Expatriates (as an MNE Parent-Foreign Subsidiary Governance Mechanism) and Performance

I previously defined MNE parent-foreign subsidiary governance as the system that directs and monitors the relationships between foreign subsidiaries and their stakeholders, among which the MNE parent is typically a major stakeholder. I view expatriates as an important MNE parent-foreign subsidiary governance mechanism. Many studies see expatriates as a key MNE parent-foreign subsidiary control mechanism (Edström & Galbraith, 1977; Fenwick, De Cieri, & Welch, 1999; Gong, 2003). Macedo-Soares and Schubsky (2010) explicitly view expatriates as an effective MNE parent-foreign subsidiary governance mechanism. Consistent with Macedo-Soares and Schubsky (2010) I consider expatriates as an MNE parent-foreign subsidiary governance mechanism. That is because I view control as analogous to only the monitoring dimension in my MNE parent-foreign subsidiary governance definition whereas I view expatriates as also having an MNE parent-foreign subsidiary alignment role analogous to the directing dimension in my definition. Monitoring is defined as observation of an agent’s effort or outcomes that is accomplished through supervision, accounting controls, and other devices. Whereas, one way alignment of an agent’s and a principal’s interests can be achieved is through contracts that make the agent’s compensation contingent on
outcomes of his or her performance that are desired by the principal (Tosi, Katz, & Gomez-Mejia, 1997).

Moreover, given that most foreign subsidiaries either do not have a board of directors or have an inactive symbolic one (Gillies & Dickinson, 1999), I expect expatriates to either be on the subsidiary’s board, when it exists, or significantly substitute for the subsidiary’s board, when it does not exist, and have a parent-subsidiary governance role in addition to their subsidiary management role. Thus, in this study, I broaden the role of expatriates from just being subsidiary managers to having a role as parent-subsidiary governors.

As foreign subsidiary governors, and similar to most domestic companies’ board members, expatriates are expected to have conformance (monitoring) and performance (directing) roles. The conformance role includes an internal role, namely monitoring management, and an external role, namely being accountable to stakeholders. The performance role includes a short-term-oriented role, namely policymaking, and a long-term-oriented role, namely strategy formulation (Tang, Crossan, & Rowe, 2011; Tricker, 2012).

*Expatriates* are employees coming from an MNE’s headquarters or other entities and working in a foreign-country subsidiary of that MNE. Expatriates typically function as *operational governance mechanisms* and *social governance mechanisms* for their parents (Beamish & Inkpen, 1998; Boyacigiller, 1990; Delios & Bjorkman, 2000).

Headquarter-subsidiary research shows that as subsidiary control increases, headquarters use of expatriates as a parent supervision mechanism increases (O’Donnell, 2000). Therefore, I contend that subsidiaries with more expatriates are expected to be
better monitored and governed, thus minimizing parent-subsidiary agency costs and agency problems and consequently increasing their survival likelihood.

I argue that the number of expatriates in a foreign subsidiary has a positive nonlinear logarithmic effect on the survival of the foreign subsidiary but does not necessarily have an effect on the profitability of the foreign subsidiary. That is because generally an MNE parent (principal) with more expatriates in a foreign subsidiary (agent) is expected to have more influence, than a counterpart with fewer expatriates, to minimize parent-subsidiary agency costs and agency problems. However, the MNE parent may not necessarily be able to maximize foreign subsidiary revenues or cover the costs of the generally more expensive expatriates versus local managers. Minimizing agency costs and problems consequently increases the survival likelihood but not necessarily the profitability of the foreign subsidiary.

In this study I theorize the number of expatriates, and not the percentage of expatriates, in the foreign subsidiary, as the antecedent to the subsidiary’s survival, for the following two reasons. First, from a governance perspective, a small number of expatriates, although it may not be a big percentage of expatriates, in the foreign subsidiary, may be enough for the parent to govern the foreign subsidiary. Second, also from a governance perspective, the governance impact of one expatriate in a smaller subsidiary may be similar to his/her impact in a bigger subsidiary, although the expatriate percentage in these two subsidiaries may be significantly different. These two cases are particularly applicable when the expatriate(s) include key top managers such as the CEO, CFO, etc. and when these expatriates are fully supported by the MNE parent; two conditions that can be applicable in many foreign subsidiaries.
MNE parent-foreign subsidiary relationships are similar to principal-agent relationships (Tan & Mahoney, 2006) since, the same way a principal delegates decision making authority to its agent, an MNE parent delegates decision making authority to its foreign subsidiary (O’Donnell, 2000). However, parent-subsidiary relationships have more pronounced information asymmetry between the parent and the subsidiary than the information asymmetry present between traditional domestic principals and agents. This higher level of information asymmetry arises from the different kinds of distances (physical, political, legal, etc.) between the headquarters and the subsidiary.

Parent-subsidiary distance and information asymmetry increase moral hazard and adverse selection (Shapiro, 2005). They increase moral hazard because they make it more difficult and costly for the parent to observe and/or monitor the subsidiary’s actions. They increase adverse selection because they make it more difficult and costly for the parent to evaluate whether the subsidiary’s actions are in the parent’s best interests (Eisenhardt, 1989).

Agency theory suggests that boards are motivated to monitor management and align management’s interests with those of owners primarily through two board incentives, namely board independence and director compensation. It argues that independent outside directors (directors who are not current or former managers/employees of the firm) have a greater incentive to monitor management because they are not socially or economically related to management. It also argues that the interests of directors with equity compensation will be more aligned with those of shareholders and thus will have a greater incentive to monitor the performance of management and direct them to pursue shareholder interests (Hillman & Dalziel, 2003).
In a similar manner, the interests of expatriates, who are usually on the payroll of the MNE-parent, will be aligned with the interests of the parent (Bonache & Fernández, 1997). Thus expatriates are expected to be and tend to be committed to the MNE-parent as a whole (as well as to the subsidiary) and therefore are deemed trustworthy parent representatives in ‘distant’ foreign subsidiaries (Gong, 2003). Thus they are considered extended forms of headquarters-subsidiary control or monitoring (Boyacigiller, 1990) and alignment (Tan & Mahoney, 2006).

Expatriates socially align or direct the parent’s and subsidiary’s interests, goals, actions, and outcomes in a way that is beneficial for both the subsidiary and parent by continually communicating and negotiating strategy and performance between the parent and subsidiary (Macedo-Soares & Schubsky, 2010). Moreover, they socially or culturally control or monitor a subsidiary’s goals, actions, and outcomes to fit with those set for it by the parent by sharing and inculcating the parent’s values and norms with the subsidiary’s managers and employees (Ouchi, 1979).

Expatriates monitor foreign subsidiaries’ strategy implementation, successor training, and evaluating and rewarding the TMT (Moore, 2006; Rindova, 1999; Selmer & Luk, 1995). They also align these activities with the MNE-parent’s expectations by scrutinizing, evaluating, and regulating the actions of TMT members to meet the expectations of the MNE-parent, thus lowering moral hazard and adverse selection.

Lower foreign subsidiary moral hazard and adverse selection and greater alignment of the parent’s and the subsidiary’s interests lowers parent-subsidiary agency costs and minimizes their agency problems (Jensen & Meckling, 1976; O’Donnell, 2000). Fama and Jensen (1983b) argue that reducing agency problems significantly contributes
to the survival of different organizational forms. Similarly, I argue that minimizing parent-subsidiary agency problems considerably increases the survival likelihood of a subsidiary (Jensen, 1983).

Although the number of expatriates in a foreign subsidiary is expected to increase the survival of the foreign subsidiary, this expatriate-survival relationship is anticipated to be nonlinear logarithmic. That occurs because, as the number of expatriates increases and agency costs and problems decrease, subsidiary self-serving behaviors decline.

However self-serving behaviors decline at a decreasing rate with each additional expatriate, since the marginal benefit from expatriate governance gradually decelerates (Harzing, 2002). That is because the marginal control benefits, such as direct surveillance of foreign subsidiaries by MNE parent managers, instilling parent’s values and goals in the subsidiary, and weaving informal communication networks between parent and subsidiary and among subsidiaries (Harzing, 2002), reaped from an additional expatriate, gradually decrease.

Therefore, I argue that increments at lower expatriate numbers (e.g. from 0 to 5) are more profound than similar increments at higher expatriate numbers (e.g. over 6). My logic is that, at the higher end, the total expatriate costs may become significantly more than the total agency costs saved by the assignment of these expatriates (Collings, Scullion, & Morley, 2007). This in turn may induce MNE parents to replace additional expatriates by other control alternatives, such as international training programs, meetings, and task forces, that may serve the same control purpose at a lower cost (Harzing, 2002).
Although I expect the number of expatriates in a foreign subsidiary to have an effect on the survival of the foreign subsidiary, for the following reasons I do not expect it to necessarily have an effect on the profitability of the foreign subsidiary. First, the number of expatriates in a foreign subsidiary is expected to minimize MNE parent-foreign subsidiary agency problems that are in turn expected to increase foreign subsidiary survival. However, expatriates are not expected to maximize foreign subsidiary revenues due to their lower host country legitimacy (Schotter & Beamish, 2011a) and reduced understanding of the local market (e.g. local customers, suppliers, and competitors), local culture, local language, etc. compared to their local counterparts (Widmier, Brouthers, & Beamish, 2008). Lower revenues would lead to lower profitability or at best unimproved profitability.

Second, while expatriates may improve control, coordination, and knowledge transfer (Widmier et al., 2008), due to their lower host country legitimacy, they increase operating costs incurred in effectively managing the local workforce (Gaur, Delios, & Singh, 2007). Third, in many cases expatriate costs may outweigh their financial benefits. For example, it is generally estimated that the cost associated with an international assignment is between three and five times an assignee’s home salary per year, let alone a corresponding local’s salary (Selmer, 2001). Moreover, expatriate managers’ failure rates range from a low of 3 percent to as high as 70 percent with the estimated cost of a failed expatriate assignment to be as high as $1,000,000 (Croccitto, Sullivan, & Carraher, 2005). Furthermore, the benefits of expatriate assignments are not very clear and only few companies measure expatriate return on investment (ROI) (Collings et al., 2007). Therefore I hypothesize that:
Hypothesis 2a: The number of expatriates in a foreign subsidiary has a positive nonlinear logarithmic effect on that foreign subsidiary’s survival.

Hypothesis 2b: The number of expatriates in a foreign subsidiary has a negligible effect on its profitability.

2.3. Risk Orientation (as an MNE Parent-foreign Subsidiary Governance Mechanism) and Performance

At the public sector level, the term ‘risk governance’ refers to the ‘various ways in which many actors, individuals, and institutions, public and private, deal with [public or societal] risks surrounded by uncertainty, complexity, and/or ambiguity (van Asselt & Renn, 2011). I define risk governance at the business sector level, as the ways in which corporate boards in general, and MNE boards in particular, oversee corporate risks surrounded by uncertainty, complexity, and/or ambiguity. Within the risk and governance literatures I thus expand the use of the term ‘risk governance’ beyond the public sector to the business sector.

It is important to note that corporate risk governance and corporate risk management are not the same. Risk management refers to “the culture, processes and structures that are directed towards taking advantage of potential opportunities while managing potential adverse effects (ASXCGC, 2006: 31).” The Chief Risk Officer (CRO) is usually the highest corporate manager responsible for risk management.
Risk governance refers to the board “ascertaining, to a reasonable degree, that the executive team has identified and assessed critical risks and has appropriate risk mitigation and management in place that are designed to address the risks that the organization faces (Errity & Ristuccia, 2012: 1).” The Risk Governance Committee is usually the board-level committee responsible for governing/overseeing company risks. If there is no risk governance committee, the full board holds this responsibility. To highlight the importance of risk governance, the U.S. Securities and Exchange Commission (SEC) issued Proxy Disclosure Enhancements rules in December 2009, which were effective in February 2010. These rules require disclosure of the board’s role with regard to risk oversight in the company’s annual proxy statement. The board’s risk oversight activities include overseeing the risk management infrastructure, addressing risk and strategy simultaneously, assisting with risk appetite and tolerance, monitoring risks, overseeing risk exposure, overseeing and supporting the CRO, and consulting external risk experts (Errity & Ristuccia, 2012).

Risk governance is increasingly expected and required from boards of directors. This is evident from the clear trend by capital market regulators and stock exchanges around the world, since the early 2000s, to recommend to, or require, corporations to improve their internal risk management practices (Brown, Steen, & Foreman, 2009; Errity & Ristuccia, 2012; Kleffner, Lee, & McGannon, 2003; Sobel & Reding, 2004).

To govern their risks, MNEs explicitly or implicitly follow one of three risk orientations. I define risk orientation (Pan & Tse, 2000) as an organization’s degree of comfort when facing uncertain, complex, and/or ambiguous gains or losses (Ehrlich & Maestas, 2010; van Asselt & Renn, 2011). I describe MNEs as endorsing one of the
following three risk orientations: extreme risk-averting orientation, moderate risk-taking orientation, or excessive risk-seeking orientation (Kahneman & Tversky, 1979; Wiseman & Gomez-Mejia, 1998).

I adopt the view that generally subsidiaries’ and parents’ risk orientations are similar. This may contradict agency theory’s belief that principals’ (parents) and agents’ (subsidiaries) risk profiles are different, namely that agents are risk-averse whereas principals are risk-neutral (Hoskisson & Hitt, 1994). However, Lane, Cannella, & Lubatkin (1998) found some evidence to suggest that the risk profiles of principals and agents are more similar than different. Moreover, anecdotal evidence collected from the interviews I conducted with subsidiary general managers showed that almost all MNEs had formal risk compliance policies/guidelines/systems and that their subsidiaries typically complied with these risk policies. However, this is not to say that these guidelines do not provide subsidiaries with some risk discretion when making their decisions. Therefore, this section’s following arguments are built on the assumption that generally subsidiaries’ and parents’ risk orientations are similar.

I argue that an MNE parent’s risk has a nonlinear, declining, s-shaped effect on its foreign subsidiary’s survival (see Figure 2.1). Accordingly, I argue that a subsidiary of a parent with an extreme risk-averting orientation is more likely to survive than a counterpart of a parent with a moderate risk-taking orientation, which in turn is more likely to survive than a counterpart of a parent with an excessive risk-seeking orientation.

Furthermore, I contend that different subsidiaries within the same risk orientation have different survival likelihoods. Specifically, for subsidiaries of parents who are moderate risk-takers and who thus formally or informally encourage their subsidiaries to
be moderate risk-takers as well, the higher their risk level compared to their industry peers, the higher their survival likelihood. In contrast, for subsidiaries of parents who are either extreme risk-avers or excessive risk-seekers and who thus formally or informally encourage their subsidiaries to be correspondingly extreme risk-avers or excessive risk-seekers as well, the higher their risk level compared to their industry peers, the lower their survival likelihood.

To develop these arguments further, I first clarify what is meant by a *rational actor* and a *boundedly rational actor*. Kahneman (2003) describes a *rational actor* as someone endowed with a cognitive system that has the logical ability of sound *reasoning* and the low computing costs of fast *intuition*. He adds “Reasoning is done deliberately and effortfully, but intuitive thoughts seem to come spontaneously to mind, without conscious search or computation, and without effort (Kahneman, 2003: 1450). The operations of [intuition] are fast, automatic, effortless, associative, and often emotionally charged; they are also governed by habit, and are therefore difficult to control or modify. The operations of [reasoning] are slower, serial, effortful, and deliberately controlled; they are also relatively flexible and potentially rule-governed. The difference in effort provides the most useful indications of whether a given mental process should be assigned to [intuition] or [reasoning] (Kahneman, 2003: 1451).” In contrast, a *boundedly rational actor* relies more on intuition than on reasoning and his/her behavior is not guided by what he/she is able to compute, but by what he/she happens to see at a given moment. He/she often processes information in a superficial manner and represents categories by prototypes. Given his heavier reliance on intuition, a boundedly rational actor is more prone to biases and errors in thinking (Kahneman, 2003).
For subsidiaries encouraged to be moderate risk-takers, I argue that the higher their risk level compared to their moderate risk-taking industry peers, the higher their survival likelihood. That is because moderate risk-taking subsidiaries are considered to be rational risk-takers since they neither extremely avoid risks nor excessively seek risks but take risks in a moderate manner. Prospect theory suggests that they rationally calculate the prospects of the outcomes of their risky choices then wisely choose to take risks that are more likely to benefit them than to harm them. Moreover, it suggests that taking risks in a rational manner allows the subsidiary to make more optimal decisions that increase its competitiveness and thus its survival likelihood (Tversky & Kahneman, 1986).

For subsidiaries encouraged to be extreme risk-avers or excessive risk-seekers I argue that the higher their risk level compared to their industry peers, the lower their survival likelihood. That is because extreme risk-avers are considered to be boundedly rational actors since their judgment is biased. Prospect theory suggests that their judgment is biased because they intuitively misjudge the prospects of the outcomes of their risky choices by overestimating the likelihood of loss. Consequently, they erroneously avoid risks that could have benefited them if they had taken them. Avoiding risks in an unintendedly biased manner leads the subsidiary to make more suboptimal decisions that decrease its competitiveness and thus its survival likelihood (Tversky & Kahneman, 1986).

Relatedly, a similar argument holds for excessive risk-seekers because they are considered to be boundedly rational actors since their judgment is biased. Prospect theory suggests that their judgment is biased because they intuitively misjudge the prospects of the outcomes of their risky choices by overestimating the likelihood of gain.
Consequently, they erroneously seek risks that ultimately harm them. Seeking risks in an unintendedly biased manner leads the subsidiary to make more suboptimal decisions that decrease its competitiveness and thus its survival likelihood (Tversky & Kahneman, 1986).

Although I expect an MNE parent’s risk to have an effect on its foreign subsidiary’s survival, I do not expect it to necessarily have an effect on its foreign subsidiary’s profitability for the following reasons. First, the empirical evidence measured over the past 50 to 75 years regarding the risk-return relationship is mixed or weak at best (Lundblad, 2007). For example, mainstream finance theory, namely the capital asset pricing model (CAPM) developed by Sharpe (1964), Lintner (1965), and Mossin (1966) predicts a positive relationship between risk and return. More recent research still supports this prediction (e.g. Bansal and Lundblad (2002), Ghysels, Santa-Clara, and Valkanov (2005), etc.). However, an important and rich strategy research stream, developed by Bowman (1980, 1982, 1984), known as Bowman’s Paradox, predicts a negative relationship between risk and return. More recent research still supports this prediction as well (e.g. Andersen, Denrell, and Bettis (2007), Deephouse and Wiseman (2000), etc.). Moreover, a third stream of research shows that there is no significant relationship between risk and return (e.g. Fletcher (2000), Fama and French (1992), Strong and Xu (1997)).

Second, this relationship seems to depend on many different factors including data used (Bali & Peng, 2006), statistical techniques used (Ghysels et al., 2005) measures used (Baucus, Golec, & Cooper, 1993; McNamara & Bromiley, 1999), market conditions
(e.g. whether it is an up market or a down market) (Fletcher, 2000), seasonality of risk premia (Corhay, Hawawini, & Michel, 1987), etc. Therefore I hypothesize that:

Hypothesis 3a: The relationship between parent risk orientation and foreign subsidiary survival is nonlinear (declining s-shaped), with the slope negative for parents with an extremely risk-averse orientation, positive for parents with a moderate risk-taking orientation, and negative for parents with an excessively risk-seeking orientation (see Figure 2.1).

Hypothesis 3b: An MNE parent’s risk orientation has a negligible effect on its foreign subsidiary’s profitability.
Figure 2.1 Relationship between Risk Orientation (as an MNE Parent-Foreign Subsidiary Governance Mechanism) and Subsidiary Survival
2.4. Regional Headquarters (as an MNE Parent-Foreign Subsidiary Governance Mechanism) and Performance

A regional headquarters (RHQ) is a subsidiary or an office that has control over the operation of one or more other offices and subsidiaries in other economies or countries in the region (Enright, 2005b). It adds value by linking the activities of corporate headquarters with the activities of the subsidiaries within its region (Enright, 2005a). A RHQ may perform various activities such as corporate governance, management, and strategy activities as well as aggregated scale-sensitive functional and support activities (Enright, 2005b). An RHQ may have an administrative charter, an entrepreneurial charter, or both (Mahnke, Ambos, Nell, & Hobdari, 2012). In this thesis I focus on the RHQs’ corporate governance activity which is considered part of an RHQ administrative charter. That is, I focus on a RHQ role in governing its parent’s foreign subsidiaries that are operating in the countries within its region. As an intermediate subsidiary governance mechanism, some of the corporate governance sub-activities that a RHQ performs include: coordination of other operations within region, monitoring of other regional operations, reporting regional activities to parent company, regional liaison center for parent company, and regional strategy formulation (Enright, 2005b).

A RHQ functions as an intermediate subsidiary governance mechanism because it acts as a mediating hierarch (Blair & Stout, 2001; Lan & Heracleous, 2010) between its corporate HQ and its HQs’ foreign subsidiaries operating in the countries within the RHQs’ region. As a mediating hierarch it mediates the tension between its corporate
HQs’ call for global integration / efficiency and its local subsidiaries’ push for national effectiveness / responsiveness (Bartlett & Beamish, 2014; Doz & Prahalad, 1984).

From an agency theory perspective, as a governance mechanism, a RHQ simultaneously acts as an agent to its MNE parent and as a principal to its parent’s foreign subsidiaries operating within its region. I argue that having a RHQ improves the MNE-parent’s governance of the subsidiaries operating within the RHQ’s region by reducing parent-subsidiary agency problems. This, in turn, improves the survival likelihood of these foreign subsidiaries.

One major reason why an MNE-parent establishes a RHQ is to better govern a group of foreign subsidiaries in a geographically, economically, legally, politically, etc. distant region by reducing the agency problems between the MNE-parent and those distant subsidiaries. Establishing a RHQ improves the communication process between the MNE-parent and its ‘distant’ foreign subsidiaries affiliated with the established RHQ. Geographically distant subsidiaries may be in time zones that are different from that of the MNE-parent. Economically distant subsidiaries may be in markets with economic environments / characteristics that are different from those of the MNE-parent’s market. Legally distant subsidiaries may be in countries with laws and regulations that are different from those of the MNE-parent’s country. Politically distant subsidiaries may be in countries with political environments / systems that are different from those of the MNE parent’s country (Berry, Guillén, & Zhou, 2010).

The establishment of a RHQ improves the communication between MNE parent and its foreign subsidiaries affiliated with the RHQ because the RHQ understands and bridges the parent’s characteristics and environments and the subsidiaries’ characteristics
and environments. For example a RHQ understands both the parent’s strategy and expectations for the region and the subsidiaries’ geographical, economic, legal, and political operating environments in that region. This gives the RHQ the capability to facilitate the information flow and information interpretation between the MNE parent and its corresponding regional subsidiaries. This also gives the RHQ the ability to provide operational and context-specific subsidiary information to global HQ, information that is essential for global HQ to govern its foreign subsidiaries (Ciabuschi, Dellestrand, & Holm, 2012). Moreover, this gives the RHQ the ability to monitor several subsidiaries (agents) on behalf of the global HQ which reduces the number of agents the global HQ needs to monitor directly (Alfoldi, Clegg, & McGaughey, 2012). As a result, this helps the RHQ reduce information asymmetry and moral hazard and improve the interests, goals, and outcomes alignment between the parent and its subsidiaries operating in the region.

This, in turn, decreases the agency problems between the MNE-parent and the subsidiaries in the region. It also decreases the agency costs that may result from subsidiaries’ (agents’) pursuing their self-interest at the expense of parent (principal) interests (Hillman & Dalziel, 2003). By decreasing parent-subsidiary agency problems and agency costs, the RHQ helps both its subsidiaries and ultimately its parent increase their survival likelihoods (Fama & Jensen, 1983b).

Although I expect foreign subsidiaries governed by RHQ to have a higher survival likelihood than their counterparts not governed by RHQ, I do not expect them to necessarily be more profitable than these counterparts for the following reason. A RHQ acts as an additional hierarchical level in an organization’s structure. It increases an
organization’s vertical complexity (the number of levels in the hierarchy of an organization) (Carillo & Kopelman, 1991). The literature suggests that the impact of vertical complexity on performance is mixed at best (Anderson & Brown, 2010; Handel, 2014). Bureaucratic theorists such as Blau (1972; Blau & Meyer, 1987) from sociology, Chandler (1977; 1990) from business, and Williamson (1985; 1975) from economics argue that bureaucracies are efficient forms of organization. Whereas, post-bureaucratic and neo-liberal organization theories argue that leaner organizations perform better than bureaucratic ones (e.g. Carillo and Kopelman (1991), Love and Nohria (2005), etc.). Therefore, I hypothesize that:

**Hypothesis 4a: Foreign subsidiaries of parents with regional headquarters (RHQs) in the regions where these foreign subsidiaries operate are more likely to survive than their counterparts of parents without RHQs in the regions where they operate.**

**Hypothesis 4b: Foreign subsidiaries of parents with regional headquarters (RHQs) in the regions where these foreign subsidiaries operate do not necessarily financially perform better than their counterparts of parents without RHQs in the regions where they operate.**

2.5. **Expatriates Moderate the Effect of Ownership on Survival**

Previous sections that developed the ownership-performance and expatriates-performance hypotheses suggested that MNE parents use their ownership in their foreign
subsidiaries as a *strategic governance mechanism* (Alces, 2008; Doz & Prahalad, 1984; Xu et al., 2004); and use the expatriates they send to their foreign subsidiaries as *social, cultural, and/or operational governance mechanisms* (Beamish & Inkpen, 1998; Boyacigiller, 1990; Delios & Bjorkman, 2000). They use these mechanisms to reduce MNE parent (principal)-foreign subsidiary (agent) agency problems and thus increase the survival of their foreign subsidiaries. This section argues that expatriates complement/substitute for MNE parent ownership and thus moderate the effect of MNE parent ownership on foreign subsidiary survival.

In classical domestic corporate governance, shareowners govern management’s behaviors through several ways that include the following: Monitoring their company’s stock price through the stock market and buying and selling their company’s stocks as a signal to management of their (i.e. shareholders) satisfaction/dissatisfaction with their company’s governance and performance; Electing nonexecutive directors to represent them on boards and thus indirectly shape the strategic decisions, direction, and outcomes of their company according to their (i.e. shareowners) best interests; Communicating and negotiating directly with management about their (i.e. stockowners) preferences; Voting on important decisions during company general meetings; Formally submitting shareholder proxy proposals to companies; Using the media to alert other investors to their company’s problems and their (i.e. shareholders) proxy proposals (Gillan & Starks, 2000, 2007).

In MNE parent-foreign subsidiary governance, among the above mentioned ways, parents may be limited to using the following methods to govern their foreign subsidiaries: Directly negotiating with the foreign subsidiary’s management; Appointing
subsidiary board directors who come from the MNE parent to align the subsidiary’s interests with the parent’s interests; Voting on important foreign subsidiary-related decisions during company meetings (Konopaske, Werner, & Neupert, 2002). In addition, they may provide training, services, and resources and send expatriates to their subsidiaries to govern these foreign subsidiaries (Schaan, 1988).

Therefore, in MNE parent-foreign subsidiary governance, parents may use expatriates as social, cultural, and/or operational governance mechanisms together with ownership to govern their foreign subsidiaries. As social and cultural governance mechanisms, expatriates work on aligning the values, practices, and informal communications as well as the mission, vision, and objectives, of the subsidiary with those of its parent. They perform these functions so that the culture and social behavior of the subsidiary and its employees are consistent with those of its parent (Fenwick et al., 1999; Harzing, 2002). As operational governance mechanisms, expatriates monitor and (dis)approve of subsidiary activities such as production, R&D, marketing, and finance activities and align these activities so that the operational behavior of the subsidiary is consistent with the formal policies and informal expectations of its parent (Torbiörn, 1994; Xu et al., 2004).

Moreover, ownership is an ex ante MNE parent-foreign subsidiary governance mechanism during international expansions while expatriates are an ex post MNE parent-foreign subsidiary governance mechanism during international operations (Konopaske et al., 2002). Therefore, ownership is considered to be an ex ante strategic governance mechanism while expatriates are considered to be an ex post social, cultural, and/or operational governance mechanism. Despite this, from looking at the way these two
governance mechanisms are used by shareowners, one can see that their uses overlap in several ways and that they may complement and/or substitute for each other (Chung & Beamish, 2005; Delios & Bjorkman, 2000; Harzing, 2002; Konopaske et al., 2002; Schaan, 1988) in reducing MNE parent-foreign subsidiary agency problems and thus increasing foreign subsidiary survival. Therefore I argue that expatriates moderate the effect of ownership on subsidiary survival, such that this effect is stronger when the number of expatriates is lower and weaker when the number of expatriates is higher.

Given the above mentioned ways MNE parents use ownership and expatriates to govern their foreign subsidiaries, one can argue that the effect of increasing parent ownership on subsidiary survival will be higher when the number of expatriates in the subsidiary is lower than when the number of expatriates in the subsidiary is higher. That is because, when the number of expatriates in the foreign subsidiary is higher, expatriates as a parent-subsidiary governance mechanism are expected to almost completely substitute for ownership as a parent-subsidiary governance mechanism, since the greater number of expatriates is expected to completely substitute for an owner’s efforts to monitor and align the behavior of the subsidiary with its (i.e. owner’s/parent’s) expectations. Whereas, when the number of expatriates in the foreign subsidiary is lower, expatriates as a parent-subsidiary governance mechanism are expected to only complement ownership as a parent-subsidiary governance mechanism, since the fewer number of expatriates are expected to only complement an owner’s efforts to monitor and align the behavior of the subsidiary with its (i.e. owner’s/parent’s) expectations.

For example, when the number of expatriates in a foreign subsidiary is high, it would be expected that they will be governing the subsidiary’s culture as well as its
operations. That is, they will be working on aligning the subsidiary’s values, mission, vision, and objectives as well as its various activities (e.g. production, R&D, marketing, finance, etc.). This would replace the MNE parent’s efforts to govern the foreign subsidiary through a subsidiary board or through voting on important subsidiary-related decisions in company meetings or through providing training, services, and / or resources to the subsidiary from a distant. Consequently, this would reduce the effect of a higher level of MNE parent ownership on a foreign subsidiary’s survival.

Whereas, when the number of expatriates in a foreign subsidiary is low, it would be expected that their influence will be lower than when that number is high and thus they may be governing only the subsidiary’s culture or operations or neither. Thus their presence in the subsidiary would not replace the MNE parent’s efforts to govern the subsidiary through the parent’s own, generally more distant, governance mechanisms but would probably complement these efforts. Consequently, this would increase the effect of a higher level of MNE parent ownership on a foreign subsidiary’s survival. Therefore I hypothesize that:

_Hypothesis 5: Expatriates modify the effect of ownership on foreign subsidiary survival; the effect of MNE parent ownership on foreign subsidiary survival is stronger (weaker) when the number of expatriates in the foreign subsidiary is lower (higher)._
CHAPTER 3

3. PILOT CANADIAN STUDY: METHODS AND RESULTS

3.1. Methods

Following recent calls for methodological advancements in international business research (Punnett & Shenkar, 2004; Scandura & Williams, 2000; Schotter & Beamish, 2013), I used a multi-method (i.e. quantitative and qualitative) approach. First, I conducted a pilot quantitative survival analysis to investigate how Japanese MNE parents governed their Canadian subsidiaries which were more likely to survive, compared to Canadian subsidiaries that were less likely to survive. Second, after quantitatively confirming that better surviving Canadian subsidiaries of Japanese MNEs are generally governed through higher parent ownership ratios, higher numbers of expatriates, and lower levels of risk, I conducted ten interviews (McCracken, 1988), each around one hour in length, with Canadian subsidiary CEOs, board members, or top management team (TMT) members, mostly of Japanese MNE parents, to better understand why these better surviving Canadian subsidiaries are governed that way by their Japanese MNE parents. I combined quantitative and qualitative methods to ensure higher levels of relevance and validity (Jick, 1979). Following Bruning, Sonpar, and Wang (2012), and Bresman, Birkinshaw, and Nobel (1999) I (1) describe my methods in two sections, quantitative and qualitative approaches, and (2) present my statistical findings in a quantitative results section and my interview findings in a qualitative results section.
3.1.1. **Quantitative Approach**

3.1.1.1. **Sample and Data**

This pilot study tested my theory on a sample of Canadian subsidiaries of Japanese parent MNEs. These companies were identified from several editions of Kaigai Shinshutsu Kigyou Souran, Kuni-Betsu (Japanese Overseas Investments, by Country), published by Toyo Keizai (referred to as the TK dataset hereafter). The TK dataset provides *subsidiary-level data* on the overseas activities of Japanese MNEs.

A Canadian-Japanese sample was appropriate for several reasons. First, Japanese inward FDI stock into Canada amounted to approximately $16 billion in 2010, an increase of 11 percent from 2009, and Japan is the leading Asian foreign direct investor in Canada followed by China (Canada, 2012). Second, the Canadian-Japanese sample provided Canadian subsidiary-level governance data which could also be matched with Japanese parent-level governance data. Third, additional data on Canadian subsidiaries of Japanese MNEs could be found in the Dun & Bradstreet Canadian Key Business Directories for all the years of the sample. Fourth, the extensive time distribution in the dataset offered considerable variance in the survival-vs.-exit outcomes of the Canadian subsidiaries.

Additional Canadian *subsidiary-level data* were hand-coded from the 1991-2009 editions of the Dun & Bradstreet Canadian Key Business Directory to complement the TK’s subsidiary-level data. Japanese MNE *parent-level data* were drawn from the *Nikkei Economic Electronic Databank* of Nihon Keizai Shimbun, Inc. (NEEDS) and matched
with parent MNE names in the TK data. Country-level data were collected from the World Bank’s World Development Indicators.

3.1.1.2. Variables

**Dependent Variable (DV)**

**Subsidiary Exit:** Following previous studies on subsidiary survival (Dai, Eden, & Beamish, 2013), this study’s dependent variable Subsidiary Exit is an indicator variable, SubsidiaryExit, that takes a value of 1 if subsidiary x exits at time t, and 0 if it remains (survives). Observations start in 1990, and continue until an exit occurs, or they are right-censored in 2008. I follow Delios and Beamish (2001) in treating delisted subsidiaries from the sample as exits, because the TK dataset is almost exhaustive for all cases of Japanese FDI. This approach has been validated by another study by Delios and Beamish (2004) in which they compared identified cases of exit in the TK dataset with reported cases of exit. For the period 1990–2008 there were 69 identified exits out of 196 Canadian subsidiaries of 142 Japanese parent MNEs and a total of 1,621 observations.

**Independent Variables (IVs)**

**Ownership Ratio:** consistent with previous research ownership ratio is measured as the logarithm of the percentage of the focal subsidiary’s equity owned by the largest Japanese owner. The largest Japanese owner is used because typically it is considered the Japanese parent (Dhanaraj & Beamish, 2004).
Expatriate Number: consistent with previous research (Chung & Beamish, 2005; Delios & Bjorkman, 2000; Plourde, Parker, & Schaan, 2013) I measure expatriate number as the logarithm of the number of expatriates in the subsidiary.

Risk Orientation: I measured risk orientation as the Japanese parent’s sector-adjusted debt ratio. To calculate this measure I first calculated the Japanese parent’s debt ratio (i.e. total liabilities divided by total assets). Second, I calculated the average debt ratio for each sector of the three sectors: Manufacturing, Trade, and Services & Others (see next page for a detailed description of sector) by adding the debt ratios of all the Japanese parents in a sector and dividing their total by the number of parents in that sector. Finally, I divided each Japanese parent’s debt ratio by its sector’s debt ratio to get each firm’s sector-adjusted debt ratio. I also squared and cubed the sector-adjusted debt ratio to test the nonlinear s-shaped relationship between risk orientation and survival likelihood that I hypothesized.

Using a firm’s sector-adjusted debt ratio as a proxy to measure its risk orientation is appropriate for several reasons. First, firm debt ratios have been used in the literature to measure firm risk (Abor, 2007; Beaver, Kettler, & Scholes, 1970; Berger, Ofek, & Yermack, 1997; Friend & Lang, 1988; Miller & Bromiley, 1990; Wen, Rwegasira, & Bilderbeek, 2002). Second, among the other used debt ratio measures, the debt ratio measure that I used (i.e. the total liability divided by total assets measure) has been shown to exhibit the highest association with risk (Beaver, 1966). Third, this pilot study’s sample consists of Canadian subsidiaries of Japanese MNEs and sector appears to influence governance mechanisms in general (Coles, McWilliams, & Sen, 2001) and
corporate debt ratios in Japan in particular (Remmers, Stonehill, Wright, & Beekhuisen, 1974).

**Control Variables**

I controlled for several variables that the literature suggests may be possible alternative explanations for subsidiary survival and that could consequently confound my results. First, at the subsidiary level, I controlled for the following variables.

**Subsidiary age:** consistent with (Dai et al., 2013) I controlled for subsidiary age to account for (1) the possible effect of the liability of newness and (2) the possible effect of the ability of older subsidiaries to adapt to host-country conditions, on subsidiary survival. I measured subsidiary age as the logarithm of the number of years a subsidiary has operated since its date of establishment in the host country.

**Subsidiary Size:** I controlled for subsidiary size to account for liabilities of smallness and structural inertia since previous studies have shown a positive relationship between the size and survival of foreign subsidiaries (Li, 1995). I measured subsidiary size as the logarithm of the total number of subsidiary employees.

**Subsidiary sector:** I controlled for subsidiary sector. Given that my Canadian subsidiaries’ sample was a relatively small sample I grouped all the industries into 3 broad sectors (manufacturing = 1, trade = 2, and services & others =3) to keep the number of variables in my model at a statistically acceptable level.

Second, at the parent level, consistent with Kim, Lu, and Rhee (2012) I controlled for *Parent Performance* and *Parent Size* since these variables are known to usually affect subsidiary survival (Delios & Beamish, 2001). I measured parent performance as the
return on assets of the parent and measured parent size as the logarithm of the parent’s number of employees.

Third, at the country level, consistent with Dai et al. (2013), I controlled for Host Market Size, Host Market Potential, and Host Market Inflation Rate, factors expected to influence foreign subsidiary survival, to control for the effect of their variation over the years of the study on foreign subsidiary survival. I measured host market size as the logarithm of host country per capita gross domestic product (GDP). I measured host market potential as the percentage change in GDP of the host country from one year to the other. I measured host market inflation rate as the inflation, GDP Deflator (annual %), for different years.

3.1.2. Qualitative Approach

I interviewed 10 participants who had the following positions. Nine were working at Canadian subsidiaries of foreign MNEs, mainly Japanese MNEs; six were subsidiary CEOs; one was a subsidiary board member; and two were subsidiary TMT members. The tenth was the Subsidiary Governance Senior Officer at the Canadian headquarters of a very large Canadian-based MNE, who was responsible for governance of the local and foreign subsidiaries of that MNE. In addition, one of the CEOs I interviewed was a former Canadian subsidiary CEO and a current Director at the Japanese MNE headquarters of that Canadian subsidiary. One of the major reasons for interviewing these two latter participants was to get a headquarters perspective, in addition to the subsidiary
perspective, on foreign subsidiary governance, so as to triangulate my data and reduce bias.

Five of the participants worked in Canadian subsidiaries of Japanese MNEs and the other five worked in Canadian subsidiaries of foreign non-Japanese MNEs of different national origins. One important reason for interviewing CEOs, BOD members, and / or TMT members of Canadian subsidiaries of non-Japanese MNEs as well as Japanese MNEs was to enhance the generalizability of this thesis’ findings. The interviews were conducted in mid-2013. The Ethics Approval Notice, Introduction Letter, and Consent Form are available in Appendix A.

The purpose of conducting these interviews was to enhance my understanding on how MNE parents govern their foreign subsidiaries and why they govern them that way. Consequently, in order to be interviewed, participants had to be CEOs, board members, or TMT members of Canadian subsidiaries of foreign MNEs and particularly Japanese MNEs. Participants were recruited mainly through personal contacts and referrals by these personal contacts. Some were also recruited through the Ivey Alumni Relations office and the Institute of Corporate Directors (ICD) and Canadian Foundation for Governance Research (CFGR).

The interviews were semi-structured; the interview guide is available in Appendix B. Broadly, the interviews focused on the following three overarching questions: (1) How do you influence the changes in your subsidiary’s governance mechanisms / structures, namely the use of expatriates, ownership, and risk? (2) Why do you attempt to influence the changes in these governance mechanisms / structures (i.e. the use of expatriates,
ownership, and risk) in your subsidiary? and (3) How does your parent use these governance mechanisms (i.e. ownership, expatriates, and risk) to govern your subsidiary?

The interviews were recorded and transcribed then coded and analyzed with NVivo (Bazeley & Jackson, 2013). Finally, following Bruning et al. (2012) and Yin’s (2011) qualitative data presentation and composition approaches, my qualitative findings were presented in a qualitative results section as brief direct or indirect explanations, narratives, or quotations.

“It is generally accepted that measurement instruments affect that which they are trying to measure, thus biasing the value of the measurement from the ‘true’ value. This phenomenon is referred to as measurement error and there are often statistical and mechanical ways to ‘correct’ for it (Lupton, 2011: v).” In qualitative research, such as the one in this part of this thesis, the measurement device is the researcher. Accordingly, I provide this brief reflexivity statement to help the reader understand my background, experiences with the explored phenomenon, and how my background and experiences may have shaped my interpretation of the phenomenon (Creswell, 2013).

I am a person who has both Lebanese and Canadian citizenships. I was raised, studied, and worked for several years in Lebanon. I recently lived, studied, and worked for several years in Canada. In Lebanon, I lived in the Greater Beirut Area; Was raised by a father who was an officer in the Lebanese Army and a mother who was a school teacher; Earned a PhD in Psychology; Worked as a psychologist, university instructor, and consultant; And was the founder and managing partner for my own consulting, training, and recruitment company that served the Middle East & North Africa (MENA)
region. In Canada, I pursued my second PhD in International Business and Strategy that I am completing now, worked as a research assistant, and lived in London, Ontario for around six years.

In Lebanon, I experienced firsthand how a business and government system that is usually considered to be closer to a relation-based governance system works. In Canada, I experienced firsthand as well how a different business and government system that is usually considered to be closer to a rule-based governance system works (Li, Park, & Li, 2004).

These contrasting experiences definitely enriched and broadened my understanding of corporate governance in general and comparative governance mechanisms and practices in particular. However, I am an international business and strategy scholar and I believe rule-based governance mechanisms and practices provide a more efficient and a better environment for international business, foreign trade, and strategic planning and management. Accordingly, I may be potentially biased in favor of rule-based governance mechanisms and practices whether within MNEs or across countries. Nevertheless, I hope that my potential biases have been mitigated by my rigorous striving to collect and analyze my data with reflexive thought and honest introspection.

3.2. Results

This section consists of two subsections, a quantitative results subsection and a qualitative results subsection.
3.2.1. Quantitative Results

This subsection presents this study’s quantitative results. I used survival analysis, namely the extended Cox regression technique, to test my hypotheses. An extended Cox model is appropriate because the dependent variable is survival likelihood and the independent and control variables are time-varying and the extended Cox model can incorporate and test for such time-dependent covariates (Kleinbaum & Klein, 2005).

Table 3.1 presents descriptive statistics and Pearson correlations for the study variables. This correlation matrix shows that, among all covariates, there are only two correlations slightly above 0.5, namely the correlation between Inflation Rate and Lg Host Market Size and the correlation between Lg Expatriate Number and Lg Subsidiary Employees. However, even these two correlations are below 0.6, which suggests that multicollinearity should not be a concern. Nevertheless, there are several covariates that are significantly correlated (p < 0.05). Therefore to ensure the absence of multicollinearity and ensure the robustness of the results, I performed regressions and collinearity diagnostics for all covariates one by one. That is, I regressed each covariate on all the other covariates to get all their variance inflation factors (VIFs). All VIFs were below two which ensures that multicollinearity is unlikely to be an issue in the analyses (Field, 2009).

I test my hypotheses using a four-stage hierarchical extended Cox regression model. Table 3.2 presents the findings, in which my Risk Orientation construct is operationalized as Parent Sector-Adjusted Debt Ratio, Parent Sector-Adjusted Debt Ratio
Squared, and Parent Sector-Adjusted Debt Ratio Cubed. All four models are highly significant (p < 0.001) and the -2 Log Likelihood decreases as one moves from Model 1 to Model 4. This suggests that each model fits the data better than the previous models. The full model, Model 4 in Table 3.2, shows that all hypotheses were supported. For the interpretation of results, a coefficient estimator with a negative value suggests a decreased likelihood of foreign subsidiary exit or an increase in likelihood of foreign subsidiary survival.

Model 1 is the baseline model. It includes only control variables. Among the subsidiary-level controls, as expected, Model 1 shows that a foreign subsidiary’s age (measured as Log of subsidiary age) and size (as measured by its Log of subsidiary number of employees) are respectively marginally and highly significantly related to its survival likelihood (p < 0.10 and p < 0.001 respectively). Moreover, the sector in which a subsidiary operates is significantly associated with that subsidiary’s survival likelihood, since the reference sector, manufacturing, in this categorical variable is significantly related to foreign subsidiary survival likelihood (p < 0.001). The results show that Trading subsidiaries are significantly more likely to survive than their manufacturing counterparts (p < 0.001 and B is negative) and Services and Others subsidiaries are marginally more likely to survive than their manufacturing counterparts (p < 0.10 and B is negative). This may be attributed to the fact that Trading and Services subsidiaries require less capital investment to survive (Brouthers & Brouthers, 2003).
<table>
<thead>
<tr>
<th>Variables</th>
<th>Mean</th>
<th>SD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subsidiary Exit</td>
<td>.043</td>
<td>.202</td>
</tr>
<tr>
<td>LgSubsidiary Age</td>
<td>1.105</td>
<td>.332</td>
</tr>
<tr>
<td>LgSubsidiary Employees</td>
<td>1.520</td>
<td>.821</td>
</tr>
<tr>
<td>Subsidiary Sector</td>
<td>1.834</td>
<td>.686</td>
</tr>
<tr>
<td>LgParentEmployees</td>
<td>4.018</td>
<td>.653</td>
</tr>
<tr>
<td>ParentROA</td>
<td>.028</td>
<td>.051</td>
</tr>
<tr>
<td>LgHostMarketSize</td>
<td>4.384</td>
<td>.111</td>
</tr>
<tr>
<td>HostMarketPotential</td>
<td>1.461</td>
<td>2.041</td>
</tr>
<tr>
<td>InflationRate</td>
<td>2.170</td>
<td>1.166</td>
</tr>
<tr>
<td>LgParentOwnershipRatio</td>
<td>1.908</td>
<td>.175</td>
</tr>
<tr>
<td>LgExpatriateNumber</td>
<td>.450</td>
<td>.338</td>
</tr>
<tr>
<td>ParentSectorAdjustedDebtRatio</td>
<td>1.093</td>
<td>.539</td>
</tr>
<tr>
<td>ParentSectorAdjustedDebtRatioSquared</td>
<td>1.006</td>
<td>.284</td>
</tr>
<tr>
<td>ParentSectorAdjustedDebtRatioCubed</td>
<td>1.250</td>
<td>.847</td>
</tr>
<tr>
<td>SubsidiaryAge</td>
<td>15.279</td>
<td>10.883</td>
</tr>
<tr>
<td>SubsidiaryEmployees</td>
<td>143.815</td>
<td>323.992</td>
</tr>
<tr>
<td>ParentEmployees</td>
<td>29305.079</td>
<td>52613.260</td>
</tr>
<tr>
<td>HostMarketSize</td>
<td>25101.003</td>
<td>7564.709</td>
</tr>
<tr>
<td>ParentOwnershipRatio</td>
<td>85.064</td>
<td>24.001</td>
</tr>
<tr>
<td>ExpatriateNumber</td>
<td>2.925</td>
<td>4.125</td>
</tr>
</tbody>
</table>

**. Correlation is significant at the 0.01 level (2-tailed).
*. Correlation is significant at the 0.05 level (2-tailed).

Number of observations = 1621;
Number of Canadian subsidiaries = 196;
Number of Japanese parent MNEs = 142;
Number of Canadian subsidiary Exits = 69

Note: Variables 13 to 20 show descriptive statistics for the ParentSectorAdjustedDebtRatio squared and cubed and for several other variables in their raw form before being log transformed; only variables 1-14 are part of the Cox Regression model.
<table>
<thead>
<tr>
<th>Variables</th>
<th>Model 1</th>
<th></th>
<th>Model 2</th>
<th></th>
<th>Model 3</th>
<th></th>
<th>Model 4</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>SE</td>
<td>B</td>
<td>SE</td>
<td>B</td>
<td>SE</td>
<td>B</td>
<td>SE</td>
</tr>
<tr>
<td><strong>Control Variables</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>LgSubsidiaryAge</td>
<td>-.991</td>
<td>.602</td>
<td>-1.570</td>
<td>*</td>
<td>-.617</td>
<td>-1.632</td>
<td>*</td>
<td>-.623</td>
</tr>
<tr>
<td>LgSubsidiaryEmployees</td>
<td>-.825</td>
<td>**</td>
<td>-.459</td>
<td>*</td>
<td>.184</td>
<td>-.435</td>
<td>*</td>
<td>.183</td>
</tr>
<tr>
<td>SubsidiarySector (Manufacturing: Reference)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SubsidiarySector (Trading)</td>
<td>-1.195</td>
<td>***</td>
<td>-.873</td>
<td>**</td>
<td>.313</td>
<td>-.973</td>
<td>**</td>
<td>.321</td>
</tr>
<tr>
<td>SubsidiarySector (Services and Others)</td>
<td>-.514</td>
<td>+</td>
<td>.307</td>
<td>-.202</td>
<td>.333</td>
<td>-.191</td>
<td>.333</td>
<td>-.232</td>
</tr>
<tr>
<td>LgParentEmployees</td>
<td>.332</td>
<td>+</td>
<td>.198</td>
<td>.073</td>
<td>.220</td>
<td>.123</td>
<td>.227</td>
<td>.166</td>
</tr>
<tr>
<td>HostMarketPotential</td>
<td>-.144</td>
<td>+</td>
<td>.086</td>
<td>-.132</td>
<td>.087</td>
<td>-.136</td>
<td>.086</td>
<td>-.137</td>
</tr>
<tr>
<td>InflationRate</td>
<td>.209</td>
<td>.133</td>
<td>.181</td>
<td>.134</td>
<td>.179</td>
<td>.134</td>
<td>.181</td>
<td>.132</td>
</tr>
<tr>
<td><strong>Main Variables</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>LgParentOwnershipRatio</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>LgExpatriateNumber</td>
<td>-1.546</td>
<td>**</td>
<td>-.522</td>
<td>-1.538</td>
<td>**</td>
<td>-.514</td>
<td>-1.544</td>
<td>**</td>
</tr>
<tr>
<td>ParentSectorAdjustedDebtRatio</td>
<td>-1.909</td>
<td>***</td>
<td>.566</td>
<td>-1.887</td>
<td>***</td>
<td>.571</td>
<td>-2.023</td>
<td>***</td>
</tr>
<tr>
<td>ParentSectorAdjustedDebtRatioCubed</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- 2 Log-Likelihood</td>
<td>760.817</td>
<td></td>
<td>731.636</td>
<td></td>
<td>729.152</td>
<td></td>
<td>721.211</td>
<td></td>
</tr>
<tr>
<td>Model Chi-Square</td>
<td>138.564</td>
<td>***</td>
<td>169.461</td>
<td>***</td>
<td>173.328</td>
<td>***</td>
<td>180.504</td>
<td>***</td>
</tr>
</tbody>
</table>

Number of observations = 1621;
Number of Canadian subsidiaries = 196;
Number of Japanese parent MNEs = 142;
Number of Canadian subsidiary Exits = 69
+ p < .10;  * p < .05;  ** p < .01;  *** p < .001 (all two-tailed)
In this baseline model, among the parent-level controls, parent size (as measured by the Log of parent number of employees) is marginally negatively related to subsidiary survival ($p < 0.10$). This relationship shows that foreign subsidiaries of smaller MNEs are more likely to survive than those of larger MNEs (Delios & Beamish, 2001; Dhanaraj & Beamish, 2009). This is consistent with Kostova and Zaheer’s (1999) organizational complexity notion, which suggests that while parent size provides a stronger resource base it increases vulnerability to local demands. It is also in line with Franko’s (1971) findings that suggest that MNEs with larger parents have more flexibility to structure their operations in a country. Larger firms have a greater ability to move subsidiaries to new locations within a country or region and consolidate several subsidiaries into a single unit, thus decreasing the likelihood of their foreign subsidiaries’ survival (Chung, Lee, Beamish, & Isobe, 2010). Meanwhile, parent performance (as measured by their ROA) had no observable relationship with subsidiary survival.

Among the country-level controls, as expected, a subsidiary’s host market size (as measured by the Log of the host market’s per capita GDP) and host market potential (as measured by the host market’s percentage change in GDP) were respectively highly and marginally related to subsidiary survival ($p < 0.001$ and $p < 0.10$ respectively). This suggests that foreign subsidiaries operating in larger markets and in markets that have a higher potential for growth are more likely to survive than their counterparts operating in smaller markets and in markets that have a lower potential for growth. However, in this baseline model, host market inflation rate was not significantly related to subsidiary survival. This may be due to the fact that the relation between host market inflation and
subsidiary survival is an indirect one. Inflation usually decreases market growth which is expected to ultimately decrease subsidiary survival.

Model 2 includes the two independent variables, parent ownership ratio and expatriate number, and the linear form of the third independent variable, parent sector-adjusted debt ratio, in addition to the control variables in Model 1. The results of the controls in Model 2 are broadly similar to those in Model 1 except for the parent size variable. The relationship between this control and subsidiary survival likelihood becomes non-significant (p > 0.10).

More importantly, Model 2 shows, as expected, that there is a significant logarithmic relationship between a parent’s ownership level in its foreign subsidiary and that foreign subsidiary’s survival likelihood (p < 0.01). Furthermore, it also shows that there is a significant logarithmic relationship between the number of expatriates in a foreign subsidiary and that subsidiary’s survival likelihood (p < 0.001). These two results clearly support the first two sub-hypotheses, namely H1a and H2a. They demonstrate that as parent ownership and number of expatriates in a subsidiary increase and agency problems decrease, subsidiary self-serving behaviors decline. However they decline at a decreasing rate, as increments in the ownership levels and expatriate numbers in the lower end will have a larger impact in reducing potential for subsidiary self-serving behavior, and thus agency costs, than similar ones at the higher end. Consequently, increments in the ownership levels and expatriate numbers in the lower end will have a larger impact in increasing subsidiary survival than similar ones at the higher end. In addition, Model 2 shows that there is only a marginal relationship between the linear form of the third independent variable, parent sector-adjusted debt ratio, and foreign
subsidiary survival likelihood. This suggests that basically there is no linear relationship between parent risk orientation and foreign subsidiary survival likelihood.

Model 3 includes the parent sector-adjusted debt ratio squared variable on top of the variables in Model 2. The results of the variables (controls and independent variables) in Model 3 are generally similar to the ones in Model 2 except for the linear form of the parent sector-adjusted debt ratio. In Model 3 this variables became non-significant (p > 0.1). More importantly, Model 3 shows that there is no significant relationship between the quadratic form of the third independent variable, parent sector-adjusted debt ratio squared, and foreign subsidiary survival likelihood. This suggests that there is no significant quadratic relationship between parent risk orientation and foreign subsidiary survival likelihood.

Model 4 includes the parent sector-adjusted debt ratio cubed variable on top of the variables in Model 3. The results of the variables (controls and independent variables) in Model 4 are broadly similar to the ones in Model 3 except for the parent performance (as measured by parent ROA) variable. In this model, parent performance was significantly negatively related to foreign subsidiary survival likelihood (p < 0.01). Similar to Franko’s (1971) findings, this can be attributed to the fact that better performing parents have more flexibility to structure and move their subsidiaries within a country and to consolidate subsidiaries into a single unit.

Most interestingly, Model 4 clearly shows that once parent sector-adjusted debt ratio cubed is included in this full model, all three relationships between the three parent sector-adjusted debt ratio variables (parent sector-adjusted debt ratio, parent sector-adjusted debt ratio squared, and parent sector-adjusted debt ratio cubed) and foreign
subsidiary survival likelihood, become significant ($p < 0.05$, $p < 0.05$, and $p < 0.01$ respectively). Adding this last cubed variable to the model made all three risk orientation variables significant when previously the first two risk orientation variables were respectively only marginally significant and non-significant. This supports the argument that the relationship between risk orientation and subsidiary survival is a cubic and not a linear or quadratic one. The positive and negative values of the coefficients of the three risk orientation variables suggest that the relationship between parent risk orientation and foreign subsidiary survival likelihood has an s-shaped form (see Figure 3.1 for a graph of the relationship between risk orientation and subsidiary exit likelihood; The relationship between risk orientation and subsidiary survival likelihood would have an inverse graph but because of the data’s structure I could only draw the graph of the subsidiary exit relationship in Figure 3.1). This clearly supports the third sub-hypothesis, H3a.
Figure 3.1 Relationship between Risk Orientation (as an MNE Parent-Foreign Subsidiary Governance Mechanism) and Subsidiary Exit Likelihood
3.2.2. **Qualitative Results**

“I don't believe that there is a direct correlation between governance and profitability. I think it is the other way around. It is more of a null hypothesis. There is a correlation between governance and lack of failure.” – Robert G. Bertram

This subsection presents this study’s qualitative results. The purpose of my qualitative analysis was to provide a better understanding of how and why the use of subsidiary-level and parent-level foreign subsidiary governance mechanisms, such as ownership, expatriates, and risk orientation, increase the survival likelihood and profitability of foreign subsidiaries of MNEs.

First, my interviews corroborated my quantitative findings in that most of my participants believed that foreign subsidiaries that are more likely to survive are governed by their MNE parents through higher parent ownership, higher number of expatriates, and lower risk as MNE parent-foreign subsidiary governance mechanisms. These qualitative findings were consistent with my quantitative results.

Second, these interviews complemented my quantitative findings in that they clarified how subsidiaries that are more likely to survive are governed by their parents and why they are governed that way. For instance, one participant explained that subsidiaries “would survive better because there will be insurance of compliance with [host country and parent country regulations], in other words, the risk of fines or penalties
would be mitigated because somebody [i.e. the parent] was making sure that they’re in compliance with their regulatory environment.”

Furthermore, one subsidiary general manager, who served as a subsidiary manager in more than one country for a very well-known and -respected MNE, believed that there absolutely was a relationship between higher parent ownership in a foreign subsidiary and higher foreign subsidiary survival likelihood. He explained that, compared to independent distributors of foreign MNEs, “we were willing to take losses in certain [wholly-owned subsidiaries] in order to have a longer term horizon that would make these [temporarily losing wholly owned subsidiaries] profitable over the long run. The company [i.e. the MNE] was willing to invest for the longer term whereas an independent distributor just would not be doing that.”

A subsidiary general manager, who himself was an expatriate, also explained how using expatriates as a subsidiary governance mechanism increased subsidiaries’ survival likelihoods at his parent corporation. He explained that in his parent corporation, they usually send expatriates to establish foreign subsidiaries. Once the subsidiary’s performance is on track they are fine with locals running the subsidiary. In that case, they still have expatriate teams go on short assignments to audit the behavior and performance of the subsidiary on a biennial basis. However, when a subsidiary is not behaving or performing as expected, such as not following the parent’s policies or meeting the parent’s targets, one or more expatriates are sent to fix these problems by reinforcing the parent’s culture and expectations.

In addition, another subsidiary CEO, whose company was number two in its industry worldwide, suggested that, following his parent’s risk guidelines, his subsidiary
took moderate risks (for example, customer financing risks), “very similar to industry risk norms taken by our top two competitors but did not take extreme risks similar to the ones taken by our number four, five, and six competitors. Nevertheless we were more flexible than our number one competitor. [For example, we would do] letter of credit or just invoice, but we would never do a consignment shipment, never!” He added “since we were not outside of range of our competition, this was fine.” This interview anecdotally confirmed my quantitative findings related to the impact of risk orientation on subsidiary survival and briefly described certain types of subsidiary risks that would threaten these subsidiaries’ survival.

What was most interesting was the quote provided at the beginning of this section. This quote was provided by Robert G. Bertram, an extremely experienced governance expert who has been a director on over 12 company boards. This quote suggested that MNE parent-foreign subsidiary governance mechanisms may impact foreign subsidiary survival but not necessarily impact foreign subsidiary profitability. Thus, it prompted me to test, not only for the relationship between MNE parent-foreign subsidiary governance mechanisms and foreign subsidiary survival, but also for the relationship between these governance mechanisms and foreign subsidiary profitability. Testing for both of these relationships using the small Canadian subsidiaries sample showed that although governance impacts survival it may not necessarily impact profitability. However, given that the Canadian sample was a small sample, and that testing for no governance-profitability relationship (i.e. arguing and testing for the null hypothesis) required a big enough sample to ensure enough statistical power, I embarked on testing this relationship
more formally in the main study in the next chapter. Therefore the next chapter presents the methods and results related to testing for the relationships between governance and survival on the one hand and governance and profitability on the other hand using a large multi-country study.
CHAPTER 4

4. MAIN MULTI-COUNTRY STUDY: METHODS AND RESULTS

This main study constitutes of two sub-studies, a multi-country survival analysis and a multi-country profitability analysis.

4.1. Multi-Country Survival Analysis

4.1.1. Methods

4.1.1.1. Sample and Data

The purpose of this analysis was to address the first research question (‘How do MNE parents govern their foreign subsidiaries to ensure better performance measured as foreign subsidiary survival and foreign subsidiary profitability?’) using a large longitudinal sample of Japanese MNEs with subsidiaries in multiple countries and regions from 1990 till 2008. This multi-country survival analysis tested Hypotheses 1a, 2a, 3a, 4a, and 5. It used a very large sample compiled from the TK dataset, NEEDS databases, World Bank economic and governance data, and Centre d’Etudes Prospectives et d’Informations Internationales (CEPII) data. The objectives were to 1) confirm the generalizability of the corresponding survival analysis findings from the Canadian pilot study for hypotheses H1a, H2a, and H3a, and 2) broaden the analysis to include a fourth MNE parent-foreign subsidiary governance mechanism, regional headquarters (RHQ) (H4a), and the interaction between ownership and expatriates.
4.1.1.2. **Variables**

**Dependent Variable (DV)**

**Subsidiary Exit:** Following previous studies on subsidiary survival (Dai et al., 2013), this study’s dependent variable Subsidiary Exit is an indicator variable, SubExit, that takes a value of 1 if subsidiary x exits at time t, and 0 if it remains (survives). Observations start in 1990, and continue until an exit occurs, or they are right-censored in 2008. I follow Delios and Beamish (2001) in treating delisted subsidiaries from the sample as exits, because the TK dataset is almost exhaustive for all cases of Japanese FDI. This approach has been validated by Delios and Beamish (2004) in which they compared identified cases of exit in the TK dataset with reported cases of exit. For the period 1990–2008 there were 2,757 identified exits out of 12,101 foreign subsidiaries and a total of 84,369 observations.

**Independent Variables (IVs) and Modifier Variable (MV)**

**Ownership Ratio:** Consistent with previous research ownership ratio is measured as the logarithm of the percentage of the focal subsidiary’s equity owned by the largest Japanese owner. The largest Japanese owner is used because typically it is considered the Japanese parent (Dhanaraj & Beamish, 2004).

**Expatriate Number:** This thesis theorizes expatriate number simultaneously as an independent variable (main variable) and a modifier variable that amplifies (strengthens) the effect of ownership ratio on foreign subsidiary survival. Consistent with previous research (Chung & Beamish, 2005; Delios & Bjorkman, 2000; Plourde et al., 2013) I measure expatriate number as the logarithm of the number of expatriates in the
subsidiary to test for the nonlinear logarithmic relationship between expatriate number and foreign subsidiary survival.

**Risk Orientation:** I measured risk orientation as the Japanese parent’s sector-adjusted debt ratio. To calculate this measure I first calculated the Japanese parent’s debt ratio (i.e. total liabilities divided by total assets). Second, I calculated the debt ratio for each of the three sectors: *Manufacturing*, *Trade*, and *Services & Others* (see next page for a detailed description of sector) by adding the debt ratios of all the Japanese parents in a sector and dividing their total by the number of parents in that sector. Finally, I divided each Japanese parent’s debt ratio by its sector’s debt ratio to get each firm’s sector-adjusted debt ratio. Then, I log-transformed the sector-adjusted debt ratio to test the hypothesized nonlinear logarithmic relationship between risk orientation and survival. Using a firm’s sector-adjusted debt ratio as a proxy to measure its risk orientation is appropriate for several reasons. First, firm debt ratios have been used in the literature to measure firm risk (Abor, 2007; Beaver et al., 1970; Berger et al., 1997; Friend & Lang, 1988; Miller & Bromiley, 1990; Wen et al., 2002). Second, among the other available debt ratio measures, I selected the total liabilities divided by total assets measure as it has been shown to exhibit the highest association with risk (Beaver, 1966). Third, the pilot study’s analysis of Canadian subsidiaries of Japanese MNEs found that sector appears to influence governance mechanisms in general (Coles et al., 2001) and corporate debt ratios in Japan in particular (Remmers et al., 1974).

**Subsidiary Governed by Regional Headquarters (RHQ):** I measure this variable as an indicator variable. 1 indicates that the Japanese MNE parent has a RHQ in the region in which the MNE parent’s foreign subsidiaries operate and suggests that that
parent’s subsidiaries in that region are governed by a RHQ. 0 indicates that the Japanese MNE parent does not have a RHQ in the region in which the MNE parent’s foreign subsidiaries operate and suggests that that parent’s subsidiaries in that region are not governed by a RHQ. To identify world regions I follow Delios and Beamish (2005) and consider the world to consist of seven geographic regions, namely Africa, Asia, Europe, Latin America, Middle East & North Arica (MENA), North America, and Oceania.

Control Variables

This study controlled for several variables that the literature suggests may be possible alternative explanations for subsidiary survival and that could consequently confound my results. First, at the subsidiary level, I controlled for the following variables.

Subsidiary age: Consistent with (Dai et al., 2013) I controlled for subsidiary age to account for (1) the possible effect of the liability of newness and (2) the possible effect of the ability of older subsidiaries to adapt to host-country conditions, on subsidiary survival. Subsidiary age was measured as the logarithm of the number of years a subsidiary has operated since its date of establishment in the host country.

Subsidiary Size: I controlled for subsidiary size to account for liabilities of smallness and structural inertia since previous studies have shown a positive relationship between the size and survival of foreign subsidiaries (Li, 1995). Subsidiary size was measured as the logarithm of the total number of subsidiary employees.

Subsidiary sector: I controlled for subsidiary sector. All the industries were grouped into 3 broad sectors (manufacturing = 1, trade = 2, and services & others =3).
Second, at the parent level, consistent with Kim et al. (2012) I controlled for *Parent Size*, *Parent Performance*, and *Parent Sector* since these variables are known to usually affect subsidiary survival (Delios & Beamish, 2001). Parent size was measured as the logarithm of the parent’s number of employees, parent performance, as the return on assets of the parent, and parent sector, as a categorical variables with manufacturing = 1, trade = 2, and services & others = 3.

Third, at the country level, consistent with Dai et al. (2013), I controlled for *Host Market Size*, *Host Market Potential*, and *Host Market Inflation Rate*, factors expected to influence foreign subsidiary survival. Host market size was measured as the logarithm of host country per capita gross domestic product (GDP). Host market potential was measured as the percentage change in GDP of the host country from one year to the other. Host market inflation rate was measured as the inflation, GDP Deflator (annual %), for different years.

I also controlled for *Geographic Distance*, *Host Country Political Stability*, and *Geographic region*. Geographic Distance measured the distance between Japan and the host country. I compiled this data from the GeoDist database published by the Centre d’Etudes Prospectives et d’Information Internationale (CEPII). This dataset measures geographic distances between countries following the great circle formula, which uses latitudes and longitudes of the most important cities / agglomerations (in terms of population).

Host Country Political Stability ranked the political stability of all countries on a scale from 0 to 100 (World Bank Governance Indicators). Other World Bank Governance indicators, such as other political and legal governance indicators, were initially include
in the statistical models, however they were later remove due to potential multicollinearity problems. As implied above, Geographic Region was measured as a categorical variable with Africa = 1, Asia = 2, Europe = 3, Latin America = 4, Middle East & North Arica (MENA) = 5, North America = 6, and Oceania = 7.

4.1.2. Results

The purpose of this multi-country survival analysis was to investigate how Japanese MNE parents govern their foreign subsidiaries to ensure better foreign subsidiary survival. Survival analysis, namely the extended Cox regression technique, was used to test the hypotheses. An extended Cox model is appropriate because the dependent variable is foreign subsidiary survival likelihood and the independent and control variables are time-varying and the extended Cox model can incorporate and test for such time-dependent covariates (Kleinbaum & Klein, 2005).

Table 4.1 presents descriptive statistics and Pearson correlations for this study’s variables. This correlation matrix shows that, among all covariates, there are only four correlations above 0.5, namely the correlations between Log Host Market Size and Political Stability, Log Host Market Size and Subsidiary Geographic Region, Parent Sector and Subsidiary Sector, and Geographic Distance and Subsidiary Geographic Region. Several covariates are significantly correlated (p < 0.05). Therefore to ensure the absence of multicollinearity and ensure the robustness of my results, I performed regressions and collinearity diagnostics for all covariates one by one. That is, each covariate was regressed on all the other covariates to obtain all their variance inflation
factors (VIFs). All VIFs were below four which ensures that multicollinearity is unlikely to be an issue in the analyses (Field, 2009).

Table 4.2 presents the Extended Cox Regression results. All 6 models are highly significant (p < 0.001) and the -2 Log Likelihood decreases as one moves from one Model to the next. All the changes in -2 Log Likelihood from one Model to the next are significant. These results suggest that each model fits the data significantly better than the previous models. The full model (Model 6) in Table 4.2, shows that all hypotheses, except the parent sector-adjusted debt ratio hypothesis, were fully supported. The parent sector-adjusted debt ratio hypothesis was only partially supported as it emerged as a nonlinear logarithmic relationship rather than the initially hypothesized nonlinear s-shaped relationship. For the interpretation of results, a coefficient estimator with a negative value suggests a decreased likelihood of foreign subsidiary exit or an increased likelihood of foreign subsidiary survival.
### Table 4.1 Descriptive Statistics and Pearson Correlations

<table>
<thead>
<tr>
<th>Variables</th>
<th>Mean</th>
<th>S.D.</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>9</th>
<th>10</th>
<th>11</th>
<th>12</th>
<th>13</th>
<th>14</th>
<th>15</th>
<th>16</th>
</tr>
</thead>
<tbody>
<tr>
<td>SubExit</td>
<td>0.033</td>
<td>0.178</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>LgSubAge</td>
<td>0.930</td>
<td>0.403</td>
<td>-0.008*</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>LgSubEmployees</td>
<td>1.680</td>
<td>0.794</td>
<td>-0.066**</td>
<td>-0.191**</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SubSector</td>
<td>1.762</td>
<td>0.769</td>
<td>0.033**</td>
<td>-0.035**</td>
<td>-0.459**</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>LgParentEmployees</td>
<td>3.774</td>
<td>0.693</td>
<td>0.014**</td>
<td>-0.093**</td>
<td>-0.334**</td>
<td>-0.016**</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ParentROA</td>
<td>3.230</td>
<td>4.525</td>
<td>0.050**</td>
<td>0.001</td>
<td>0.006</td>
<td>-0.018**</td>
<td>-0.048**</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ParentSectorAdjusted</td>
<td>4.145</td>
<td>0.710</td>
<td>0.038**</td>
<td>0.010</td>
<td>0.035</td>
<td>0.018</td>
<td>0.016</td>
<td>0.006</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>LgHostROA</td>
<td>3.928</td>
<td>0.617</td>
<td>0.026**</td>
<td>0.248**</td>
<td>-0.341**</td>
<td>0.252**</td>
<td>0.060**</td>
<td>0.032**</td>
<td>-0.010**</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>HostMarketPotential</td>
<td>3.675</td>
<td>0.927</td>
<td>-0.009**</td>
<td>-0.195**</td>
<td>0.131**</td>
<td>-0.127**</td>
<td>-0.029**</td>
<td>-0.100**</td>
<td>-0.003</td>
<td>-0.387**</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>InflationRate</td>
<td>14.187</td>
<td>155.194</td>
<td>-0.002</td>
<td>0.038**</td>
<td>-0.017**</td>
<td>-0.018**</td>
<td>0.022**</td>
<td>-0.003</td>
<td>-0.011**</td>
<td>-0.066**</td>
<td>-0.080**</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GeogDistance</td>
<td>6779.179</td>
<td>3880.848</td>
<td>0.027**</td>
<td>0.227**</td>
<td>-0.174**</td>
<td>0.156**</td>
<td>0.067**</td>
<td>0.014**</td>
<td>-0.020**</td>
<td>-0.488**</td>
<td>-0.476**</td>
<td>-0.192**</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>PoliticalStability</td>
<td>57.537</td>
<td>25.409</td>
<td>0.009**</td>
<td>0.116**</td>
<td>-0.292**</td>
<td>0.210**</td>
<td>0.012**</td>
<td>-0.044**</td>
<td>-0.009**</td>
<td>0.075**</td>
<td>-0.0294</td>
<td>0.071**</td>
<td>-0.299**</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SubGeographicRegion</td>
<td>3.217</td>
<td>1.703</td>
<td>0.028**</td>
<td>0.153**</td>
<td>-0.193**</td>
<td>0.152**</td>
<td>-0.007**</td>
<td>-0.012**</td>
<td>-0.008**</td>
<td>0.517**</td>
<td>0.347**</td>
<td>0.024**</td>
<td>0.697**</td>
<td>-0.355**</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>LgParentOwnership</td>
<td>1.841</td>
<td>0.242</td>
<td>0.045**</td>
<td>-0.026**</td>
<td>-0.223**</td>
<td>0.154**</td>
<td>0.085**</td>
<td>0.050**</td>
<td>0.041**</td>
<td>-0.335**</td>
<td>0.085**</td>
<td>0.007**</td>
<td>0.184**</td>
<td>0.241**</td>
<td>0.189**</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ratio</td>
<td>0.561</td>
<td>0.360</td>
<td>-0.090**</td>
<td>0.121**</td>
<td>0.448**</td>
<td>0.089**</td>
<td>0.250**</td>
<td>-0.015**</td>
<td>-0.078**</td>
<td>0.036**</td>
<td>0.020**</td>
<td>-0.008**</td>
<td>0.042**</td>
<td>0.019**</td>
<td>0.049**</td>
<td>0.020**</td>
<td>0.025**</td>
<td></td>
</tr>
<tr>
<td>AdjDebtRatio</td>
<td>0.297</td>
<td>0.073</td>
<td>-0.023**</td>
<td>0.002</td>
<td>0.084**</td>
<td>0.011**</td>
<td>0.341**</td>
<td>-0.399**</td>
<td>-0.014**</td>
<td>-0.077**</td>
<td>-0.043**</td>
<td>0.027**</td>
<td>0.054**</td>
<td>0.027**</td>
<td>0.024**</td>
<td>0.024**</td>
<td>-0.116**</td>
<td>-0.087**</td>
</tr>
<tr>
<td>SubGovernedByRHQ</td>
<td>0.271</td>
<td>0.445</td>
<td>0.000</td>
<td>-0.007</td>
<td>0.057**</td>
<td>0.022**</td>
<td>0.178**</td>
<td>0.037**</td>
<td>-0.060**</td>
<td>0.021**</td>
<td>0.015**</td>
<td>-0.037**</td>
<td>0.055**</td>
<td>0.036**</td>
<td>0.040**</td>
<td>0.024**</td>
<td>0.057**</td>
<td>0.105**</td>
</tr>
</tbody>
</table>

* * Correlation is significant at the 0.05 level (2-tailed).
** Correlation is significant at the 0.01 level (2-tailed).

Number of observations = 84,369;
Number of foreign subsidiaries = 12, 101;
Number of Japanese parent MNEs = 1,540;
Number of foreign subsidiary Exits = 2,757.

Note: Variables 18 to 24 show descriptive statistics for variables in their raw form before being log transformed; only variables 1-17 are part of the Cox Regression model.
### Table 4.2 Hierarchical Extended Cox Regression Predicting Subsidiary Exit

<table>
<thead>
<tr>
<th>Variables</th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
<th>Model 4</th>
<th>Model 5</th>
<th>Model 6</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>SE</td>
<td>B</td>
<td>SE</td>
<td>B</td>
<td>SE</td>
</tr>
<tr>
<td><strong>Control Variables</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 LgSubAge</td>
<td>-2.90***</td>
<td>.07</td>
<td>-2.90***</td>
<td>.07</td>
<td>-2.99***</td>
<td>.07</td>
</tr>
<tr>
<td>2 LgSubEmployees</td>
<td>-.63***</td>
<td>.03</td>
<td>-.65***</td>
<td>.03</td>
<td>-.38***</td>
<td>.03</td>
</tr>
<tr>
<td>3 SubSector (Manufacturing: Reference)</td>
<td>***</td>
<td>***</td>
<td>***</td>
<td>***</td>
<td>***</td>
<td>***</td>
</tr>
<tr>
<td>4 SubSector (Trading)</td>
<td>-.48***</td>
<td>.05</td>
<td>-.37***</td>
<td>.05</td>
<td>-.28***</td>
<td>.05</td>
</tr>
<tr>
<td>5 SubSector (Services &amp; Others)</td>
<td>-.12†</td>
<td>.07</td>
<td>.01</td>
<td>.07</td>
<td>.10</td>
<td>.07</td>
</tr>
<tr>
<td>6 LgParentEmployees</td>
<td>.33***</td>
<td>.03</td>
<td>.28***</td>
<td>.03</td>
<td>.32***</td>
<td>.03</td>
</tr>
<tr>
<td>7 ParentROA</td>
<td>-.03***</td>
<td>.00</td>
<td>-.03***</td>
<td>.00</td>
<td>-.03***</td>
<td>.00</td>
</tr>
<tr>
<td>8 ParentSector (Manufacturing: Reference)</td>
<td>***</td>
<td>***</td>
<td>***</td>
<td>***</td>
<td>***</td>
<td>***</td>
</tr>
<tr>
<td>9 ParentSector (Trading)</td>
<td>.65***</td>
<td>.05</td>
<td>.51***</td>
<td>.05</td>
<td>.51***</td>
<td>.05</td>
</tr>
<tr>
<td>10 ParentSector (Services &amp; Others)</td>
<td>.13†</td>
<td>.07</td>
<td>.04</td>
<td>.07</td>
<td>.04</td>
<td>.07</td>
</tr>
<tr>
<td>11 LgHostMarketSize</td>
<td>-.41***</td>
<td>.07</td>
<td>-.32***</td>
<td>.07</td>
<td>-.26***</td>
<td>.07</td>
</tr>
<tr>
<td>12 HostMarketPotential</td>
<td>.00</td>
<td>.01</td>
<td>.01</td>
<td>.01</td>
<td>.01</td>
<td>.01</td>
</tr>
<tr>
<td>13 InflationRate</td>
<td>.00***</td>
<td>.00</td>
<td>.00***</td>
<td>.00</td>
<td>.00***</td>
<td>.00</td>
</tr>
<tr>
<td>14 GeogDistance</td>
<td>.00***</td>
<td>.00</td>
<td>.00***</td>
<td>.00</td>
<td>.00***</td>
<td>.00</td>
</tr>
<tr>
<td>15 PoliticalStabilityRank</td>
<td>.01***</td>
<td>.00</td>
<td>.01***</td>
<td>.00</td>
<td>.01***</td>
<td>.00</td>
</tr>
<tr>
<td>16 SubGeographicRegion (Africa: Reference)</td>
<td>***</td>
<td>***</td>
<td>***</td>
<td>***</td>
<td>***</td>
<td>***</td>
</tr>
<tr>
<td>17 SubGeographicRegion (Asia)</td>
<td>-1.37***</td>
<td>.28</td>
<td>-1.39***</td>
<td>.28</td>
<td>-1.03***</td>
<td>.28</td>
</tr>
<tr>
<td>18 SubGeographicRegion (Europe)</td>
<td>-.53</td>
<td>.25</td>
<td>-.56</td>
<td>.25</td>
<td>-.38</td>
<td>.25</td>
</tr>
<tr>
<td>19 SubGeographicRegion (Latin America)</td>
<td>.11</td>
<td>.25</td>
<td>.12</td>
<td>.25</td>
<td>.13</td>
<td>.25</td>
</tr>
<tr>
<td>20 SubGeographicRegion (MENA)</td>
<td>-.39</td>
<td>.31</td>
<td>-.50</td>
<td>.31</td>
<td>-.42</td>
<td>.31</td>
</tr>
<tr>
<td>21 SubGeographicRegion (North America)</td>
<td>-.21</td>
<td>.25</td>
<td>-.27</td>
<td>.25</td>
<td>-.02</td>
<td>.25</td>
</tr>
<tr>
<td>22 SubGeographicRegion (Oceania)</td>
<td>-.91***</td>
<td>.27</td>
<td>-.93***</td>
<td>.27</td>
<td>-.78**</td>
<td>.27</td>
</tr>
<tr>
<td>23 LgParentOwnershipRatio</td>
<td>-1.04***</td>
<td>.06</td>
<td>-1.04***</td>
<td>.06</td>
<td>-1.04***</td>
<td>.06</td>
</tr>
<tr>
<td>24 LgExpatNumber</td>
<td>-1.27***</td>
<td>.07</td>
<td>-1.28***</td>
<td>.07</td>
<td>-1.29***</td>
<td>.07</td>
</tr>
<tr>
<td>25 LgParentSectorAdjustedDebtRatio</td>
<td>1.80***</td>
<td>.32</td>
<td>1.85***</td>
<td>.32</td>
<td>1.81***</td>
<td>.32</td>
</tr>
<tr>
<td>26 SubGovernedByR HQ</td>
<td>-.09</td>
<td>.04</td>
<td>-.09</td>
<td>.04</td>
<td>-.09</td>
<td>.04</td>
</tr>
<tr>
<td><strong>Interaction</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>27 LgExpatNumber*LgParentOwnershipRatio</td>
<td>.80***</td>
<td>.21</td>
<td>.80***</td>
<td>.21</td>
<td>.80***</td>
<td>.21</td>
</tr>
<tr>
<td>- Log-Likelihood</td>
<td>54448.89</td>
<td>54231.45</td>
<td>53905.55</td>
<td>53873.54</td>
<td>53869.04</td>
<td>53854.34</td>
</tr>
<tr>
<td>Model Chi-Square</td>
<td>3588.19***</td>
<td>3879.88***</td>
<td>4105.56***</td>
<td>4118.09***</td>
<td>4122.97***</td>
<td>4230.00***</td>
</tr>
<tr>
<td>Change in - Log-Likelihood</td>
<td>3288.07***</td>
<td>217.45***</td>
<td>325.90***</td>
<td>32.01***</td>
<td>4.49*</td>
<td>14.70***</td>
</tr>
</tbody>
</table>

Number of observations = 84,369; Number of foreign subsidiaries = 12, 101; Number of Japanese parent MNEs = 1,540; Number of foreign subsidiary Exits = 2,757.  
† p < .10; * p < .05; ** p < .01; *** p < .001 (all two-tailed)
Model 1 is the baseline model. It includes only control variables. Among the subsidiary-level controls, as expected, Model 1 shows that subsidiary age (as measured as Log of subsidiary age) and subsidiary size (as measured by its Log of subsidiary number of employees) are both positively significantly related to subsidiary survival likelihood (p < 0.001 for both). Moreover, subsidiary sector is significantly associated with subsidiary survival likelihood since the reference sector, manufacturing, is significantly related to foreign subsidiary survival likelihood (p < 0.001). The results show that Trading subsidiaries are significantly more likely to survive than their manufacturing counterparts (p < 0.001 and B is negative) and Services and Others subsidiaries are marginally more likely to survive than their manufacturing counterparts (p < 0.10 and B is negative). This may be attributed to the fact that Trading and Services subsidiaries require less capital investment to survive (Brouthers & Brouthers, 2003).

In this baseline model, among the parent-level controls, parent size (as measured by the Log of parent number of employees) is negatively significantly related to subsidiary survival (p < 0.001 and B is positive). This relationship shows that foreign subsidiaries of smaller MNEs are more likely to survive than those of larger MNEs (Delios & Beamish, 2001; Dhanaraj & Beamish, 2009). This is consistent with Kostova and Zaheer’s (1999) organizational complexity notion, which suggests that while parent size provides a stronger resource base, it increases vulnerability to local demands. It is also in line with Franko’s (1971) findings that suggest that MNEs with larger parents have more flexibility to structure their operations in a country. Larger firms have a greater ability to move subsidiaries to new locations within a country or region and consolidate several subsidiaries into a single unit, thus decreasing the likelihood of their
foreign subsidiaries’ survival (Chung et al., 2010). Moreover, as expected, parent performance (as measured by ROA) is positively significantly related with subsidiary survival. Furthermore, parent sector is significantly related to subsidiary survival (Manufacturing: p < 0.001) and subsidiaries with parents that are in the trading sector are less likely to survive (p < 0.001 and B is positive) and subsidiaries with parents that are in services and other sectors are marginally less likely to survive (p < 0.1 and B is positive) than subsidiaries with parents that are in the manufacturing sector.

Among the country-level controls, as expected, a subsidiary’s host market size (as measured by the Log of the host market’s per capita GDP) and host market inflation rate were respectively negatively and positively related to subsidiary survival (p < 0.001 for both and Bs negative and positive respectively). Whereas, a subsidiary’s host market potential (as measured by the host market’s percentage change in GDP) had no observable relationship with a subsidiary’s survival (p > 0.1).

Moreover, a subsidiary’s geographic distance from Japan was negatively related (p < 0.001 and B is positive) to a subsidiary’s survival. Unexpectedly, host country political stability was negatively related to subsidiary survival (p < 0.001 and B is positive). This may be attributed to the fact that subsidiaries operating in politically stable countries may be faced with stronger competition due to the attractiveness of operating in those countries which may increase their likelihood of failure compared to subsidiaries operating in politically unstable countries but prone to lower competition as well. Moreover, research shows that subsidiaries operating in more politically unstable countries may develop political experience and capabilities that may enhance their chances for survival (Delios & Henisz, 2003; Frynas & Mellahi, 2003).
Furthermore, a subsidiary’s geographic region was significantly related to a subsidiary’s survival likelihood (for the reference category, Africa, p < 0.001). The other categories of this variable show that, subsidiaries in Asia, Europe, and Oceania are significantly more likely to survive than their counterparts in Africa (p < 0.001, p < 0.05, and p < 0.001 respectively and B is negative for all).

Model 2 tests for H1a. It includes this study’s first main variable, log parent ownership ratio. The results of the controls in Model 2 are widely similar to those in Model 1. The results for log parent ownership ratio suggest that, as expected, there is a significant positive nonlinear logarithmic relationship between an MNE parent’s ownership ratio in its foreign subsidiary and that foreign subsidiary’s survival likelihood (p < 0.001 and B is negative). Thus H1a is supported.

Model 3 tests for H2a. It includes this study’s second main variable, log expatriate number. The results of the controls in Model 3 are widely similar to those in Model 1. The results for log expatriate number suggest that, as expected, there is a significant positive nonlinear logarithmic relationship between the number of expatriates in a foreign subsidiary and that foreign subsidiary’s survival likelihood (p < 0.001 and B is negative). Thus H2a is supported.

Model 4 initially tested for H3a, namely that there is a negative (declining) nonlinear s-shaped relationship between an MNE parent’s sector-adjusted debt ratio and its foreign subsidiary’s survival. Given that parent sector-adjusted debt ratio squared and parent sector-adjusted debt ratio cubed were found non-significant in this multi-country sample, they are not reported in Table 4.2. However, Model 4 reports the coefficient of the relationship between log parent sector-adjusted debt ratio and foreign subsidiary
survival. This coefficient was found to be significant. The results of the controls in Model 4 are widely similar to those in Model 1. The results for log parent sector-adjusted debt ratio suggest that there is a significant negative nonlinear logarithmic relationship between an MNE parent’s sector-adjusted debt ratio and its foreign subsidiary’s survival likelihood (p < 0.001 and B is positive). Thus H3a is partially supported since the relationship between parent risk orientation and subsidiary survival still emerged as significant negative nonlinear, although logarithmic rather than s-shaped in form.

Model 5 tests for H4a. It includes this study’s fourth main variable, subsidiary governed by RHQ. The results of the controls in Model 5 are widely similar to those in Model 1. The results for subsidiary governed by RHQ suggest that, as expected, a foreign subsidiary that is governed by a RHQ is significantly more likely to survive than its counterpart that is not governed by a RHQ (p < 0.05 and B is negative). Thus H4a is fully supported.

Model 6 tests for H5. It includes the effect of this study’s interaction between parent ownership ratio and expatriate number on foreign subsidiary survival. The results of the controls in Model 6 are widely similar to those in Model 1. The results for the interaction in Model 6 suggest that, as expected, the number of expatriates in a foreign subsidiary modifies (amplifies/strengthens) the positive effect of the MNE parent’s ownership ratio in that subsidiary on that subsidiary’s survival likelihood (p < 0.001 and B is positive). Thus H5 is fully supported.

To probe this significant interaction further, three Cox regression models were run at three levels of the modifier variable, expatriate number. The first model was run at the low number of expatriates equal to zero expatriates (the values for this model are the ones
reported in Table 4.2). The second model was run at the medium number of expatriates equal to four expatriates. The number four expatriates was chosen because the mean number of expatriates in the sample was 4.537 and four expatriates was more theoretically meaningful than 4.537 given that human beings cannot be divided into parts. The third model was run at the high number of expatriates equal to eight expatriates to be equidistant from zero expatriates with respect to the closest number to the mean expatriate number, four expatriates. The regression coefficients for the parent ownership ratio variables at low expatriate number, medium expatriate number, and high expatriate number were $B_{\text{at low expatriates}} = -0.909$ (significant, $p < 0.001$), $B_{\text{at medium expatriates}} = -0.348$ (significant, $p < 0.01$), and $B_{\text{at high expatriates}} = -0.148$ (not significant, $p > 0.1$).

These results suggest the following. When the number of expatriates is low, the effect of higher levels of parent ownership on subsidiary survival is high and significant (the slope between ownership and subsidiary failure is 0.909 and negative and significant). When the number of expatriates is medium, the effect of higher levels of parent ownership on subsidiary survival is medium and significant (the slope between ownership and subsidiary failure is 0.348 and negative and significant). When the number of expatriates is high, the effect of higher levels of parent ownership on subsidiary survival is low and non-significant (the slope between ownership and subsidiary failure is 0.148 and negative and non-significant). Therefore, as the number of expatriates in a foreign subsidiary increases, the effect of higher parent ownership levels in that subsidiary on that subsidiary’s survival decreases. This further supports H5.

To identify the relative importance of each main variable in explaining variability in the probability of foreign subsidiary survival, one needs to compare the changes in -2
log-likelihood resulting from the inclusion of each new main variable and interaction term in Table 4.2. -2 log-likelihood is a measure of how much unexplained variability there is in the dependent variable; therefore the difference or change in -2 log-likelihood indicates how much new variance has been explained by each new model (Field, 2009).

Comparing the different changes in -2 Log-Likelihood resulting from the inclusion of each new main variable or interaction term in Table 4.2, one can notice the following. The relative importance of each variable, from the most important to the least important, in explaining new variance in the probability of foreign subsidiary survival, is as follows: expatriate number (change in -2 log-likelihood = 325.90, p < 0.001); parent ownership ratio (change in -2 log-likelihood = 217.45, p < 0.001); parent sector-adjusted debt ratio (change in -2 log-likelihood = 32.01, p < 0.001); interaction between ownership and expatriates (change in -2 log-likelihood = 14.70, p < 0.001); and subsidiary governed by RHQ (change in -2 log-likelihood = 4.49, p < 0.05). These results suggest that a change in the number of expatriates led to the highest change in the probability of survival of a foreign subsidiary, whereas a change of a subsidiary from not being governed by an RHQ to being governed by an RHQ led to the lowest change in the probability of survival of that foreign subsidiary.

The same above analyses were replicated using a sample that included only subsidiaries with 20 employees or more and subsidiaries with Japanese parents with an ownership ratio of 5% or more. The same significant results were found for Log Ownership Ratio, Log Expatriate Number, Log Parent Sector-Adjusted Debt Ratio, and the interaction between Log Ownership Ratio and Log Expatriate Number. Only Subsidiary Governed by RHQ became non-significant. Upon further analysis, it was
found that RHQs had a median number of employees of 20 employees whereas subsidiaries that are not RHQ had a median number of employees equal to 45. Moreover, the total number of subsidiary-years that were RHQs was 9950, whereas the total number of subsidiary-years that were not RHQs was 213,133. When subsidiaries with fewer than 20 employees were deleted around half of the RHQs in the sample were dropped, whereas far fewer non-RHQ subsidiaries were dropped from the original sample.

These important changes in the relative percentages between RHQs and non-RHQ subsidiaries decreased the explanatory power of RHQs relative to non-RHQs. To avoid understating the impact of a subsidiary being governed by an RHQ on its survival, this study presents the results of the original sample in Table 4.2, especially that the results for the other main variables are the same for both.

4.2. Multi-Country Profitability Analyses

4.2.1. Methods

This multi-country profitability analysis is in some ways similar to the multi-country survival analysis, however using profitability, rather than survival, as the dependent variable, and using several cross-sections of the data, rather than longitudinal data, for the statistical analyses. The purpose of this analysis was to answer the second part of this thesis’ first research question (‘How do MNE parents govern their foreign subsidiaries to ensure better foreign subsidiary profitability?’) using a large sample of Japanese MNEs with subsidiaries in multiple countries and regions. To answer this part of the first research question, this study tested Hypotheses 1b, 2b, 3b, and 4b using
several multinomial and binary logistic regression analyses. Thus, to test these hypotheses, one multinomial and one binary logistic regression analysis was conducted for each individual year from 2000 till 2008. That is, nine multinomial regressions and nine binary regressions, a total of 18 logistic regression analyses, were conducted to test for these four hypotheses. The purpose of repeating these regressions over 9 years was to ensure the robustness of the results.

Using multinomial and binary logistic regression is appropriate because, as explained in more detail later, the dependent variable was correspondingly either a trichotomous or a dichotomous categorical variable. Multinomial logistic regression is appropriate for analyzing data with a categorical dependent variable with multiple categories. Binary logistic regression is appropriate for analyzing data with a categorical dependent variable with only two categories (Field, 2009).

The data sources used to build the datasets utilized in these multi-country profitability logistic regression analyses were the same data sources employed to build the multi-country survival analyses, namely the TK, NEEDS, World Bank economic and governance data, and Centre d’Etudes Prospectives et d’Informations Internationales (CEPII) data. The variables used in these multi-country profitability analyses were broadly similar to the variables used in the multi-country survival analyses, however the dependent variables were a trichotomous profitability dependent variable and a dichotomous profitability dependent variable (DV). The trichotomous profitability DV was measured as 1 = gain, 2 = breakeven, and 3 = loss. The dichotomous profitability DV was measured as 1 = gain and 0 = breakeven or loss.
The subsidiary profitability measure was based on a managerial assessment of profitability that has been demonstrated to have construct validity (Dess & Robinson, 1984). The subsidiary’s general manager or the equivalent provided this assessment in response to a question in Toyo Keizai’s survey. The profitability question asked the subsidiary general manager to classify the financial performance of the subsidiary into one of three categories: loss, breakeven, or gain. The classification was an absolute assessment of profitability made without reference to other subsidiaries of the MNE to which the given subsidiary belonged.

4.2.1.1. Testing Null Hypotheses

Hypotheses 1b, 2b, 3b, and 4b are essentially null hypotheses. In the strictest sense, the null hypothesis must always be false, because no two real-world measures have zero correlations between them (Lane et al., 1998). However, Field (2009) indicates that one can test null hypotheses and be confident enough to fail to reject (or “accept”) the null when the statistical test that one uses has enough statistical power to show that the relationship between two phenomena that was thought to be a true relationship is instead found to be trivial. He then defines the power of a statistical test as the probability that a given test will find an effect assuming that one exists in the population. He also provides guidelines, based on Cohen (1988, 1992), about the sample size recommended to achieve the desired level of power and to detect small, medium, and large effect sizes. He then recommends that statistical power be at least 0.8 (power = 1 – beta (0.2) = 0.8) so that one will be 80% confident that one will find an effect when it exists or that there will be
only 20% probability that one will make a Type II error of not detecting an effect when it actually exists. With 0.8 power and an alpha-level of 0.5 one would need 783 observations to detect a small effect size ($r = 0.1$), 85 observations to detect a medium effect size ($r = 0.3$), and 28 observations to detect a large effect size ($r = 0.5$) (Field, 2009). Tables 4.3 and 4.4 show that the sample size for the multi-country multinomial and binary profitability analyses for year 2005 was 877. The sample sizes for the replication analyses for years 2000 to 2008 ranged between 714 and 2021 observations. These sample sizes are either in the acceptable range or much larger than the sample size recommended to detect a small effect ($r = 0.1$) with 80% power. Thus, I can fail to reject (or “accept”) this study’s null hypotheses if no significant results are found.

### 4.2.2. Results

The descriptive statistics and Pearson correlations in Table 4.1 also apply to these multi-country profitability analyses since the same covariates are used in these analyses. Only SubExit, the multi-country survival analysis DV should be excluded from the table since the DVs for the current analyses are the trichotomous and dichotomous profitability DVs. Moreover, the sample sizes differ.

Regarding the multinomial and binomial logistic regression results, Tables 4.3 and 4.4 show the results for these analyses for the year 2005. I present the results of the year 2005 (before the global financial crisis) to avoid possible bias from use of data from years during or after that crisis. These tables clearly show that the overall models are significant. For the multinomial logit, Table 4.3 shows that Chi-square = 114.869 and is
highly significant (p < 0.001); and that R-square = 0.154. These results suggest that the model reasonably explains the variance in the DV. Furthermore, several control variables are significant. However, none of the main variables are significant.

Similarly, for the binomial logit, Table 4.4 shows that Chi-square = 78.276 and is highly significant as well (p < 0.001); and that R-square = 0.122. These results also suggest that the model reasonably explains the variance in the DV. The explanatory power (R-square) decreased with the decrease in information in the DV (the DV changed from being trichotomous to being dichotomous). Furthermore, several control variables are significant. However, none of the main variables are significant.

Although, for the sake of parsimony, I do not present the multinomial and binomial logistic regression results for all the years from 2000 to 2008, the results for these replication years are broadly similar to the results in Tables 4.3 and 4.4. Only in very few analyses, out of the total 18 analyses, did certain main variables appear marginally significant or significant. With the level of statistical power used, the ability to detect small effect sizes, and the replication of these results over several years and using two logistic regression techniques, these analyses allow me to fail to reject (or “accept”) the hypothesized null relationships. Thus, these results support H1b, H2b, H3b, and H4b. Specifically, these results provide evidence that ownership, expatriates, risk, and RHQ have negligible effects on foreign subsidiary profitability.
Table 4.3 Multinomial Logistic Regression Predicting Subsidiary Profitability in 2005

<table>
<thead>
<tr>
<th>Variables</th>
<th>B</th>
<th>S.E.</th>
<th>Exp(B)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Gaining vs. Losing</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Intercept</td>
<td>13.451 ***</td>
<td>3.855</td>
<td></td>
</tr>
<tr>
<td>LgSubAge</td>
<td>.657 *</td>
<td>.335</td>
<td>1.929</td>
</tr>
<tr>
<td>LgSubEmployees</td>
<td>.520 *</td>
<td>.262</td>
<td>1.682</td>
</tr>
<tr>
<td>SubSector (Manufacturing)</td>
<td>.477</td>
<td>.498</td>
<td>1.610</td>
</tr>
<tr>
<td>SubSector (Trading)</td>
<td>.944 *</td>
<td>.472</td>
<td>2.571</td>
</tr>
<tr>
<td>SubSector (Reference: Services &amp; Others)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>LgParentEmployees</td>
<td>.534 *</td>
<td>.263</td>
<td>1.706</td>
</tr>
<tr>
<td>ParentROA</td>
<td>.102 ***</td>
<td>.026</td>
<td>1.107</td>
</tr>
<tr>
<td>ParentSector (Manufacturing)</td>
<td>-.572</td>
<td>.514</td>
<td>.564</td>
</tr>
<tr>
<td>ParentSector (Trading)</td>
<td>-.535</td>
<td>.554</td>
<td>.586</td>
</tr>
<tr>
<td>ParentSector (Reference: Services &amp; Others)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>LgHostMarketSize</td>
<td>.005</td>
<td>.753</td>
<td>1.005</td>
</tr>
<tr>
<td>HostMarketPotential</td>
<td>-.008</td>
<td>.088</td>
<td>.992</td>
</tr>
<tr>
<td>InflationRate</td>
<td>-.051</td>
<td>.073</td>
<td>.950</td>
</tr>
<tr>
<td>GeogDistance</td>
<td>.000</td>
<td>.000</td>
<td>1.000</td>
</tr>
<tr>
<td>PoliticalStabilityRank</td>
<td>.018</td>
<td>.012</td>
<td>1.019</td>
</tr>
<tr>
<td>SubGeographicRegion (Asia)</td>
<td>-14.529 ***</td>
<td>1.259</td>
<td>.000</td>
</tr>
<tr>
<td>SubGeographicRegion (Europe)</td>
<td>-15.551 ***</td>
<td>1.024</td>
<td>.000</td>
</tr>
<tr>
<td>SubGeographicRegion (Latin America)</td>
<td>-15.320 ***</td>
<td>1.444</td>
<td>.000</td>
</tr>
<tr>
<td>SubGeographicRegion (MENA)</td>
<td>-14.877 ***</td>
<td>1.871</td>
<td>.000</td>
</tr>
<tr>
<td>SubGeographicRegion (North America)</td>
<td>-15.176 ***</td>
<td>.885</td>
<td>.000</td>
</tr>
<tr>
<td>SubGeographicRegion (Reference: Oceania)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>LgParentOwnershipRatio</td>
<td>-9.948</td>
<td>.702</td>
<td>.387</td>
</tr>
<tr>
<td>LgExpatNumber</td>
<td>-.262</td>
<td>.495</td>
<td>.769</td>
</tr>
<tr>
<td>LgParentSectorAdjustedDebtRatio</td>
<td>2.511</td>
<td>1.835</td>
<td>12.322</td>
</tr>
<tr>
<td>SubGovernedByRHQ (No)</td>
<td>.038</td>
<td>.296</td>
<td>1.039</td>
</tr>
<tr>
<td>SubGovernedByRHQ (Reference: Yes)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Breakeven vs. Losing</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Intercept</td>
<td>16.474 ***</td>
<td>4.147</td>
<td></td>
</tr>
<tr>
<td>LgSubAge</td>
<td>1.065 **</td>
<td>.396</td>
<td>2.902</td>
</tr>
<tr>
<td>LgSubEmployees</td>
<td>.070</td>
<td>.295</td>
<td>1.072</td>
</tr>
<tr>
<td>SubSector (Manufacturing)</td>
<td>-.276</td>
<td>.558</td>
<td>.759</td>
</tr>
<tr>
<td>SubSector (Trading)</td>
<td>-.028</td>
<td>.529</td>
<td>.973</td>
</tr>
<tr>
<td>SubSector (Reference: Services &amp; Others)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>LgParentEmployees</td>
<td>.084</td>
<td>.300</td>
<td>1.088</td>
</tr>
<tr>
<td>ParentROA</td>
<td>.028</td>
<td>.028</td>
<td>1.029</td>
</tr>
<tr>
<td>ParentSector (Manufacturing)</td>
<td>.362</td>
<td>.571</td>
<td>1.436</td>
</tr>
<tr>
<td>ParentSector (Trading)</td>
<td>-.259</td>
<td>.630</td>
<td>.772</td>
</tr>
<tr>
<td>ParentSector (Reference: Services &amp; Others)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>LgHostMarketSize</td>
<td>-.571</td>
<td>.815</td>
<td>.565</td>
</tr>
<tr>
<td>HostMarketPotential</td>
<td>.049</td>
<td>.100</td>
<td>1.050</td>
</tr>
<tr>
<td>InflationRate</td>
<td>-.039</td>
<td>.081</td>
<td>.961</td>
</tr>
<tr>
<td>GeogDistance</td>
<td>.000</td>
<td>.000</td>
<td>1.000</td>
</tr>
<tr>
<td>PoliticalStabilityRank</td>
<td>.026 *</td>
<td>.013</td>
<td>1.027</td>
</tr>
<tr>
<td>SubGeographicRegion (Asia)</td>
<td>-15.325 ***</td>
<td>1.112</td>
<td>.000</td>
</tr>
<tr>
<td>SubGeographicRegion (Europe)</td>
<td>-15.418 ***</td>
<td>.698</td>
<td>.000</td>
</tr>
<tr>
<td>SubGeographicRegion (Latin America)</td>
<td>-15.920 ***</td>
<td>1.362</td>
<td>.000</td>
</tr>
<tr>
<td>SubGeographicRegion (MENA)</td>
<td>-31.818</td>
<td>3518.233</td>
<td>.000</td>
</tr>
<tr>
<td>SubGeographicRegion (North America)</td>
<td>-15.545</td>
<td>.000</td>
<td>.000</td>
</tr>
<tr>
<td>SubGeographicRegion (Reference: Oceania)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>LgParentOwnershipRatio</td>
<td>-9.997</td>
<td>.796</td>
<td>.369</td>
</tr>
<tr>
<td>LgExpatNumber</td>
<td>-.304</td>
<td>.562</td>
<td>.738</td>
</tr>
<tr>
<td>LgParentSectorAdjustedDebtRatio</td>
<td>1.761</td>
<td>2.074</td>
<td>5.820</td>
</tr>
<tr>
<td>SubGovernedByRHQ (No)</td>
<td>.281</td>
<td>.345</td>
<td>1.325</td>
</tr>
<tr>
<td>SubGovernedByRHQ (Reference: Yes)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

-2 Log-Likelihood = 1281.481; Chi-Square = 114.689 ***; Nagelkerke R-squared = .154

Notes: Number of Observations = 877; Subsidiary Profitability was measured in 2005 and coded as 1 = Gaining; 2 = Breakeven; 3 = Losing; The reference category is 3 = Losing; All covariates were measured in 2004 to create a 1 year lag between covariates and dependent variable; SubGeographicRegion (Africa) is not in this model because there were no African subsidiaries with complete data in the analysis for 2004; + p < .1; * p < .05; ** p < .01; *** p < .001 (All two-tailed).
### Table 4.4 Binomial Logistic Regression Predicting Subsidiary Profitability in 2005

<table>
<thead>
<tr>
<th>Variables</th>
<th>B</th>
<th>S.E.</th>
<th>Exp(B)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>-2.795</td>
<td>1.912</td>
<td>.061</td>
</tr>
<tr>
<td>LgSubAge</td>
<td>.015</td>
<td>.233</td>
<td>1.015</td>
</tr>
<tr>
<td>LgSubEmployees</td>
<td>.472 **</td>
<td>.170</td>
<td>1.603</td>
</tr>
<tr>
<td>SubSector (Reference: Manufacturing)</td>
<td>*</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SubSector (Trading)</td>
<td>.291</td>
<td>.239</td>
<td>1.338</td>
</tr>
<tr>
<td>SubSector (Services &amp; Others)</td>
<td>-.656 +</td>
<td>.354</td>
<td>.519</td>
</tr>
<tr>
<td>LgParentEmployees</td>
<td>.483 **</td>
<td>.171</td>
<td>1.621</td>
</tr>
<tr>
<td>ParentROA</td>
<td>.084 ***</td>
<td>.018</td>
<td>1.088</td>
</tr>
<tr>
<td>ParentSector (Reference: Manufacturing)</td>
<td>*</td>
<td></td>
<td></td>
</tr>
<tr>
<td>ParentSector (Trading)</td>
<td>.435 +</td>
<td>.237</td>
<td>1.545</td>
</tr>
<tr>
<td>ParentSector (Services &amp; Others)</td>
<td>.799 *</td>
<td>.365</td>
<td>2.224</td>
</tr>
<tr>
<td>LgHostMarketSize</td>
<td>.371</td>
<td>.469</td>
<td>1.449</td>
</tr>
<tr>
<td>HostMarketPotential</td>
<td>-.041</td>
<td>.057</td>
<td>.960</td>
</tr>
<tr>
<td>InflationRate</td>
<td>-.020</td>
<td>.042</td>
<td>.981</td>
</tr>
<tr>
<td>GeogDistance</td>
<td>.000</td>
<td>.000</td>
<td>1.000</td>
</tr>
<tr>
<td>PoliticalStabilityRank</td>
<td>.001</td>
<td>.008</td>
<td>1.001</td>
</tr>
<tr>
<td>SubGeographicRegion (Reference: Asia)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SubGeographicRegion (Europe)</td>
<td>-.867 +</td>
<td>.490</td>
<td>.420</td>
</tr>
<tr>
<td>SubGeographicRegion (Latin America)</td>
<td>-.273</td>
<td>1.010</td>
<td>.761</td>
</tr>
<tr>
<td>SubGeographicRegion (MENA)</td>
<td>.621</td>
<td>1.429</td>
<td>1.861</td>
</tr>
<tr>
<td>SubGeographicRegion (North America)</td>
<td>-.415</td>
<td>.632</td>
<td>.660</td>
</tr>
<tr>
<td>SubGeographicRegion (Oceania)</td>
<td>-.570</td>
<td>.779</td>
<td>.565</td>
</tr>
<tr>
<td>LgParentOwnershipRatio</td>
<td>-.321</td>
<td>.437</td>
<td>.725</td>
</tr>
<tr>
<td>LgExpatNumber</td>
<td>-.047</td>
<td>.318</td>
<td>.954</td>
</tr>
<tr>
<td>LgParentSectorAdjustedDebtRatio</td>
<td>1.379</td>
<td>1.245</td>
<td>3.971</td>
</tr>
<tr>
<td>SubGovernedByRHQ (Yes)</td>
<td>.125</td>
<td>.202</td>
<td>1.133</td>
</tr>
</tbody>
</table>

-2 Log Likelihood = 982.640
Chi-square = 78.276***
Nagelkerke R-square = .122
Number of Observations = 877

Notes: Subsidiary Profitability was measured in 2005 and coded as 1 = Gaining; 0 = Breakeven or Losing; All covariates were measured in 2004 to create a 1 year lag between the covariates and the dependent variable; SubGeographicRegion (Africa) is not in this model because there were no African subsidiaries with complete data in the analysis for 2004.

+ p < 0.1; * p < 0.05; ** p < 0.01; *** p < 0.001
CHAPTER 5

5. DISCUSSION

The purpose of this thesis was to answer the following research questions: (1) how do MNE parents govern their foreign subsidiaries to ensure better performance (measured as foreign subsidiary survival and foreign subsidiary profitability), (2) why they govern these foreign subsidiaries that way. I argued that MNE parent-foreign subsidiary governance relationships are similar to principal-agent relationships, in that both need to reduce / solve the agency problem. Thus, I drew on agency theory to build my theoretical framework.

To answer the first research question, agency theory and prospect theory based hypotheses were developed. Overall the statistical findings show that foreign subsidiaries that are more likely to survive are governed by MNE parents through a higher number of expatriates, higher parent ownership, lower risk, and regional headquarters (RHQ). Further, the relative importance of these governance mechanisms follows the descending order in which they are presented in the previous sentence. That is, the use of expatriates is the most effective governance mechanism whereas the use of RHQs is the least effective governance mechanism among these four significantly effective governance mechanisms.

In addition, the findings suggest that the ownership and expatriates governance mechanisms complement each other. Specifically, the effect of a parent’s higher ownership on a subsidiary’s survival decreases as the number of expatriates in that subsidiary increases.
However, it is interesting that the findings show that although these four MNE parent-foreign subsidiary governance mechanisms impact foreign subsidiary survival, they do not necessarily impact foreign subsidiary profitability. This finding quantitatively supports the qualitative insight provided by a seasoned governance expert whom I interviewed while collecting qualitative data for this thesis.

To answer the second research question, I conducted interviews with subsidiary CEOs, TMT members, and board members. Consistent with agency theory, I found that MNE parents use ownership, expatriates, risk orientation, and RHQ as foreign subsidiary governance mechanisms to monitor their foreign subsidiaries’ behaviors. However, beyond agency theory, but consistent with classical corporate governance, they use subsidiary governance mechanisms such as expatriates and risk orientation to also direct their foreign subsidiaries’ behaviors.

5.1. Research Implications

This study offers the following theoretical and empirical contributions. First, it contributes to agency theory by advancing it in the following ways. Classical economic agency theory (Jensen & Meckling, 1976) embraces the following assumptions, among others: (1) a single principal (shareholders), (2) a single agent (management), (3) the principal and the agent are two distinct individuals or groups (in the case of two groups the individuals within each group have homogeneous interests, goals, and behaviors), and (4) the principal knows what is best for the firm and thus ideally creates an optimal contract that ensures that the agent does what the principal thinks is best for the firm and
then monitors the agent’s behavior (Shapiro, 2005). More recent agency theory research in economics, political science, law, sociology, and business extends the above first two assumptions and introduces multiple principals and multiple agents into agency-based studies (Kiser, 1999; Shapiro, 2005; Waterman & Meier, 1998). To my knowledge, this study is the first to combine agency theory and MNE corporate governance to explicitly extend the above third assumption by conceptualizing MNE-parent managers and foreign subsidiary expatriate managers as acting as principals and agents simultaneously.

This study does this in the following two ways. Firstly, classical agency theory and corporate governance consider ownership as a governance mechanism used by shareholders (principals) to govern the behavior of managers (agents). This study extends agency theory by combining it with MNE governance to suggest that, in the context of MNE parent-foreign subsidiary governance, MNE-parent managers, who act simultaneously as agents to MNE shareholders and principals to foreign subsidiary managers, use foreign subsidiary ownership as a governance mechanism to govern the behavior of their foreign subsidiary managers. Domestic parent managers, who may also act simultaneously as agents to their shareholders and principals to their domestic subsidiary managers, may also use subsidiary ownership as a governance mechanism to govern the behavior of their domestic subsidiary managers. However, to my knowledge the literatures on international and domestic parent-subsidiary relationships neither explicitly extend this third assumption nor unambiguously consider MNE or domestic parent managers as acting as agents and principals simultaneously. Moreover, domestic parents and their domestic subsidiaries are less geographically, economically, politically, legally, etc. distant and are expected to have less divergent interests and goals than their
(MNE) parent-(foreign) subsidiary counterparts. This makes domestic parent-subsidiary agency problems minor compared to the more pronounced ones of their (MNE) parent-(foreign) subsidiary counterparts. This, in turn, renders the simultaneous agent and principal roles of MNE parent managers much more salient than those of their domestic parent counterparts. Given that (MNE) parent-(foreign) subsidiary agency problems are more pronounced than those of their domestic parent-subsidiary counterparts I expect MNEs to rely more on subsidiary ownership as a subsidiary governance mechanism than their domestic counterparts, especially given that, with lower agency problems, domestic parents could govern their domestic subsidiaries by relying more on non-ownership governance mechanisms (Schaan, 1988).

Secondly, agency theory similarly considers managers as agents to owners or principals. This study extends agency theory and the expatriate literature by suggesting that expatriates, who are usually subsidiary managers, simultaneously act as agents (subsidiary managers) to headquarters and principals (subsidiary governors representing the parent) to foreign subsidiaries. Future research may need to investigate how such principal and agent managers resolve and integrate their personal internal agency conflicts.

Furthermore, expatriates, being not only parent agents but simultaneously subsidiary principals, can go beyond agency theory’s prediction as acting only as parent controllers for their subsidiary’s behaviors, to having a role as governors of their subsidiary’s strategy. This extends the above fourth assumption of agency theory that predicts that the expatriate (agent) will be passive and just do what the parent believes is best for the subsidiary, to suggest that the expatriate will be proactive and do what (s)he
believes is best for the subsidiary and MNE parent overall. Such a proactive behavior would be more similar to corporate governance’s prediction that corporate board members act not only as monitors of management’s behavior but also as directors of corporate strategy.

Second, this study contributes to prospect theory (Kahneman & Tversky, 1979) by extending it from the individual level to the MNE parent-foreign subsidiary level. More specifically, prospect theory attempts to explain individual decisions under risk. This study extends it to an international business context to explain the relationship between MNE parent-foreign subsidiary risk orientation and foreign subsidiary survival. The pilot study advances prospect theory by showing when foreign subsidiaries behave in a rational manner and when they behave in a biased manner. It shows that moderate risk-takers, that is rational actors, increase their survival likelihood by taking more moderate risks than their industry peers, whereas extreme risk-aversers and excessive risk-seekers, that is biased actors, decrease their survival likelihood by increasing their risk-aversion and increasing their risk-seeking than their industry peers respectively.

Third, this study contributes to corporate governance research by extending it in the following ways. Conceptually, it advances corporate governance studies by widening their scope to parent-subsidiary governance and broadening its mechanisms to include intra-organizational governance mechanisms, such as parent-subsidiary ownership, expatriates, risk orientation, and RHQ. The classical corporate governance literature typically studies internal (e.g. monitoring by the board of directors, compensation, internal audits, etc.) and external (e.g. market for corporate control, media pressure, government regulations, etc.) corporate governance mechanisms to the domestic firm.
This study extends the corporate governance literature by studying a third group of mechanisms, namely, *intra-organizational governance mechanisms* between parent and subsidiaries of the MNE. Moreover, conceptually it advances corporate governance by borrowing the concept of risk governance from sister disciplines such as political science and public policy and redefining it to serve as a valuable concept in corporate governance in the business sector.

Empirically, it advances corporate governance research by conducting one of the first empirical and multi-method studies on MNE parent-foreign subsidiary governance and by showing that MNE parent-foreign subsidiary governance matters. However it was also found that MNE parent-foreign subsidiary governance impacts foreign subsidiary survival but not necessarily foreign subsidiary profitability, a distinction that has not been made before either in the MNE governance literature or in the classical corporate governance literature. Previous findings on the relationship between corporate governance and performance have been mixed (for examples see: Dalton, Daily, Ellstrand, & Johnson, 1998; Gompers et al., 2003; Klapper & Love, 2004; Larcker et al., 2007). Making the distinction between these two kinds of performance may help explain why. Moreover, the few previous studies related to MNE parent-foreign subsidiary governance and performance are mostly conceptual and / or qualitative (e.g. Adams, 1996; Ghoshal & Nohria, 1989; Kim et al., 2005; Nohria & Ghoshal, 1994). This study provides quantitative as well as qualitative evidence supporting the impact of subsidiary governance on subsidiary survival but not profitability. Furthermore, it empirically advances the field of MNE and subsidiary governance by utilizing advanced multi-
methods, including advanced survival analysis logistic regression methods that have not been used in this area before.

In addition, empirically the pilot study advances risk research by showing that the relationship between firm risk and survival is nonlinear rather than linear. This may explain why previous findings on the relationship between risk and performance are contradictory (for examples see: Bowman, 1980; Fama & French, 1992; Fletcher, 2000; Henkel, 2009; Nickel & Rodriguez, 2002; Wiseman & Bromiley, 1991). This may also reconcile the findings of the capital asset pricing model (CAPM) that suggest that the relationship between risk and performance is positive (Sharpe, 1964) and the findings of Bowman’s paradox that suggest that the relationship between risk and performance is negative (Bowman, 1980) by explaining the conditions that change the sign of this relationship.

5.2. Practical Implications

This study offers practical implications for directors and managers. The findings can help MNE and subsidiary directors and managers make better MNE parent-foreign subsidiary governance decisions. For instance, the first finding shows that a parent’s level of ownership in its foreign subsidiary increases the survival likelihood of that subsidiary although at a decreasing rate. This broadly suggests that if MNE directors and managers want to increase the survival likelihood of their foreign subsidiaries they would be advised to have a higher level of ownership as a governance mechanism in these subsidiaries. However, the marginal utility of increasing their level of ownership in these
foreign subsidiaries decreases as their ownership in these subsidiaries increases. Thus they may wish to operate international joint ventures (IJVs) in which they own a material equity share, as well as wholly owned subsidiaries. These recommendations are consistent with previous findings that suggest once an MNE parent owns 40% or more in an IJV, the survival likelihood of that IJV is not much different than that of a wholly owned subsidiary (Dhanaraj & Beamish, 2004).

The second finding shows that the number of expatriates in a foreign subsidiary increases the survival likelihood of a subsidiary although at a decreasing rate. This broadly suggests that having more expatriates in a foreign subsidiary would generally increase the survival likelihood of that subsidiary, however beyond an optimal number of expatriates, the marginal subsidiary survival benefit of having an additional expatriate in the subsidiary decreases gradually. This may be attributed to the high cost of expatriates relative to their marginal benefit as their number increases in subsidiaries. This finding is consistent with previous findings suggesting broadly that the number or percentage of expatriates positively influences subsidiary performance (Fang, Jiang, Makino, & Beamish, 2010; Gong, 2003; Very, Hébert, & Beamish, 2004). However, some studies suggest that MNEs may be gradually using fewer conventional expatriates in their foreign subsidiaries (Beamish & Inkpen, 1998; Collings et al., 2007; Kobrin, 1988) for various reasons. Therefore one must view this suggestion as a broad recommendation and must consider all the idiosyncrasies of each subsidiary and the availability, cost, and other limits on the use of expatriates before deciding on the specific number of expatriates to send to each subsidiary.
The third finding, from the main study, suggests that an MNE parent’s level of risk decreases the survival likelihood of its foreign subsidiaries, although at a decreasing rate. Thus, if MNE directors and managers want to increase the survival likelihood of their foreign subsidiaries they would be advised to follow a risk-averse or moderate risk taking orientation as opposed to an excessive risk-seeking orientation, at the headquarters as well as at the subsidiary level (see Figure 3.1).

The fourth finding indicates that foreign subsidiaries governed by RHQ are more likely to survive than their counterparts that are not governed by RHQ. This provides an internal additional benefit to the use of RHQs.

The fifth finding, related to the relative importance of the different MNE parent-foreign subsidiary governance mechanisms, suggests that if directors and managers want to benefit from a larger governance impact on foreign subsidiary survival, they may want to use the most effective among the governance mechanisms investigated in this thesis, namely expatriates. However, if they are content with smaller governance impact that would still influence foreign subsidiary survival, it may be sufficient to use RHQs as MNE parent-foreign subsidiary governance mechanisms.

The sixth finding, that the ownership and expatriates governance mechanisms interact with each other to influence foreign subsidiary survival, suggests that directors and managers may substitute / complement ownership with expatriates and vice versa to impact subsidiary survival. This may further suggest that broadly directors and managers may be able to substitute / complement certain governance mechanisms with others to impact firm performance in general.
The final interesting finding is that, although MNE parent-foreign subsidiary governance mechanisms impact foreign subsidiary survival, they do not necessarily impact foreign subsidiary profitability. This finding may be attributed to the fact that governance mechanisms consistently discipline a company and ensure that it does not make decisions that are detrimental to its survival. However, a company needs a sustained entrepreneurial spirit to grow and prosper financially.

5.3. Limitations and Future Directions

This thesis has the following limitations. First, one limitation of this thesis is related to its subsidiary performance measures. One way this thesis measures subsidiary performance is as subsidiary survival. Although this is a legitimate measure for longer term firm performance (Combs, Crook, & Shook, 2005; Fischer & Pollock, 2004) that has been used in numerous studies (e.g. Delios and Beamish (2001), Gaur and Lu (2007), Kim et al. (2012), etc.), a limitation of this thesis’ data is that the data does not differentiate between subsidiary exits due to dissolution or underperformance on the one hand and those due to divestiture even when the subsidiary is performing well on the other. Future research may need to account for this distinction, although one would expect the number of exits due to divestiture when a subsidiary is performing well to be small relative to the number of exits due to the other two reasons. As a matter of fact, previous research on intended and unintended IJV and wholly owned subsidiary termination provides evidence that most IJVs are terminated due to unintended business failure and that IJV parents usually do not terminate successful joint ventures. Further,
changes in external conditions (misleading demand and competition from local firms) are the generic causes of unintended termination for all types of foreign subsidiaries, IJVs and wholly owned subsidiaries (Makino, Chan, Isobe, & Beamish, 2007).

Moreover, another way this thesis measures subsidiary performance is as subsidiary profitability. In this thesis subsidiary profitability is measured as a trichotomous or dichotomous categorical variable indicating the subsidiary manager’s report of whether the subsidiary has gained, broke-even, or lost during a specific period. Future research may need to measure subsidiary performance using continuous variables such as subsidiary growth or market share to capture more information in the subsidiary performance variable and consequently provide better governance-performance predictions. One of the limitations of this thesis data is that it did not provide subsidiary market share data.

Second, the findings of this thesis provide general recommendations on how MNE parents can use select MNE parent-foreign subsidiary governance mechanisms to improve their foreign subsidiaries’ survival. To provide such general recommendations this thesis controls for a range of variables that may vary among subsidiaries. However, it does not consider conditions that predict when to use which governance mechanism. The purpose of this thesis was to provide mainly (because it also provides at least one contingency performance prediction) universalistic, as compared to contingency or configurational, performance predictions (Delery & Doty, 1996). These mainly universalistic findings can be foundational for more contingency and configurational MNE parent-foreign subsidiary governance-performance future research predictions.
Third, this thesis conceptualizes expatriates as “employees coming from an MNE’s headquarters or other entities and working in a foreign-country subsidiary of that MNE.” However, due to data limitations it operationalizes expatriates as employees in the foreign subsidiary coming from the Japanese MNE parent. By using this proxy measure this thesis could not identify expatriates coming from sister subsidiaries. Expatriates from different origins (e.g. countries other than Japan, headquarters, or sister subsidiaries) may have different governance effects on subsidiary performance. Future research may need to identify the different origins of expatriates and account for their differential governance effects on subsidiary performance.

Fourth, this thesis studied only Japanese MNEs. Future research should replicate this study with data from numerous MNEs in a diverse set of cultures (e.g. U.S. MNEs, European MNEs, etc.) to ensure the wider generalizability of its findings. Japanese MNEs may have a unique governance structure, especially when they are parts of Keiretsus (Berglöf & Perotti, 1994). Future research needs to distinguish between Keiretsu and non-Keiretsu Japanese MNEs and this factor’s impact on their governance mechanisms and performance.

Fifth, a foreign subsidiary’s purpose / mandate may influence its parent-subsidiary governance mechanisms and performance (Birkinshaw, 1996; Schotter & Beamish, 2011b). For instance, the purpose / mandate of certain subsidiaries may not necessarily be to seek profits but to seek resources, two mandates that may influence parentsubsidiary governance and subsidiary survival / profitability differently. This thesis did not account for this ‘subsidiary purpose’ factor. Future research needs to
distinguish between the different subsidiary mandates and their effects on parent-
subsidiary governance and performance.

Sixth, in this thesis risk orientation was measured as the sector-adjusted debt ratio
in which the debt ratio was measured as total liabilities divided by total assets. This debt
ratio measure has been previously used as a proxy measure of firm risk. Although it
captures financial risk it does not necessarily capture other types of risk such as operating
risk, political risk, etc. Future research may need to develop a more complex
multidimensional risk measure that can more accurately capture a wider range of firm
risks.
APPENDICES

APPENDIX A: ETHICS APPROVAL NOTICE

Use of Human Subjects - Ethics Approval Notice

Principal Investigator: Paul Beamish
Re PhD Candidate: Bassam Farah
Review Number: 023/12 BREB
Protocol Title: Canadian Subsidiary Governance: A Multi-Method Approach
Ethics Approval Date: August 21, 2012 Expiry Date: August 21, 2013
Documents Reviewed and Approved: Ethics Protocol, Letter of Information

This is to notify you that The Ivey School of Business Research Ethics Board for Non-Medical Research Involving Human Subjects (NMREB) which is organized and operates according to the Tri-Council Policy Statement: Ethical Conduct of Research Involving Humans and the applicable laws and regulations of Ontario has granted approval to the above named research study on the approval date noted above.

This approval shall remain valid until the expiry date noted above assuming timely and acceptable responses to the NMREB’s periodic requests for surveillance and monitoring information. If you require an updated approval notice prior to that time you must request it using the UWO Updated Approval Request Form.

During the course of the research, no deviations from, or changes to, the study or consent form may be initiated without prior written approval from the NMREB except when necessary to eliminate immediate hazards to the subject or when the change(s) involve only logistical or administrative aspects of the study (e.g. change of monitor, telephone number). Expedited review of minor change(s) in ongoing studies will be considered. Subjects must receive a copy of the signed information/consent documentation.

Investigators must promptly also report to the NMREB:

a) changes increasing the risk to the participant(s) and/or affecting significantly the conduct of the study;

b) all adverse and unexpected experiences or events that are both serious and unexpected;

c) new information that may adversely affect the safety of the subjects or the conduct of the study.

If these changes/adverse events require a change to the information/consent documentation, and/or recruitment advertisement, the newly revised information/consent documentation, and/or advertisement, must be submitted to this office for approval.

Members of the NMREB who are named as investigators in research studies, or declare a conflict of interest, do not participate in discussion related to, nor vote on, such studies when they are presented to the NMREB.

Signature:
Assocate Dean - Faculty Development & Research

This is an official document. Please retain the original in your files.
Introduction Letter: Subsidiary Governance of Foreign Multinationals

Dear Mr. ___________.

My name is Bassam Farah. I am a Ph.D. candidate at the Ivey Business School, Western University. As part of my doctoral thesis, I am working with my supervisor Professor Paul W. Beamish on a research study that investigates subsidiary governance mechanisms of multinational enterprises (MNEs).

The purpose of this study is to better understand if and how subsidiary managers and/or directors influence subsidiary governance mechanisms. We are specifically interested in how expatriate staffing, ownership structures, and business risk play a role in the overall governance, and how this affects performance. We are confident that the results of our work will help to inform managers and directors at MNE foreign subsidiaries and headquarters about how to optimize governance structures.

We believe that your company would be a good research site and that the results of our study would be interesting to you as an executive. Thus we are asking you to participate in this study. Once completed, we would of course share the aggregate results of the study with you, if you were interested. If you agree to participate in this study we would like to set up an appointment for a 45-minute interview. This interview could be conducted in person, but preferably by phone. Your name and the name of your organization will remain strictly anonymous throughout this study. Your participation is entirely voluntary and not compensated. You will be asked questions related to the above topic.

In case you have any questions on the procedure for this study or your rights as a participant, please feel free to contact the supervisor for this study, Professor Paul W. Beamish (Phone: 519-661-3237; Email: pbeamish@ivey.ca) or the Office of Research Ethics, Western University (Phone: 519-661-3036; Email: ethics@uwo.ca). You can keep this letter for your record. Your signature on the consent form indicates your consent to participate in this study. During the interview you may choose not to answer any question(s), or withdraw from participating at any time. All collected information will be strictly confidential. This study does not involve any known risks. A total of 10-15 individuals are expected to participate in this stage of the study.

Please feel free to reach me at 661-771-6571 or at bfarah.phd@ivey.ca if you have any questions, and also if you would like a copy of the publications generated from this study.

Sincerely,

Dr. Bassam Farah  PhD Psy, MA Psy, MBA
Ph.D. Candidate International Business & Strategy
Ivey Business School
Western University
London, Ontario, Canada N6A 3K7
Consent Form

Research Project: Interviews on “Subsidiary Governance of Foreign Multinationals”.

I have read the introduction letter, and agree to participate. All questions have been answered to my satisfaction.

Name:
Signature:
Date:
I am interested in receiving the results of this study: YES/NO.

Researcher: Bassam Farah
Signature:
Date:
APPENDIX C: INTERVIEW GUIDE

Overarching Research Question(s):

How do you influence the changes in your subsidiary’s governance mechanisms / structures, namely the use of expatriates, ownership, and risk?
Why do you attempt to influence the changes in these governance mechanisms / structures (i.e. the use of expatriates, ownership, and risk) in your subsidiary?
How does your parent use these governance mechanisms (i.e. ownership, expatriates, and risk) to govern your subsidiary?

Interview Questions:

Name:
Position:
Date started (and ended) position:
Is the subsidiary manager an expatriate or not: yes or no
Subsidiary location:

1.1. How was your subsidiary set up in terms of ownership (i.e. nationality of owners, number of owners, number of shares for each owner, percentage of shares for each owner, etc.)?
1.2. Why do you think it was set up that way?
1.3. Who made these decisions (i.e. headquarters, regional headquarters, subsidiary, etc.)?
1.4. Do you have any influence on these decisions? If so, what kind of influence?
1.5. In the past, have you taken any initiative(s) to influence the changes in ownership in your subsidiary? If so, what were these initiatives? What were their outcomes? Why did you take them?
1.6. In the future, how would you influence the changes in ownership in your subsidiary? And why?
1.7. Do you believe you should have more or less influence on these decisions? Why, and in what way?
1.8. How does your parent use ownership to govern your subsidiary?

2.1. How was your subsidiary set up in terms of expatriates (i.e. nationality, number, percentage, positions, etc.)?
2.2. Why do you think it was set up that way?
2.3. Who made these decisions (i.e. headquarters, regional headquarters, subsidiary, etc.)?
2.4. Do you have any influence on these decisions? If so, what kind of influence?
2.5. In the past, have you taken any initiative(s) to influence the changes in expatriates in your subsidiary? If so, what were these initiatives? What were their outcomes? Why did you take them?
2.6. In the future, how would you influence the changes in expatriates in your subsidiary? And why?
2.7. Do you believe you should have more or less influence on these decisions? Why, and in what way?
2.8. How does your parent use expatriates to govern your subsidiary?

3.1. How was your subsidiary set up in terms of risk guidelines [level of liquidity (liquidity ratio = current assets / current liabilities), level of (total) debt (debt ratio = total liabilities / total assets), level of interest coverage (times interest earned ratio = earnings before interest and tax / interest expense), credit terms, etc.]?
3.2. Why do you think was it set up that way?
3.3. Who made these decisions (i.e. headquarters, regional headquarters, subsidiary, etc.)?
3.4. Do you have any influence on these decisions? If so, what kind of influence?
3.5. In the past, have you taken any initiative(s) to influence the changes in risk orientation in your subsidiary? If so, what were these initiatives? What were their outcomes? Why did you take them?
3.6. In the future, how would you influence the changes in risk orientation in your subsidiary? And why?
3.7. Do you believe you should have more or less influence on these decisions? Why, and in what way?
3.8. How does your parent use risk guidelines to govern your subsidiary?

4.1. In your subsidiary, do you find evidence for or against the relationship between subsidiary governance (e.g. the use of ownership, expatriates, and risk) and subsidiary survival and / or profitability? What kind of evidence / relationship? Why do you think this evidence exists or does not exist?
4.2. How (& why) do you think your subsidiary governance mechanisms (e.g. expatriates, ownership, risk orientation, etc.) affect your subsidiary’s survival and / or profitability?
4.3. In your experience, which subsidiary governance mechanisms are most effective, why?

5.1. How would you improve foreign subsidiary governance?
5.2. Do you have any documents about your company that you can provide that may include relevant governance information that may be useful for this research?
5.3. Is there anyone at headquarters who may be willing to give me a headquarters perspective on subsidiary governance? If so, please can you connect me with this person?
5.4. Do you know any other subsidiary managers who may be willing to participate as an interviewee for this research?
REFERENCES


Hays, K., & Schnurr, L. 2010. BP shares soar as spill spreads. 7 July 2010: Reuters.


Smith, H. 2011. BP one year on: How events unfolded. 20 April 2011, [IFAonline.co.uk](http://IFAonline.co.uk).


# CURRICULUM VITAE

**Bassam Farah PhD, MBA, DES**

## EDUCATION

<table>
<thead>
<tr>
<th>Degree</th>
<th>Discipline</th>
<th>Thesis Topic</th>
<th>University</th>
<th>Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>PhD</td>
<td>Business – Strategy &amp; International Business</td>
<td>International Corporate Governance Leadership</td>
<td>Western University – Ivey; London, Ontario, Canada</td>
<td>2014</td>
</tr>
<tr>
<td>PhD</td>
<td>Psychology (with highest distinction)</td>
<td>Leadership</td>
<td>Lebanese University; Beirut, Lebanon</td>
<td>2008</td>
</tr>
<tr>
<td>DES (Diplôme d’Etudes Supérieures)</td>
<td>Psychology</td>
<td>Leadership</td>
<td>Lebanese University; Beirut, Lebanon</td>
<td>2003</td>
</tr>
<tr>
<td>MBA</td>
<td>Business</td>
<td>Leadership</td>
<td>American University of Beirut; Lebanon</td>
<td>2002</td>
</tr>
<tr>
<td>BA</td>
<td>Psychology</td>
<td></td>
<td>American University of Beirut; Lebanon</td>
<td>1996</td>
</tr>
</tbody>
</table>

## AWARDS & HONORS

2013 Ontario Graduate Scholarship (OGS) Award ($15,000 for 1 year): Co-granted by the Ontario government and Western University to students demonstrating excellence in their graduate programs.

2013 Berdie and Irvin Cohen Doctoral Business Scholarship ($5,000 for 1 year).

2013 European Foundation for Management Development (EFMD) Best Case Award for the “MENA Business Cases” category annual international case writing competition.

2012 Robert Bertram Doctoral Research Award ($15,000 for 1 year; only 3 PhD students from disciplines such as Law, Finance, Political Science, General Management, etc. receive this prestigious annual national award). It is granted by the Canadian Foundation for Governance Research (CFGR), a foundation established by the Institute of Corporate Directors (ICD).

2012 Academy of International Business (AIB) Best Reviewer Award [32 out of 997 reviewers received this award (3%); only 3 out of the 32 best reviewers were PhD candidates].

2008 Graduated from the PhD in Psychology program at the Lebanese University with the Highest Honor (Grade: 90/100)

## PUBLICATIONS

<table>
<thead>
<tr>
<th>Publication Type</th>
<th>Publication Title</th>
</tr>
</thead>
<tbody>
<tr>
<td>Case(s):</td>
<td>• Farah, Bassam &amp; Paul W. Beamish, 2010. Chabros International</td>
</tr>
</tbody>
</table>
Group: A World of Wood (published at Ivey Publishing Case number 9B10M100); Case is based on field work at Chabros International Group in Lebanon.

Teaching Notes:


TEACHING EXPERIENCE

2011 (July) | Workshops Co-Leader: Lebanese American University (LAU), Notre Dame University (NDU), and Haigazian University (HU), Beirut, Lebanon; Co-led 3 full-day workshops on ‘How to Teach and Write Business Cases’ for faculty members at the above mentioned 3 largest English-teaching universities in Lebanon after the American University of Beirut (AUB).

2011 (Feb) | Case Teacher, Western University, Ivey Business School, London, Ontario, Canada; taught the case that I co-authored with Prof. Paul W. Beamish (i.e., Chabros International Group) in the International Venturing course that is offered to Honors in Business Administration (HBA) students and taught by Prof. Chris Williams.

2005-2008 | Instructor, Haigazian University, Faculty of Business Administration and Economics, Beirut, Lebanon; taught the following courses several times:
- Marketing Management
- Entrepreneurial Marketing
- Cost Accounting

2005-2008 | Instructor, C&E American University, Business Program, Beirut, Lebanon; taught the following courses several times:
- Management of Organizations
- Managerial Leadership and Decision Making
- Marketing Principles

Note: I taught most of the above 6 courses several times so in total I taught 13 courses from 2005-2008